

Financial Reporting Quality, Private Information, Monitoring, and the Lease-versus-Buy Decision

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ABSTRACT: A flourishing stream of research suggests that liquidity-constrained firms with low accounting quality have limited access to capital for investments. We extend this research by investigating whether these firms are more likely to lease their assets. Lessors' superior control rights allow them to provide capital to constrained firms with low-quality accounting reports. Consistent with this conjecture, we find that low accounting quality firms have a higher propensity to lease than purchase assets. To verify that leasing does not merely reflect these firms' desire for off-balance-sheet accounting, we investigate whether banks' access to private information and monitoring affect the relation between accounting quality and leasing. We find the association between accounting quality and leasing decreases when banks have higher monitoring incentives and when loans contain capital expenditure provisions. These results suggest that other mechanisms can substitute for the role of accounting quality in reducing information problems.

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