

Usefulness of financial reports

A study of the information need in banks'
credit assessment

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Abstract

Title: Usefulness of financial reports - a study of the information need in banks' credit assessment.

Background and problem: Financial reports are created for the users as decision support. Stakeholders are often subjects to information asymmetry. Banks represent one of the primary stakeholders and financiers of a company, and place great emphasis on financial reports in their credit assessment process. The question is, however, how useful the financial information actually is. According to previous research, banks consider accounting information as troublesome in some respects, mostly due to accounting choices and judgments. As the newly introduced K-regulations in Sweden are mandatory from 2014, it is not clear how the choice between K2 and K3 will affect a company's creditworthiness.

Purpose: The purpose of this study is to investigate the usefulness of accounting information presented in financial reports, as a part of banks' information need in the credit assessment process.

Methodology: To achieve the purpose, a qualitative research was used. Empirical material was gathered through semi-structured interviews with respondents representing five different banks in Sweden. The respondents were bank officers with great knowledge in the credit assessment process. Secondary data formed the frame of reference, and was collected mainly from scientific articles and doctoral dissertations.

Findings and conclusions: This study shows that accounting information is useful and represents one of the main components in the corporate analysis when the bank is performing credit assessment. Since the banks' rating systems do not alter financial information; two identical companies, apart their choice of K2 and K3, may receive different ratings and consequently different interest rates. However, banks thorough corporate analysis is favorable when changes in accounting regulations are implemented. As they possess great knowledge in the company's business, accounting choices and regulations becomes almost a non-issue.

Keywords: Accounting, financial reports, user, bank, K2, K3, credit assessment, corporate analysis, rating.

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1. Introduction

The first chapter contains a problem discussion regarding usefulness of financial reports for the bank, as one of the main users and stakeholders. More specifically, how the relationship between the bank and the company can lead to information asymmetry and consequently cause undesired effects. The purpose of examining the above is formulated into three research questions. This is followed by outlining this study's specific contributions and limitations. Lastly, definitions of recurrent terms and concepts are presented.

1.1 Background and problem discussion

One of the main reasons why a company puts effort into accounting is to satisfy its users. Stakeholders can be investors, employees, financial institutes and suppliers (Freeman et al, 2010). According to the larger standard-setters, a stakeholder should be satisfied when the information is useful for decision making (Young, 2006). The usefulness might depend on the user and it is rather diffuse to what extent financial information is adapted to the stakeholders and how useful the information given in financial reports actually is (Young, 2006).

According to Bruns (2004), external stakeholders are often subjects to information asymmetry, especially when it comes to small and medium sized companies. Larger listed companies' need to submit information regarding their activities at the stock market, while smaller companies do not have the same obligations and resources to collect and submit such information. Instead, the company's board and owners possess most information, which might not be documented or accessible to external stakeholders (Bruns, 2004). Due to today's principles-based regulations, stakeholders of smaller companies sometimes experience discomfort with the possibility for judgments that these regulations bring, which in turn can affect the result (Svensson, 2003). Information asymmetry tends to increase risk and consequently cause higher costs for a stakeholder when doing business with the company (Andersson, 2001).

There are several groups of stakeholders in need of financial information provided by a company. One of the primary stakeholders in Sweden are banks (Marton, 2013). For many reasons, it is virtually impossible to conduct business without some kind of relationship to a bank. Further, bank financing is one of the main sources for capital among companies in Sweden (Bruns, 2004). During 2012, companies in Sweden borrowed a total of 1163 billion SEK from banks (Swedish Bankers' Association, 2013). According to Bruns and Fletcher (2007), the produced financial statement is

one of the areas where creditors put most emphasis. This indicates that the accounting information received today fulfills their need to some extent, even though it may have to be altered in order to show the 'real' underlying result, and additional information needs to be evaluated (Svensson, 2003). When banks are granting credit, they put a price on the risk they take; lower risk equals lower interest rates and vice versa (Andersson, 2001). Lack of information increases risk, since there is less information to evaluate (Bruns, 2004).

Since banks already see the use of accounting information as somewhat troublesome due to the possibilities to affect results with judgments and other results smoothing activities (Svensson, 2003), it may be headed in the direction of getting even more difficult in the near future. From 2014, it is mandatory to choose between the new accounting regulations K2 and K3 for the majority of Swedish companies. The accounting regulations are fundamentally different, as K2 is considered as a rule-based system and K3, on the other hand, is principles-based (BFN, 2013). Depending on the regulation system, two otherwise identical companies could produce very different financial statements. As mentioned earlier, criticism considering principle-based systems usually is based on the fact that companies can alter the result with judgments (Svensson, 2003). The main criticism of rule-based systems is, instead, due to companies trying to structure transactions to work around the rules and thereby affecting the result in a desired way (Baily & Sawers, 2012).

With two different regulations for companies to choose between, the following questions arise: does the choice matter? Will credit granting be affected as a consequence of differences in the regulations, or is one regulation more suitable for companies that are in need of bank financing to conduct their business? It is unclear how banks reason and if they are taking possible differences that may occur into consideration in their corporate analysis. Considering accounting information constitutes a component in the credit assessment process, its quality is of importance in order to determine a company's creditworthiness, but also for efficient allocation of capital on the market (Svensson, 2003).

1.2 Purpose

The purpose of this study is to investigate the usefulness of accounting information presented in financial reports, as a part of banks information need in the credit assessment process.

1.2.1 Research questions

To investigate the usefulness of accounting information in financial reports, the following research questions are examined:

- *What kind of information is required (financial and non-financial) and how is it used in banks credit assessment process?*
- *How does accounting information from financial reports matter for Swedish banks as users?*
- *How can differences in accounting regulations, as the ones between K2 and K3, affect a company's creditworthiness?*

1.3 Contribution

This study contributes with gaining new insights on how one of the main stakeholders is closing the information gap between them and the company; through corporate analysis and risk rating in the credit assessment process. Thus, minimizing risk and decrease transaction costs (Andersson, 2001).

The main debate around rule-based versus principles-based accounting regulations has concerned US-GAAP in relation to IFRS. This study instead shows how credit assessments are affected by two different comprehensive regulation systems, K2 and K3, selectable for companies within the same context.

1.4 Limitations

The financial reports' usability will only be viewed from a creditor's perspective. The focus will thus be on lenders as banks in Sweden, consequently other types of credit institutions and other lenders not are included in this study.

It is the credit assessment that is in focus; no further immersion in other kinds of assessments when the bank is doing business with a company is taken into account.

1.5 Abbreviations and definitions

Almi: Organization that provides venture capital and advisory services in the establishment phase of a business.

BFL (Bokföringslagen): The Swedish Accounting Law.

Branch: A banking office where advisory and other financial services are offered to private and/or corporate customers.

Corporate advisor: Bank officer with specialization in corporate matters.

Corporate loan officer: A corporate advisor with the mandate to grant credit to companies.

Corporate analysis: Evaluation of a company's financial and non-financial position.

Credit: A loan or financing solution for a company or an individual, provided by banks and other financial institutions.

Credit assessment: A process in banks when analyzing and evaluating a company's possibility to obtain credit.

Creditworthiness: Ability for a company to pay its debts, which is assessed in the credit assessment process. It is usually measured in rating systems.

K-project: A project with the purpose to simplify financial reporting for companies in Sweden, based on rules in the Swedish Accounting Law (BFL).

Lag (2004:297) om bank- och finansieringsrörelse: Law governing the Swedish banking operations.

Swedish Companies Registration Office (Bolagsverket): Organization responsible for making Swedish companies' annual reports official.

Swedish Financial Supervisory Authority (Finansinspektionen): Authority supervising Swedish banks and other financial institutions.

UC (Upplysningscentralen): Credit Reporting Agency in Sweden, providing credit reports to banks, the public sector and companies in different industries.

ÅRL (Årsredovisningslagen): The Swedish Annual Accounts Act.

2. Frame of reference

To understand why the bank is interested in information about a company's financial position, the second chapter presents theories explaining the stakeholder-company-relationship and how the asymmetric information between them leads to transaction costs. The selected theories create a basis for this study, in order to explain further how banks reason when it comes to credit assessment. In addition, a presentation of rule-based and principles-based regulations is outlined, to gain understanding in how differences in accounting occur due to various guidelines. The distinct differences between the Swedish K2 and K3 regulations are described as well as illustrated in a practical example.

2.1. Stakeholder theory

There is no doubt that a company to a great extent is influenced by its surroundings. To illustrate this, the stakeholder term was created by Freeman in 1984, to prove that a company has more groups than stockholders to meet the needs of (Freeman et al, 2010). The stakeholder perspective is about how customers, suppliers, employees, financiers such as stockholders and banks, communities and managers interact with the company.

Relationships and interactions that the company has to its business environment do not only include the obligation to meet the stakeholders' need, but is also influenced by them to different degrees (Mainardes, Alves & Raposo, 2011). It is stated that a common feature for Swedish companies is the need of external financing to conduct business (Winborg & Landström, 2000). Bank loans are thus one of the most important financing sources, which makes the company's understanding of factors that can have an impact on the chance of obtaining a loan essential.

Freeman et al (2010) clarifies that when researchers and practitioners a few decades back were looking for answers to explain management problems, it mostly involved questions about how value is created and traded in a constant changing and global business context. Also, what kinds of connections that exist between capitalism and ethics. In order to answer these questions, the stakeholder theory suggests that the analysis should be built on all relationships that can affect a company. According to Freeman et al (2010), these problems can best be solved by putting the stakeholder theory into center when discussing business and management, since these relationships are essential for the existence of a company. Since the beginning of the

stakeholder concept up until today, its importance has increased through greater general interest and media coverage.

2.2. Principal-agent theory

As stakeholders and companies do business together, benefiting from each other's knowledge, services and payment, their positions rarely are the same. This can be described with the help from the agency theory, showing that interaction may lead to undesirable consequences. The theory takes its starting point in stating that the agent is the one who performs the work that the principal asks of him. This relationship might cause so called agency problems (Jensen & Meckling, 1976). Firstly, interests and goals may differ between the parties and therefore conflict with each other, and it is difficult for the principal to investigate whether the agent has acted according to what has been agreed upon. Secondly, problems concerning risk sharing that occur when the view of risk differs can lead to different opinions on how to act accordingly. Therefore, the principal-agent theory concentrates on what is the most efficient contract between the two parts (Eisenhardt, 1989).

The kind of relationship that the principal-agent theory can be applied on is between the bank as a lender to a company. The bank represents the principal who is in need of information to make assessments, and the company possesses this information to a greater extent than the bank, such as risks and possibilities as well as expected return (Bruns, 2004). However, the situation may be contrary since the bank sometimes has better knowledge on an aggregated level about projects or businesses that might be successful for a small or medium sized company (Bruns, 2004). This kind of information asymmetry in one or both directions therefore occurs when one of the parties has better information than another, which will be discussed further in section 2.2.1.

