Paper title:

Financial Reporting Quality and Corporate Financing: Evidence from The Financial Crisis

Abstract:

This paper examines how financial reporting quality affects corporate financing when capital supply conditions deteriorate. I use the 2007-2008 financial crisis to compare debt and equity financing of opaque and transparent firms when a negative shock in the supply of capital occurs. In line with the diverse sensitivity to informational problems of debtholders and equity investors, I find that firms with low accounting quality use more debt financing and less equity financing in the aftermath of the crisis. Yet, the effects are weaker if firms utilize arm's-length debt. In this case, opaque firms report lower debt financing and greater equity financing. Indeed, the higher vulnerability of arm's length debtholders to informational problems makes them more reluctant to finance opaque firms and the difficulties to obtain debt funds trigger these firms to seek equity as an alternative source of financing. The study provides new empirical evidence on the role of transparency in corporate financing choices by investigating its impact under adverse capital supply conditions. Above all, I documents that the effect of accounting quality on firms' financing decisions ultimately rests on capital providers' exposure to informational problems and demand for accounting information.