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Accounting Quality and Information Asymmetry of Foreign Direct Investment Firms

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Highlights

- This study uses data from Taiwan to investigate the accounting quality and information asymmetry of foreign direct investment firms.
- FDI firms are found to engage more in earnings management and have more information asymmetry.
- Managerial ownership, an internal governance mechanism, can improve accounting quality and information asymmetry.

Abstract

This study argues that the foreign direct investment firms mislead stakeholders and are associated with greater information asymmetry due to the raised agency problem. Results show that both earnings management and idiosyncratic volatility increase with foreign investment. Managerial ownership mitigates such inefficiency.

Keywords: earnings management, idiosyncratic risk, foreign direct investment, managerial ownership

JEL: G14, G30

1. Introduction

One of the heated discussions on foreign direct investment (FDI) is the agency problem between managers and stakeholders. Lee and Kwok (1988) argue that legal differences, multicounty financial statements, and multicounty auditors make it difficult to monitor managers in international markets. Choi et al. (2016) report that the extent of institutional dissimilarity between institutions in home and host countries worsens monitor function of stakeholders. In addition, Singhal and Zhu (2013) argue that managers may be willing to make potentially value-destroying diversification decisions to derive and preserve private benefits such as enhanced status, high perquisites, future employment prospects, and reduced employment risk. Weak monitor function in FDI firms provides more opportunities for managers to pursue personal interests, which

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