2.2.1 Information asymmetry

Asymmetric information is a result of agency problems discussed in the previous section. Akerlof (1970) explained the phenomenon by using the car market, where the seller knows more about the car than the buyer. In sum, the information asymmetry leads to uncertainty about the quality of the car. This consequently makes sellers of 'good' cars avoid putting theirs on the market, which creates a market for 'bad' cars called 'lemons' in America.

The basis of Akerlof's (1970) theory is attributable to the relationship between lenders and borrowers. Even though there might be an information imperfection in both directions, almost always the bank is dependent on the information given by the company (Bruns, 2004). This advantage appears when an owner or manager in the company enhances information that can be beneficial for the company, not primarily in accordance with benefits for the bank. There may also be a lack of information when a small or newly established business needs bank financing (Svensson Kling, 1999). Further, the information asymmetry is proved to be most prominent among privately held companies. Mainly due to the fact that these companies have one owner who also is in control, since behavior and personality influence the business to a great extent (Bruns, 2004). According to Svensson (2003), asymmetric information leads to greater uncertainty and inefficient capital allocation. This uncertainty has its price, as higher risk equals higher interest rates (Andersson, 2001), which is further discussed in section 2.2.2 concerning the transaction cost theory.

In contrast to publicly held companies, the privately held have less legal demands on producing information and are often small. Naturally, there are fewer possible agency problems, due to the small size of a privately held company. However, access from internal control systems is difficult for banks to take part in since there rarely are any (Bruns, 2004). Therefore information asymmetry is common between these two parties, as knowledge and strategies are more informal, possessed by the owner and manager.

There are some actions which banks take to reduce this kind of information asymmetry. According to Smith (1993), it is not uncommon to limit the borrower to a specific accounting choice, restrain the possibility to sell certain assets or use financial ratios as minimum requirements for profitability. This could, however, increase agency problems and information asymmetry in the long run. If companies do not reach certain important goals or limits, they might alter the figures one way or another; often by using excessive optimism in judgments or activating more costs than reasonable (Argenti, 1976).

2.2.2 Transaction cost theory

Every transaction on the market is associated with costs. Efficient management of transactions is therefore beneficial in order to lower these costs. Williamson (1981) explains that the better handling of transaction costs, the better functioning market.

Banks provide the capital which many companies are in need of to conduct operations. However, to ensure the repayment ability and thereby avoid credit losses, the bank is naturally interested in reducing the information asymmetry between them. If done successfully in the long run, costs associated with the credit assessment process can decrease through more accurate assessments. In turn, this can lead to better capital allocation for the market as a whole, as well as to lower credit costs for the individual company (Bruns, 2004).

With the above presented theories in mind, dealing with how to satisfy stakeholders and users need and how the information asymmetry can be reduced, thus avoiding transaction costs, the question of how information is used arises. Accounting information from financial reports provides an important basis to make judgments of a company's financial position. Therefore, the next section describes information need and how accounting information is used by the primary stakeholders. Also, more specifically, how banks are performing credit assessments, based on previous research.

2.3 Use and purpose of the annual report

A major driving force behind the creation of an annual report is to convey information to its users (Smith, 2006). The central issue when it comes to accounting is therefore how financial reporting should be formed.

According to Edenhammar & Thorell (2009), external stakeholders' needs in Sweden are of great importance and have been so for many years. Further, the requirement of publication in Sweden for even the smallest company is peculiar, as every annual report published is available at the Swedish Companies Registration Office. This is unlike in many other countries where publication not always is required for small companies.

Stakeholders ask for various information depending on their specific interests. When comparing different stakeholders and their relationships to the company, it appears that the information needs differ. It is also likely that the information need varies within the same group of users (Smith, 2006). Depending on the size of a company, the number of stakeholders varies. A small business is generally rather uncomplicated, with the same owner and manager (Edenhammar & Thorell, 2009). The larger the company, the greater demands for publication due to more and larger stakeholder groups.

Lenders primarily want information about repayment ability on loan and interest as well as collateral (Svensson, 2003). They are therefore interested in liquidity and solvency which can be linked to credit risk (Andersson, 2001). Shareholders, on the other hand, occupy a special position since their compensation is not contractually committed unlike most other stakeholders (Smith, 2006). Their return is thus dependent on a residual of what is left after other stakeholders have had their fair share. That is also why their interest mainly is about return on their invested capital. Another significant difference between these two users is how they view a company's future development, as lenders have an 'either or' perspective on a borrower's ability to repay the loan (Smith, 2006). This is in accordance with the shift towards a going concern approach for banks, where focus lies in investigating whether a company will be able to continue its operations on its premises or not (Berry & Robertson, 2004). In contrast, shareholders focus on all possible future scenarios (Smith, 2006).

Differences in information requirements are substantial between public and privately held companies (Edenhammar & Thorell, 2009). Due to the wide stakeholder circuit that a publicly held company has, the information for practical reasons should be accessible. Privately held companies do not have the same requirements for disclosures in the annual report. This gives them a greater opportunity to be selective when providing information to a stakeholder (Edenhammar & Thorell, 2009). However, both Smith (1993) and Svensson (2003) conclude that banks often demand extra information and include these demands in the credit contract.

Since the annual report distinctively focuses on the need of users for their decision-making, the question has arisen to what extent it actually is adapted to its users. Young (2006) therefore wanted to explore what is taken for granted, that is if accounting information is useful to the users. Principles of accounting methods that are developed by standard setters, such as accountants and auditors, are not based on interests of investors or other users (Young, 2006). Further, the overall goal for the standard-setting in accounting is stated to be usefulness for users. This is however, according to Young (2006), created from a self-constructed rational user of financial data, rather than knowing how users in reality use the information.

2.4 Credit assessment

One specific business common in the banking world is corporate credit granting. In order for the bank to make accurate assessments, the bank as a stakeholder and user, concentrates on certain aspects and is in need of useful information to evaluate a company. When assessing a credit application from a company, main focus lies in deciding if the borrower will be able to repay loan and interest (Svensson Kling, 1999). It is in their nature as profit making organizations, but is also stipulated in the Swedish law, Lag (2004:297) om bank- och finansieringsrörelse 8:1. It says that a creditor should make sure that the borrower can repay the loan and also, if necessary, issue collateral. Further, Swedish Financial Supervisory Authority has issued policies on how to work with credit risk, including requirements about a creditor's right to sufficient information to evaluate the company's financial position. Also to evaluate the possibility to repay the loan and if there is any risk for devaluation in issued collateral (FFFS 2004:6).

Uschida (2011) points out that to grant or not to grant credit are built on three factors: relationship, financial statements and collateral. The main focus in Swedish banks is on produced financial statements and activities that shift risk from the bank to the borrowing company (Bruns & Fletcher, 2007). According to Bruns and Fletcher (2007), creditors also take into account previous performance in projects and in relationship to the bank. The need for collateral is greater when it comes to smaller companies, though the main focus is still on the repayment ability (Svensson, 2003). Companies that are new to the bank also need to prove that they possess the competence to succeed with their new project. Owners or board might have to issue personal collateral, especially if the company has a weak financial position (Bruns & Fletcher, 2007).

Credit assessment is performed by a loan officer, where experience and knowledge might have an impact on the credit granting process. Andersson (2001) found out that more experienced loan officers reviewed more information than new loan officers. However, more experienced loan officers were more likely to reject a loan application than the less experienced. Andersson (2001) explains that with the fact that a rejection of a good application is less damaging than grant a credit and have the company default and thus get credit losses.

2.4.1 Use of accounting information in credit assessment

Bruns and Fletcher (2007) conclude that lenders place most focus on presented accounting figures. Further, Andersson (2001) explains that banks consider that financial statements are quite reliable because of the audit requirement in Sweden. Financial reports such as income statement, balance sheet and cash flow report are mainly used in prediction models. There are several studies showing that the use of financial ratios, at least in a short time perspective, is good predictors of a possible company default (Andersson, 2001).

Usage of the overall accounting information during the last decades remains an important source in the credit assessment process in banks. Previous research shows that the importance of its constituents has shifted though. Cash flow analysis, in accordance to a going concern approach, has increased while use of balance sheet ratios is reduced (Berry & Robertson, 2004).

The normal process in Swedish banks when performing credit assessment is to collect financial information from the potential borrower and from UC, where information often can be imported directly to the banks' own systems and from there produce financial ratios. According to Svensson (2003), most bankers are satisfied with accounting information when it comes to calculate financial ratios, and about half of them consider the same about cash-flow and reported values of assets in the balance sheet. When it comes to collateral, on the other hand, market values are more commonly used.

Argenti (1976) presents some criticism on the use of financial ratios and of accounting presented in financial reports. He argues that companies that are underachieving are more likely to start using 'creative accounting', which means optimistic instead of neutral views in judgments and sometimes even producing fake illegal transactions, which makes financial ratios less useful as predictors. However, Andersson (2001) discusses two earlier studies of companies, showing that bankruptcy could be predicted in 80-85 percent with the help from financial ratios. There is some tendency to lose predictability using financial ratios in modern time, but if combined with market-related variables, the predictability of companies going bankrupt increases according to Beaver, McNichols & Rhie 2005. Even though, Svensson (2003) has noted that banks see some problems regarding possibilities to smoothen or affect results in a desired way, such as activation of self-generated intangible assets or by accelerated depreciation. According to Svensson (2003) it is not unusual to set up guidelines in the credit contract on how the company should manage their

accounting combined with incentive to follow the contract, for example on lower interest rates.

Financial statements are used in banks' corporate analysis and also in their rating models (Riksbanken, 2004). Some rating models can be almost fully automatic, while others require more manual inputs (Svensson, 2003). The purpose is to define risk when granting credit; the equity a bank needs to hold to cover the credit is based on said risk (Riksbanken, 2004). The models include more information than financial ratios, such as credit history, market information and information about board and owners. Jacobson, Lindé and Roszbach (2005) found out that two Swedish banks that had a shared customer base could rate individual companies very differently. However, the risk classification in the portfolio conformed quite well.

Both Andersson (2001) and Svensson (2003) discuss the problem with timeliness regarding financial reports, as they are often outdated when published. Companies that are underachieving tend to wait even longer to release their reports (Argenti, 1976). However, Svensson (2003) have found that lenders may demand or collect accounting information on a more regular basis, if necessary. It is more commonly used when granting credit to new customers or companies with a weak financial position. Svensson (2003) also concludes that long time customers are evaluated more on behalf of personal relationship than accounting information.

How accounting information is viewed by banks may differ between geographical markets. Silver (2001) noted that in smaller communities, financial statements are used to verify descriptions from board and owner, and information from other institutions in the community can also be used to evaluate the information. In larger cities the process often work in the other direction. Financial information is used in advance, to prepare questions and areas to focus on when meeting with board and owners of the company.

Once clarified how accounting information is used by the bank in the credit assessment process, next question arises: what kind of information is presented in financial reports? There are certain legal requirements, but choosing between regulation systems is possible in Sweden's accounting act structure. Therefore, next section introduces the demands for content in annual reporting and a description of the K-project recently introduced, consisting of rule-based and the principles-based regulation systems. Lastly key differences between the regulation systems are presented.

