

Accepted Manuscript

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Jaewoo Kim

PII: S0165-4101(17)30076-9
DOI: [10.1016/j.jacceco.2017.11.010](https://doi.org/10.1016/j.jacceco.2017.11.010)
Reference: JAE 1172

To appear in: *Journal of Accounting and Economics*

Received date: 14 August 2014
Revised date: 10 August 2017
Accepted date: 16 November 2017

Please cite this article as: Jaewoo Kim , Asymmetric Timely Loss Recognition, Adverse Shocks to External Capital, and Underinvestment: Evidence from the Collapse of the Junk Bond Market, *Journal of Accounting and Economics* (2017), doi: [10.1016/j.jacceco.2017.11.010](https://doi.org/10.1016/j.jacceco.2017.11.010)



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Asymmetric Timely Loss Recognition, Adverse Shocks to External Capital, and Underinvestment: Evidence from the Collapse of the Junk Bond Market

Jaewoo Kim

William E. Simon School of Business, University of Rochester

Email: jaewoo.kim@simon.rochestser.edu

August 2017

Abstract

Using the collapse of the junk bond market in the early 1990s as an exogenous shock to external capital, I document, in both difference-in-differences and triple difference designs, that speculative-grade firms that recognize economic losses in a timely manner experience a smaller reduction in investment following the collapse. The effect is more pronounced for speculative-grade firms with a low level of asset liquidation value. Using the excess bond premium as a proxy for fluctuations in the supply of capital, I also extend the generalizability of my findings to a broader sample of 84,421 firm-years over the 1972–2011 period.

JEL Classification: G01; G31; G32; G33; M41

Keywords: Accounting Conservatism; Asymmetric Timely Loss Recognition; Financial Reporting Conservatism; Financing Frictions; Investment; Supply of Capital; Shocks to External Capital; Excess Bond Premium

* This paper is based on my dissertation at the University of Iowa. I thank my dissertation committee members—Daniel Collins (co-chair), Paul Hribar (co-chair), Jon Garfinkel, Erik Lie, and Ryan Wilson—for their valuable advice and comments. I am also grateful to S.P. Kothari (editor) and Jieying Zhang (referee) for their helpful comments and suggestions. I appreciate helpful comments from Bryce Schonberger, Phil Quinn, Xiaoli Tian, Joanna Wu, and Jerry Zimmerman. I am also grateful to workshop participants at the University of Iowa, the University of Rochester, Indiana University, Texas A&M University, UT Dallas, Emory University, the University of Georgia, Cornell University, and Korea University. I gratefully acknowledge financial support from the Ballard and Seashore Dissertation Fellowship at the University of Iowa.

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