The Role of Financial Reporting Quality in Reducing Information Asymmetry and Improving Investment Efficiency in Listed Companies

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Abstract: In capital markets, financial reporting quality is recognized as a key mechanism for reducing the information gap between managers and investors and enhancing economic decision-making. When information asymmetry is high, resource allocation becomes inefficient, and the likelihood of deviation from optimal investment levels increases. The primary objective of this study is to examine the effect of financial reporting quality on reducing information asymmetry and improving investment efficiency in companies listed on the Tehran Stock Exchange. This research is applied in purpose and descriptive–correlational in method. Data from 120 manufacturing companies were collected and analyzed over the period 2019 to 2023. Financial reporting quality was measured using the Dechow and Dichev (2002) model, and investment efficiency was assessed using the Biddle et al. (2009) model. Data analysis was conducted using multiple regression and EViews software. The results revealed that financial reporting quality has a significant effect on reducing information asymmetry and investment deviations, including both overinvestment and underinvestment. Companies that provide higher-quality financial reports have been more successful in allocating financial resources to profitable projects. High-quality financial reporting is not only an instrument for monitoring managerial behavior but also a critical factor in enhancing transparency, reducing the cost of capital, and increasing investor trust. Improving the quality of financial reporting requires the development of supervisory institutions, professional training, and the reform of corporate governance mechanisms.

Keywords: financial reporting quality, information asymmetry, investment efficiency, stock exchange.

1. Introduction

The quality of financial reporting has long been considered a foundational pillar in ensuring the transparency, credibility, and stability of capital markets. High-quality financial reports serve as a primary communication channel between managers and external stakeholders, reducing the information gap and improving decision-making by investors, creditors, and regulators [1-3]. In emerging and transitional markets, such as Iran, where institutional frameworks and investor protection mechanisms are evolving, the role of transparent reporting is even more critical [4-6]. Poor reporting quality can lead to hidden agency problems, higher capital costs, and inefficient investment allocation, while reliable disclosures foster trust, enhance governance, and promote economic growth [7, 8].

Information asymmetry arises when managers possess superior information about the firm's performance, risks, and future prospects compared to outside investors. This imbalance leads to adverse selection, moral hazard, and distorted capital allocation decisions [9, 10]. Reliable financial statements reduce this asymmetry by providing timely, accurate, and comparable data [11, 12]. Dechow and Dichev's accrual quality framework, widely recognized as a robust measure of reporting quality, shows that higher earnings quality reflects better working capital management and fewer estimation errors [1].

Prior studies highlight that high-quality reporting mitigates managerial overconfidence, aligns internal and external perceptions, and strengthens resource allocation [5, 13]. In Iran, where market volatility and regulatory inconsistencies have often weakened investor trust, robust disclosure standards can offset informational disadvantages and create a fairer investment environment [4, 7]. Recent international evidence also shows that technological innovation, such as the adoption of electronic auditing systems, enhances reporting transparency and accessibility [14, 15].

Efficient investment decisions occur when firms undertake positive net present value projects and avoid overinvestment (wasteful spending due to free cash flow) or underinvestment (failure to exploit profitable opportunities due to financing constraints). Poor-quality reporting exacerbates inefficiency by increasing financing costs and limiting external monitoring [2, 3]. Conversely, transparent and accurate reporting facilitates better capital allocation and investor confidence [8, 16].

Research has demonstrated that high reporting quality helps managers avoid behavioral biases and emotional decision-making by reinforcing rational judgment and accountability [13]. In Iran, empirical findings indicate that improving disclosure quality reduces both overinvestment and underinvestment, especially in manufacturing companies where capital expenditures drive long-term competitiveness [6, 7]. This aligns with global evidence showing that accruals-based quality measures are directly linked to more accurate forecasting of cash flows and resource needs [1, 2].

The modern reporting environment is shaped by global regulatory developments, digital transformation, and stakeholder-driven accountability [17-19]. Corporate preparers increasingly recognize that investor expectations extend beyond conventional financial figures to include non-financial and forward-looking disclosures [18]. Integrated reporting and sustainability-related transparency have gained traction internationally and can complement traditional financial reports to reduce uncertainty [10, 15].

Technological tools such as artificial intelligence (AI) and electronic auditing systems are emerging as enablers of reporting accuracy and timeliness [14, 15]. Studies have shown that AI-driven systems increase the reliability of data and reduce fraud and manipulation risks [15, 20]. In the Iranian context, leveraging digital audit tools and enhancing internal controls are seen as necessary to meet international reporting standards and improve comparability [11, 16].

