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Accounting information quality, governance efficiency and capital investment choice

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ABSTRACT

This paper examines the relationship between accounting information quality and capital investment choice from the perspective of accounting information's governance function. Measuring capital investment choice as the correlation of growth of operating income between company and industry, this paper investigates whether and to what extent companies focus on their core business. The results show that the higher the quality of publicly listed firms' accounting information, the stronger that correlation, particularly when the corporate governance of the listed company is poor. The findings imply that accounting information quality can thus optimize the capital investment choice, which complements and strengthens the functioning of corporate governance. Hence, regulators should pay more attention to the market's power to supervise the behavior of listed firms, improve the governance functions of accounting information and increase the efficiency of capital allocation.

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1. Introduction

China's stock market has developed rapidly since 1990, when the capital market was set up. The number of listed companies increased from 10 in 1990 to 2063 in 2010. In the 1990–2010 period, about 5253.7 billion yuan in outside capital flowed into listed companies by initial public offerings, seasoned equity offerings or corporate bonds (China Statistical Yearbook, 2011). Whether companies allocated the capital into their own core businesses has become a very important issue, which more and more market participants are focusing on.

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