

Check lucrative deals and conservatism in Iranian banks

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Abstract

The results of this study show that there is a significant inverse relationship between disclosure quality and cost of equity of companies listed on the stock exchange. So that by increasing the quality of disclosure of the cost of equity, capital is reduced. It seems that, in Iran capital market, disclosure quality increases stock liquidity by affecting the level of information asymmetry in the distribution of information among corporate executives and investors, by reducing transaction costs. Finally, by reducing information risk associated with the estimation of distribution parameters it leads to reduce the cost of equity. Also, according to the findings of this research, in Iran capital markets there is a significant inverse relationship between the conservatism the Company's cost of equity capital. So that by increasing conservatism of the cost of equity, capital is reduced. This can be explained from the perspective of contract theory. Based on the theory of interpretation of contracts, accounting conservatism is a mechanism to reduce conflict between creditors and shareholders and their interests.

Keywords: Check lucrative deals and conservatism in Iranian banks

Introduction

Various definitions about investment have been provided in financial literature. Investment is the present value of money in a period of time, in order to earn income in the future [Riley, 2009]. Investors according to the investee company's risk characteristics and environmental conditions, determine their expected return. If we look to investment discuss from the perspective of investment companies, returns expected by investors is the investee company's cost of capital. In the other words, the cost of capital is the minimum rate of return that remains constant with its economic value. The cost of capital is important from two perspectives. The first aspect is that all securities valuation models are based on the cost of capital. The second dimension is that investment of funds by the company, determine investment priorities, and determine the optimal capital structure and optimal performance assessment units would not be practical without a capital cost [Hejazi, 2006]. So, we can say that all decisions to invest in a

company are affected by the company's cost of capital that this matter represents the degree of the subject importance.

Theoretical foundations and literature of the research

Disclosure quality and cost of the ordinary shares capital

Supporting theories of the impact and quality of disclosure on the costs of ordinary shares are divided into three categories. Somebody like Omyhyod and Mendelssohn 1 (1986) claim that through the disclosure of private information of the companies, bad choices can be reduced which lead to price differences offer to buy and sell stocks, and in this way, cost of the ordinary share of the company can be reduced. According to these two researchers, chance of information asymmetry in the distribution of information between individuals within and outside the organization an entity to disclose further reduced that has caused reduction of the price, and leads to reduce the cost of issuing equity [Omyhyod and Mendelssohn [5], 1986, 223-249]. Askrand and Vrchya [6] (2002) carried out research on the impact of disclosure on the costs of ordinary shares during the initial public offering stock. They found that Increase the asymmetry in the distribution of information disclosure makes the market decline is normal that this would reduce the cost of capital. According to their statements, since the asymmetry in information dissemination and evaluation are less than the stock with a direct relationship, so reduction of informational asymmetry makes the difference between the actual value of the shares and the value set by the early investors reduced, consequently, cost of equity is also reduced [Askrand and Verchya, 2002].

Conservatism and cost of ordinary share

The concept of conservatism in accounting has a long history. Watts [10] (2003) rooted conservatism in financial reporting and economic reasons, and considers the four factors contracts, litigation, and tax legislation in the formation of notes. From the perspective of conservatism is due to contractual agreements with individuals and groups (such as shareholders, creditors, managers). According to this interpretation, conservative accounting for showing and pointing to the moral hazard caused by the various groups that unequal and asymmetric information, salary and benefits are unequal, Ltd, is [Watts, 2003, 207-221]. Managers, in order to increase their personal interests, act in using accounting standards, which are the basis of information for investors. If there is no limitation for opportunistic behavior of managers, then, the accounting figures in financial reports prepared and will be presented biased. This leads to Increase shareholders' expectations and cost of ordinary share. But conservatism verifiable by the requirements of their capabilities, limits opportunistic behavior and biased managers, so that cancel biased behavior of manager, and identifies delayed profits, resulting in lower net assets and profit.

Research hypotheses

Research hypothesis has been developed in three groups as follows:

First hypothesis: the quality of disclosure and cost of equity capital and there is a significant negative relationship.

The second hypothesis: between conservatism and cost of equity capital and there is the third hypothesis: quality interactions disclosure and conservatism associated with the cost of equity significant negative relationship.

The methodology, population, statistical sample and test hypotheses method

Method of this research is quasi-experimental and correlational. Information on literature and theoretical fundamentals are extracted from library resources, scientific databases, and internal and external articles. As well as data and outcomes have been collected from research databases, new device, and company financial statement. And after the initial processing in Excel, the Eviews software was analyzed statistically. To test the hypotheses, multivariate linear regression model was used as a data panel. To test the hypotheses, using the Chow test, data integration was tested properly. And then, methods type was determined based on results of Hausman test (fixed effects or random effects); estimation has been carried out according to the type of the method. To evaluate the significance of the F-statistic model in order to evaluate the significance of independent variables, coefficient of t test was used. And, decision has been taken at 95% compared to the acceptance or rejection of the assumptions. Also, in order to check the normality of residuals, matches remaining residual variance and independence, Jarque-Berra tests, Lagrange multiplier test and Watson camera statistic d were used respectively. The population of this study includes all companies listed on the Tehran Stock Exchange and consists of 453 company. Considering the time of the survey and availability of data, study period has been set on nearly 7-year from 2003 till 2009. In this study, screening methods (FA) is used for sampling. To this purpose, five criteria were considered, and if the companies meet all these criteria have been selected as sample:

- 1) Company should be accepted before 2001 in Tehran Stock Exchange, and enabled until the end of 2009 in exchange (339 companies).
- 2) Company should not be in group of investment companies or financial intermediation (327 companies).
- 3) During the 2001 to 2009 fiscal year, the company should have not changed, and its financial year should not lead to end of March (159 companies).
- 4) The company should have been active, and there should not be more than 6 month interruption in transactions of company (87 companies).
- 5) Information required for company should be available (87 companies).

