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IFRS Adoption, Information Asymmetry and FDI

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Abstract

Foreign investors prefer markets with less information asymmetry and high-quality financial information that enables them to assess investment prospects at a lower cost. Therefore, IFRS employs as one of the critical inputs to increase transparency, reduce information asymmetries and ultimately affect investors' decision making. Hence, this paper attempts to highlight the existing gaps in the IFRS literature to motivate future researchers to study the relationship between IFRS adoption and FDI. This paper also suggests to future study to examine the mediating roles of Information asymmetry in the relationship between IFRS adoption and FDI.

Keywords: IFRS adoption, information asymmetry, foreign direct investment, ASEAN countries

1. INTRODUCTION

One of the most important goals of economic policy in almost every country in the world is to increase their economic growth. Increasing volume of financial capital flows across countries is one of the striking developments over the past three decades that can affect world economic growth (Cooper, 1999). Despite the fact that a variety of financial capital flows exists, there is a significant preference among countries to attract more Foreign Direct Investment (FDI) (Akisik, 2014). Particularly, FDI plays a crucial role in contributing to economic growth (Feeny, Iamsiraroj & McGillivray 2014; Thampanishvong & Kannika 2015; Iamsiraroj 2016; Ojewumi & Akinlo1 2017). Therefore, both developed and developing countries have been competing to increase their shares of FDI (Akisik 2014).

However, differences between national accounting standard practices have been recognized as an essential informational barrier to FDI (Chen, Ding, & Xu, 2014). Indeed, foreign investors prefer markets with high-quality information that enables them to assess investment prospects at a lower cost (Van Tendeloo & Vanstraelen 2005; Akisik 2008; Gordon, Loeb & Zhu 2012; Castillo-merino, Menéndez-plans & Orgaz 2014). Besides of all the benefits of FDI for economic of countries, the lack of proper financial reporting standards along with an ineffective corporate governance system has recently been recognised in explaining the inadequacy of FDI (Gordon et al. 2012; Akisik 2014). Therefore, International Financial Reporting Standard (IFRS) and a robust corporate governance might be one way to overcome this inadequacy.

The underlying benefit of IFRS adoption is to provide comparable and reliable financial statements to decision makers. In addition to the benefits for investors, IFRS adoption facilitates the development of world trade, which in turn promotes the economic growth of the adopting countries (Zaidi & Huerta 2014; Samuels & Piper 1985). IFRS adoption may affect financial decisions by reducing information processing costs, primarily for foreign investors who are familiar with IFRS, and facilitate cross-border capital flows (Akisik 2008; Gordon et al. 2012; Naranjo, Saavedra & Verdi 2013). Thus, by reducing information processing costs, IFRS can also have an impact

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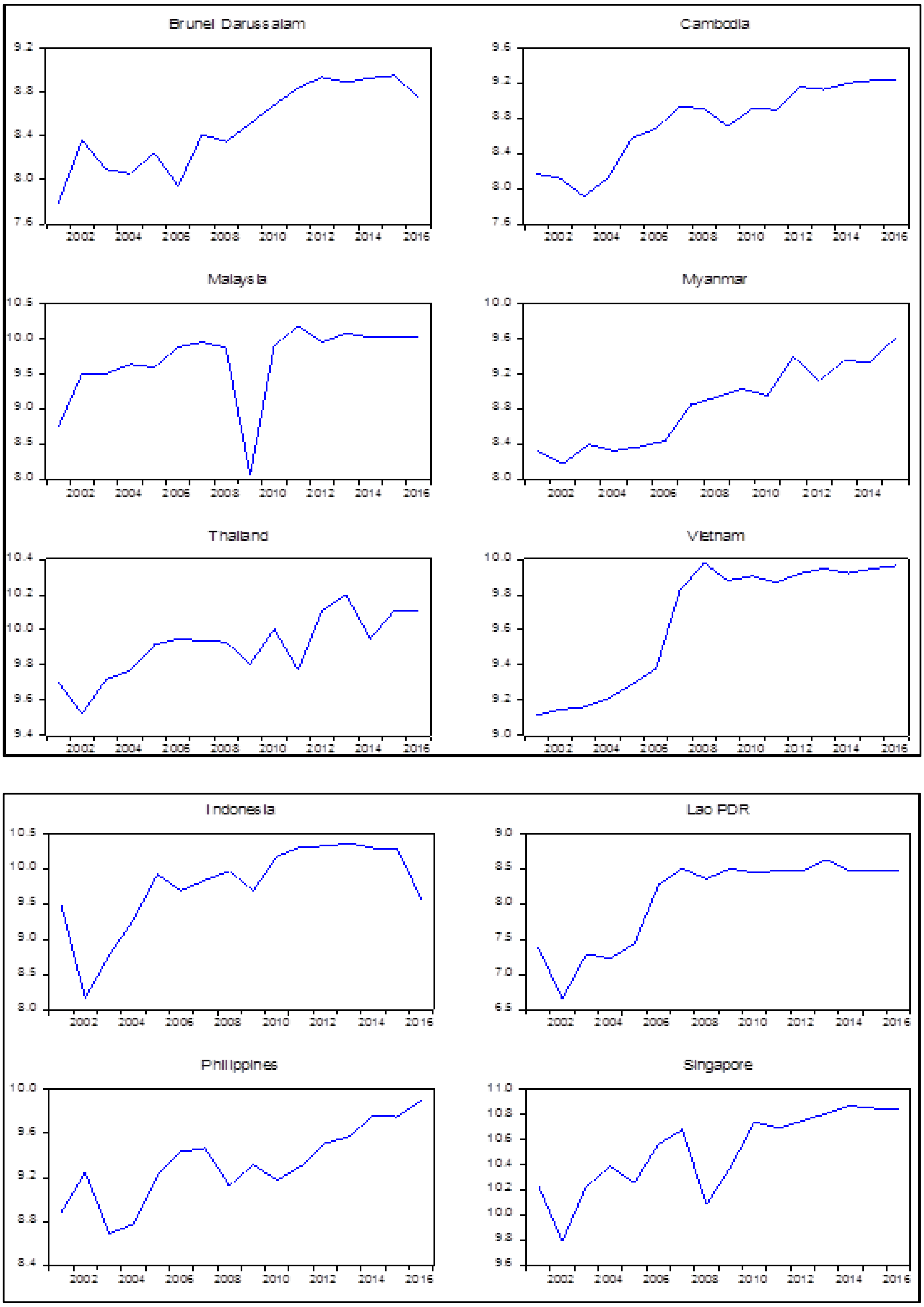
on FDI and ultimately may lead to economic growth. The effects of IFRS on accounting information quality and consequently more transparency have also been observed in previous studies such as Ball 2006; Beijerink 2008; Epstein 2009; Al Mutawaa & Hewaidy 2010; Okpala 2012; Ahmed, Neel & Wang 2013; Lourenço & Branco 2015 and Zaidi & Paz 2015.

