

# **Bank Soundness and Cash Holdings: Evidence from a Bank- Centered Financial Market**

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## **Abstract**

We examine the relationship between the bank's soundness and cash holdings in Japan, which is a bank-centered market. We find that the deterioration of a bank's soundness makes firms increase their cash holdings and the cash flow sensitivity of cash. The increase in cash mitigates underinvestment problems when their banks face serious bad-loan problems. Furthermore, the value of cash in firms with unsound banks is more valuable than in the firms with sound banks. These relations are not found in high rated firms. Our results imply that the bank soundness affects firms' cash holdings in a bank-centered market and are consistent with pre-cautionary motive.