Corporate governance structures, such as risk committees, audit committees, and the independence of external auditors, are vital for improving reporting credibility [11, 12]. Effective governance strengthens monitoring mechanisms, ensures adherence to accounting standards, and minimizes opportunistic reporting behaviors [8, 21]. Additionally, the cultural and institutional context influences disclosure practices. In Iran, the regulatory environment is still evolving to align with international best practices, and developing governance infrastructures can significantly affect reporting transparency [4, 5].

Evidence from emerging economies suggests that when regulatory enforcement is weak, firms may engage in earnings management to influence external perceptions [2, 3]. However, as oversight mechanisms strengthen and

investor demand for high-quality information grows, the cost of such opportunistic practices rises, incentivizing better reporting [17, 18].

Although numerous studies have examined the association between financial reporting quality and capital allocation efficiency worldwide [2, 3], evidence from Iran remains limited and often fragmented [4, 7]. Many Iranian studies have focused primarily on the predictive power of earnings or the relationship between managerial overconfidence and investment outcomes without fully addressing the mediating role of information asymmetry [5, 9]. Furthermore, with the growing importance of digitalization and governance reform in Iranian capital markets, there is a need for updated evidence that integrates traditional financial metrics with new technological and institutional dynamics [14, 15, 20].

This research addresses these gaps by empirically analyzing how financial reporting quality influences both information asymmetry and investment efficiency among Tehran Stock Exchange manufacturing firms.

2. Methodology

The present study is applied in terms of purpose and descriptive–correlational in nature, examining the relationships among financial reporting quality, information asymmetry, and investment efficiency in companies listed on the Tehran Stock Exchange. The overall research approach is quantitative and empirical, and secondary data were used to test the hypotheses.

The statistical population includes all manufacturing companies listed on the Tehran Stock Exchange over the 5-year period from 2019 to 2023. Sampling was performed using a systematic elimination method, and companies with incomplete financial information during the study period or those classified as financial institutions (banks, insurance companies, and holdings) were excluded. Ultimately, about 120 companies were selected as the final sample.

To measure financial reporting quality, the Dechow and Dichev (2002) model, which is based on accruals, was employed. Information asymmetry was assessed through stock return dispersion, and investment efficiency was measured using the Biddle et al. (2009) model, which is based on the relationship between capital expenditures and sales growth.

Financial statement data were extracted from the Codal system and Rahavard Novin software, and data analysis was conducted using EViews software and a multiple linear regression model. To examine normality, multicollinearity, autocorrelation, and heteroscedasticity, appropriate statistical tests such as Jarque–Bera, Variance Inflation Factor (VIF), Durbin–Watson, and White tests were applied. The significance level for the tests was set at 5 percent.

3. Findings and Results

The findings of the present study provide empirical evidence regarding the relationship between financial reporting quality, information asymmetry, and investment efficiency in manufacturing companies listed on the Tehran Stock Exchange. The results are presented in three parts: descriptive statistics of the variables, correlation analysis for hypothesis testing, and multiple regression analysis for explaining the direct and interactive effects of the studied factors.

Table 1. Descriptive statistical analysis of variables

Variable	Mean	Median	Standard Deviation	Minimum	Maximum	Brief Interpretation
Financial Reporting Quality	0.278	0.274	0.065	0.121	0.451	Moderate level of reporting quality among the sample companies
Information Asymmetry	0.215	0.208	0.093	0.042	0.512	High dispersion among companies regarding information accessibility
Investment Efficiency	0.003	0.001	0.084	-0.217	0.238	Presence of both overinvestment and underinvestment simultaneously

The descriptive analysis shows that the average financial reporting quality among the selected companies is moderate, indicating that although some firms have relatively high-quality reporting, there is still room for improvement across the market. The dispersion of information asymmetry (standard deviation = 0.093) suggests a considerable variation between companies regarding the availability and transparency of information for investors. The investment efficiency variable fluctuates around zero, reflecting the coexistence of both overinvestment and underinvestment within the sample firms. These descriptive insights highlight heterogeneity in reporting practices and investment behavior across companies.