2.5 The content of the annual report

The Swedish Annual Accounts Act (ÅRL 2:1) describes what the annual report shall consist of:

1. A balance sheet
2. An income statement
3. Notes
4. A management report

In addition, a large company presents a finance analysis.

2.5.1 Definition of small and large companies

The definition of a small company is a company that does not fulfill the requirements to be considered large, which are more than one of the following conditions according to 1:3 ÅRL (FAR, 2013):

- Average number of employees in the company during each of the last two financial years has exceeded 50 persons,
- Total assets of the company during each of the two last financial years has exceeded 40 million SEK,
- Reported net sales of the company during the last two financial years has exceeded 80 million SEK.

Furthermore, a company whose shares, warrants or debt securities are listed on a stock exchange, an authorized marketplace or another regulated market are always considered large.

2.6 Simplifying K-project

The Swedish Accounting Standards board initiated a project in 2004, the so called K-project, in order to simplify the financial reporting for smaller companies. There are four sets of accounting regulations, from which a company will choose one to follow depending on the size of a company (BFN, 2013). It is the rules and requirements in the Swedish Accounting law, BFL, which form the basis for its design. Each category contains a comprehensive regulation package with the purpose to meet the company's complexity level and other factors.

- K1 (BFNAR 2006:1): Sole traders establishing simplified financial statements.
- K2 (BFNAR 2008:1): Annual reporting in small companies.
- K3 (BFNAR 2012:1): Annual reporting and consolidated financial statement.
- K4 is for companies who must or choose to follow IFRS.

K3 is the main regulatory for Swedish companies, created with inspiration from IFRS for SMEs, with adjustments for the connection between accounting and taxation in Swedish accounting and other norms and practices (BFN, 2013). It is principal-based, in contrast to K2 which is rule-based and therefore contains more restrictions than K3. K2 is an option for companies that are considered small according to the Swedish Annual Accounts Act. Most of Swedish companies are small (Lennartsson, 2013) and therefore able to choose between the new sets of accounting regulations K2 or K3.

2.6.1 Differences between K2 and K3

The main difference between K2 and K3 is the fundamentals in how the regulations are created. K3 is principle-based and K2 is rule-based (BFN, 2012). How effects of the new regulations will appear is difficult to concretize since K3 will be applied for the first time in the year-end 2013/2014 (BFN, 2012). However, the regulations are formulated and there are some substantial differences between them. Not every detail is covered in this section, but the main differences are elucidated below.

2.6.1.1 Tangible and intangible assets

K2	K3
<p><i>Depreciation:</i></p> <p>Both tangible and intangible assets are allowed to be depreciated within 5 years with the K2 regulations, but the real period of use can be used. It is not allowed to split assets such as buildings down to components and depreciate them separately.</p>	<p><i>Depreciation:</i></p> <p>In K3, the period of use has to be estimated and the asset will be depreciated during that time frame. Tangible assets, such as buildings, needs to be split up and components need to be depreciated separately.</p>

<p><i>Appreciation:</i> Within K2, the only asset allowed to appreciate is buildings, with a limit of the taxation value, but no deferred tax are to be accounted for.</p> <p><i>Self-generated intangible assets:</i> Self-generated intangible assets arising from research and development activities are not allowed to activate in the balance sheet.</p>	<p><i>Appreciation:</i> K3 does not limit appreciation to buildings. All assets can be appreciated as long as the criteria in the Swedish Annual Accounts Act, ÅRL, are fulfilled. Hence, there should be a reliable and permanent increase on the asset's value. (ÅRL 4:8).</p> <p><i>Self-generated intangible assets:</i> There is an option to activate such costs arising from research and development activities.</p>
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2.6.1.2 Provisions, accruals and other costs

<p>K2</p> <p><i>Provisions:</i> There is no need to account for provisions, if the amount is less than 25 000 SEK or 10 percent of the equity capital. Provisions are only allowed to account for if there are legal or contractual obligations.</p> <p><i>Accruals:</i> All accruals over 5000 SEK needs to be moved to the right period. It is not necessary if the cost is a recurring cost with a maximum spread of 20 percent.</p>	<p>K3</p> <p><i>Provisions:</i> K3 does not have any limitations for when allowed to account for provisions.</p> <p><i>Accruals:</i> All costs are subject for evaluation and if considered as significant it has to be moved to the right period. No exceptions for recurring costs.</p>
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<p><i>Leasing:</i> All lease contracts shall be classified as operational.</p>	<p><i>Leasing:</i> Lease contracts can be classified as either operational or financial.</p>
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Appendix B includes two fictitious companies, X and Y, created according to the different regulations presented above. The companies' financial statements shows how differences in K2 and K3 can affect accounting figures in balance sheet and income statement, and in extension financial ratios. More information about the companies are found in section 3.3.1.1.

2.7 Rule-based versus principles-based

All accounting regulations are more or less based on rules; even regulations considered as principles-based. Not every transaction is a subject to judgments and evaluation, but regulations containing more rules and limits are usually called rule-based whereas principle-based have fewer limitations and are less specific (Collins, Pasewark & Riley, 2012).

The debate around the use of either system has been extensive, and has mainly focused on the differences between US-GAAP and IFRS. Main criticism of a rule-based regulation system, as US-GAAP, is the possibility for a company to structure its transactions to go around the rules (Baily & Sawers, 2012; Collins, Pasewark & Riley, 2012; Agoglia, Douponik & Tsakumis, 2011). However, the pro rule-based regulations argue that rule-based regulations increase comparability, since there are less judgments and more specific instructions and bright-line thresholds (Agoglia, Douponik & Tsakumis, 2011). Criticism of principles-based regulations as IFRS has, on the other hand, concerned that stakeholders loose comparability and that a company can, due to excessive optimism or pessimistic view, affect its financial statements in a given direction. People in favor of principles-based regulations however argue that a company's ability to make judgments gives better view of its real financial position (Baily & Sawers, 2012).

To summarize the criticism, it is based on the opinion that companies either choose to work around the rules to achieve desired financial figures, or use the possibility for judgments to affect the final result. This aligns with Argenti's (1976) findings that

underachieving companies tend to manipulate their result. Svensson's (2003) research confirmed that corporate loan officers see a problem with the possibilities to smoothen the results. A company showing good results almost always performs better and a company showing negative results almost always performs worse (Svensson, 2003; Argenti, 1976).

2.8 Summary of the reference frame

The theories presented in the frame of reference are chosen to enable a thorough analysis of the usefulness of financial reports in banks' credit assessment. They tell us that the bank, as a stakeholder and user, is in great need of information from the company. There is an existing information asymmetry in their relationship, which can be explained with the help from the principal-agent theory. Information asymmetry increases transactions costs, therefore it is necessary to find ways to reduce the information gap.

Previous research shows that criticism on how accounting is produced concerns accounting choices and its abilities of manipulating and smoothening financial figures and consequently ratios. Also, differences in regulation structures that causes worse comparability. To reduce information asymmetry in the credit assessment process, banks do not settle with financial reports; relationship and issuing collateral are two important pillars as well.

The main focus in the debate regarding rule- and principles-based regulations has been the differences between US-GAAP and IFRS and problems regarding structured transactions and judgments. The K-regulations are built on these two ways of producing accounting, which actualizes the debate as they are selectable for companies within the same context.

The reference frame provides important insights and creates a basis for the analysis of the empirical findings in chapter five.

3. Methodology

The third chapter explains how usefulness in financial reports, as a part of the banks information need, has been investigated. It contains descriptions on how theories, previous research and information about the K-regulations were collected. This is followed by explaining how the empirical material was gathered through interviews with representatives from Swedish banks. To understand how the material was processed, the chapter includes descriptions of the analyzing method and possible shortcomings with the chosen method.

3.1 Research approach

The task in this study was to gain an understanding of why and how financial statements are used to serve as a basis for decision making for the one of the main stakeholders. The empirical research concerned how accounting information matters in the credit assessment process in banks.

The Swedish accounting regulations, K2 and K3, differs in certain respects. This study has focused on analyzing whether these differences may affect a company's creditworthiness or the assessment of a company. To be able to draw conclusions in this matter, two perspectives were explored to gain understanding for each side; the accounting perspective and the banking perspective. By analyzing the usefulness from two angles, conclusions could be drawn about how adapted the information is and also its importance in and impact on the credit assessment process. Hence, the purpose was to find common patterns among the banks in the empirical study, as the investigation was about providing a comprehensive picture rather than highlighting differences between banks.

3.2 Research method

In order to answer the research questions, the use of a qualitative research method were appropriate. This enabled a thorough analysis with space for explanations and detailed answers from previous research presented in the reference frame, as well as from the loan officers interviewed. Thereby a deeper understanding for their perspective as practical users of the accounting information. The findings in a qualitative research are thus based on non-quantifiable data in which attitudes, values, and perceptions can be gained (Lundahl & Skärvad, 1992).

Several arguments for a qualitative research method when performing the empirical study could be pointed out. Firstly, the nature of a credit assessment generally is dependent on the specific person's earlier experience and expertise (Andersson, 2001). A loan officer, who is processing a loan application, has specific internal policies as well as legal requirements to adhere to. However, it is difficult to obtain data on an aggregated level, illustrating fully how loan officers manage different assessment situations. This put obstacles to a quantitative research, which would have been more appropriate when data can be quantified (Lundahl & Skärvad, 1992). Secondly, the choice of methodology was in accordance with most of the relevant previous research on the field. Gathering data from earlier research with the same alignment, in combination with an own empirical research with interviews, provided an appropriate platform for the analysis of the subject.

Empirical material was gathered through interviews with corporate bank loan officers, who possess significant knowledge of the credit assessment process. The interviews were semi-structured, with a questionnaire designed to invite to discussion (Gillham, 2000). However, this approach enabled quantifying the answers to some extent and to find some common denominators (Lundahl & Skärvad, 1992) which enabled a perception of their view of a company's financial position based on financial and non-financial information. The interviews were complemented with the constructed companies, X and Y, based on the K-regulations. A more detailed description of how the interviews were performed can be found in the interview guide-section 3.3.2.1. How the constructed companies were created can be found in section 3.3.1.1.

3.3 Data collection

3.3.1 Secondary data

In order to create an image of what has been previously discussed in the field that was examined; the study took its start in exploring previous research on the usability of accounting information for users in general, but primarily on its usability in the credit assessment of a company. Information was collected mainly through databases provided by the library of Gothenburg University, which has access to a range of different academic journals. Besides, several doctoral dissertations in printed form were borrowed through the library.

Recognized theories, such as the stakeholder theory and the agency theory, can be linked to the relationship between a bank and a company. These theories were

outlined in the frame of reference to form an appropriate perspective of the study and also to serve as a basis for the chosen subject. Theories presented here were, as far as possible, collected from the writers who developed the respective concept or from scientific papers or dissertations describing this concept.

Together with fundamental theories explaining why certain phenomenon occurs in the relationship between the two parties, the bank and the company, knowledge on the use of accounting information formed the next part of the reference frame. Main sources used were scientific articles and doctoral dissertations. This gave an accurate picture of elements questioned before. In this way the key factors could be identified and research results showing differences could be compared. In addition, academic literature was used when explaining some essential concepts of accounting and its users.

