

The effects of good and bad news on the conservatism and timely identification of profits and losses in Tehran Stock Exchange

Narges Ziaghomi

Department of Accounting , Ahvaze Branch , payam noor University , Iran

Corresponding author: Narges Ziaghomi

ABSTRACT: The present study examines the effects of good and bad news on the conservatism and timely identification of profits and losses. Research hypotheses have been tested using correlation coefficients analysis and regression modeling. The first research hypothesis empirically tests the difference between profit and loss timeliness and the second hypothesis empirically tests the difference of market's reaction to the good and bad news. To measure timeliness and conservatism efficiency coefficient and coefficient of the dummy variable multiplied by the linear regression model introducing equation of profits / returns are used. The research population was listed companies in Tehran Stock Exchange using knockout sampling method, 228 companies were selected during the period 2002 to 2009 as the research sample. Experimental tests results indicate a significant and positive relationship between good and bad news and conservatism and timeliness of profits and losses. In addition, the results show that according to our forecast, profits have more extreme reactions than return.

Keywords: Good news, bad news, conservatism, timeliness (being timed).

INTRODUCTION

Decision making is an issue that plays an important role all affairs of human life. Today, one of the factors affecting the decision is achieving relevant news and information timely and in appropriate time. Economic and financial issue is one thing that is strongly influenced by the flow. Almost all external users are trying to predict earnings in a future period by using reported financial information. Thus, investors use financial information to fulfill their expected returns. In this study, the effects of the news on the market for some quality attributes of earnings such as conservatism and timeliness are considered to understand its relationship with decision making and thus with attracting investment and financing resources more tangibly.

Research background

Accounting profit is the most important figure calculated by accounting information system and because of this, most of empirical research in the areas of capital markets (financial empirical research) has been contributed to it. Accounting profit is important in two respects: One aspect of having a load of information to support decision making of people such as shareholders and the other, from the aspect of evaluation, in order to do something such as a contract between the groups associated with the company. Only it is possible because of the conditions governing on its accounting environment, severity and frequency of use compared to another use will be more or less. But what is common to both areas in third world countries, is non efficient capital markets. The application of accounting profits for the investigation and evaluation has been started in Iran and the second area (Kani, 2002).

Basu's (1997) interpreted conservatism as a result of reflecting bad news more quickly than good news in profit. This interpretation suggests a systematic difference between good and bad news from two aspects (timeliness) and (stability) in profits. Basu used the stock returns, to measure news, because the annual return on equity carry of the news throughout the year. This interpretation of conservatism affects the relationship between profits / returns. Using

a measure named the time asymmetry of the profit, Basu concluded that profit response to bad news (negative stock returns) is more timely than profit response to good news (positive stock returns).

Francis (2002) investigated the influence of seven qualitative benefits, including accruals quality, earnings persistence, earnings predictability, uniformity in profit, relating profit to equity, earnings timeliness and earnings conservatism on the cost of common stock capital.

Their findings confirmed that the timeliness of earnings on the capital cost of ordinary shares has a significant impact.

Bix and colleagues (2004) considered conservatism and timeliness of earnings as accounting earnings quality standards in a study entitled "the link between earnings timeliness, earnings conservatism and board composition". Using examples from England and using the time asymmetry model of the profit proposed by Basu (1997) concluded that Status of board members is an important factor in determining the quality of earnings reported by English companies.

Kurdestani and Majd (2007) studied five qualitative benefits including profit stability, profit predictability, relating profit to equity, profit timeliness and conservatism with costs of common stocks in a research entitled "studying the relationship between profit qualitative features and costs of common stocks". Research findings indicate the effect of the profit qualitative features on the common stock's cost.

Research hypotheses

1 - Profits significantly are timelier than losses.

2 - Market indicates a more severe reaction to the bad news than good news.

Research realm

The time realm of research, from 2002 to 2009

The place realm of research, the listed companies in Tehran Stock Exchange

Thematic realm of the present study was to investigate the influence of good and bad news on conservatism and timeliness of identifying gains and losses in the Tehran Stock Exchange.

MATERIALS AND METHODS

The research is empirical research. The research sample consisted companies accepted from 2002 in Tehran Stock Exchange, that are not among investment firms and their financial year ends 29 Esfand. After applying the requirements, 228 companies were selected as population.

