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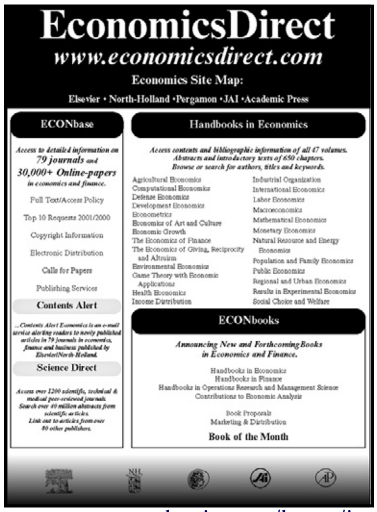

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Gavin Cassar, Christopher D. Ittner, Ken S. Cavalluzzo

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Alternative Information Sources and Information Asymmetry Reduction: Evidence from Small Business Debt

Gavin Cassar[a*], Christopher D. Ittner[b], Ken S. Cavalluzzo[c]

[a]INSEAD, PMLS 1.23, Boulevard de Constance, 77305 Fontainebleau, France

[b]The Wharton School, University of Pennsylvania, Steinberg Hall-Dietrich Hall (Suite 1300), 3620 Locust Walk, Philadelphia, PA 19104-6365

[c]CJK Capital Management, Doylestown PA

[*]Corresponding author. Tel.: +33 0 1 60 72 92 08; fax: +33 0 1 60 72 92 53.

Email: cavalluk2@yahoo.com
Email: gavin.cassar@insead.edu
Email: ittner@wharton.upenn.edu

Abstract
We examine whether more sophisticated accounting methods (in the form of accrual accounting) interact with other information sources to reduce information asymmetries between small business borrowers and lenders, thereby lowering borrowers' probability of loan denial and cost of debt. We find that higher third party credit scores, but not the use of accrual accounting, decrease the likelihood of loan denial. However, firms using accrual accounting exhibit statistically lower interest rates after controlling for many factors associated with the cost of debt. Further, the interest rate benefits from accrual accounting are greatest when the borrower's credit score is low and/or the length of its banking relationship with the lender is short. This evidence indicates that accrual accounting can benefit small business borrowers, but that the information contained in third-party credit scores and obtained through ongoing banking relationships can substitute for the incremental information provided by accrual accounting in some cases.

Highlights

- We examine firms' accrual use with other information sources on financing outcomes.
- Higher credit scores, but not accrual accounting use, decrease loan denial.
- Firms using accrual accounting exhibit statistically lower interest rates.
- Benefit from accruals is decreasing in firms' credit score and relationship length.
- Firm age further moderates relations between information sources and interest rates.