The sections dealing with the Swedish accounting system, annual reporting, the K-project and rule-based versus principles-based accounting, are based primarily on accounting rules presented by FAR/BFN and previous research. The created companies were based on differences in K2 and K3 presented in the reference frame, to provide a practical example of how differences can appear.

3.3.1.1 Construction of company X and Y

Two companies' financial statements are attached in Appendix B. These companies were named X and Y, where X's financial statements were based on K2 and Y's were based on K3. The two different financial reports were created with the help from a real company's financial report, however either named or associated with the original company. The information was retrieved from Swedish Companies Registration Office. In this way, it was ensured that the fictitious companies are realistic.

When selecting companies from the Swedish Companies Registration Office, the main selection criterion was that the chosen company should have the possibility to choose between K2 and K3. Therefore companies considered large according to the Swedish Annual Accounts Act were excluded.

Another criterion was to choose an industrial company to use as a basis when constructing the companies. In this way it was ensured that there were tangible assets in the balance sheet. This also made it possible to illustrate the ability to use them as collateral and to show the effect of appreciation rules within each regulation.

The adjustments in the financial statements were made with the help from a practical manual issued by BFN (2012). The main focus when creating the companies was to highlight some of the differences in K2 and K3, mainly the ones mentioned in the frame of reference. For example company Y, who has activated self-generated intangible assets. Both companies reevaluate their property, but with different amounts since K2 limit the value to taxation value. There is also financial leasing in company Y.

3.3.2 Primary data

Primary data were collected through interviews with representatives from five banks.

The area examined empirically involved how corporate loan officers in Swedish banks work with credit assessment when handling a credit application. More specifically, what factors that are relevant and which information that is required from a company when granting credit.

3.3.2.1 Interview Guide

All interviews were recorded after approval from the respondents. The interviews focused on the credit process and other areas which a corporate loan officer is considered to have knowledge in. The semi-structured interviews were designed to steer the direction of the interview but also enable for the respondents to answer freely. This enabled the respondent to use own nuanced examples and illuminate areas that he considers relevant in accordance to the interview approach, which were preferable since the credit granting process to some extent is dependent on the loan officer involved in the case. Another characteristic of a semi-structured interview is that we, as interviewers, probe the interviewee so that the initial statements are elaborated as much as needed (Collis & Hussey, 2009).

An important pre-condition was that each respondent had taken part of the interview material beforehand. In this way time was more efficiently used, and it also prepared the respondent prepared for the interview.

The interview material consisted of the following:

- *Interview questions*

Before conducting the interviews, it was critical to make sure that the interview questions were formulated so that the accurate perspective was reflected by each respondent, and that they served as a basis for drawing conclusions on the usefulness of financial reports. The bank perspective was in focus, meaning that the interview questions focused on their information need and the use of accounting information, in order to create a picture of each bank's credit granting process. The interview questions were designed in accordance with the structure of the frame of reference. This consistency was crucial when later analyzing and drawing conclusions.

The questionnaire can be found in Appendix A.

- *Companies X's and Y's financial statements*

The two otherwise identical companies X's and Y's financial statements worked as a complement when discussing and asking questions during the interview, mostly questions concerning accounting choices. In this way, the interviewers as well as the respondents were able to relate to a real situation, rather than speaking about companies in general. According to Gillham (2000), there is a risk of people saying one thing during an interview but not acting that way in the situation asked about. Andersson (2001) considers this to be quite common among loan officers. Using practical examples gave more reliability to the answers from the respondents. It was useful to ask quite specific questions even if it was semi-structured interviews. The usage of these created companies varied between the interviews.

Companies X's and Y's financial statements can be found in Appendix B.

Confidentiality

The representatives from each bank were presented with name and current position before the empirical findings were outlined. To enable more freedom and open responses from the respondents (Collis and Hussey, 2009), their name and bank was not associated with specific persons' answers when presenting the empirical results. Consequently, each of the five respondents was named by initial A-E. They were informed about the confidentiality of their answers, both in the information sent out

in advance and also in the beginning of the interview. In the empirical findings section, there has been a distinction between what each respondent claims, and how the bank as a whole works and approaches. Thus the respondents' own reflections were kept apart from the discussion of general practices as much as possible.

3.4 Data analysis

Transcriptions of the interviews were made as soon as they were performed; the same day or the following. In this way the information was not lost which made the analysis between the interviews easier (Gillham, 2000).

Analysis of the transcribed information was done by marking up useful information in the transcripts. The marked information was put into categories that were appropriate considering the answers received (Collis & Hussey, 2009; Gillham, 2000). Answers were color coded and presented in a table with categories in columns and respondents in rows. The three columns dividing relevant responses presented in the empirical findings were:

- Banks information requirements
- Use of accounting information in credit assessment
- Accounting choices

Within these categories, several subcategories were identified when later presenting the empirical findings. There is always a risk for bias since the categories were created by the authors, which can misinterpret the respondents' answer (Gillham, 2000). To strengthen the credibility, all categories were based on the selected frame of reference and consequently aligned in the chronological order of the interview questions. Responses linked directly to X's and Y's financial statements were placed in the last category 'accounting choices', as it was only mentioned when asking questions concerning accounting information.

The interviews were held in Swedish. Once the interviews were transcribed and the empirical material was under study, every response was translated into English before presenting it in the empirical findings. This was done with caution to avoid distorting responses.

Once the empirical findings were outlined, the comprehensive analysis of the empirical material set against the frame of reference took place. The findings were

screened several times to find connections to theories and previous research. However, the same structure as the rest of the thesis was pursued in order to maintain the consistency throughout the whole thesis.

3.5 Selection of respondents

Choosing respondents started with identifying the five largest banks in Sweden, based on employees, lending, deposits and the size of the balance sheet. Those are Swedbank, Handelsbanken, SEB, Nordea and Danske Bank (Swedish Bankers' Association, 2013). Next step was to establish contact with these banks to get hold of appropriate respondents for interviews.

Since the interviews exclusively concerned corporate credits and how the credit assessment processes works, the selection consequently was corporate loan officers with a mandate to grant credit to companies and who do this on a regularly basis. The first contact with representatives from each bank was made through their customer services, or directly through bank branches in the Gothenburg area where contact information were available at the banks' websites. Phone numbers and e-mail details were exchanged. Difficulty of getting hold of suitable respondents varied. Personal contacts with employees in two of the banks facilitated the process of searching for respondents and made it more accurate. Nordea had no contact information to their branches and getting hold of a corporate loan officer was particularly difficult, since all contact has to be made through customer services. When contact were finally established the interview request was turned down due to lack of time.

Instead of interviewing Nordea, a representative from Sparbanken Alingsås, which is a part of Swedbank group, was contacted. Since the credit assessment process differs between inner-city banks and banks in smaller communities (Silver, 2001) this may help the study to get a more conclusive picture. Of course with the confidentiality still taken into consideration.

3.5.1 Contact with the respondents during the interview process

This process resulted in scheduling meetings with representatives from four of the five banks desired, however five interviews in total. This amount of interviews can be sufficient to achieve an understanding of the area that is being investigated, according to Gillham (2000). Time of the interviews ranged from 50-90 minutes.

Documents containing interview questions and company X's and Y's financial statements were sent beforehand by e-mail to each respondent.

When interviews had been held, each respondent were offered to go through the interview material before it was published, to ensure that the answers has been interpreted correctly. Complementary questions were sent out to some of the respondents by e-mail after the interviews had been held. They were offered to take part of the final result of the study.

3.6 Credibility

3.6.1 Validity

The secondary data was selected by the authors of this thesis to create a suitable frame of reference. It was essential to ensure that the results showed the chosen subject from the correct angle and reflected it in an accurate way (Collis & Hussey, 2009). Noteworthy is that there might be other appropriate theories and previous research available. To frame the study qualitatively and reduce the risk of omitting relevant information, a comprehensive literature review was conducted. Not only to find interesting previous research on the area, but also to retrieve inspiration from their structure and selected reference frame.

A thorough immersion of prevailing laws and regulations was made when creating companies X and Y. Also, screening manuals and brochures containing guidelines of K2 and K3, issued by BFN. This was made in order to ensure that the created financial statements were valid and credible.

Validity of the empirical research

Previous research and theories has helped creating a picture of central areas and key factors worth having knowledge in before interviewing the loan officers. However, to be receptive and attentive has been vital in order to ask follow-up questions and get the most out of each interview. To ensure accurate focus when reflecting the banking perspective, this was of importance since theory and practice only coincide to some extent.

3.6.2 Reliability

To ensure the reliability of the literature that was used, almost all sources were scientific literature and doctoral dissertations that has been critically viewed.

The adjustments made in companies X's and Y's financial statements are only possible and may not reflect how the financial statements would have looked if these companies had reported within either regulation. A real transition to the new K-regulations would require a lot more information and time.

Reliability of the empirical research

Since the credit assessment process is characterized by judgments, there is a risk that the empirical research and its sample of respondents were not fully representative. As one of the largest banks in Sweden, Nordea, was not represented in this study, there was a risk of not getting a fully picture of how the largest banks in Sweden performs their credit assessments.

Andersson (2001) found out that the level of experience a loan officer possesses affects both the information collected and how they use it. There are also differences in how analysis are made, since experienced corporate loan officers are more forward looking while junior corporate loan officers tends to focus more on historical performances. Moreover, Svensson (2003) states that banks situated in smaller locations collect information provided by local knowledge and personal contact rather than accounting information. Almost all of the respondents in this study are working at branches in Gothenburg, which may have lead to missing out on these alternative approaches in smaller locations. However, Sparbanken Alingsås can be classified as one such. Once again, it was included in the empirical research to get a conclusive picture, without revealing the respondent.

To be able to rely on the findings in this study, the same result should be achieved if it was repeated (Collis & Hussey, 2009). As a result of personal reflections from the interviewee's point of view, there may be a difficulty of repeating the empirical study fully. However, work procedures should not differ substantially between different employees in one specific bank, which made interviewing one representative from each bank satisfying. The important thing kept in mind was to critically absorb and retell given responses by the respondent.

The interviews were, to different degrees, complemented by companies X's and Y's financial statements as a basis for discussion. Information about the companies' management and position overall was limited, which made it impossible for the bank representatives to draw conclusions based on these financial statements. However, its complementary significance strengthened certain assertions when discussing questions concerning accounting choices.

4. Empirical findings

The fourth chapter presents the empirical material gathered through interviews with representatives from five different banks in Sweden. This is in order to obtain a picture of how the bank, as a user, uses the financial information to reduce the information gap between them and the company. More specifically in the credit assessment process. The first section contains a presentation of each bank and respondent. The second section provides a presentation of the responses that came up in the interviews, divided into categories concerning information requirements and credit assessment.

4.1 Presentation of the respondents

Below a short presentation of each bank and respondent is given.

4.1.1 Swedbank

Swedbank is one of Sweden's largest banks in terms of number of customers and also has a leading position in the Baltic countries. An interview was made with Niclas Frostelind, who works as a credit risk manager for the western region. He has been working at Swedbank for almost 25 years, predominantly with corporate matters in different working positions.

