**Evaluation the principal components of accounting and its impact on the stock returns of listed companies in Tehran Stock Exchange**

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**Abstract:** In this study, the principal components of accounting and its impact on the stock returns of listed companies in Tehran Stock Exchange was investigated for a 5 year period from 2006-2010. The main basis for analysis in this research is relationship between accounting and stock returns. In this study, indicators to assess operating management, investment management and financial management that affect stock returns are examined. In the hypotheses testing of this study, a panel least squares regression models were used that examines the relationship between financial ratios and stock returns simultaneously. Results show that stock returns only have positive and significant relationship with asset turnover ratio which is an indicator of performance evaluation of operating management. The results also indicate that the operational performance of the company stock returns would increase business opportunities and also enhance the company's ability to earn income through sales. The results of this study can help managers select and implement trade policy and economic policy can be helpful as well potential of shareholders of the results of this study may have order to identify the value of shares stimulus.

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**1. Introduction**

One of the main purposes of accounting information is to assist users in predicting the future cash inflow entity and consequently to predict investment returns. Some of the variables that affect the stock return in the stock market are due to the financial information provided by the accounting system. Economic environment includes all factors affecting users, accounting system and capital markets. In this environment, all components communicate and interact with each other. One of the advantages of knowing the economic environment is identifying potential users of accounting information and prioritizing their needs. Due to market as part of the economic environment, including any kind of taste, so it can be an indicator of the amount of demand for the information. This issue caused a great deal of research in relation to the market forces which have various affects on it.

Findings of this research can be used for managers and investors. As these findings for managers can more accurately increases strengths and identify weaknesses of the company under the leadership (assessment task management stewardship). Because the managers of the company's policies and goals to achieve profit and growth expectations are set, the finding of the present study enhances their ability to make more accurate decisions. In addition, these results will help for understanding the main component that has affect on stockholders' equity account. They also participate in evaluating current performance and predict future performance and help whether it remains stationary or seeks to revise company policies. Investors also are able to use these results to identify factors affecting stock returns.

**Literature review:**

In each country, the structure of capital markets has great influence on the ability of managers to affect on the stock price. According to Fama point of view (1970), in an efficient capital market, stock prices fully reflect all information is available in various securities. From the perspective of Hand (1990), Efficient Capital Market Hypothesis is based on the premise that investors have the ability to have enough information in published reports and charts to analyze accounting and accounting through accounting data to actual cash flows realized.Based onTinic perspective (1990), based on the efficient capital market hypothesis, stock prices reflect information from the financial statements of accounting.But this is true only when these financial statements include information regarding unforeseen changes in future cash flows and the company's dividend distribution and it is also a source of information other than financial statements mentioned in the market. Then Foster (1986) and Kothari (2001) stated that despite the empirical evidence on the efficient capital market hypothesis, this theory has widespread acceptance in the world. Another hypothesis in this context is a mechanical theory of efficient capital markets hypothesis is in line. This hypothesis is based on the capital markets; interest has focused on the report. In other words, the market price of shares of a single company, according to a company's profit is measured and the slightest attention to the accounting methods used in calculating the profits. According to Watts and Zimmerman view (1986), an approach that is similar to the mechanical theory, behavioral theory is stable. Based on this approach, investors lacked sufficient ability to understand the actual cash flows of the company's financial data are reported. The hypothesis is that the difference between mechanical and behavioral stability, stability of investment behavior theory to the non-expert investors and professional investors divides, while Tinic (1990) say that in both hypotheses, using different accounting methods have a different impact on stock prices are the actual cash flows of the company, have the same effect. Then through Belkoui perspective (1992), the behavioral consistency hypothesis assumes that a sufficient number of investors capable of understanding the nature of accounting methods not only survived due to the profit and loss (Belkoui, 1992).

