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INVESTMENT EFFICIENCY AND EARNINGS QUALITY: EUROPEAN EVIDENCE

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Introdução

The drivers for firm's investment behavior is a fundamental question in corporate finance. In perfect capital markets, firms invest efficiently choosing only projects with positive net present values. However, capital markets are not perfect. There are imperfections, such as information asymmetries and agency problems, that can affect firms' investment decisions, leading to inefficiencies in the form of over and underinvestment. The quality of financial reporting has been considered a driver of investment efficiency.

Problema de Pesquisa e Objetivo

This study aims to analyse the relationship between earnings quality and investment efficiency in the European context, in order to understand whether a higher earnings quality has an important role in mitigating investment inefficiencies. To further understand the relationship between earnings quality and investment efficiency, the roles of cash and financial constraints are also analysed.

Fundamentação Teórica

Firms deviate from the optimal investment level due to the occurrence of frictions. These imperfections in the markets are primarily caused by information asymmetries between firm insiders and outside capital providers, creating agency problems, such as, moral hazard (Jensen, 1986) and adverse selection (Myers and Majluf, 1984). According to Bushman and Smith (2001), information asymmetries and agency problems are the most common and important distorting factors that influence firms' investment efficiency in imperfect markets.

Metodologia

Firm-year pooled regressions, based on unbalanced panel data and controlling for country, year and industry fixed effects, were estimated using a sample composed by listed and unlisted European companies, from 19 countries and 17 industries, for the period 2010-2018. The earnings quality measured is based on the accruals quality model from Dechow and Dichev (2002). Investment efficiency measure is derived from previous research, mainly the model of growth opportunities of Biddle et al. (2009) and further expansions.

Análise dos Resultados

Results show a negative and significant relation between earnings quality and investment inefficiency. In both scenarios of investment inefficiency, overinvestment and underinvestment, results suggest that a higher quality of the reported earnings mitigates investment inefficiencies. Results also suggest that the negative relation holds for cash constrained and unconstrained firms, and that in firms that are financially unconstrained (higher level of cash and a lower level of leverage) the combined effect with earnings quality is associated with a lower investment efficiency.

Conclusão

Our results of a positive relation between earnings quality and investment efficiency suggest that higher earnings quality is related with a better information environment, including lower information asymmetries and reduced agency conflicts, which contributes to the improvement of investment decisions.

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