4.1.2 Handelsbanken

Handelsbanken has its home markets in Sweden, but also Britain, Denmark, Finland, Norway and the Netherlands. What is characteristic for Handelsbanken is its highly decentralized organization structure. Patrik Hedemyr, who works as a corporate advisor at a branch in Gothenburg, was interviewed. He has been working in the banking sector for 11 years; began as a private advisor and then switched to his current position.

4.1.3 SEB

SEB operates mainly in the Nordic region, the Baltic countries and Germany and has its emphasis on the corporate section. An interview was made with Reinert Siweborn, who works as a corporate advisor at a branch in Gothenburg. He has been working at the bank for almost 30 years, of which 15 years have been focused on small and medium sized companies.

4.1.4 Danske Bank

The Danske Bank Group is Denmark's largest financial group, and also one of the largest in the Nordic region, including Sweden. Per-Olof Ström, who is a deputy branch manager and corporate client manager at a branch in Gothenburg, was interviewed. He has been working in the banking sector for over 30 years. First as private advisor, but the last 20 years with corporate matters in several different positions.

4.1.5 Sparbanken Alingsås

Sparbanken Alingsås is an independent savings bank, operated as a limited company and owned 100 percent by the foundation Sparbanksstiftelsen Alingsås. Over the years, some savings banks have united to what is today Swedbank. Others, like Sparbanken Alingsås, have remained independent, however with some cooperation with Swedbank. An interview with Eric Karlsson was made at the branch in Alingsås, one of a total of five branches in the surrounding area. He has been working in the banking sector for over 10 years, first as a private advisor for a couple of years and then as a corporate advisor at Swedbank. His current position is as a corporate advisor at Sparbanken Alingsås.

4.2 Information need in the credit assessment process

4.2.1 Classification depending on size of a company

Four of the five interviewed banks divide their company customers into separate categories in a similar way, based on the size of turnover and sometimes complexity level. This, in turn, controls how resources are allocated as well as the company's branch belonging, as most of the banks have offices or departments working with a particular group.

Small corporates are roughly those who have a turnover between 1-10 million SEK. Companies with a turnover of 10 million up to half a billion SEK are considered as *medium corporates* in two of the banks, while companies from 10 million up to 100-200 million SEK in one of the banks. *Large corporates* is a category that stands for different constellations in each bank, which to a great extent implies listed companies and large international companies. One of the banks, however, divides companies based on its geographical ties, which consequently steers its responsible branch. From a credit perspective, this bank categorizes companies by its level of credit, where a

company with credit exceeding 5 million SEK is considered large and all others small.

4.2.2 Banks' information requirements

New corporate customers

To form an opinion about how a company's business works and what contributes to revenue is an essential part of the assessment of a company, when granting credit as well as creating other solutions; something that all five respondents undoubtedly agree upon. Before the first meeting, usually an overall review of the company's accounts is done to get a perception of how the company has performed historically. The first meeting focuses mainly on the entrepreneur's detailed description of the company's mission statement and how the company generates revenue. Companies are handled in accordance with their size and complexity, which determines how much time that should be spent and how deep the required analysis should be.

Bank A processes a majority of its new corporate customers through a department dealing with incoming inquiries received through the website, where the company completes a number of tasks on their activities. Following the evaluation of possible initiation of business relations, the department forwards the applicant to the appropriate bank branch which continues to establish contact. The department does not handle credit applications, but makes an initial assessment of whether the bank is interested in creating solutions and funding the applicant. Respondent E explains that there are rarely any standard credit applications, it is more about the interaction between the company and the advisor. The connection starts with a personal meeting, where discussing the purpose of the funding forms the core. On this basis the questions are asked on factors which come into play, including the scope and complexity of the company.

Respondent D declares that when doing business with a new customer, one should make sure to get acquainted with the company thoroughly.

"The longer the process has been, the better the deal later." – Respondent D

It begins by going through the purpose of switching banks, input values and the company's current stage. Respondent D explains further that openness from the outset is beneficial for both parties. Not providing all the information from the beginning, as later revealed, could complicate the company's future prospects. All

respondents agree that working with a company to a great extent concerns confidence for the board, president and owner. Respondent C explains that the smaller segments are about personalization and analyzing the person behind the company, to identify competencies, possible risks and so on. Bank C stretches as far as stating that sometimes one individual in a company is considered so important that it requires a life insurance policy.

Bank A and B prefer having a prior relationship with the people behind the company. This means any type of previous contact, either as private customers, existing corporate customer or through connections, before financing could be considered.

“The risk of business credit is much higher than private credit.” - Respondent B

Since many companies that bank A and B work with are owner-managed, they also prefer to do business with the owner’s private banking business, to involve the entire chain.

If a company is in its startup phase, bank C rarely provide funding. Further, banks A, B, C and E mention that a relatively common business financing solution for a company is taking help from one of many partners in the business credit world, such as Almi. Bank C sets strict demands and will not take a high risk, reasoning in accordance with the other four banks, which can make a partner such as Almi a complement for a company that is in an early stage and in need of external capital. The respondents mention that this approach is due to their banking policies and legal demands of not providing venture capital.

Existing corporate customers

Each company usually has an advisor who is responsible for the contact and follow-up. Meetings are held a couple of times a year, which may however vary widely depending on the specific company’s situation and stage. The size is also a key factor, as frequent contact is more common with larger and more complex companies. Meetings are often held at the company’s facilities. Respondent B explains that annual meetings aim to go through possible needs for investments in the near future, what previously granted credit limits look like and other current issues. According to respondent B, it is however often a quick action once a company is in need of funding; then quick decisions are required. Furthermore, several respondents mention the need for other persons involved in the company in various respects,

such as a board member or finance manager, to participate at meetings if areas of their expertise and knowledge will be discussed. This is mostly the case with medium or large companies. It also happens that the auditor is present at meetings with the bank, according to respondents C and D; either to help gather relevant materials or answer questions about transactions. Respondents B and C highlight the importance of having regular follow-ups with companies. This enables the knowledge of the company's objectives and possible investments in the future and helps avoiding surprises.

There is a distinct forward-looking emphasis among the banks. Respondent C talks about the need to get the entrepreneur to explain the company's future prospects. If the plan for example is to expand, what strategy will make it a reality. This applies to both new and existing customers. Bank E requests access to the company's business plan, to take part in its vision, budgets and financial targets.

"Insight into a company's future plans is important in order to determine whether the company is suitable for a loan not only today, but for years to come."
– Respondent B

The case for many small companies and entrepreneurs is that they are not always versed in economics. Several respondents mention that this sometimes can be problematic. According to respondent E, large companies generally are easier to work with, in an analysis perspective. This is mostly due to greater availability of financial plans and forecasts, together with an accounting function that can provide various reports; a prerequisite that a small business rarely has. This could ultimately make the analysis difficult when making a credit decision for a small company, says respondent E. It is not unusual that there is a lack of explicit plans for the future for small companies, according to respondent A. Their activities float on, with the hope of making more money in the future; without a specific plan of how to make it happen.

All of the banks receive current information from UC of occurrences in the company, such as a payment default or change of board members. Respondent D has noticed that companies with prosperous business sometimes voluntarily submit monthly and quarterly reports, without demands from the bank. However, if business deteriorates, there is a tendency that reports are not submitted as frequently.

“If a company falls into difficulties and business starts to deteriorate, the economic knowledge of the entrepreneur is put to test.” - Respondent D

There are examples of companies whose business has worsened. Thanks to skills and competence in the company, relevant reports have been produced, which makes it more likely that the bank wants to continue to be financier. Incomplete reports may however affect how the bank views a company in terms of risk, states respondent D.

When granting credit, bank B considers that the annual report must be audited. Bank A has a strong desire for auditing as well, however prior relationship with the company comes into play. If the bank has a previous record of the company, where it is known that the financial statements are well, based on experience for many years; auditing may matter less. An unaudited annual report for a new corporate customer could, on the other hand, be a risk factor, according to respondent A. As a result, the bank may demand collateral in the form of personal guarantees.

Banks C, D and E explain that, besides annual report, periodical financial statements are also required. Respondent E explains that this, in combination with a budget, indicates how well the company meets its goals at closer intervals. Bank C is thorough with every detail of the figures reported and can in some cases require audited period financial statements, for example when funding in an acquisition situation.

4.2.3 Credit assessment

When it comes to granting credit, all banks require a lot of information in order to form a comprehensive picture of the company. That means financial information, but also non-financial information, such as the people behind the company, their business model and business environment. Their main focus is to identify risk factors, to be able to calculate the risk of default and consequently the scope of potential losses. Hence, the requirements can be divided into three groups; financial information to use both in rating models and in analysis, interaction with the company to understand its business, and valuation of collateral. All respondents emphasize the importance of knowing the company when assessing their loan application.

“Knowing the company is to know their risks.” – Respondent C

If the risk is too high, granting credit is out of question. Knowing your customers includes many factors, and each respondent mentions various ones. One important factor is the knowledge of the respective industry; to measure one specific company against others and evaluating a particular industry's up and downturns. Other aspects highlighted by the respondents are to understand how the company operates in its market.

"The bank has much expertise in different businesses and industries, but can never know more about the company's business than the entrepreneur, operating on a daily basis."

– Respondent D

Understanding the company also includes getting information about its customers and suppliers. For example, a few larger customers or suppliers are considered as higher risk, compared to many smaller customers or suppliers. Further, a company's inventory value can be a tricky post according to respondents A, C and D. Not because of the valuation principles concerning inventory, but rather the nature of the inventory itself. Respondent A exemplifies by explaining that if a company is selling metal defaults, there will be minimal inventory obsolescence. A company selling fresh fish, on the other hand, will have a sharp decline in inventory value quickly. Therefore, according to respondent A, it is crucial having a plan of how to handle possible default in the fish company, to be able to make use of the inventory value.

Respondent A mentions that personal guarantee is one way of getting the owner committed in a possible default situation, enabling the process to go as smoothly as possible. It will ensure that the owner stays in the company after a default, to preserve as much value as possible. Both banks A and C sometimes have requirements of certain insurances, for example life insurance, for a valuable employee or insurances that will cover expenses if a property needs to be restored due to hazardous productions.

Respondent C brings up legal risk that also needs to be considered. How will, for example, an entrepreneur handle a divorce? The legal construction between partners is one of many other aspects that needs to be taken into account. Respondent C explains that legal requirements sometimes are set up for the company to fulfill, to obtain and maintain credit. It is mainly of two kinds. General rules applicable for all sizes of companies as well as convergence packages with different financial ratios the customer should reach. Respondents A, C and E mentions that these types of general requirements concern, for instance, sizes of dividends or demands from the bank that

credits should be repaid prior to loan from the owner. Respondent B mentions that they try to steer the company's amortization. For some companies it is regulated that a company should reach a certain solidity, yield on assets, or other financial ratios. However, respondents A, C and D stress the importance of understanding these demands before agreeing to them. Therefore, according to respondent E, it is not suitable for a small company with little or no knowledge in accounting. Respondent A also includes their quest to sparse the usage of financial ratios in the credit agreements, due to the consequence of increased administrative burden for the corporate loan officers.

