

## ACCOUNTING 4

### Debt Contracting, Banking, Disclosure and Information Intermediaries

Spring 2022

Wednesdays - 10:20-11:50 and 12:10 -13:40 (with a few exceptions)

**Instructor: Regina Wittenberg-Moerman**

[reginaw@marshall.usc.edu](mailto:reginaw@marshall.usc.edu)

**Office Hours: Thursdays - 11:00 to 12:00 (tentative).**

### **Course Description and Learning Objectives**

The objective of this class is to provide students with a sound framework for understanding and evaluating empirical research in debt contracting, banking, disclosure and information intermediaries. Our focus will be on methodology and research design as well as on the underlying economic questions. The course will aim to survey a wide variety of the empirical research in accounting and to touch on related research in corporate finance, with an emphasis on recent developments in both areas.

We will be covering a variety of topics, including: Debt Markets and Financial reporting; Debt as a Governance Mechanism; Advanced Topics in Disclosure; The Role of Lenders in Disclosure and Information Environment; Loan Officer Behavior.

For each session, students will be provided with a set of papers to read. Students will be assigned to present a paper (or multiple papers if they are related) and will be responsible for leading the discussion on that paper. The format of each session is not intended to be a lecture but an active discussion, and students will act as both the author and discussant on the papers they are assigned.

### **Required Materials:**

Readings are available in a Dropbox folder: XXX or Blackboard.

### **Class format**

For each paper, we will be discussing the following questions:

1. The research question and the theoretical or intuitive constructs motivating it. Why is the question (un)interesting? Are there well-specified alternatives to the hypotheses? Is the question descriptive or predictive? How compelling is the logic/intuition used to develop the hypotheses?
2. What is the study's research design? Consider the sample selection and empirical tests.

3. How well is the research design tied to the research question? To what extent is the design capable of distinguishing between alternative hypotheses?
4. What difficulties arise in drawing inferences from the empirical work?
5. What are the major results? How do the authors interpret them? How do you interpret them?
6. What research questions are raised by the paper's results, and what unresolved research questions related to the paper could be investigated? How?

### **Final Project**

This assignment involves the preparation and presentation of a research proposal with the ultimate objective of jump starting your research. Research Proposal should be relevant to the topics studied in class.

Your research proposal should cover the following areas:

1. The research question.
2. Existing literature in this area.
3. Why this project is important: its incremental contribution to the literature (answer the “who cares?” question).
4. Your research approach (field study, analytical, experimental, empirical archival) and why it is appropriate.
5. Sources of data (including the data collection process)
6. Research design, including the discussion of the identification strategy (natural experiment, instrumental variables, regression discontinuity, etc.).
6. The strengths and weaknesses of your proposed research strategy vis-à-vis alternatives.
7. The potential limitations of the proposed study.

Students are required to present the proposal during the sessions 11 and 12). The presentation will last 20 minutes with a 5-10 minutes discussion.

The deadline for turning in the write-up will be announced in class (from mid to late May).

### **Grading**

	<u>% of Grade</u>
Weekly paper presentations	25%
Class participation	15%
Final project presentation	20%
Final project write-up	<u>40%</u>
	100%

## **Sessions Outline (tentative)**

**April 20**

### **Session # 1 and 2: Introduction to Debt Contracting Debt Markets and Financial reporting**

#### **Background Reading**

Armstrong, C., W. Guay, and J. Weber, 2010, The role of information and financial reporting in corporate governance and debt contracting, *Journal of Accounting and Economics* 50: 179–234 (debt contracting sections).

H. Christensen, V. Nikolaev, and R. Wittenberg-Moerman, Accounting information in financial Contracting: The incomplete contract theory perspective, *Journal of Accounting Research* 54, 2016.

Basu, S., 1997, The conservatism principle and the asymmetric timeliness of earnings, *Journal of Accounting and Economics* 24: 3-37.

#### **Required Reading**

Dichev, I., and D. Skinner, 2002, Large-sample evidence on the debt covenant hypothesis, *Journal of Accounting Research* 40: 1091–123.

Sufi, A., 2007. Information asymmetry and financing arrangements: Evidence from syndicated loans, *The Journal of Finance* 62: 629-668.