In this study, after collecting the required data, in the form of some conceptual models that are presented in the following, we will estimate the models and according to them we will test the hypotheses and answer the research questions. In this study Spearman and Pearson correlation tests were used.

In this model:

X_t = profit (loss) per share for period t

P_{t-1} = price per share in period $t-1$

R_{it} = return within 12 months, this period starts from the end of fiscal year $t-1$ and includes sharing profits.

ϵ_{it} = normal distribution error with zero mean and constant variance.

In above model β_1 , β_2 and α , are y -intercept and regression model slope coefficients that are obtained in fulfilling the model.

In this model:

α , β_1 , β_2 , β_3 are intercept and regression models slope coefficients that are obtained by fulfilling the model. R_{it} is the stock return and Dum is dummy variable that indicates bad news and when return value is negative, it is 1 and in the other cases it is zero.

The population

The population consists of persons or objects that have at least one common trait. A common trait in this study is all listed companies in Tehran Stock Exchange for the period from 1381 to 1388 that has the following features:

- Their fiscal year end is March 29.
- They shouldn't be among investment, insurance firms and banks.

All the required information during the course of the investigation, should be available.

RESULTS AND DISCUSSION

Correlation Analysis

Pearson correlation test results show that in 2002 to 2009, (Respectively, with correlation coefficients of 0.269, 0.336, 0.410, 0.492, 0.184, 0.412 and 0.256), there is a significant correlation between dividends and stock returns at 1% level. There is significant correlation in 2002 (0.186) at the 5% level between dividends and stock return. In the total sample, also a correlation coefficient between dividends and stock returns (0.281) is significant at the 1% level.

Spearman rank correlation test results show that there is a significant correlation between dividends and stock returns are 1% level between 2002 and 2009 (respectively, with correlation coefficients of 0.218, 0.324, 0.482, 0.534, 0.600, 0.345, 0.503 and 0.453),. In the total sample, the correlation coefficient between dividends and stock returns (0.407) is significant at the 1% level.

In the first research hypothesis it is predicted that earnings reactivity coefficients are significantly greater than loss of reactivity coefficients. In fact it is expected that return coefficient in model (1-3) for the profitable companies is more than unprofitable companies.

Table (1). The estimation results of model (1-3) in a combined form

Subjects	Unprofitable companies	Profitable companies	variables
***130/0 (000/0)	***195/0- (000/0)	***159/0 (000/0)	Intercept
***082/0 (000/0)	**056/0- (016/0)	***090/0 (000/0)	Efficiency
	***147/0 (000/0)		Significance tests for differences in coefficients
%397/8	%209/5	%887/13	The coefficient of determination
***162/141 (000/0)	**879/5 (017/0)	***449/225 (000/0)	Fisher's exact test (significance)
***932/7 (000/0)	723/0 (653/0)	***339/17 (000/0)	Bound F test results
996/0 (318/0)	----	318/0 (573/0)	Hausman test results
Random effects	simple combined data	Random effects	Assessment Type

In unprofitable companies, lack of significance of Limer statistics (0.723) indicates that the model must be estimated using combined data approach. The results of estimating model (1-3) by this approach show that in unprofitable companies, intercept (-0.195) and earnings reactivity coefficients (R) (-0.056) respectively at the 1% and at 5% level are significant. Also, the results show that stock returns, account for around 5% of the dividend changes.

Significance of Fisher statistics (5.879) is also significant at 5% level. This means the total significance of the model. Generally results show that profitable companies' reactivity coefficient (0.090) significantly (0.147) at 1% level is greater than earnings reactivity coefficient of unprofitable companies (-0.056). This shows that the first hypothesis is not rejected.

In all of sample companies, the significance of Limer statistics (7.932) at the 1% level and not significant Hausman statistic (0.996) indicates that the model should be estimated with a random effects approach. The estimation results of model (1-3) with the mentioned approach show that in total sample, intercept (0.130) and the earnings reactivity coefficient (R) (0.082) are significant at the 1% level. The results also show that the stock return can explain about 8% of dividend changes. Fisher statistic significance is (141.162) and it is significant at the 1% level. This means the overall significance of the model.

