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Quality of Financial Reporting Choice: Determinants and Economic Consequences

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Abstract

I investigate the determinants and economic consequences associated with firms' financial reporting choices. Recognizing the endogeneity associated with these choices, I find evidence of a positive association between investors' demands for firm-specific information and financial reporting quality. I also find that higher proprietary costs are associated with a lower quality of financial information. As for the economic consequences, the evidence suggests that firms with high quality financial reporting policies have reduced information asymmetries. However, after accounting for the endogeneity associated with the reporting quality choice, I find no significant evidence that firms choosing to provide financial information of higher quality enjoy a lower cost of equity capital. These results demonstrate the importance of explicitly modeling the endogeneity of financial reporting choices in investigating the associated economic consequences.

Keywords: financial reporting quality, earnings quality, disclosure, cost of capital, proprietary costs, risk factors, endogeneity

JEL Classification: G12, M41, M43

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