Ball, R., R. Bushman, and F. Vasvari, 2008, The debt-contracting value of accounting information and loan syndicate structure, *Journal of Accounting Research* 46: 247–87.

Costello, A., and R. Wittenberg-Moerman, 2011, The impact of financial reporting quality on debt contracting: Evidence from internal control weakness reports, *Journal of Accounting Research* 49: 97–136.

#### **Supplementary Reading**

Smith, C., and J. Warner, 1979, On financial contracting: An analysis of bond covenants, *Journal of Financial Economics* 7: 117–61.

Asquith, P., A. Beatty, and J., Weber, Performance pricing in bank debt contracts, *Journal of Accounting and Economics* 40: 101–28.

Zhang, J., 2008, The contracting benefits from accounting conservatism to lenders and borrowers. *Journal of Accounting and Economics* 45: 27-54.

Wittenberg-Moerman, R., 2008, The role of information asymmetry and financial reporting quality in debt trading: Evidence from the secondary loan market, *Journal of Accounting and Economics*

46: 240–60.

Li, N., 2010, Negotiated measurement rules in debt contracts, *Journal of Accounting Research* 48: 1103–144.

Li, N., 2016, Performance measures in earnings-based financial covenants in debt contracts, *Journal of Accounting Research*, forthcoming.

Dyreng, S., R. Vashishtha, and J. Weber, 2017, Direct evidence on the informational properties of earnings in loan contracts, *Journal of Accounting Research* 55: 371–406.

## **April 21**

### **Session # 3: Debt as a Governance Mechanism**

#### **Background Reading**

Aghion, P., and P. Bolton, 1992, An incomplete contracts approach to financial contracting, *The Review of Economic Studies* 59: 473–494.

Roberts, M., and A. Sufi, 2009, Financial contracting: A survey of empirical research and future directions, *Annual Review of Financial Economics*: 207–26.

H. Christensen, V. Nikolaev, and R. Wittenberg-Moerman, Accounting information in financial Contracting: The incomplete contract theory perspective, *Journal of Accounting Research* 54, 2016.

#### **Required Reading**

Chava, S., and M. Roberts, 2008, How does financing impact investment? The role of debt covenants, *Journal of Finance* 63: 2085–121.

Nini, G., D. Smith, and A. Sufi, 2012, Creditor control rights, corporate governance, and firm value, *Review of Financial Studies* 25: 1713–61.

Nini, G., D. Smith, and A. Sufi, 2009, Creditor control rights and firm investment policy, *Journal of Financial Economics* 92: 400–420.

#### **Supplementary Reading**

Hart, O., and J. Moore, 1988, Incomplete contracts and renegotiation, *Econometrica* 56: 755–85.

Garleanu, N., and J. Zwiebel, 2009, Design and renegotiation of debt covenants, *Review of Financial Studies* 22: 749–781.

Li, N., F. Vasvari, and R. Wittenberg-Moerman, 2016, Dynamic threshold values in earnings-based covenants, *Journal of Accounting and Economics* 61: 605–629.

Christensen, H., V. Nikolaev, 2012, Capital versus performance covenants in debt contracts,

*Journal of Accounting Research* 75: 75–116.

## **April 27**

### **Session # 4 and 5: Debt as a Governance Mechanism Loan Officer Behavior**

#### **Required Reading**

Roberts, M., and A. Sufi, 2009, Renegotiation of financial contracts: Evidence from private credit agreements, *Journal of Financial Economics* 93: 159–84.

Roberts, M., 2015, The role of dynamic renegotiation and asymmetric information in financial contracting, *Journal of Financial Economics* 116: 61-81.

Cole, S., M. Kanz, and L. Klapper, 2015. Incentivizing calculated risk-taking: Evidence from an experiment with commercial bank loan officers. *The Journal of Finance* 70 (2): 537-575.

Hertzberg, A., J.M. Liberti, and D. Paravisini, 2010. Information and incentives inside the firm: Evidence from loan officer rotation. *Journal of Finance* 65 (3): 795–828.