A number of empirical studies have shown that the market is able to recognize that you really choose a method of accounting with monetary consequences or not? For example, the view of Dhaliwal (1986), using evidence relating to pension liabilities due to market can be predicted, even before the financial debts if there are (Dhaliwal, 1986). In addition, based on views of Dukes (1976), Lev and Sougiannis (1996) Aboody and Lev (1998), the market capitalization of research and development expenditure, the nature of the assets. Although, it's possible that company decide to take these costs as an expense in the financial statements. Select the purchase method and the unity of interests in discussions on mergers and acquisitions of companies has been noticeable. Market behavior and stability of a company purchase method is used to merge the company, the market reaction shows negative goodwill amortization. Study authors such as Hong et al., (1978), Davis (1990), Rau and Vermaelen (1998) show that market behavior is not stable and only if the profit and loss figure does not care. On the other hand, some studies findings are not inconsistent with the hypothesis that behavioral stability. Jennings et al (1996) and Vincent (1997) have noted that the ratio of benefit to cost (P/E) less than the purchase method of interest is unity. Andrade (1999) in their study a significant relationship between abnormal returns and changes in the revenue realized that the choice between the methods and composition of the company of study is attributable to the size of this limited communication. Hand (1990) also presented a new theory of behavioral consistency based on the assumption that market stability behavior of sophisticated investors and in fact, when non-expert investors are doing stock market pricing behavior is similar to that market stability. He also uses the theory of information, stock returns of companies that had adopted a policy of substituting capital debt test. The statistical results obtained were consistent with the theory (Hand, 1990).

Harris and Olson (1990) found evidence that stock returns are based on the evidence; a sample of companies in the oil and gas industry companies is closely linked to its book value. In addition, the study showed that the market can reasonably successful efforts method and the full costing of oil and gas companies in exploration expenditures are used to distinguish. The next dissertation research conducted by two researchers on the subject have stated that the relationship observed between the book value and book value of equity or stability can be attributed to investment behavior or not? During the study they did about attributing this relationship stable investment behavior on the book value of the evidence to obtain. They concluded that the carrying value may not be essential for investors but a stabilizing factor in the behavior of investors in the market due to lack of experience and lack of information was expressed. Gupta and King, 1997; Waller et al., 1999; Chen and Schoderbek, 2000 opinion is that when market participants to gain enough experience to get relevant information only on the number of reported earnings by business unit will focus.

Empirical research suggests that yet the behavior of participants in the market, when stock prices are based on accounting data to predict their personality that are stable behavior. Hopkins, 1996; Hirst and Hopkins, 1998; Hopkins et al., 2000 even in the capital market analysts who have experience and sufficient data are assumed to be the rule not the exception. Shields and Bit of perspective and colleagues (1994), although the number of reported earnings to shareholders behavioral stability and the effect on the market price of the shares is the incentive for companies to select specific accounting methods, does not provide. Luft (2001) conducted a trial on the issue of whether people are spending on intangible, emphasis on capital expenditures or turn them off as the cost of people think. Beattie et al, 1994 although the number of reported earnings to shareholders behavioral stability and the effect on the market price of the shares is the incentive for companies to select specific accounting methods, does not provide. However causes administrators to realize that financial reporting has an impact on stock price.

Mayer-Sommer, 1979; O’Keefe and Soloman, 1985 were of the opinion that managers are not fully convinced that due to the efficiency of capital markets. Kothari (2001) stated that, although the empirical evidence does not provide a convincing about the market is not efficient, but there is a strong evidence show that managers behave as though the market is focused on earnings reports. For example, the choice between the purchase method and the interests of unity, the stock market prefers to use the benefits of the union, because the union benefits have a positive effect method will result in a positive effect on income is stock prices. The pricing for education, corporate and union interests affected by the choice of procurement method is. Empirical evidence shows the benefit of techniques used in Alliance; study participants are paying more money for education.

Based on Nathan, 1988; Robinson and Shane, 1990; Lys and Vincent, 1995; Ayers et al., 1999 view, when the directors believe that the financial markets are focused, more interest earnings management the use of appropriate accounting methods.

Beattie et al, 1994; Leuz, 2003 expressed the view that based on the use of earnings management by a company, influenced by the characteristics of the business environment in the country where the company operates. In countries with developed capital markets, the corporate structure of a distributed (decentralized), this powerful law firms, investors and power laws tend to reduce the policies of the earnings management. Jun, Sang et al, 2002 study examines the relationship between liquidity and stock returns. In this study, the relationship between liquidity and stock returns using time series analysis were examined. Results indicate a significant positive relationship between stock returns and liquidity ratios.

Bartholdy (2002) study showed that financial ratios such as price to earnings, book value and market value are included in the prediction of stock returns. Lam (2002) to explain stock returns in Hong Kong from a multivariate regression model was used. He concluded that the expected positive relationship between stock return and market value of the company, also found that the ratio of book value to market value is high power to explain average returns. The relationship between the ratio of book value to market value and return on equity was negative.

Dimitropoulos and Asteriou (2009) in a study entitled "Communication with the financial statements and their impact on stock prices," a survey of 101 companies listed in the Athens Stock Exchange and the effect of a 10-year period at the same time accruals, earnings per share and a special six-ratio as an indicator of stock price manipulation in the financial statements were reviewed.