Table 2. Pearson correlation analysis for hypothesis testing

Hypothesis	Variables Examined	Correlation Coefficient (r)	Significance Level (p)	Hypothesis Test Result
H1	Financial Reporting Quality and Information Asymmetry	-0.38	< 0.01	Significant (Reject H0)
H2	Financial Reporting Quality and Investment Efficiency	0.41	< 0.01	Significant (Reject H0)

The Pearson correlation results confirm a significant negative relationship between financial reporting quality and information asymmetry ($r = -0.38$, $p < 0.01$). This implies that higher quality in financial disclosures is associated with lower levels of informational imbalance between managers and external investors. Additionally, a significant positive correlation exists between financial reporting quality and investment efficiency ($r = 0.41$, $p < 0.01$). This finding indicates that companies with more reliable and transparent reporting allocate their financial resources more effectively, minimizing both overinvestment and underinvestment. Both hypotheses (H1 and H2) were supported, suggesting that enhanced reporting practices play a crucial role in market transparency and efficient capital allocation.

Table 3. Multiple regression analysis results

Independent Variable	Regression Coefficient (β)	Significance Level (p)	Direction and Strength of Effect
Financial Reporting Quality	0.217	< 0.01	Positive and significant
Information Asymmetry	-0.196	< 0.05	Negative and significant
Firm Size	Control	–	–
Financial Leverage	Control	–	–
Return on Assets	Control	–	–

The multiple regression results indicate that financial reporting quality ($\beta = 0.217$, $p < 0.01$) exerts a positive and significant impact on investment efficiency, confirming that better-quality reporting leads to more effective allocation of capital to profitable projects. Conversely, information asymmetry ($\beta = -0.196$, $p < 0.05$) negatively and significantly influences investment efficiency, meaning that higher information gaps hinder optimal investment decisions. The control variables—firm size, financial leverage, and return on assets—were included to ensure model

robustness. Furthermore, the interaction analysis revealed that the beneficial impact of financial reporting quality is amplified in larger firms or those experiencing fewer financial constraints, highlighting the moderating role of organizational capacity and financial flexibility.

4. Discussion and Conclusion

The primary purpose of this study was to examine how financial reporting quality influences information asymmetry and investment efficiency in manufacturing companies listed on the Tehran Stock Exchange. The results demonstrated that financial reporting quality has a significant negative relationship with information asymmetry and a positive, meaningful relationship with investment efficiency. In addition, regression analysis confirmed that higher-quality financial reporting improves the effectiveness of capital allocation and reduces deviations caused by overinvestment or underinvestment. These findings reinforce the argument that the transparency and reliability of financial reports play a central role in supporting sound decision-making by both managers and investors [1-3].

The first major result shows that financial reporting quality reduces information asymmetry among market participants. The negative and significant correlation between these two variables suggests that when firms prepare reports with fewer accrual estimation errors and greater reliability, external stakeholders face less uncertainty about the firm's true financial condition. This outcome is consistent with the theoretical framework proposed by Dechow and Dichev, which links accrual quality to the reduction of hidden managerial discretion [1]. Similar patterns have been reported in Iranian capital markets, where transparent accounting practices have been shown to reduce the gap between insider and outsider knowledge and increase investor confidence [6, 9]. Moreover, Rahimi and Kiani's findings indicate that enhancing comparability and consistency in accounting reports leads to greater interpretability and fairness in the information flow, thereby lowering information risk [11].

Another important explanation for the decline in information asymmetry is the strengthening of governance mechanisms associated with high-quality reporting. Our findings align with Omidi Kordeshouli and Pazhouhi, who argue that specialized oversight bodies such as risk committees and audit committees play a mediating role by ensuring the accuracy and timeliness of disclosures [12]. Effective governance and internal control systems, as emphasized by Drilia, limit the scope of earnings manipulation and reduce uncertainty in financial communication [20]. Additionally, the results support the argument that the adoption of innovative auditing methods, including electronic audit platforms and AI-based financial systems, contributes to narrowing information gaps by enhancing the quality and accessibility of financial data [14, 15].

The second key result highlights the positive and significant relationship between financial reporting quality and investment efficiency. This outcome confirms that companies with higher-quality disclosures are better positioned to allocate capital effectively, avoiding the dual pitfalls of overinvestment and underinvestment. The relationship observed is strongly supported by global empirical studies. Chen and colleagues found that high-quality reporting allows managers and investors to more accurately predict future cash flows and project returns, thus improving investment decisions [2]. Similarly, Li and Wang documented the same positive link in Chinese markets, showing that robust financial reporting acts as a monitoring mechanism against inefficient capital allocation [3]. In Iran, research by Alhani Sahr and Eskandar also revealed that enhancing financial transparency leads to a measurable decline in investment inefficiency across listed firms [7].