After considering all the above criteria, 87 companies screened as society remains all of which were chosen as the sample of research. So our observations reached to 609 years that the observations are in the form of 20 different industries.

5- The research model and operational definition of variables

In this study, all three hypotheses have been tested by using equation (1). In this model reflection of the quality cost represent the conservation degree, represents the disclosure quality rating reflects the company's market beta, confirms the company's stock market value; and book value reflects the market value of the company.

The research includes conservatism and disclosure quality variables as independent variables, and the dependent variable is the cost of equity. Also, since in previous studies the impact of systematic risk (beta), the ratio of book value to market value and the size of the company's cost of capital has been approved, in present study, each of these variables enter under control variables into the model; and its impact on capital costs can be controlled. In the following, operational definition and method of calculating each of these variables is described.

Research findings

In order to gain a better understanding about population and variables, variables descriptive summary is presented in Figure 1.

Table 1: Descriptive statistics variables

Elongation	Skewness	Most amount	Lowest amount	Standard deviation	average	Observation number	variable
18/250	2/932	1/523	0/000	0/141	0/207	609	Cost of ordinary share
60/662	-3/045	8/048	-10/341	1/035	0/043	609	Conservatism
0/729	-0/068	98	-13	22/225	52/405	609	Disclosure Quality
2/148	0/332	3/805	-3/296	0/934	0/330	609	Market beta
6/801	2/055	2/832	0/010	0/335	0/352	609	The ratio of book value to market
-0/316	0/299	16/956	9/511	12/924	13/061	609	size of the company

Table 2: Chow test results for the model

Verification methods	result	P-Value	Degree of independency	StatisticsF
Using panel data	rejection	0/006	(472•85)	1/477

In study of the meaningfulness of the model, according to the statistics probability F is smaller than 05/0 (0.000) with 95% confidence significance of the model is confirmed. Determining model coefficient suggests that 83/16 percent of the changes in the cost of equity is explained by the independent variables in the model. The result further control variables genealogy research shows significant positive relationship between book value and market value cost of equity. However, in connection with the relationship between the company and the size and cost of equity market beta was no significant relationship.

According to the results presented in Figure 7 the disclosure quality variable coefficient was negative (103 / 0-), and the possibility of its t-statistic is less than 05/0 (016/0), then the hypothesis is rejected and a significant negative relationship between disclosure quality and cost of equity at 95% is confirmed. As a result, the first research hypothesis is accepted. Recent findings and research results AskrandVerchya (2002) and Rtyach and Klarsven (2010) is consistent. The results of this research with empirical evidence provided by captured and BezazZadeh (2003) on the existence of an inverse relationship between the disclosure and cost of equity capital is consistent in Iran. In connection with the second hypothesis, since conservatism variable rate() is negative (131 / 0-) and the probability of its t-statistic is less than 05/0 (021/0). As a result, the hypothesis is rejected and there is a significant negative relationship between conservatism and cost of equity at 95% is confirmed. The second hypothesis is accepted. Recent findings and research results of ArtyachClarson (2010) and Kurdistan and Haddad (2009) is consistent. Also for the third hypothesis, since the index of variable was positive (002/0 and its t-statistic is smaller than 05/0 (047/0), as the result, the hypothesis is rejected, and evidences suggest that by increasing the quality of disclosure, the effect of conservatism on the cost of equity capital is reduced. So the third hypothesis is also accepted. Also, results of the control variables show that there a significant positive correlation between the ratio of book value to market value and the cost of equity. However, in connection with the relationship between the company and the size and cost of equity market beta there was no significant relationship.

Conclusion

The results of this study show that there is a significant inverse relationship between disclosure quality and cost of equity of companies listed on the stock exchange. So that by increasing the quality of disclosure of the cost of equity, capital is reduced. It seems that, in Iran capital market, disclosure quality increases stock liquidity by affecting the level of information asymmetry in the distribution of information among corporate executives and investors, by reducing transaction costs. Finally, by reducing information risk associated with the estimation of distribution parameters it leads to reduce the cost of equity. Also, according to the findings of this research, in Iran capital markets there is a significant inverse relationship between the conservatism the Company's cost of equity capital. So that by increasing conservatism of the cost of equity, capital is reduced. This can be explained from the perspective of contract theory. Based on the theory of interpretation of contracts, accounting conservatism is a mechanism to reduce conflict between creditors and shareholders and their interests. As in an economic environment, behavior management and financial reporting is more conservative, earnings will be more reasonable and they will be measured reliably. This leads to a more reasonable expectation of shareholders and creditors, and the company's cost of capital puts more power. Also, evidences show that through increase in the quality of disclosure Iranian companies, the effect of conservatism is reduced on the cost of equity capital. It may be argued that in Iran capital market, conservative influence on the cost of equity is affected by the Company's information environment; and only if there is information asymmetry, choose of a more conservative accounting system can lead to reduce the cost of equity through the transfer of personal information managers.

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