Investor reaction to IFRS for financial instruments in Europe: The role of firm-specific factors

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1. Introduction

On July 24, 2014, the International Accounting Standards Board (IASB) released International Financial Reporting Standard (IFRS) 9 – Financial Instruments, to replace International Accounting Standard (IAS) 39. The introduction of IFRS 9 was solicited during the recent financial crisis by various international organizations, with the aim of improving accounting for financial instruments (Bischof and Daske, 2016).

Because of the potential impact of IFRS 9 on accounting quality, it is an empirical question whether firm-specific factors affect the investors’ perceptions about the ability of IFRS 9 to increase shareholder value.

In the present study, we answer this question by examining whether firm-specific factors associated with information quality and information asymmetry influence the market reaction to announcements related to the standard-setting process of IFRS 9. This analysis is deemed necessary, because the evolving literature that documents capital-market effects of IFRS reporting indicates that firm characteristics require further investigation, such to better identify the drivers of the heterogeneity in the economic consequences (Daske et al., 2008; Armstrong et al., 2010; Christensen et al., 2013; Dos Santos et al., 2016). Furthermore, an understanding of the capital-market outcomes of IFRS 9 is of interest to policy makers, as it helps evaluating whether the reform leads to higher financial reporting quality, and thus benefits international investors (European Commission, 2015).

Following Onali and Ginesti (2014), we explore the impact of the IFRS 9 adoption by measuring variations in the three-day market adjusted return (MAR) and by taking into account the effect on the MAR due to several economic factors. Unlike...
previous studies, we also take into account variations in the MAR that are due to systematic patterns in stock returns during the week (day-of-the-week effects), as well as Fama-French factors (FFF) and Carhart factors (CF). Such an approach allows us to considerably reduce the bias in the estimated MAR that may result from market-wide temporal patterns in returns or other firm-level characteristics.

The main results of our analysis reveal that higher pre-adoptive information quality and lower pre-adoptive information asymmetry have a positive impact on the MAR. Moreover, we find that financial firms react worse than non-financial firms to IFRS 9 adoption events.

We emphasize that our main contribution to the literature is twofold. First, by considering a large dataset of European listed firms, we perform a new and comprehensive investigation on the firm-level heterogeneities in the reaction to all events related to the standard-setting process of IFRS 9. Second, we provide novel empirical evidence of the fact that, contrary to a quite common view (see, for example, Armstrong et al., 2010), the IFRS adoption may not improve accounting quality for firms with low liquidity and high information asymmetry.

This study is organized as follows: Section 2 reviews the literature on the effects of IFRS adoption. Section 3 describes the methodology and the data. Section 4 presents and discusses the main results obtained and Section 5 concludes.

2. Literature review

There is an intense academic debate about the implications of IFRS adoption for capital markets (Daske et al., 2013; Christensen et al., 2013). Most research to date has focused on positive capital-market effects of IFRS, arguing that IFRS adoption would increase market liquidity and decrease cost of capital (Daske et al., 2008), stimulate cross-border investment (Gordon et al., 2012) and improve financial analysts’ information environment (Byard et al., 2011). In addition, some empirical studies provide support for positive share prices reaction to events that increase the likelihood of IFRS adoption (Armstrong et al., 2010; Joos and Leung, 2013).

However, the adoption of IFRS may not necessarily lead to benefits for investors (Christensen, 2012). For instance, some scholars suggest that IFRS adoption could generate costs for the preparation of IFRS reports as well as more consulting fees due to the need to acquire expertise with the new accounting framework (Hail et al., 2010). Therefore, it is plausible to expect that investors may negatively react to the IFRS adoption, if they believe that the transition costs to IFRS would exceed any benefit (Joos and Leug, 2013; Prather-Kinsey and Tanyi, 2014).

3. Methodology and data

3.1. Hypothesis

As reported by Armstrong et al. (2010), pre-adoptive information quality and pre-adoptive information asymmetry at the firm level affected the market reaction to announcements related to the 2005 mandatory adoption of IFRS across Europe. Consistently with this finding, we put forward the following hypothesis:

H1: Pre-adoptive information quality and pre-adoptive information asymmetry influence the investors’ reaction to the standard-setting process of IFRS 9.

3.2. Methodology

Following MacKinlay (1997), we develop an event study to examine the market reaction to IFRS 9. To this aim, first of all we identify the IFRS 9 adoption events based on the public announcements provided by the IASB and the European Financial Reporting Advisory Group (EFRAG). We use the LEXIS/NEXIS database to control for potentially confounding news during each event window. Such a procedure leads to a set of 22 IFRS 9 adoption events, which are reported in Table 1.1

To check whether the 22 events considered are actually relevant to investors, we examine the extent to which the Google Search Volume Index (SVI) for the keyword “IFRS 9” is higher in weeks around these events (Da et al., 2011). We run a two-sample t-test for the time period from 05/07/2009 to 06/09/2014, and we find that in the weeks around the 22 IFRS 9 events considered the SVI is significantly larger (at the 1% level).

Subsequently, we calculate the MAR as the difference between the 3-day log stock return and the log return of the proxy for the market portfolio. As a proxy for the market portfolio, we adopt the DJ STOXX Global 1800 Index Ex Europe (Armstrong et al., 2010).

To empirically test H1, we run regressions of the MAR for each firm i and event t on a set of firm-level covariates. In particular, to take into account the incremental effect of firm-specific factors, we implement several regression models (all the variables are described in Table 2). We start from the following baseline specification focusing on factors related to information quality and information asymmetry:

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1 For events until 31/12/2012, we maintain the same interpretation as in Onali and Ginesti (2014).

Please cite this article as: E. Onali et al., Investor reaction to IFRS for financial instruments in Europe: The role of firm-specific factors, Finance Research Letters (2017), http://dx.doi.org/10.1016/j.frl.2017.01.002
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