To ensure quality in the decisions made by the corporate loan officers, at least two people are always involved in the case. This is called 'duality principle', where the loan officer together with a higher decision-making body, such as the branch manager, makes final credit decisions. When the size of the credit or the complexity of the business increases, decisions are often made higher in the hierarchy; usually consisting of credit experts or credit committees.

When presenting the information, experienced loan officers are often better at presenting succinct and persuasive cases according to respondent A and E. The experience makes it easier to sell the case to other decision makers, according to respondent A.

4.2.3.1 The use of accounting information

All respondents state that the use of financial information is a matter of course; financial reports that contain satisfying numbers form the core in the credit assessment.

"We don't proceed if the numbers are unsatisfactory, even if the person behind is highly skilled. The numbers are crucial." – Respondent A

Respondent E describes two ways of working with the numbers presented. One way is to screen the financial statements beforehand and note questions arising when trying to figure out the business. Or starting with meeting the company, followed by immersion in its financial statements to verify what has been narrated by the entrepreneur.

Cash-flow

According to respondents A, B and C, the most important financial report is the cash-flow statement. Respondent D considers it as important as the other financial reports. Respondent E did not rank the financial reports. Respondent B explains that the primary focus lies in the operating cash-flow, which enables analysis of the company's core activity. Respondents A and B clarifies that the generated cash flow is what will determine if the company is able to repay loan and interest. Since the cash flow report only is mandatory for larger corporations according to the Swedish Annual Accounts Act, the banks sometimes needs to collect the information in other ways than through the annual report. Bank B sometimes requires the company to create cash-flow report anyway and bank D sometimes creates the report themselves.

Balance sheet and income statement

Book values from the balance sheet are often used when valuing business mortgage as collateral for credits. Bank B always uses the last annual report when evaluating the values and makes roughly calculates, where value on inventory estimates to 40-50 percent of the book value, 60-70 percent on receivables and 10 percent on fixed assets. When referring to company X and Y, the percentages might differ depending on fixed assets these companies have, on what the inventory consists of and who their customers are. Non-tangible assets are rarely calculated to any value at all, according to respondent B. Receivables in a service providing company are often valued less than in a retail company, according to respondent A. This is because it is easier for customers to claim that the service was not provided or finished, than claim non received physical goods. However, when it comes to collateral such as real estate, it is more common to use market values since the information in the balance sheet often is significantly lower due to deprecations. Respondent D explains that they, as a consequence, need to do a real valuation of the property.

Income statement together with balance sheet forms the basis for calculations of financial ratios. These calculations are mainly used in rating systems and to identify trends; for example if the turnover or costs are increasing or decreasing. However, respondent E highlights a risk with the trend analysis. When looking at a one man company, the costs and results may vary a lot between the years depending on what salaries the owner takes out. Respondent E clarifies that in these cases it is better to understand the customer's situation.

Risk rating / Scoring

All the banks explain that they have their own credit rating system, approved by the Swedish Financial Supervisory Authority. These systems are used when classifying a company in terms of risk; central in credit granting. This is called credit rating or scoring. The credit rating is a part of the assessment process for the banks, together with corporate analysis in the form of financial and non-financial information.

The primary use of the credit rating models is to receive an appropriate price on the credit to the company, in accordance with its risk classification. Common for rating in the banks is that size of the credit and collateral are taken into account. Other factors influencing the price, according to respondent E, are competitors' prices on credits and expected yield from shareholders.

Bank A mostly enters hard facts into their rating model, such as information from the annual reports and of prior payment defaults. The information is never altered before entered into the system. The only factor that might be taken into account is over-values, primary those related to real estates. For smaller companies, ratings are imported from UC, without entering them into the bank's own rating system.

Bank B has a similar approach. Their systems produces ratings based on the financial information and provide ratio measurements divided into two categories. *Financial strain* measures different results and cash-flow based ratios, and *financial resilience* focuses on ratios in the balance sheet. The numbers are not altered before they are entered into the system; however soft values are included which has an impact on the final rating score and consequently on pricing. Hence, the final rating is made by an employee at the bank.

Bank C has an all automatic process for smaller companies, with no changes and manual inputs. For larger companies there are more parameters to be taken into consideration, including non-financial information as well. Most of the information is collected from UC; also company specific information about the board and owners can be entered manually for larger companies.

Bank D also collects their information from UC, such as historical data, but also adds other types of company-specific information. Bank D does not alter the information before entering it to the rating system. The reason for not changing the information is to avoid that the involved loan officer's own feelings or competence which may affect the outcome.

“The rating system is quite strict, as it should be, because risk lies in the other hand”.
– Respondent D

Bank E has a rating system which includes all companies with a turnover over 1 MSEK. The rating is built on financial ratios, behavior and changes in the company, such as switching board members. Mostly, the rating system includes hard facts from previous annual reports and how conscientious the company has been historically in its relations to the bank. In addition, the corporate loan officer grades the company's products, board of directors and more. This, however, does not have a large impact on the final scoring. The information is not altered before it is entered into the rating model. According to respondent E, the rating is supposed to be based on financial history. Altering and testing different scenarios belongs to the corporate analysis and does not affect the rating.

4.2.3.2 Accounting choices

The banks makes clear that accounting choices are only included in the corporate analysis to a minimum extent. There is a considerably greater focus on what lies behind the numbers rather than the choice of presenting them. Respondent A refers to company X and Y. Since company Y's balance sheet contains non-tangible assets and company X's does not, a loan officer needs to learn why; not because it is wrong or frowned upon, rather to receive a perception of its value in the case of a default. Respondent D explains that they take potential over-values in properties into account, such as those in companies X and Y, but their evaluation is based on market value. In the corporate analysis respondent D also manipulates the figures to screen for risk in different 'what if' scenarios. For example, what happens when the value of inventory rises or a customer defaults?

Bank B has almost the same view as the above, and does consequently not alter the numbers when calculating the financial ratios. Adaptations can be done for non-recurring events, as sale of a property, whose information is usually provided in the disclosures of the annual report.

“We prefer audited reports. The accounting choices themselves are not important as long as the numbers can be trusted.” – Respondent B

Respondent C is interested in knowing what lies behind the numbers and exemplifies with companies X and Y. Both of them have work in progress in their

balance sheet. The accounting is understandable, but the bank is more interested in how far along in the process these goods are, or if they could be used or sold as they are. In addition to knowing what lies behind the numbers, bank C also does pro forma balance sheets in order to identify vulnerabilities in the flow and hence find potential risks. Non tangible assets and goodwill can be eliminated when analyzing how the company really performs.

“Much work is sometimes invested to understand the presented financial information. In some cases we ask questions directly to the auditor to ensure that values are correct.”

– Respondent C

Respondent E explains that when analyzing financial statements, they can be altered in simulation models in order to detect weaknesses. The changes are mainly focused on other scenarios than accounting choices though. It concerns, for example, what would happen if sales drops, the company’s main component becomes more expensive, or if the company failures to lower costs as promised.

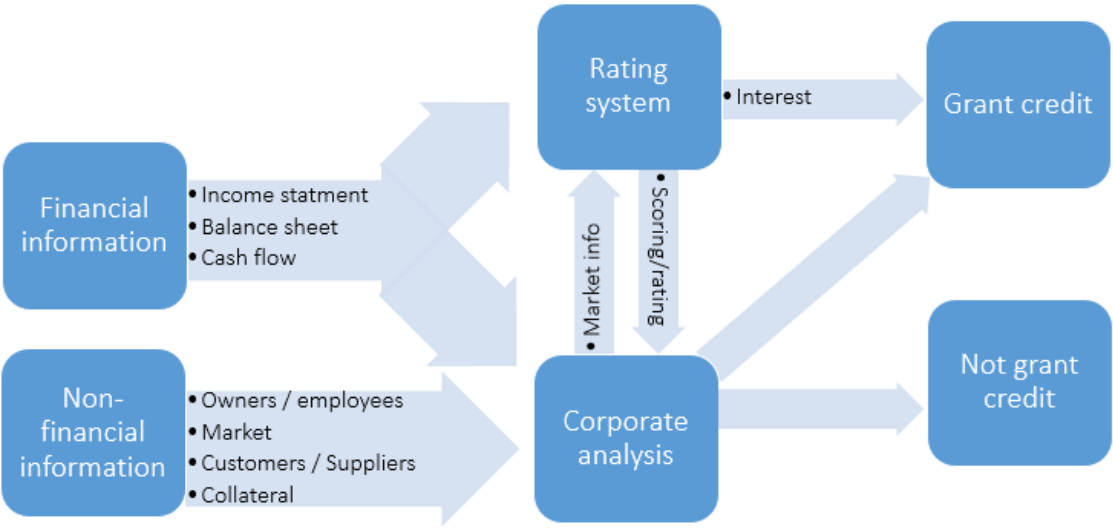
Even if there are laws and regulations steering the accounting to some extent, there is always a possibility to stretch them a bit, according to respondent E. Further, bank E has no interest in questioning the choices, however understanding them and being able to draw own conclusions.

“A good year-end report is always better and a bad report is always worse.”

– Respondent E

When discussing accounting choices, all respondents are aware of the newly introduced K-regulations. However, none of the banks seem to have an outspoken approach towards the changes that the regulations bring. Respondent E explains that they will have to adapt to the new regulations; the credit assessment process will not change but loan officers need to understand the new regulations. Respondent A does, however, mention that how K2 and K3 will affect their credit process is not discussed.

The banks' credit assessment process, in summary, is illustrated in the following figure.



Source: le Claire and Fransson, 2014

5. Analysis

In the fifth chapter the empirical findings are analyzed in separated categories. Starting with banks information need compared to the stakeholder view and the principal-agent problem with information asymmetry as a consequence. This is followed by a discussion of how banks are performing credit assessment based on information given by a company, and how accounting regulations, such as the newly introduced K-regulations, might affect the credit rating outcome, consequently creating transaction costs.

5.1 Banks' information requirements

As Freeman et al (2010) states; the company's relationships with its environment is essential for its existence. The relationship between the company and the bank has in the empirical findings shown to be highly reciprocal. Banks exist because of enabling business opportunities and creating financing solutions, while the company has obligations to collaborate and providing the bank with all kinds of requested information.

The company and the bank occupy different perspectives and it is clear that the banks want extensive financial and non-financial information, to identify and reduce risks before granting credit. The company's primary interest, on the contrary, is obtaining credit solutions to conduct business. These two different positions is clearly a subject of the principal-agent theory, which is shown in terms of information asymmetry in both directions. Bruns (2004) states that the bank sometimes has an advantage because of its knowledge about industries and businesses on an aggregated level, which is confirmed by several of the respondents. Respondent D however underlines that the bank never is able to know more about the company's business than the entrepreneur. The bank has the power to make decisions based on events and fluctuations in a specific industry. This means that the concerned company might suffer from information asymmetry, as the corporate analysis and credit granting to some extent assumes from occurrences in the industry as a whole, which not always is the accurate reflection of the particular company.

