

Who monitors opaque borrowers? Debt specialization, institutional ownership, and information opacity

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Abstract.

In this study, we suggest that the level of information opacity determines the propensity of publicly listed firms to have debt financing from only a few debt types (i.e., debt specialization). Using accruals quality as a proxy for information opacity, we find that the degree of debt specialization is lower for firms with high-quality accruals. This result is consistent with the notion that information collection and monitoring costs are higher for firms that have higher informational opacity, explaining the tendency towards debt specialization. We further argue that creditors need not monitor borrowers so closely when they are monitored by institutional owners. The empirical findings support this argument and show that firms with more stable institutional ownership are likely to have less specialized debt types. The empirical evidence is also consistent with the expectation that stable institutional ownership is likely to reduce the demand for monitoring over accruals management. Using S&P 500 membership as an exogenous event driving institutional ownership changes, we further document that debt specialization is decreasing in accruals quality when institutional investors are expected to have an influence.

JEL: M41, G32.

Keywords: debt structure, information opacity, institutional investors, accruals quality.

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