## **April 28**

### **Session # 6: Loan Officer Behavior**

#### **Required Reading**

Campbell D., M. Loumioti and R. Wittenberg-Moerman, 2019, Making sense of soft information: Interpretation bias and loan quality. *Journal of Accounting and Economics* 68 (2-3): 101240.

Demiroglu, C., O. Ozbas, R. Silva, and M. F. Ulu, 2021. Do Physiological and Spiritual Factors Affect Economic Decisions? *Journal of Finance* 76, 2481-2523.

#### **Supplementary Reading**

Morales-Acevedo, P., and S. Ongena, 2020. Fear, anger, and credit. On Bank robberies and loan conditions. *Economic Inquiry* 58: 921-952.

Cortes, K., R. Duchin, and D. Sosyura, 2016. Clouded judgment: The role of sentiment in credit origination. *Journal of Financial Economics* 121 (2): 392–413.

Drexler, A., and A. Schoar, 2014. Do relationships matter? Evidence from loan officer turnover. *Management Science* 60 (11): 2722–2736.

## **May 4**

### **Session # 7 and 8: The Role of Lenders and Bond Analysts in Shaping Disclosure and Information Environment**

## **Required Reading**

Bushman, R., A. Smith, and R. Wittenberg-Moerman, 2010, Price discovery and dissemination of private information by loan syndicate participants, *Journal of Accounting Research* 48: 921- 972.

Vashishtha, R., 2014, The role of bank monitoring in borrowers' disclosure: Evidence from covenant violations, *Journal of Accounting and Economics* 57: 176-195.

Lo, A., 2014, Do declines in bank health affect borrowers' voluntary disclosures? Evidence from international propagation of banking shocks, *Journal of Accounting Research* 52: 542-581.

De Franco, G., F. Vasvari, and R. Wittenberg-Moerman, 2009, The informational role of bond analysts, *Journal of Accounting Research* 47: 1201-1248.

De Franco G., F. Vasvari, D. Vyas and R. Wittenberg-Moerman, 2014, A debt analysts' view of debt-equity conflicts of interest, *The Accounting Review* 89: 571-604.

## **Supplementary Reading**

Ivashina, V., and Z. Sun, 2011, Institutional stock trading on loan market information, *Journal of Financial Economics* 100: 284-303.

Chen, Q., and Vashishtha R., 2017, The effects of bank mergers on corporate information disclosure. *Journal of Accounting and Economics* 64: 56-77.

## **May 9**

### **Session # 9 and 10: Bank Disclosure and Information Sharing**

## **Background Reading**

Ryan, S., 2018, Recent research on banks' financial reporting and financial stability, *Annual Review of Financial Economics*, forthcoming.

## **Required Reading**

Michels, J., 2012, "Do Unverifiable Disclosures Matter? Evidence from Peer-to-Peer Lending." *The Accounting Review* Vol. 87, No. 4: 1385-1413.

Ertan, A., M. Loumioti and R. Wittenberg-Moerman, 2017, Enhancing loan quality through transparency: Evidence from the European central bank loan level reporting initiative, *Journal of Accounting Research* 55: 877-918.

Sutherland, A., 2018, Does Credit Reporting Lead to a Decline in Relationship Lending? Evidence from Information Sharing, *Journal of Accounting and Economics*, forthcoming.

Balakrishnan, K., and A. Ertan, 2021, Credit Information Sharing and Loan Loss Recognition, 2021, *The Accounting Review*, forthcoming.

### **Supplementary Reading**

Ravina, E., 2019. Love & loans: The effect of beauty and personal characteristics in credit markets. *Working paper*.

Djankov, S., C. McLiesh, and A. Shleifer, 2007, Private credit in 129 countries. *Journal of Financial Economics* 84 (2): 299-329.

Liberti, J. M., J. Sturgess, and A. Sutherland, 2018, Economics of voluntary information sharing. *Working Paper*.

Bushman, R., C. Williams, and R. Wittenberg-Moerman, 2017, The informational role of the media in private lending, *Journal of Accounting Research*, 55(1), 115-152.

**May 23<sup>rd</sup>**

**Session # 11 and 12: Students' research project presentations**