Namazi et al., study (2006) in examining the relationship between financial ratios and stock returns accepted companies in Tehran Stock Exchange Using the information needed for the period 1999-2003 was performed. To verify the hypothesis, research, and cross-time data integration method is used. The results of the review of all companies and industries, a separate survey indicated that it was of all the financial ratios and stock returns, there is a significant relationship. Thus, all hypotheses were confirmed in the study.

Karami et al., study (2009) showed analysis of the role of financial ratios in explaining stock returns, using information from listed companies in Tehran Stock Exchange during 2000-2006 has been carried out. In this study, four groups of twelve financial ratios, liquidity ratios, leverage, activity and profitability have been studied. The hypothesis of this study, we used a multivariate regression model that simultaneously examines the relationship between financial ratios and stock returns. The results of this study indicate that the current ratio, debt to you, return on equity and profit to sales, there is a positive relation with stock returns. Based on the findings, these financial ratios small percentage of the variation in stock returns, the figure turns.

Salehnejad et al. research (2009) showed the effect of the rate of return on assets and return on equity and leverage Tehran Stock Exchange listed companies by enhancing the financial information for the period 1999-2004, 97 participants performed a cross-sectional accepted. However, the hypothesis of multivariate regression models and model delay variations in global surface and separate companies in different industries are test. Results of hypotheses testing show that the overall level of participation ratios for ROE and ROA is effective on the stock price. But no significant effect of financial leverage is reported.

IbrahimI and Saidi Research (2010), in examining the impact of accounting variables and firm characteristics on stock prices of companies listed in Tehran Stock Exchange Using data from 92 companies for the period 2001-2007. Accounting variables examined included the book value per share, return on assets, asset turnover, and operating cash flow per share and earnings per share. Firm characteristics examined include prior period stock price, size and duration of the activity. The maximum likelihood estimation method for panel data with random effects and hierarchical method is used. The results show that the three variables between stock price and earnings per share return on assets and stock price of the previous period, there is a direct relationship and variables and operating cash flow per share, for the company and asset turnover ratios do not influence the stock price, but the company's stock price and size are inversely.

**Research Questions**

Research on factors that increase the value of a business unit and its aftermath led to an increase in shareholder wealth to be focused. Also in this study, particularly on the financial statement items that have an impact on the stock value of a business unit is focused. The main research questions are:

1. Do investors pay attention to the equity when they want to evaluate an entity's accounting data or not?
2. Which policies and strategies relating to the operations, working capital management and business units affect?

**Research Hypotheses**

According to the research objectives, theoretical foundations, the research hypotheses are stated as follows:

1. There is a significant relationship between indicators to assess the operational management policies (rate of return on sales, asset turnover rate of return on assets, financial leverage, and return on equity, profit margin before interest and taxes and depreciation) and the rate of return on equity.
2. There is a significant relationship between the evaluation criteria of investment management (working capital turnover ratio, turnover ratio Inventories) and stock return.
3. There is a significant relationship between indicators of financial management assessment (current ratio) and stock return.

**Research Variables**

**Operational Management**

An indicator to assess the operational management includes the following ratios:

* Rate of return on sales (ROS): The correlation between the relative profitability of the company's operational activities, particularly the company's ability to obtain any footage shows mechanisms of benefit.
* Asset turnover (AT): This ratio shows how efficiently a company, has applied to increase the sale of their assets. This ratio indicates whether a company is particularly concerned with the achievement of the sales, the investment is too much or not?
* Rate of return on assets (ROA): This ratio indicates a company's ability to make investments that RLS has a few rials. This ratio can be obtained from the multiplication of two high proportion (ROA=ROS×AT).
* Financial leverage (FL): This ratio indicates that the company's assets through multiple IRR of the investment are achieved.
* Rate of return on equity (ROE): This ratio indicates a company's profitability in the use of resources invested by the shareholders. This ratio multiplied by financial leverage and ROA is achieved (ROE=ROA×FL).
* The proportion of profit margin before interest and taxes and depreciation (EBITDM): This ratio is an indicator of the operating performance of the Company divided by earnings before interest, tax and amortization expense on sales achieved.

**Investment Management**

Investment management can be evaluated through the following ratios:

* Working capital turnover ratio (OWCT): This ratio indicates that for every one riyal capital selling some IRR is achieved.
* Inventories turnover ratio (IT): This ratio shows how much a company has used its working capital.