The information asymmetry does not solely go in one direction. As Svensson Kling (1999) clarifies, there is a predominating information asymmetry among privately held companies. Since banks are dependent on the information given by a company according to Bruns (2004), it is quite obvious why all of the banks put great effort in getting to know the company and its environment, not only by analyzing the

financial statements. That is also probably why banks A and B want earlier references. This can be considered as a measure to reduce transaction costs, where reducing the information gap in turn minimizes the risk of credit losses. As mentioned by some of the respondents as well as according to Bruns (2004), there are seldom internal systems providing economic data in small companies, which makes the banks own analysis even more important. Asymmetric information of this nature makes level of experience of the involved corporate advisor a possible factor of affecting the outcome of a credit decision, due to highly various cases.

Another case of asymmetric information is identified through respondent D's observation, as companies whose business worsens, consequently stops sending in reports as frequently as before. Receiving information from a prosperous company therefore seems to be less problematic than with companies starting to deteriorate, not always being as transparent.

Since privately held companies has less legal demands to produce information than publicly held companies, the banks compensates by retrieving information through interaction with the company. The banks has a clear focus on the company's future plans, something that a small company in some cases not has concretized even for its own behalf. Information provided in financial statements primarily focuses on historical data; the banks however prefer business plans and forecasts to create a picture of suitability of possible funding through credit.

The desire for audited reports, and in some cases even audited periodical reports when granting credit is apparent when discussing information need with the banks. Obviously, not only do they prefer audited reports, but also interact with auditors, asking for information about transactions and accounting entries. This is a clear indicator that the banks do not satisfy with the presented numbers, rather having a critical and questioning approach.

Due to possible information asymmetry situations discussed previously, it is critical to form an effective contract, as stated by Eisenhardt (1989), where both parties understand the implications and act accordingly. All the banks solve this issue by creating contracts that regulates repayment conditions. In this way undesired consequences can be avoided, such as transaction costs.

Further, forecasts and future perspectives, in combination with financial reports and personal contact, are important in order to satisfy the banks information need. Not to

forget the banks responsibility of not drawing large conclusions about the industry a company operates in, rather than creating a picture of the company's own preconditions.

5.2 The use of annual reports

The requirement of publication in Sweden is clearly working in banks favor. They are, to a great extent, using information imported from business data bases such as UC. As mentioned by some of the respondents, rating classification is used directly from UC without using own rating models, primarily for small companies. This is another evidence of the importance of publicity.

Smith (2006) concludes that lenders have an 'either or' perspective and Berry and Robertson (2004) further found out that banks shift towards a going concern approach. Shareholders, on the other hand, build their analysis on all possible scenarios. The empirical findings shows this mindset much to be true. Several banks do indeed discuss worst case scenarios, and their possibilities of claiming existing collaterals if a default situation occur. Respondents C and E however mentions their use of simulation models that shows possible outcomes if, for example, sales decreases.

According to Smith (2006) it sometimes exist differences within the same group of stakeholders. The banks in the empirical study ask for similar information, however with some differences, which can be due to the individual corporate advisor as well as actual differences between the banks. The banks' operation approach is steered by laws and regulations, leaving no bank free to digress greatly.

5.3 Credit assessment

All five respondents discuss three factors that is also mentioned by Uchida (2011); relationship, financial information and collateral. The relationship factor shed light on operational risks within a company's business; quality of the inventory, their customer base and important suppliers. Financial information focuses more on how capital is allocated and ratios between assets and debts. It also gives the loan officers information about positive and negative trends, and if the business generates enough cash flow to repay loan and interest. Collateral, however, are based on the 'either or' perspective; how extensive the losses will be for the bank if the company defaults.

Bruns and Fletcher (2007) states that banks often work with risk shifting activities to minimize their own risk. This can be exemplified with demand for personal guarantee, which according to respondent A is used get the owner committed. The gains for the bank are twofold in case of a company default. The owner will most likely cooperate and try to preserve remaining value in the company, and the risk has shifted from the bank to the owner.

Andersson (2001) were able to show that experienced loan officers more often reject loan applications than less experienced. This conclusion is to some extent consistent with the statement from respondent E. Something that might help reduce such a scenario is the 'principle of duality', which exists in all of the banks. However, a more experienced loan officer often has greater skills in presenting the case in a compelling way for the decision making instance, according to respondent A and E. This suggests that a more experienced loan officer would have a higher ratio of approved applications. Impacts due to level of experience can however not be verified with certainty in this study. Further, there can be no decisive conclusion if a company benefits from having a more experienced loan officer when proceeding credit applications.

5.3.1 Accounting information

One of the most important reports for almost all of the banks in the empirical study is the cash flow report. Berry and Robertson (2004) found out that the importance of financial information remained the same, however with greater focus on the core processes, hence cash flow. This is in accordance with how the respondents reason. Since it is not mandatory to produce cash flow report for small companies, the banks need to either create the information themselves or require the company to do so. As accounting information is supposed to be created for users, where banks are one of the primary stakeholders for even the smallest company, one could argue that the cash flow report should be mandatory despite company size. Another perspective of the usefulness in this matter is, however, that the information is sufficient enough to create complementary needed reports, which thereby makes it useful. In this way, increased administrative burden is avoided for companies that are not in need of producing cash flow reports.

Other financial reports, including balance sheet and income statement, are used mainly in rating models to calculate financial ratios and as a part in the risk classification process according to all respondents. Beaver, McNichols & Rhie (2005)

concluded that financial ratios together with market variables are good predictors of a future company default. This explains why the banks put great trust in the rating system when evaluating a company and also why information about products, board and industry is included in the rating classification.

Financial information collected from UC is considered to be reliable, so reliable that ratings sometimes are used directly without processing the information through their own system. Svensson (2003) concluded that most of the loan officers are satisfied with the received financial information. The empirical findings indicate the same, with one exception. Collateral in properties are almost always valued to market value, which means that the bank have to do a real valuation of the property. Perhaps they would do so even if the information was disclosed, due to the sometimes vast amounts involved in the balance sheet.

A problematic area is the timeliness regarding financial reports. Both Andersson (2001) and Svensson (2003) discuss this matter in their doctoral theses. As a result, almost all of the banks collect periodical financial reports when performing credit assessment, even if it is only mandatory for a company to submit yearly reports according to the Swedish Annual Accounts Act. Even if the banks require more frequent reports than year-ends, they seem to be satisfied despite that these reports often are un-audited.

5.3.2 Accounting choices and its impact on credit rating

Respondent E claims that *“A good annual report is always better and a bad annual report is always worse”*, which is almost the same conclusion as Argenti (1976) and Svensson (2003). This indicates that the banks are aware of impacts that accounting choices can have on financial statements. Svensson (2003) mentioned that some loan officers had problems with results smoothing activities, which cannot be supported in this empirical study, since none of the respondents discussed this problem. Maybe it is an effect of the extended use of cash flow reports. A difficulty when assessing a company that was mentioned by several respondents was, however, the existence of non-tangible assets and goodwill in the balance sheet, mostly because of its little or no value in case of default.

While predictions, simulations and alterations are performed in the corporate analysis, nothing is being adjusted when the banks enter financial information into their rating systems. However, bank B determines the rating themselves, outside the system. Accounting choices would therefore likely have little or no impact on

whether to grant credit or not, considering the thoroughly corporate analysis procedure. When it comes to interest rates, on the other hand, accounting choices may affect the outcome.

Jacobson, Lindé and Roszbach (2005) did not investigate accounting choices; they did however investigate two banks with a common company customer where the same company could receive very different ratings. That means not only the accounting choices matter; the rating can also differ between banks. To what extent and how much remains unsaid in this study, since there has been no detailed investigation of the rating systems' structure. Also, even though the accounting choices may lead to substantial differences in the presented statements and ratios, no company is fully like another.

The phenomenon with different ratings depending on accounting choices has probably not arisen in connection with the introduction of K2 and K3. It probably already exists due to different accounting choices that companies in Sweden had earlier. However, it might be more prominent since K2 removes a lot of possibilities in contrast to K3. The differences in companies X's and Y's financial statements are substantial; almost all financial ratios are affected. The respondents' main focus in X's and Y's statements was that one company had non-tangible assets and the other company did not. The other differences were not highlighted by the respondents.

A company that has a desire to obtain credit as cheap as possible should choose the regulation that delivers the most beneficial financial ratios. The rule-based regulation, K2, have several limitations which inhibits the company to make adjustments according to accounting choices. Consequently, the most preferable regulation system would be K3, due to larger room for own choices. That is, however, rarely the only aspect to consider. K3 requires more resources to produce than K2. Companies about to choose between the K-regulations has to consider the possible gains that come with a *possible* lower cost of credit against the increased expenses to produce K3 reports. It is also important noting that K2 could be the regulation that produces the most beneficial ratios as well. It all comes down to the particular company's preconditions.

5.4 Final discussion

This study shows that accounting information is useful and represents one of the main components in the corporate analysis when performing credit assessment. The bank, as a user, seem to be satisfied with the provided information.

A company's financial information is used directly in the banks' rating systems. Two identical companies, apart from differences in chosen regulation system, may receive different ratings and consequently different interest rates, to what extent however not stated. Companies within the same context are able to choose between a rule-based and a principles-based regulation system. In the same time, one of the largest users do not take differences in accounting principles and regulations into account when evaluating a company.

It appears that accountants and loan officers tend to speak different languages, in accordance with Young's (2006) conclusion. As accountants question if a building should be depreciated as a whole or depreciate all components separately, loan officers ask for information about the property's market value. Accountants discuss whether a company should activate their costs for research and development or not, while loan officers' question its value in case of default.

However, the way banks work in order to reduce information gaps between them and the company is favorable when changes in accounting regulations are implemented. As banks focus on interaction with the company and understanding its business environment when granting credit, their corporate analysis as a whole is not especially affected by changes in how financial reports are produced. However, banks should be aware and continuously evaluate how regulations might affect their corporate analysis and risk classification of a company. There might be a need of greater knowledge of accounting regulations for individual loan officers as well as incorporation at a strategic level. Reducing the barrier that partially exist between accountants and banks could be a part of efforts to avoid ineffective allocation of resources, which otherwise causes transaction costs for the banking industry as well as its surroundings, including companies and society as a whole.

6. Conclusions

In the sixth chapter, conclusions based on the previous chapter are outlined. Each research question is presented and answered, to ensure that the purpose of this study has been fulfilled. Finally, suggestions for further research are presented.

6.1 Conclusion

- *What kind of information is demanded (financial and non-financial) and how is it used when banks are performing credit assessments?*

When performing credit assessment, the bank tries to collect as much information about the company as possible. The core information consists of *financial reports* including income statement, balance sheet and cash-flow reports. This information is used in two ways. It is partly entered to banks rating systems that generates ratings, which in turn determines a company's interest rate. Financial information is also used to verify information in the corporate analysis.

