

Research Article

**INVESTIGATING INFORMATIVE, CONSERVATIVE AND
CONDITIONAL ROLE OF CAPITAL STRUCTURE IN COMPETITIVE
ENVIRONMENT OF MARKET AND ITS EFFECT ON FINANCIAL
REPORTING QUALITY PROCESS IN TEHRAN STOCK EXCHANGE**

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ABSTRACT

On the one side, increased competitive pressures have been led to take conservative approaches in companies and on the other side; it has been caused to reduce expectations from future performance of business unit. At first, the research evaluates the relationship between competitive structures of products and conditional conservation and then the relationship between financing structures and conditional conservation. For this purpose, 93 companies were selected from 2006 to 2014. Basu's model (1997) was used to evaluate competition and financing effects on conditional conservation, financing and competitive structures. The results indicated that there is positive significant relationship between competitive structures of products and conditional conservation and financial reporting. Also, the companies are financed via long – term debts, do not reduce conditional conservation level, but the companies are financed via equity, reduce conditional conservation level in financial reporting.

Keywords: *Conditional Conservation, Financial Reporting Quality, Financing Structures*

INTRODUCTION

Accounting conservation can be defined as an accounting approach with a higher degree of approvability for identifying good news in comparison with bad news. According the researches of Basu (2005) and Beaver and Ryan (2005), conservation is classified into two categories: conditional and unconditional. Basu (1997) points out that approvability conservation is different from the recognition of incomes and costs which underestimates profit and assets. Other scientists (including Darrough & Stoughton, 1990; Darrough, 1993) stated that approvability conservation is one of the important factors to take conservative approaches against competitive threats and pressures. They believe that the companies operating in industry follow conservation in financial reporting to avoid entering new rivals and competing with existing competitors.

Research Background

Dhaliwat *et al.*, (2008) pointed out high competition in market improves special information flow between companies and beneficiaries, because one of the most important method used by users for evaluating of managers' performance is analytical tests. It means the comparison of provided information by company with average industry, competitors, budgets and previous information of company. Then more competition leads to more comparison with rival. Consequently, evaluation process becomes easy and with being easy of evaluation process, managers will be able less to hide bad news.

Ahmad *et al.*, (2002) showed that there is a negative relationship between increased debt and conservation, because conservation leads to reduce capital cost to debt. Hence more - competitive companies treat more conservatively to take accounting approaches.

Falsam (2009) indicated that unconditional conservation leads to reduce net value of reported assets, while conditional conservation causes to reduce expectation from future performance, because conditional conservation provides an improper image from business unit condition via identifying earlier bad news than good news. There is a positive relationship between low expectation from future performance and lower value of securities. Because in times of financial need, costs due to low expectations of future performance is worse, we expect that companies reduce their conditional conservation level in such

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situation, nevertheless, market's expectations from its future performance improve and they are financed with minimum capital cost.

MATERIALS AND METHODS

Research Method

From standpoint of methodology, the research is quasi-empirical and post – event research in the field of positive accounting researches based on actual information. Since the research can be used in information process, and then the research is an applied research. The statistical population is all industries groups operating in Tehran Stock Exchange from 2006 to 2014.

Research Hypotheses

1. There is a significant relationship between competitive structures and conservation of the companies listed on Tehran Stock Exchange.
2. There is a significant relationship between financing structures and conservation of the companies listed on Tehran Stock Exchange.

First Sub – Hypotheses

1. There is a positive significant relationship between product substitutability and conditional conservation in financial reporting.
2. There is a positive significant relationship between market size and conditional conservation in financial reporting.
3. There is a negative significant relationship between input costs (intensity of investment) and conditional conservation in financial reporting.
4. There is a negative significant relationship between intensity of industry centralization and conditional conservation in financial reporting.
5. There is a positive significant relationship the number of firms operating in an industry and conditional conservation in financial reporting.

Second Sub – Hypotheses

1. The companies are financed via long – term debt, reduce conditional conservation level in financial reporting to improve expectations from future performance.
2. The companies are financed via equity; reduce conditional conservation level in financial reporting to improve expectations from future performance.

