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Unusual incomes and returns of stock in capital market

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ABSTRACT: This study examines the effects of unusual and extraordinary incomes and returns of stock in capital market, in this study firstly we describe the topic and then express factors that reduce these factors. Finally, two theories on this topic are studied and then we conclude.

Keywords: extraordinary incomes, unusual returns, information asymmetry

INTRODUCTION

One of the objectives of financial reporting is summary information on the financial performance of the business unit periodically and income plays an important role in measuring performance of the companies. (Number one conceptual statement of Financial Accounting Standards codification Board). Professionals accounting and financial institutions have taken basic steps with an emphasis on developing accounting standards that can provide useful and relevant information for investors and other users in the form of financial statements, in order to fulfill the objectives of accounting.

With regard to economic aspects of information, financial reporting and accounting systems play vital role in efficient capital markets (Kordestani and Rudneshin,2006). One of the main targets that is the most important target from all financial reports information users' view, is to create distinction between capital and income as part of descriptive accounting process. Profits can be a measure of management efficiency. You can predict future economic unit and future distribution of dividends using historical payments of profits. Profits can be a measure for achievements and is also an indication of future management decisions (Hosseini ,2010)

The subject Statement:

(Hendrickson and van Breda ,1992) argue that the main objective of reporting profits is to provide useful information for people who have the greatest interest to financial reporting. However, the profit commitment notion as a fundamental measure has faced criticism, but in terms of information, the concept represents the accounting activities results.(Bior and Demski ,1979). Security (finance) rate of return is the main factor in choosing investment. If the rate of return on investor exceeds the expected rate of return, the value of invested assets may be more and more wealth is obtained. (Hassan zade brothers ,2011). Investors make decision to buy or sell based on stock returns and different factors such as economic, political changes in society, expectations of shareholders and economic changes and financial status of firm are effective on stock price fluctuations. Investors are faced with the following two unusual phenomena:

Short-term returns more than market: This phenomenon refers to the initial offering pattern under securities price. Long-term returns less than market: This phenomenon refers to lower return pattern of new stock ratio to market. The more underwriting new stock income from good reputation and validity, the less underprice supply will be, then short-term abnormal returns of the stock will be far lower, too. (Gerkez, 2011).

Markovitz states that utility (usefulness) of investor is a function of expected return and risk and these two are parameters of investment decision. Market efficiency does not necessarily lead to an unexpected loss of income due to lack of diversification, and abnormal return rate is depended on factors specific to the company and not on factors specific to capital market portfolio (Watts and Zimmerman, 1986)

If the price of new stocks is fairly determined, that is the price affected by governing realities and proportional with future years profitability considering confidence extent to above profits, investors direct their capital with more

confidence stock market (Gerkez ,2011). In accounting science field, the first academic study by (Ball and Brown ,1968) have been done to investigate the information content of accounting earnings to investigate the relationship between extraordinary returns and the unusual profits of companies' stocks. Numerous studies show that firms that are more profitable, investors focus them more and therefore the price will be higher. This high price will increase the rate of stock return. In efficient markets with strong form, securities are properly priced and reflect all relevant and available information in market including secret information and public data. It is assumed that all of the information are available to investors free of charge and without restriction. If there is such information, who has access to this information can use it to predict stock price and unusual returns. In fact, in order that a group achieve excess sustainability it should constantly have confidential information or the ability to obtain sustained unusual returns based on public information than other investors. (Rai and Talangi, 2009)

Effective factors on unusual returns, including:

1 - Disasters and political conditions (Vadii and Hosseini, 2011)
2 - Mental conditions and market handlers' existence (Vadii and Hosseini, 2011)
3 - The lack of accuracy in forecasting earnings per stock (Khani, 2006)
4 - Portfolios constructed based on public information (Mashayekhi , 2010)
5 - Firm Risk
6 – Non- accounting Information
7 - Information Symmetry
9 – Companies' financial data (Kusha, 2010)
10 - Cash payments (Young and Kim, 2009)
11 - Accounting variables (Bahramfar and Shams Alam, 2004)
12 - Income forecasting error (Meshki and Rabbani, 2010)
13 - The information content of earnings (Rezayi and Salmani, 2012)

Factors that affect stock's unusual incomes identification including:

1 – Collecting internal resources (Jensen Webster ,2009)
2 - Industry concentration (Jensen Webster ,2009)
3 - Market share (Evans, 2001)
4 - Type of Evans' industry (Evans, 2001)
5 - Cash and accrual components of earnings (Babe and Alhamavi ,2009)

Factors that may lead to extraordinary returns reduction and unusual benefit are as below:

Increasing the transparency and quality of reported financial information by companies reduce the information asymmetry and having potential information and reduce obtaining stock unusual returns (Haqiqat,2011). Unusual returns that are made by risk are durable, but unusual returns that are result of investor's wrong pricing don't have stability (Mashayekh, 2010). (Porter ,2004) states that: Competition in industry leads that industry's unusual income towards zero, this means that much less competition in industry, the less the degree of unusual income persistence will be in industry. So the interest rates higher than the base interest rate (in competition condition) irritates entering new capital into industry. If most investors are aware of companies' financial information effect on unusual income, unusual return of market capital will be reduced somewhat and therefore market efficiency will be increased. (Kusha, 2010).

Increasing accruals included in current incomes, unusual future incomes will be increased. And increasing cash flows included in current incomes, unusual future incomes will be reduced (Abbas Zadeh, 2011). Hemmati (2011) showed in his study that increasing company's intellectual capital will reduce its unusual return.anumber of investors have calculated the expected rate of return using a number of financial ratios, that due to lack of knowledge of investors, this information is not reflected in actual price of stock and causes excess returns for investors who are aware of this relationship. Therefore, if most investors are aware of this relationship, unusual returns in stock market will be reduced and therefore market efficiency will be increased (Falah Shams and Kusha ,2010)

Information asymmetries role creating unusual returns:

Information from the financial statements of companies have information content and if the companies have smaller size, their financial statements have more information content (Vadii and Hosseini, 2011). Information asymmetries in capital markets, increase investors' risk and shareholders and a major part of the information asymmetry is potential information. Holders of potential information can have return more than ordinary stock return

and obtaining unusual return will be possible when there is not clear and accurate information on companies' performance. Ambiguity and uncertainty of information leads to unusual returns (Haqiqat, 2011).

The more uncertainty on future is, the greater will be informed investors' information advantage over un-informed ones and other conditions and factors' stability and supplies that are exposed to information asymmetry will have more unusual short-term return (Gerkez, 20011).

Different ways of measuring stock unusual returns:

. Unusual returns: Company's stock return in year minus the average of companies' total stock return in that year.
. Unusual return: The difference between actual returns and expected returns (Meshki and Rabbani, 2010)
(Ghaemi et al .,2011) have introduced three methods for measuring unusual returns:

Adjusted average return: this quantity is obtained by subtracting the average return of stock over the estimation period from actual stock return during event period

Market adjusted return: the unusual returns subtracting market return from stock return during event period
Market model prediction error: unusual return is obtained from subtracting actual return of stock during event period with predicted return (based on market model)

Jensen and Webster in(2009) express two perspectives of compromise with industry and the company's **return associated with making unusual returns:** the results of these views are as below:

The first perspective is that: Industry focusing creates conditions that result in compromise and making unusual incomes. Market concentration and unusual incomes can be byproducts of extremely stable return rather than abusing of market power.

Another perspective is the perspective of company' efficiency that explains: unusual incomes are not results of market concentration. The major difference between the two theories is that when return incomes are results of firm size. The existence of compromise incomes is not related to company size.

Companies that try to create unusual returns in uncertainty conditions use the entry barriers for competitors to enter the market to achieve their goals. (Smith ,1776) states that when there are few sellers in the market competitive prices are smaller and more prices are compromise prices. Such barriers are related to government laws and allowing.

CONCULSION

The aim of this study is to examine the impact of unusual incomes and unusual earnings of stock in capital market and factors affecting these two variables reduction. On time identification of unusual incomes and unusual return result to on time control and reduction of their negative effect in market. When information exist asymmetrically in capital market, this asymmetry of information cause incorrect decision making of information users. Published information on income and stock returns help investors to select stocks and maintenance. However if this income and return that are in shareholders authority, are formed unrealistically, can confuse shareholders and transactions reduction and rising added costs. When there is transparency of information, market moves to effectiveness, in that case unusual are reduced and result in transactions growth and market strength.

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