2-4 results of estimating model (2-3)

To test the second hypothesis, the model (2.3) is estimated in combined basis and annually. The results of estimating model (2-3) are presented annually in the table (2). The results show that only in 2002 (0.172), 2005 (0.162) and 2008 (0.316), respectively, at 10%, 5% and 1% β_3 coefficient is significantly positive and only in these three years, the second hypothesis is not rejected. In other years, β_3 coefficient is not significant, and there is no significant difference from zero. The Fisher statistic is significant in all years of the study and it shows that the estimated model is significant in all years.

Table (2). results of estimating model (2-3) annually

Fisher statistics(significance)	The coefficient of determination	Coefficient(significance)	coefficient	years
*538/2 (059/0)	%741/4	*172/0 (078/0)		2002
***781/7 (000/0)	%950/11	051/0 (322/0)		2003
***258/9 (000/0)	%177/13	070/0 (273/0)		2004
***570/15 (000/0)	%339/18	**162/0 (039/0)		2005
***829/25 (000/0)	%431/27	165/0- (109/0)		2006
**412/3 (019/0)	%062/5	083/0 (282/0)		2007
***764/16 (000/0)	%756/20	***316/0 (002/0)		2008
***970/6 (000/0)	%256/9	073/0 (390/0)		2009

The results of estimating model (2-3) are presented using combined data in table (3). Limer statistical significance (8.022) at the 1% level and non-significance of Hausman statistics (4.080) shows that the model (4.3) should be estimated using combined data approach.

Table (3). The results of estimating model (2-3)

significance	T-student statistics	coefficient	variable
000/0	223/9	***170/0	Intercept
001/0	301/3-	***050/0-	
000/0	875/5	***051/0	
005/0	809/2	***124/0	
		%971/10	The coefficient of determination
	***178/63 (000/0)		Fisher's exact test (significance)
	***022/8 (000/0)		Bound F test results
	080/4 (253/0)		Hausman test results
	Random effects		Assessment Type

The results of estimating model (2-3) shows that the intercept (0.170), dummy variables (-0.050), efficiency (0.051) and the coefficient of the dummy variable multiplied by stock returns (0.124) are significant at the 1% level.

The significant positive coefficient of the variable Dum.R_it (0.124), indicates that the market reacts faster to bad news (than good news). This is consistent with the second hypothesis. The coefficient of determination model also shows that the explanatory variables explain about 11% of the profit changes. Fisher statistics significance (63.178) also represents the overall significance of the model.

CONCLUSION

Based on the theoretical research, according to the first hypothesis it is anticipated that the profits to be significantly timelier than the losses. To test the first hypothesis, the following model is used:

The results of estimating model using random effects approach show that intercept and earnings reactivity coefficients (R) are significant at the 1% level and thus the first hypothesis is confirmed. The results of this research are consistent with results of a research conducted by Irnia Jane Drayovsky and Stewart (2005).

Based on the research theoretical basis, according to second hypothesis it is anticipated that, the market reacts more strongly to bad news than good news. To test this hypothesis, the following model is used:

The results of estimating model using combined data approach show that dummy variable coefficient multiplied by yields is positive and significant which shows that the market reacts to bad news more quickly and this means that the second hypothesis is confirmed. The results of this study are consistent with the results of research conducted by Khaleghi Moghaddam and Khan Beigi (2009), and are inconsistent with the results of research conducted by Jane Drayovsky and Stewart (2005).

REFERENCES

- Basu S. 1997. the conservatism principle and the asymmetric timeliness of earnings, *Journal of Accounting and Economics*: 24,337
- Beaver W and Ryan S. 2000. Biases and Lags in Book Value and Their Effects on the bility of the Book-to-Market Ratio to Oredict Book Return on Eqyity, *Journal of Accounting Research*,38(1): 127-148, 2000
- Financial Accounting Standard Boared (FASB). 1980. Qualitative Characteristics of Accounting Information, Statement of Financial Accounting Concepts No. 2., Stamford, CT : FASB.
- Francis, LaFond R. 2004. Cost of Equity and Earnings Attributes", *Accounting Review*
- Watts RL. 2003. Conservatism in Accounting PartI: Explanations and Implications. *Accounting Horisons*Vol 17: 207