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## Hidden Gems and Borrowers with Dirty Little Secrets: Investment in Soft Information, Borrower Self-selection and Competition

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## **Hidden Gems and Borrowers with Dirty Little Secrets: Investment in Soft Information, Borrower Self-selection and Competition**

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This paper empirically examines the role of soft information in the competitive interaction between relationship and transaction banks. Soft information can be interpreted as a valuable signal about the quality of a firm that is observable to a relationship bank, but not to a transaction bank. We show that borrowers self-select to relationship banks depending on whether their observed soft information is positive or negative. Competition affects the investment in learning the soft information from firms by relationship banks and transaction banks asymmetrically. Relationship banks invest more; transaction banks invest less in soft information, exacerbating the selection effect.

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