Accepted Manuscript

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PII: S0275-5319(16)30427-5
DOI: http://dx.doi.org/doi:10.1016/j.ribaf.2017.07.066
Reference: RIBAF 756

To appear in: *Research in International Business and Finance*

Received date: 18-11-2016
Accepted date: 3-7-2017

The Effect of Financial Reporting Quality on Corporate Investment Efficiency: Evidence from the Tunisian Stock Market

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Abstract:

Positive Accounting Theory (Watts and Zimmerman, 1978) stipulates that financial reporting has two dimensions: market signaling and monitoring managerial behaviors. Through these signaling and stewardship means, a better financial reporting quality would have significant economic consequences in terms of efficient resources allocation, which results in improving firms' investment decision. In this paper, we examine the impact of financial reporting quality on corporate investment efficiency. Our sample is based on 25 Tunisian listed companies for the period 1997-2013. The findings confirm that some characteristics of the financial information, namely, reliability and smoothness, appear to increase the investment inefficiency, while others, i.e., conservatism and relevance, seem have no significant effect on investment decisions. We attribute such results mainly to the contextual specificities of the Tunisian environment, such as, the institutional bodies and settings, the cultural values and some characteristics of the corporate governance system.

Key words: *Financial Reporting Quality, overinvestment, underinvestment, information asymmetry, agency costs, emerging market.*

I. Introduction

Recent accounting research has examined the role of Financial Reporting Quality (hereafter FRQ) in the context of corporate investment efficiency. Ideally, in a complete market in which information asymmetry does not exist between managers and external investors, firms can optimally invest in profitable (i.e., positive NPV) projects and withdraw capital from unprofitable ones. However, when information asymmetry exists, firms may be confronted to face financing constraints (Myers and Majluf, 1984; Fazzari et *al;* 1988), which prevent them from undertaking profitable projects, resulting in an under-investment problem. Moreover, even under the assumption that financing resources are available, their allocation by managers can be done sub-optimally. They may choose to implement negative NPV investments, with the aim of maximizing their personal wealth (Jensen 1986; Stein, 2003;