**Financial Management**

Financial management by the current ratio (CR) is measured. The odds ratio for assessing the company's liquidity and ability to repay current liabilities provides. It is assumed that the magnitude of this ratio indicates that the probability is low that the company is facing liquidity problems.

|  |  |  |
| --- | --- | --- |
| Variable | Symbol | Calculation method |
| Rate of return on sales | ROS | rate of return on sales= net profit / total sales |
| Current Ratio | CR | Current Ratio= Current Assets / Current Liabilities |
| Asset turnover ratio | AT | total asset turnover ratio=total Sales/ total assets |
| Financial Leverage | FL | financial leverage= total assets/equity |
| Ratio of EBIT margin before interest, tax and amortization | EBITDM | EBITDM= EBIT Earnings before interest, tax and amortization/total sales |
| Working capital turnover ratio | OWCT | ratio of capital= total sales/ Working capital (current liabilities - Current Assets) |
| Inventory turnover ratio | IT | Inventory turnover ratio= cost of goods sold/ Total inventory |
| The ratio of market value to book value of equity (growth control variable firm) | MV/BV | MV/BV= value of equity / value of shares |

**Research limitations**

To select a sample survey, the following were considered:

1. The financial year end is 29 Esfand (20 March).
2. Companies in the period 2006-2010 have consistently exchange activities.
3. There is full information of companies.
4. Insurance companies, investment banks.
5. Companies with at least one financial year, ending March 2006-2010.
6. Companies that have reported an operating loss

To test the hypothesis model (1) is explained:

**Model (1)**

Use the following model to examine stock returns with respect to the independent variables we anticipated.

SRi,t = b0 + b1 ROSi,t + b2 CURRENT RATIOi,t + b3 ASSET TURNOVERi,t + b4 FINANCIAL LEVERAGEi,t

+ b5 OPERATING WORKINGi,t + b6 INVENTORY TURNOVERi,t + b7 EBITDA MARGINi,t +b8

MV/BVi,t + ei,t

Stock returns (SR) is the dependent variable, the model is calculated.

SRt = (Pt + Dt –Pt-1) / Pt-1

In this equation, SRt is daily stock returns and Pt is stock price on the last trading day and Pt-1 is stock price on the day before and Dt is Dividend payments last year.

**Research Methodology**

The models using statistical data are divided into three groups.Some models use the "time series" or in other words a relatively long period of several years can be estimated. Other models based on "data point" to estimate the variables in a given time period, say a week, a month or a year in the different units are examined. A third model, which is also used in this research, estimations based on "panel data". In this way, a series of cross-sectional units (eg firms) are considered in the past few years. Given that the merged observations lead to greater volatility, less among the explanatory variables, more degrees of freedom to estimate the total efficiency is higher, relative to panel studies and time-series cross-sectional studies have the advantage (Baltaji, 1995).

Financial Ratios data firms in Tehran Stock Exchange for the financial statement that is accessible through the application of innovative outcomes, has been achieved. Companies' stock prices to calculate stock returns are obtained from the site of the Tehran Stock Exchange. The collected data into Excel Software page range and preliminary calculations, the variables in this application has been made. After calculating variables for final analysis Eviews software is used. Also suitable for examining the statistical methods employed and better Hausman test and F bound.

F test of the hypothesis to be bound by the following expression:



In this test the hypothesis H0 against the hypothesis H1 be the same width, the origin of the difference is placed across the origin. If the hypothesis H0 is accepted, the least-squares method is commonly used, but if you reject the hypothesis H0 is accepted using panel data and panel data methods can be used to intercept effects. In order to determine the type of intercept (fixed or random) Hausman test is used. Hausman test of the null hypothesis would be as follows:



In this test the hypothesis H0 against the hypothesis H1 be the same width, the origin of the difference is placed across the origin. If the hypothesis H0 is accepted and commonly used method of least squares, but if you reject the hypothesis H0 is accepted using a panel data and can be used to intercept effects panel data approach. In order to determine the type of intercept (fixed or random) Hausman test is used. Hausman test of the hypothesis would be as follows:



If accepted, H1 (reject H0) method fixed effects as well as the inclusion H0 (reject H1), we use the fixed effects method.

In model (1) to the problem of correlation between the independent variables, two independent variables of the model have been removed, the rate of return on assets (ROA) and return on equity (ROE). Table (b) shows the descriptive statistics for the study variables.

