

Information Environment Quality and Idiosyncratic Return Volatility: UK Evidence

ABSTRACT

This paper examines the cross-section relationship between the quality of a firm's information environment and idiosyncratic return volatility, for a sample of UK firms listed on the London Stock Exchange.

Using panel data, we find that poor accruals quality is statistically associated with higher firm-specific return volatility. This association also holds for other measures used for the quality of the information environment: dispersion in analysts' forecasts, the innate component of accruals quality, which reflects the uncertainty about the nature of the firm's business and the discretionary component of accruals quality, which is related to managerial discretionary choices. More specifically, we find that adding the dispersion in analysts' forecasts increases the explanatory power for idiosyncratic volatility of the remaining measures of the quality of the information environment. Our results are consistent with the noise-based approach of idiosyncratic volatility. These findings are likely to contribute to the debate on whether idiosyncratic return volatility captures more firm-specific information being impounded into stock prices or essentially reflects noise.

JEL Classification: G12, G14, M40

Keywords: Idiosyncratic Volatility, Accruals Quality, Analysts' Forecasts.