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# Does financial statement information affect cross-border lending by foreign banks in the syndicated loan market? Evidence from a natural experiment

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ABSTRACT

We examine whether cross-border lending in the syndicated loan market is affected by an exogenous change in accounting standards comparability through a natural experiment based on the mandatory adoption of International Financial Reporting Standards (IFRS) across Europe. Existing studies on the economic consequences of IFRS in the debt market do not reveal whether the impact is caused by changes in accounting quality or comparability, and this literature has so far produced mixed findings on the effect of IFRS. We show that foreign banks offer IFRS-reporting corporate borrowers a larger loan share, a lower yield spread, and a longer loan maturity only when the banks are themselves domiciled in countries that mandate IFRS. Our findings imply that it was the improvement of financial statement comparability after international accounting harmonization, rather than the enhancement of accounting quality under IFRS, that reduced the information disadvantage for foreign banks and encouraged cross-border lending after mandatory IFRS adoption.

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## 1. Introduction

We investigate whether cross-border lending by foreign banks in the syndicated loan market is influenced by an exogenous change in accounting comparability induced by international accounting harmonization. As a result of an information disadvantage, foreign banks have a greater preference for lending to more transparent firms than do domestic banks (Buch, 2003; Petersen and Rajan, 2002; Mian, 2006). Differences in accounting standards across countries contribute to the information disadvantage for foreign investors because they reduce the cross-border comparability of financial statements issued by corporate borrowers (Bae et al., 2008; Bradshaw et al., 2004). Financial statements are an important source of information that reveal corporate borrowers' financial risk and therefore help determine their credit ratings (Jorion et al., 2009; Li et al., 2010; S&P, 2003). If financial statements become more comparable across countries, then the information used by foreign banks to assess corporate borrowers should become less costly and less difficult to interpret. To the extent that the financial statement information provided by corporate borrowers influences foreign banks' lending decisions, improvement in accounting comparability should increase the loan share, decrease the loan spread, and lengthen the loan maturity of cross-border lending in the syndicated loan market.

A natural experiment setting in which to examine these predictions is available through the simultaneous mandatory adoption of International Financial Reporting Standards (IFRS) across the listed firms in Europe from the fiscal year 2005 onward. The usefulness of financial statement information to investors can be influenced by IFRS adoption through changes in either financial reporting quality or cross-border accounting comparability (Ball, 2006). However, the literature has so far remained inconclusive as to which of these two underlying reasons drive the beneficial impact of IFRS adoption. Some studies indicate that the increase of cross-border investment following the adoption mainly stems from non-IFRS countries such as the US (e.g., Khurana and Michas, 2011; Shima and Gordon, 2011), which is consistent with the notion of an improvement in accounting quality. Other studies find that the increase of such investment arises mainly from other IFRS adopting countries (e.g., Amiram, 2012), which provides supportive evidence of improvement in cross-border accounting comparability. Given the importance of financial statement information to the decision of foreign lenders (Petersen and Rajan, 2002), we explore whether cross-border lending in the syndicated loan market has improved following IFRS adoption, and whether this is attributable to the improvement of cross-border accounting comparability as opposed to the improvement of financial reporting quality.

Although previous studies have evaluated the economic consequences of IFRS in the debt market (Ball et al., 2015; Chen et al., 2013; Florou and Kosi, 2013; Florou et al., 2013; Kim et al., 2011; Wu and Zhang, 2009), they provide limited evidence on whether the impact is driven by the accounting quality or the comparability effect. Furthermore, this literature has so far generated mixed findings on the effect of IFRS. On the one hand, some studies document a favorable impact such as reduced loan rates (Kim et al., 2011) and an increased sensitivity of credit ratings to accounting information (Florou et al., 2013; Wu and Zhang, 2009). On the other hand, studies find evidence of IFRS drawbacks such as a reduction in the use of accounting-based covenants (Ball et al., 2015) and an increase in loan collateralization (Chen et al., 2013), possibly due to increased accounting information uncertainty caused by fair value accounting and greater managerial discretion. Therefore, by examining whether changes in accounting comparability influence foreign banks' lending behavior, we use the context of cross-border lending to contribute to the ongoing debate on whether IFRS generates a net benefit or a net cost to the debt market.

Financial statements issued by corporate borrowers are used by financial intermediaries in two important ways. First, it serves as a major source of information, enabling financial intermediaries to make ex-ante evaluations of potential borrowers' ability to service their debt (e.g. S&P, 2003). Second, financial statement information is used to derive performance indicators in debt covenants, which in turn are designed to protect the rights of lenders should the debt-servicing capabilities of corporate borrowers deteriorate (e.g. Dichev and Skinner, 2002). Therefore, such information also plays an important role in debt contracting, which enables the ex-post monitoring of borrowers, after capital has been provided by financial intermediaries. Foreign banks' lending decisions are expected to be even more dependent on the financial statement information issued by corporate borrowers than

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