The value of non-financial information for default prediction in small and medium-sized enterprises

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Abstract

This study evaluates the value of non-financial information in predicting failure in small and medium-sized enterprises (SMEs) using a unique dataset obtained from a registry database of Norwegian firms, encompassing about 1.2 million complete firm-year observations. The non-financial information includes CEO characteristics and firm characteristics. I compare the predictive power of models based on various information sets: (1) financial ratios alone, (2) each category of non-financial information alone, and (3) a comprehensive mix of all available information.

The findings reveal that models that include non-financial information outperform those based solely on financial ratios. Notably, CEO characteristics, specifically education, tenure, and age, yield the most significant improvement in predictive accuracy. Therefore, non-financial information is a valuable input for default prediction models and can be particularly useful when financial ratios are unavailable or unreliable, e.g., for newly established or very small firms.