One of the exciting and essential region in the world related to the economic issue is ASEAN region. The FDI has played a momentous role in the economic development of ASEAN over the last two decades (Diaconu 2014). The economic growth of ASEAN countries recorded in 2016 has increased compared to economic growth in 2012 in 98 percent (World Bank, 2016). This growth percentage is not observed in other regions. FDI of ASEAN countries recorded in 2016 increased compared to FDI in 2012 in 81 percent (Graph 1.1). Moreover, ASEAN countries consist of a heterogeneous group of countries with varying levels of economic development, which is very important in attracting foreign investors. These varieties in the level of economic development in this region give excellent opportunity to do more researches on examining the effect of IFRS adoption on FDI as a most important factor of economic growth. There are also limited empirical documents that are known about this topic concerning members of the ASEAN, which includes some of the world's fastest-growing economies (Joshi et al. 2016). However, between ASEAN countries are some countries which did not adopt IFRS yet such as Indonesia and Vietnam. Therefore, based on the above discussion, whether IFRS adoption leads to less information asymmetry and eventually leads to higher FDI? So, why some countries without following IFRS still has high FDI inflow? Moreover, are there any differences between economic levels of countries on the effects of IFRS adoption on FDI? Therefore, these issues motivate future researchers to study IFRS adoption and FDI inflow.

This paper contributes to the extant literature by focusing on IFRS adoption and foreign direct investment. It is important to note that, without appropriate knowledge of the impact of IFRS adoption, potential decision makers could be misled into making a sub-optimal decision. Therefore, the outcomes of this paper would motivate researchers to examine the economic consequences of IFRS in ASEAN countries and help to generalised with findings of earlier studies. The outcomes would be relevant not only to countries that have already adopted IFRS but also to countries that are in the process of adopting the standard. Moreover, outcomes of this paper motivate researchers to examine the relationship between information asymmetry and FDI. The outcomes also can be useful for international authority bodies such as IASB, World Bank and International Monetary Fund (IMF) that have attempted to achieve harmonisation around the world in different areas such as accounting standards and corporate governance.

2. LITERATURE REVIEW

One of the interesting issues that more frequently has been analysed and discussed in the accounting field in recent years is International Financial Reporting Standard (IFRS) adoption at the international level. IFRS are part of the accounting infrastructure that assists countries to promote their economic growth (Larson & Kenny 1995; Zaidi & Huerta 2014). In general, studies on IFRS adoption and implementation found that IFRS improves the transparency and disclosure of financial statements (Christensen 2012; Ball 2006; Lambert, Leuz & Verrecchia 2007; Lourenço & Branco 2015). Improved transparency and disclosure may reduce uncertainty, agency cost, information asymmetry, cost of capital and estimation risk, while may enhance credibility, comparability, accuracy, information quality, accounting quality, market liquidity, foreign direct investment and capital market efficiency (Ball 2016; Ebrahimi Rad & Embong 2014; Gordon, Loeb & Zhu 2012; Aliabadi & SHAHRI 2016).
For the purpose of making a clear and illustrative literature to highlight the gap, this paper classifies past studies in three main categories (Figure 2.1). In general, studies that focused on IFRS can be classified into broad categories. However, there are three main categories; first category includes studies which explore determinants of IFRS adoption, the second category includes studies which carried out on consequences of IFRS adoption, and third categories look at the review paper on IFRS.