Another important aspect in credit assessment is the *relationship* factor. Loan officers go through prior engagements with the company and arrange meetings with board, owners and, if they exist, finance departments. In this way they can gain deeper understanding for the business and its potential risks. Depending on the nature of business, potential risks can be financial or associated with market, customers and suppliers.

Most loans require some sort of *collateral*, depending on the size and nature of the credit. For some collateral, values in the balance sheet are used. Market values are more common though, which means that there is a need of a thorough investigation and valuation of these assets.

- *How does accounting information from financial reports matter for Swedish banks as users?*

Accounting information represents one of the main components in the corporate analysis when making credit assessment. A company with a weak financial position, or difficulties of providing satisfying reports, will have a harder time obtaining credit than a company with a strong financial position, delivering complete reports.

However, even if the financial information is satisfying, the company has to present a convincing business idea, and be prepared to issue collateral.

Information not included in annual reports is collected in other ways; such as meetings and visits at the company's facilities. This is necessary since loan officers need to understand and learn how the company operates. It would be virtually impossible to create financial reports covering the total information need when performing credit assessment. The larger transaction, the more extensive analysis is required. This while users, as small private investors, likely are satisfied reading annual reports and analyses provided by analysts from large institutions.

- *How can differences in accounting regulations, as the ones between K2 and K3, affect a company's creditworthiness?*

The way corporate analysis is conducted by loan officers from the banks represented in this study, questions concerning accounting choices and rule-based versus principles-based are redundant. They do not affect the probability of obtaining credit.

Financial information in corporate analysis is mainly used to verify statements from board and owners, calculate financial ratios, and identify trends. The new regulations K2 and K3 will not, at least for now, affect how the bank conduct their credit assessment. Criticism has concerned problems with structured transactions within rule-based regulations, and the problem with overly positive or negative assessments from the company board within principles-based regulations. This, however, seems to be a non-issue for banks, mainly for two reasons. Firstly, they trust the presented financial statements because of the audit requirement in Sweden, and secondly, because of their own thorough corporate analysis.

The choice between K2 and K3 leads to different accounting rules to follow, which in turn opens for substantial differences in financial statements and ratios. As banks import financial information straight into rating systems, the choice of K-regulations may affect rating and consequently the price of credit in terms of interest rate.

6.2 Future research

This study provides input for further research. It is found that financial reports represent a key element in the corporate analysis as well as pricing of the credit for banks in their credit assessment. What is known is also that the new K-regulations, mandatory for companies in Sweden from year-end 2014, can lead to differences in financial statements and ratios. Credit rating classification and consequently pricing may be affected by which regulation system, K2 or K3, a company chooses to follow. It would therefore be interesting to do an investigation of how ratings are calculated in banks' rating systems, and more specifically how differences due to accounting regulations comes into play.

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8. Appendix

Appendix A

Questionnaire

- Berätta lite om dig själv och din position. Vad har du för arbetsuppgifter och vad har du arbetat med tidigare i banken?
- Hur delar ni upp olika storlekar på bolag?

Kreditprocessen

- Hur ser processen ut när ni får en låneansökan från ett litet/medelstort företag?
- Vad använder ni för interna modeller och system för att utvärdera ett företag?
- Vilken information förutom den som finns i de finansiella rapporterna från ett bolag brukar ni vilja ha från företaget?
- Hur stor roll spelar erfarenhet hos den företagsrådgivare som ansvarar för låneansökan?
- Vilka nyckeltal är viktiga för er att titta på?
- Vilka faktorer spelar in på huruvida ett bolag har låg och hög risk?

Redovisningsinformationen

- Hur viktiga är de finansiella rapporterna (balans- och resultat) i ert dagliga arbete?
- Kan det finnas några svårigheter med att bedöma ett företag utifrån redovisningsinformationen?
- Hur ser ni på de redovisningsval som finns? Gör ni några egna justeringar?
- Vilka kunskaper bör man ha inom redovisning för att kunna göra en bedömning?

Appendix B

Company X

Resultaträkning	År 2	År 1
Rörelsens intäkter		
Nettoomsättning	39 147 393	36 586 348
Produkter i arbete	131 246	-1 312 457
Övriga rörelse intäkter	84 862	424 311
	<hr/>	<hr/>
	39 363 500	35 698 203
Rörelsens kostnader		
Råvaror och förnödenheter	-27 863 919	-25 330 836
Övriga externa kostnader	-3 774 719	-2 693 557
Personalkostnader	-6 498 485	-6 309 209
Av- och nedskrivning	-246 712	-236 178
	<hr/>	<hr/>
	-38 383 836	-34 569 779
Rörelseresultat	979 665	1 128 423
Resultat från finansiella poster		
Ränteintäkter	4 464	4 252
Räntekostnader	-186 968	-211 793
	<hr/>	<hr/>
	-182 503	-207 542
Resultat efter fin. poster	797 161	920 882
Resultat före skatt	797 161	920 882
Skatt på årets resultat	-159 432	-184 176
	<hr/>	<hr/>
Årets resultat	637 729	736 705

Balansräkning

Anläggningstillgångar

Materiella anläggningstillg.

Byggnader och mark	2 165 473	1 302 540
Maskiner	182 083	273 124
Inventarier och verktyg	83 397	125 095
	<hr/>	<hr/>
	2 430 952	1 700 759

Immateriella anläggningstillg.

Egen upparbetade immat.	0	0
	<hr/>	<hr/>
	0	0

Summa anläggningstillg.	2 430 952	1 700 759
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Omsättningstillgångar

Varulager m.m.

Råvaror och förnödenheter	1 944 211	1 817 019
Pågående arbeten för annan	2 331 873	2 220 831
	<hr/>	<hr/>
	4 276 084	4 037 851

Kortfristiga fordringar

Kundfordringar	2 592 801	2 338 633
Övriga fordringar	1 402 147	1 557 941
Förutbetalda kostnader	127 784	116 168
	<hr/>	<hr/>
	4 122 732	4 012 741

Kassa bank	422 654	338 123
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Summa omsättningstillgångar	8 821 469	8 388 715
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Summa tillgångar	11 252 421	10 089 474
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Eget kapital

Aktiekapital	600 000	600 000
Uppskrivningsfond	976 905	0
	<hr/>	<hr/>
	1 576 905	600 000

Balanserad vinst	1 976 052	1 439 346
Årets resultat	637 729	736 705
	<hr/>	<hr/>
	2 613 781	2 176 052

Summa eget kapital	4 190 686	2 776 052
Långfristiga skulder		
Skulder till kredit institut	520 800	744 000
	<hr/>	<hr/>
	520 800	744 000
Kortfristiga skulder		
Checkräkningskredit	159 048	198 810
Skulder till kredit institut	28 350	81 000
Leverantörsskulder	3 570 833	3 400 794
Övriga skulder	1 467 921	1 741 850
Uppskjuten skatt	0	0
Skatteskuld	159 432	184 176
Upplupna skulder och förutbetalda intäkter	1 155 350	962 792
	<hr/>	<hr/>
	6 540 935	6 569 422
 Summa eget kapital och skulder	 11 252 421	 10 089 474

Nyckeltal	År 2	År 1
Soliditet	37,24%	27,51%
Skuldsättningsgrad	1,69	2,63
Räntabilitet totalt	8,75%	11,23%
Räntabilitet sysselsatt	16,99%	23,33%
Räntabilitet eget	19,02%	33,17%
Skuldränta	2,65%	2,90%
Låneränta	11,67%	10,19%
Räntetäckningsgrad	5,26	5,35
Kassalikviditet	69,49%	66,23%

Company Y

Resultaträkning	År 2	År 1
Rörelsens intäkter		
Nettoomsättning	39 147 393	36 586 348
Produkter i arbete	131 246	-1 312 457
Övriga rörelse intäkter	84 862	424 311
	<hr/>	<hr/>
	39 363 500	35 698 203
Rörelsens kostnader		
Råvaror och förnödenheter	-27 863 919	-25 330 836
Övriga externa kostnader	-3 043 719	-2 693 557
Personalkostnader	-6 498 485	-6 309 209
Av- och nedskrivning	-553 861	-321 461
	<hr/>	<hr/>
	-37 959 985	-34 655 062
Rörelseresultat	1 403 516	1 043 140
Resultat från finansiella poster		
Ränteintäkter	4 464	4 252
Räntekostnader	-196 968	-211 793
	<hr/>	<hr/>
	-192 503	-207 542
Resultat efter fin. poster	1 211 012	835 599
Resultat före skatt	1 211 012	835 599
Skatt på årets resultat	-242 202	-167 120
	<hr/>	<hr/>
Årets resultat	968 810	668 479

Balansräkning

Anläggningstillgångar

Materiella anläggningstillg.

Byggnader och mark	2 969 791	1 302 540
Maskiner	182 083	273 124
Inventarier och verktyg	150 063	225 095
	<hr/>	<hr/>
	3 301 937	1 800 759

Immateriella anläggningstillg.

Egen upparbetade immat.	698 511	170 567
	<hr/>	<hr/>
	698 511	170 567

Summa anläggningstillg.	4 000 448	1 971 326
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Omsättningstillgångar

Varulager m.m.

Råvaror och förnödenheter	1 944 211	1 817 019
Pågående arbeten för annan	2 331 873	2 220 831
	<hr/>	<hr/>
	4 276 084	4 037 851

Kortfristiga fordringar

Kundfordringar	2 592 801	2 338 633
Övriga fordringar	1 402 147	1 557 941
Förutbetalda kostnader	127 784	116 168
	<hr/>	<hr/>
	4 122 732	4 012 741

Kassa bank	422 654	338 123
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Summa omsättningstillgångar	8 821 469	8 388 715
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Summa tillgångar	12 821 917	10 360 041
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Eget kapital

Aktiekapital	600 000	600 000
Uppskrivningsfond	1 411 432	0
	<hr/>	<hr/>
	2 011 432	600 000

Balanserad vinst	2 183 675	1 715 196
Årets resultat	968 810	668 479
	<hr/>	<hr/>
	3 152 485	2 383 675

Summa eget kapital	5 163 917	2 983 675
Långfristiga skulder		
Skulder till kredit institut	520 800	744 000
	<hr/>	<hr/>
	520 800	744 000
Kortfristiga skulder		
Checkräkningskredit	159 048	198 810
Skulder till kredit institut	103 350	161 000
Leverantörsskulder	3 570 833	3 400 794
Övriga skulder	1 494 292	1 741 850
Uppskjuten skatt	412 124	0
Skatteskuld	242 202	167 121
Upplupna skulder och förutbetalda intäkter	1 155 350	962 792
	<hr/>	<hr/>
	7 137 200	6 632 365
Summa eget kapital och skulder	12 821 917	10 360 041

Nyckeltal	År 2	År 1
Soliditet	40,27%	28,80%
Skuldsättningsgrad	1,48	2,47
Räntabilitet totalt	10,98%	10,11%
Räntabilitet sysselsatt	20,30%	20,43%
Räntabilitet eget	23,45%	28,01%
Skuldränta	2,57%	2,87%
Låneränta	11,11%	9,89%
Räntetäckningsgrad	7,15	4,95
Kassalikviditet	63,69%	65,60%