Information asymmetry and firm-level investment efficiency: Evidence from analysts' forecasts and daily trading

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Abstract

This paper examines the influence of information asymmetry on firm-level investment efficiency. Previous literature mainly indirectly or partially studies the effect of information asymmetry on investment efficiency. In this chapter, direct and unambiguous proxies of information asymmetry derived from analyst forecasts are used to investigate the role of information asymmetry in firms' investing decisions. Moreover, the effects of information asymmetry on under- and over- investments are tested separately and the results are found to be consistent with the adverse selection hypothesis and principal-agent conflict explanation. Specifically, firms with better information environment or lower information asymmetry are found to be less likely to under-invest or over-invest compared with the predicted investment levels based on investment opportunities. Meanwhile, better information environment is also shown to be able to reduce investment when the firm is already over-investing and to increase investment when the firm is under-investing. Results are robust across various regression methodologies and to different estimates of the variables.

Keywords: *Information asymmetry; Investment efficiency*