Graph 1.1 FDI inflow in ASEAN countries (1981-2016)

Studies on IFRS

- 1) Determinants of IFRS adoption
  - 1-1) Properties of IFRS
  - 1-2) Affected factors on IFRS adoption
  - 1-3) IFRS perception
  - 1-4) IFRS compliance
- 2) Consequences of IFRS adoption
  - 2-1) Market consequences of IFRS adoption
    - 2-1-1) Analysts' forecasts accuracy
    - 2-1-2) Earning management
    - 2-1-3) Value relevance
    - 2-1-4) Information Quality
    - 2-1-5) Information asymmetry
  - 2-2) Economic consequences of IFRS adoption
    - 2-2-1) Economic growth
    - 2-2-2) Cost of equity capital
    - 2-2-3) Foreign direct investment
- 3) Review papers on IFRS

Figure 2.1 Classification of existing studies on IFRS

It is essential to understand the consequences of IFRS adoption in countries. Therefore, this paper with the purpose of highlight the gap classifies studies which examined the consequences of IFRS adoption into studies which examined the market consequences of IFRS and studies which examined the economic consequences of IFRS. Market consequences of IFRS category looked at studies which examined the effects of IFRS on financial reporting in firms' level. For example, the effects of IFRS on analysts' forecasts accuracy and earning management, information quality, information asymmetry and value relevance of IFRS adoption. While economic consequences of IFRS category looked at studies which examined effects of IFRS adoption on economic growth in general and particularly examined the effects of IFRS on investments. This category includes both firms' level, cost of equity, and country level, economic growth and foreign direct investment.

Based on past studies on economic consequence of IFRS, and effects of IFRS adoption and cost of equity capital, it is clear that this area also extensively investigated in past studies. Therefore, only regarding economic consequences of IFRS, Foreign direct investment should be review and synthesise to find the gap of the study. It is believed that accounting information prepared based on IFRS leads to increase accountability and transparency (Nnamdi et al. 2016). Role of IFRS on developing of a country has been a notable research attention (Larson & Kenny 1995; Larson 1993; Gordon et al. 2012; Tekin 2012). According to Cooper (1999) world economies besides of IFRS adoption effects, has been affected by increasing volume of financial capital flows across countries. Consequently, there is a significant preference among countries to attract more Foreign Direct Investment (FDI) between both developed and developing countries since economic and financial globalisation enabled free movement of capital (Akisik 2008; Almfraji & Almsafir 2014). Prior researchers reported that there is a substantial relationship between IFRS and FDI. For example, Akisik (2014), Chen, Ding and Xu (2014), Gordon et al. (2012) and Nnadi and Soobaroyen (2015).

Based on the above discussion, there are good reasons to suggest that IFRS may well be an additional important driver of FDI. However, in the literature, there are limited studies that looked at IFRS as determinants of FDI (Gordon et al. 2012). According to Gordon et al. (2012), the fact that the relationship between FDI and IFRS has not been well developed is not surprising because, individuals conducting research related to IFRS and individuals conducting research related to FDI tend to have a different research focus such as economic and international business research that tend to focus on global and macroeconomic business concerns.

Furthermore, evidence of economic consequences of IFRS is still limited in developing countries especially concerning the impact of IFRS adoption on foreign direct investment. Furthermore, the IFRS Foundation has recognised the need to understand the impact of IFRS adoption in different parts of the world, especially in developing or emerging countries. However, there is no lack of study except in developing countries, but because of the past mixed results, it is necessary to study on economic consequences of IFRS in developed countries as well. There are also little empirical documents that are known about this topic concerning members of the Association of South East Asian Nations (ASEAN), which includes some of the world's fastest-growing economies and as a sample combining developed and developing countries together (Joshi et al. 2016).

2. SUMMARY AND CONCLUSION

This paper proposes explicitly to future studies to study the effects of IFRS adoption on FDI. In the best of my knowledge, there is no study that examines the effect of IFRS on FDI in ASEAN countries. Although above mentioned studies in literature review section addressed issues similar to those proposed in this paper, however, first, this paper suggests to look at the effects of IFRS adoption on FDI after convergence date of IFRS for ASEAN countries rather than consideration countries almost in before convergence date of IFRS as was done by Gordon et al. (2012) and Akisik (2008). Second, for further understanding the effects of IFRS adoption on FDI, this paper suggests to future studies to compare this relationship before and after IFRS convergence. Third, there are also limited studies which looked at the relationship between IFRS adoption and information asymmetry and FDI. Therefore, also this paper suggests examining the effects of IFRS adoption on information asymmetry improvement to increase FDI. Fourth and finally, FDI is an essential factor to assist the examining the country level effects of IFRS adoption. In literature, there are insufficient studies which looked at the effects of IFRS adoption on country level and compare this effects between them. Therefore, future studies with examining the effect of IFRS on information asymmetry reduction and FDI enhancement at a country level and compare those effects between ASEAN countries may fill the important gap in existing studies.

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