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The Effect of Peer Firms' Financial Reporting Tone on Firm Investment: The Moderating Role of Information Disclosure Quality and Industry Competition

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ABSTRACT

The tone of peer firms' financial reports, as a strategic signal, shapes perceptions of economic and industry conditions, influencing firm investment decisions. An optimistic peer tone encourages investment, while a pessimistic peer tone reinforces caution and conservatism. High-quality peer disclosure enhances the spillover effect of peer tone, while industry competition may amplify this effect on firm investment. This study aims to determine the effect of peer firms' financial reporting tone on firm investment by considering the moderating roles of information disclosure quality and industry competition. The sample comprises 130 companies listed on the Tehran Stock Exchange from 2012 to 2023, and the hypotheses were tested using OLS regression and panel data methods. The results indicate that the more optimistic the tone of peer firms' financial reports, the more the firm invests. An optimistic peer tone creates a safe environment signaling strong market potential and stability to managers. When peers publish high-quality and transparent financial information, the credibility of their optimistic tone increases and strengthens managers' confidence. In competitive industries, managers may interpret an optimistic peer tone as a signal of increasing competition, leading to more conservative investment decisions.

1. Introduction

Traditional financial theory posits that firm investment decisions are independent of external influences (Modigliani & Miller, 1958). However, in reality, these decisions are influenced by peer firms, creating a phenomenon known as the peer effect on investment decisions. Peers are firms with similar structural, technical, and industrial characteristics that influence each other's strategies and performance. This phenomenon, though understudied, drives policy convergence.

The tone of financial reports is an important aspect of qualitative financial reporting. In accounting literature, it refers to the extent to which board reports use optimistic or pessimistic language. The informational perspective, based on signaling theory, argues that managers can signal market conditions through optimistic or pessimistic tones in textual reports. In contrast, the opportunistic behavior view, based on agency theory, suggests that managers use financial reporting to serve their own interests. When peer reports have an optimistic tone, they signal favorable market conditions and encourage firms to invest more to maintain market position. A pessimistic tone from peers can make firms more risk-averse, potentially delaying investment. The quality of peer information disclosure can amplify the spillover effect of financial reporting tone on a firm's investment decisions. Firms with higher earnings co-movement tend to publish higher-quality information, which enables stakeholders to assess a firm's position using industry peers' data. As risk and uncertainty in investment rise in competitive environments, the spillover effect of peer tone on firm investment may be amplified by increasing industry competition.

2. Hypotheses

The research hypotheses are as follows:

H1: Peer firms' financial reporting tone positively affects firm investment.

H2: The quality of peer firms' information disclosure strengthens the effect of their financial reporting tone on firm investment.

H3: Industry competition strengthens the effect of peer firms' financial reporting tone on firm investment.

3. Methods

In this study, data were collected from annual and quarterly financial statements, footnotes, and databases ("Rahavard Novin" and "Codal") of companies listed on the Tehran Stock Exchange to measure variables and test hypotheses. The sample comprises 130 companies listed on the Tehran Stock Exchange from 2012 to 2023. To test the hypotheses, OLS regression and panel data methods were employed.

4. Results

The results indicate that peer firms' financial reporting tone has a positive and significant effect on firm investment. This means that the more optimistic the peer firms' financial reporting tone, the more the firm invests. The results further indicate that the quality of peer firms' information disclosure strengthens the positive effect of peer firms' financial reporting tone on firm investment. However, the results indicate that competition in the industry weakens the positive effect of peer firms' financial reporting tone on firm investment.

5. Discussion and Conclusion

The tone of peer firms' financial reports, as a strategic signal, shapes perceptions of economic and industry conditions, influencing firm investment decisions. This study examines this effect, considering the moderating roles of information disclosure quality and industry competition. The results indicate that the coefficient for the variable of peer firms' financial reporting tone has a positive and significant effect on firm investment at a 95% confidence level. In other words, the more optimistic the peer firms' financial reporting tone, the more the firm invests. Thus, H1 is supported. An optimistic peer tone creates a safe environment signaling strong market potential and stability to managers. This positive outlook not only improves the firm's market position but also attracts a wider range of investors who view optimism as an indicator of future growth. The results for H2 indicate that the coefficient of the interactive variable Peers' Earnings Co-movement × Peers' Tone is positive and significant at the 95% confidence level. In other words, the quality of peer firms' information disclosure enhances the positive effect of peer firms' financial reporting tone on firm investment. Thus, H2 is supported. Based on these results, when peer firms provide transparent and high-quality financial information, the credibility of their optimistic tone increases and strengthens managerial confidence not only in those companies but also in the industry as a whole.

For H3, the results indicate that the coefficient of the interactive variable HHI× Peers' Tone is negative and significant at the 90% confidence level, contrary to expectations. In other words, industry competition weakens the positive effect of peer firms' financial reporting tone on firm investment. Thus, H3 is not supported. Possible reasons for this finding in the Iranian capital market include that, while an optimistic tone of peers generally encourages firm investment, in highly competitive industries, the opposite effect may occur. In such industries, managers may view the optimistic tone of peers as a signal of intensifying competition. This could suggest challenges such as reduced profit margins, market saturation, and fierce price competition, leading managers to adopt more conservative investment strategies.

Keywords: Financial reporting tone, peer firms, firm investment, earnings co-movement, industry competition.