Tehran Stock Exchange of spatial realms and territory, 2006-2010. The study population included 126 companies in Tehran Stock Exchange and the sample are companies that are chosen as follows:

|  |  |
| --- | --- |
| Description | No. |
| All listed companies are traded on the Stock Exchange since 85 to 89 have been evaluated | 393 |
| Deduction: Companies are dismissed or accepted from 85 years and after | (118) |
| Companies that have been active since 2006-2010 in stock | 275 |
| Deduction: insurance companies, investment banks | (31) |
| Companies that have been active since 2006-2010 in stock, after deducting insurance companies, investment banks | 244 |
| Deduction: Companies that at least one financial year, from 85 to 89 to the end of March | (54) |
| Deduction: Companies that have reported an operating loss | (64) |
| Number of statistical sample | 126 |

**Research Findings**

To examine the hypothesis that examines the relationship between stock returns and accounting rates of pay, the model (1) using a least squares regression is a test panel. For this purpose, the F test is used to bind the results in Table (a) is shown.

**F Bound Test**

Table (a)

|  |
| --- |
| F Bound Test |
| Test | Statistics | Statistics value | *df* | P value | Data Type |
| Chow | F | 1.483833 | 125494 | 0.002 | Panels with the effects of the intercept |

According to the p-value, assuming H0 is rejected at the 95% significance level, assuming H1, ie the intercept difference is accepted.

**Hausman Test**

To determine the effects of the intercept of the Hausman test is used to test the results in Table (b) is shown.

Table (B)

|  |
| --- |
| Hausman Test |
| Test | Statistics | Statistics value | *df* | P value | Type of effects of intercept |
| Hausman | Chi-Sq | 69.122 | 10 | 0.000 | Fixed effects intercept |

According to the p-value, assuming H0 is rejected at the 95% level and the assumption H1, the fixed intercept will be accepted.

According to bind F-test and Hausman, panel data regression with fixed effects, intercept, model, least squares in Table panel (c) is presented.

**Least square test**

Table (c)

* The estimated model (1) using ordinary least squares panel model with fixed effects for intercept

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Evaluation Index | Variable | Type of Relationship | Significant | Accept or reject the hypothesis |
| Operating Management | ROS | Reverse | Non-significant | Reject |
| ASSETTURNOVER | Direct | significant | Accept |
| EBIT DAMARGIN | Direct | Non-significant | Reject |
| FINANCIALLEVERAGE | Direct | Non-significant | Reject |
| Investment Management | OPERATINGWORKING | Reverse | Non-significant | Reject |
| NVENT ORYTURNOEF | Reverse | Non-significant | Reject |
| Financial Management | CURRENTRATIO | Reverse | Non-significant | Reject |

**Conclusion:**

In this study, the relationship between stock returns of listed companies in Tehran Stock Exchange and variables defined in the course of the financial information of the Company from 2006-2010 was analyzed.

Table (d)

|  |
| --- |
| Dependent variable |
| Independent variable | Coefficient | t-statistics | P\_Value | Relationship |
| ROSS | -0.113 | -0.377434 | 0.7060 | Reverse |
| ASSETTUTNOVER | 0.619 | 2.852569 | 0.0045 | Direct |
| EBITDAMARGIN | 0.137 | 0.461294 | 0.6448 | Direct |
| FINANCIALLEVERAGE | 0.011 | 0.688855 | 0.4912 | Direct |
| OPERATINGWORKING | -0.000 | -0.430355 | 0.6671 | Reverse |
| INVENTORYT URN OVER | -0.008 | -0.506206 | 0.6129 | Reverse |
| CURRENTRATIO | -0.153 | -1.123192 | 0.2619 | Reverse |
| MVBV | -0.138 | -2.630168 | 0.0088 | Reverse |
| SIZE | 1.027 | 7.380763 | 0.0000 | Direct |
| TRADEVOL | 0.000 | 1.436824 | 0.1506 | Direct |
| C | -27.097 | -7.478505 | 0.0000 | Reverse |
| Modified R2 | 1.104081 |
| F-statistics | 1.541275 |
| P\_Value | 0.000486 |
| Durbin\_Watsonstatistics | 2.015248 |

Table (d) show that stock returns only asset turnover ratio is an indicator of the operational management, performance evaluation has a significant positive correlation. It seems that market participants (potential shareholders, analysts, etc.), in stock valuation firms and their investment decisions, according to the accounting information relating to operational management and that information as input data, decision models, are considered.

It should be noted that the results of this research can not always be expected and finding means that stock prices reflect information is not available on the Tehran Stock Exchange which is indicative of poor performance. Another question that arises and according to the authors of this article requires further research to examine the effects of behavioral finance, aboriginal and environmental Iran is on stock returns. The findings can guide managers in selecting and implementing appropriate policies to be useful. In addition, potential shareholders could also make benefit in the identification of the key drivers of shareholder value by their decisions.

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