

Extended Abstract

1. Introduction

This study investigates the relationship between audit quality and labor investment efficiency. Prior research highlights the crucial role of financial reporting in reducing information asymmetry between managers and shareholders (e.g., Bushman & Smith, 2001). High-quality financial reporting not only informs investors about firms' past performance but also facilitates more efficient future investment decisions, including labor-related investments.

Consistent with this view, a growing body of empirical literature documents a positive association between financial reporting quality and both labor and non-labor investment efficiency (e.g., Modares & Hesarzadeh, 2008; Biddle et al., 2009; Chen et al., 2011; Hashemi et al., 2013; Garcia-Lara et al., 2016; Aflatoni & Khazaie, 2016). This study extends this stream of research by focusing on audit quality as a key institutional mechanism that may influence labor investment efficiency in an emerging market setting, namely the Iranian capital market.

Previous studies indicate that higher audit quality is associated with improved financial reporting quality and stronger monitoring functions (e.g., Balsam et al., 2003; Dunn & Mayhew, 2004; Reichelt & Wang, 2010; Lennox et al., 2016). High-quality audits help mitigate moral hazard problems and reduce adverse selection costs by lowering information asymmetry between managers and shareholders.

Beyond financial reporting quality, auditors may directly affect firms' labor investment efficiency. Industry-specialist auditors, for instance, possess extensive knowledge not only about their clients but also about other firms operating within the same industry. This cross-firm expertise enables auditors to transfer industry-specific insights, thereby assisting managers in making more informed labor investment decisions. Accordingly, this study examines audit quality as an important determinant of labor investment efficiency.

2. Hypothesis

Prior auditing research emphasizes the role of external auditors in information production and risk assessment. Auditors monitor managerial activities by evaluating operational, investment, and financial risks and incorporating these risks into audit planning and execution (Cohen et al., 2002; Bedard & Johnstone, 2004).

Enhanced auditor oversight constrains managers' incentives to engage in inefficient labor investment behaviors, such as excessive hiring or firing,

over-investment in negative net present value labor projects, or delaying the termination of unproductive employment initiatives. Moreover, by reducing information asymmetry, high-quality audits attract investors, lower firms' cost of capital, and mitigate under-investment in labor. Overall, audit quality is expected to influence labor investment efficiency both indirectly—through improved financial reporting quality—and directly, via value-added services such as advisory input, knowledge sharing, assurance, and monitoring mechanisms (Boubaker et al., 2018; Langberg & Rothenberg, 2021).

Hypothesis (H1):

Higher audit quality improves firms' labor investment efficiency.

3. Methods

This study adopts a quantitative and ex post facto research design based on empirical hypothesis testing. The sample consists of 122 firms listed on the Tehran Stock Exchange over the period 2008–2020. Financial data were extracted from firms' annual financial statements using Rahavard Novin software.

Panel data regression analysis was employed to test the research hypothesis, with statistical analyses conducted using EViews and SPSS software. Labor investment efficiency was measured based on the Pinnuck and Lillis (2007) model, which estimates expected labor investment as a function of firm-specific characteristics, including sales growth, profitability, stock returns, firm size, liquidity, leverage, loss indicators, and industry effects. Deviations from expected labor investment were interpreted as inefficiencies, capturing both over-investment and under-investment in labor.

4. Results

The regression results reveal a positive and statistically significant relationship between audit quality and labor investment efficiency. Furthermore, audit quality is found to be negatively and significantly associated with both over-investment and under-investment in labor.

These findings suggest that firms engaging higher-quality auditors experience fewer distortions in hiring and firing decisions. By strengthening the monitoring framework, improving the information environment, and reducing agency conflicts, audit quality contributes to more efficient labor investment outcomes.

5. Discussion and Conclusion

The findings of this study indicate that audit quality plays a critical role in improving labor investment efficiency and steering firms toward more optimal employment decisions. High-quality audits reduce information asymmetry, enhance managerial discipline, and support efficient resource allocation by discouraging unnecessary hiring and layoffs.

From a policy perspective, the results have important implications for corporate managers, employment policymakers, regulators, and the auditing profession. Strengthening audit quality can enhance investor confidence, reduce capital costs, and promote sustainable employment practices. These findings also underscore the importance of regulatory oversight and corporate governance reforms aimed at improving audit quality in emerging capital markets.

Overall, this study contributes to the literature by providing empirical evidence on the role of audit quality in labor investment decisions within an emerging market context, highlighting audit quality as a key mechanism for improving both financial reporting transparency and real economic outcomes.

Keywords

Audit Quality, Labor Investment Efficiency, Over-Investment in Labor, Under-Investment in Labor, Auditor Size, Tehran Stock Exchange