One reason for this improvement in investment efficiency is the mitigation of behavioral biases in managerial decision-making. Shahabi Rad and colleagues suggest that when reliable financial information is accessible, managers' personal judgments and emotional influences are reduced, supporting rational capital budgeting and

less opportunistic spending [13]. Similarly, Hassas Yeganeh and Hasani al-Qar highlight that high-quality reporting moderates the effects of managerial overconfidence, ensuring that capital expenditures are more closely tied to actual firm performance and market needs [5]. Our results are in harmony with these conclusions, demonstrating that reliable reporting provides a strong foundation for disciplined and performance-based investment policies.

Furthermore, the regression analysis indicated that the positive impact of reporting quality on investment efficiency is stronger for larger firms or those with fewer financial constraints. This moderating effect aligns with the view that organizational capacity and resource flexibility amplify the benefits of high-quality disclosures. Larger companies typically have more advanced governance systems and can integrate sophisticated audit technologies, such as those discussed by Johri and Almubaydeen, to ensure the accuracy of their reports [14, 15]. These firms also tend to have broader investor bases, making credible reporting a strategic asset for attracting capital and maintaining market reputation [17, 18].

Another dimension to consider is the evolving role of non-financial and integrated reporting practices. While this study primarily focused on accrual-based measures of quality, the literature suggests that including environmental, social, and governance (ESG) indicators can further reduce uncertainty and improve investment decisions. Muhi and Benaissa argue that integrated reporting strengthens the credibility of traditional disclosures and provides a more holistic view of firm performance, which can enhance capital allocation efficiency [10]. Bogdan and co-authors similarly point to the value of narrative and non-financial information in turbulent environments where financial indicators alone may not fully capture future risk [18].

Finally, the results underscore the importance of continuous regulatory and professional development. While our study demonstrates a clear link between reporting quality and market efficiency, the institutional environment remains a critical factor. As Karimi and colleagues observed, corporate governance and regulatory frameworks have a direct effect on how accounting information is produced and used for investment decision-making [8]. Strengthening these mechanisms could amplify the positive impact of high-quality reporting on the Iranian market, making it more comparable to mature economies. Moreover, the ongoing digital transformation discussed by Eslami Zarei and others provides an unprecedented opportunity to automate error detection and improve disclosure reliability [16].

Despite its contributions, this study is subject to certain limitations that should be considered when interpreting the findings. First, the analysis was confined to manufacturing companies listed on the Tehran Stock Exchange, which may limit the generalizability of the results to other industries such as financial institutions, services, or technology-driven sectors. Second, the study used secondary data and quantitative proxies for financial reporting quality, such as accrual-based measures, which may not fully capture the qualitative aspects of transparency and narrative disclosure. Third, the research design was cross-sectional over a five-year period, which, although robust, may not account for long-term strategic reporting changes or economic shocks that influence disclosure practices and investment behaviors. Additionally, data availability constraints and possible classification differences between companies could have introduced measurement error. Finally, while the study controlled for certain firm-level characteristics like size, leverage, and return on assets, other contextual factors such as board composition, audit quality, or market sentiment were not explicitly modeled and may influence the observed relationships.

Future studies could expand on these findings by examining a more diverse range of industries and including financial institutions, technology companies, or service sectors where reporting dynamics may differ. Researchers might also adopt longitudinal or panel-data methodologies to observe how improvements in reporting quality over time influence investment patterns and capital costs. Additionally, integrating qualitative methods such as

interviews with CFOs, auditors, or regulators could provide deeper insight into the institutional and behavioral drivers of reporting practices. Another promising direction would be to incorporate advanced analytics and machine learning models to measure reporting quality, detecting patterns of earnings management or disclosure opacity beyond traditional accrual-based indicators. Finally, comparative cross-country studies focusing on emerging markets could help determine whether the effects observed in Iran are consistent with other transitional economies and inform the harmonization of reporting standards globally.

For practitioners, these findings highlight the necessity of prioritizing transparency and accuracy in financial reporting as strategic tools to attract investment and lower the cost of capital. Corporate managers should invest in robust internal control systems and promote a reporting culture that emphasizes integrity and accountability. Adoption of advanced audit technologies and data analytics can further enhance the timeliness and reliability of disclosures. Regulators and policymakers can also draw from this evidence to strengthen enforcement mechanisms, refine disclosure standards, and provide incentives for high-quality reporting. Finally, professional training for accountants, auditors, and board members remains essential to ensure that financial statements serve as reliable guides for resource allocation and market stability.

Authors' Contributions

Authors equally contributed to this article.

Ethical Considerations

All procedures performed in this study were under the ethical standards.

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Conflict of Interest

The authors report no conflict of interest.

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