Designing similar to Falsam's model (2009) and Karuna's model (2007), determinant factors are added to competitive structures of products and following model were used.

$$I - EARN = \alpha_0 + \beta_0 * I - DUM + \beta_1 * COMP_{it} + \beta_2 * I - CONTROLS_{it} + \beta_3 * (I - DUM_{it} * COMP_{it}) + \beta_4 * (I - DUM_{it} * I - CONTROLS_{it}) + \beta_5 * I - RET_{it} + \beta_6 * (I - RET_{it} * COMP_{it}) + \beta_7 * (I - RET_{it} * I - CONTROLS_{it}) + \beta_8 * (I - DUM_{it} * I - RET_{it}) + \beta_9 * (I - DUM_{it} * I - RET_{it} * COMP_{it}) + \beta_{10} * (I - DUM_{it} * I - RET_{it} * I - CONTROLS_{it}) + e$$

I letter indicates that the variables are in industry level. If β_9 is significant, there is a significant relationship between competitive structures of products and conditional conservation. It means that bad signs and news (negative return) are reflected timely than good and news in accounting return.

Relationship between Financing Structures and Conditional Conservation

Basu' model (1997) was used to measure conditional accounting conservation in the section. Also, financing structures were added to Basu' model to study the relationship between financing structures and accounting conditional conservation and following model was obtained:

$$EARN = \alpha_0 + \beta_0 * DUM + \beta_1 * FIN_{it} + \beta_2 * CONTROLS_{it} + \beta_3 * (DUM_{it} * FIN_{it}) + \beta_4 * (DUM_{it} * CONTROLS_{it}) + \beta_5 * RET_{it} + \beta_6 * (RET_{it} * FIN_{it}) + \beta_7 * (RET_{it} * CONTROLS_{it}) + \beta_8 * (DUM_{it} * RET_{it}) + \beta_9 * (DUM_{it} * RET_{it} * FIN_{it}) + \beta_{10} * (DUM_{it} * RET_{it} * CONTROLS_{it}) + e$$

If β_9 is significant, it is approved that there is a significant relationship between financing structures and conditional accounting conservation. Being positive of β_9 indicates that bad signs and news (negative

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return) are identified more when financing. If β_9 is negative, it means that bad signs and news are reflected less when financing in accounting income.

Empirical Results

Results of Testing Research Hypotheses

Results of testing the relationship between competition dimension and conditional conservation

As can be seen in following table, it is approved that there is conditional conservation in Tehran Stock Exchange at 95 per cent confidence level. According to Basu (1997), β_2 coefficient is 3.03 and significant. It means that profit (loss) responds to bad signs and news (negative returns) is stronger than good signs and news (positive returns). Watson – Durbin statistics is close to 2 (1.7). It indicates that there is not autocorrelation problem.

$$EARN_t = \alpha_0 + \beta_0 * DUM_{it} + \beta_1 * RET_{it} + \beta_2 * (DUM_{it} * RET_{it}) + \varepsilon$$

Significant level	t-statistics	Coefficient	Sign prediction
0.000	19.30	2.42	+/- Constant
0.50	-0.67	-4.63	+/- DUM
0.011	1.59	1.07	+ RET
0.030	2.16	3.30	+ DUM*RET
Adjusted determination coefficient			0.37
Watson – Durbin Statistic			1.7
f-statistics (ANOVA)			11.99***

Substitutability of Products and Conditional Conservation

There is a negative significant relationship between substitutability of products and conditional accounting conservation. This is against our expectation, because we predicted that there is a positive relationship between substitutability and conditional conservation.

Nevertheless, first hypothesis is rejected, because, if DIFF ratio is high, operating income will be more and consequently, this topic increases competition.

In addition to, there is a direct relationship between operating income and tax ratio and or company is received more attention behalf political authorities. Then there is a negative relationship between operating income and conditional accounting conservation. The finding is not compatible with findings of Falsam's research (2009).

Volume of Market Demand and Conditional Conservation

There is a positive significant relationship between volume of market demand and conditional accounting conservation (at 95% confidence level and coefficient 1.65). It means that if demand volume is more, market activities follow conditional accounting conservation to reduce competitors' potential motive for entering to competitive market. Then second hypothesis is supported. The finding is agreement with findings of KordLor and Shahryari (2010), Karuna (2008) and Falsam (2009).

Entry Obstacles (Investment Volume in Fixed Assets) and Conditional Conservation

There is a negative significant relationship between entry obstacles (investment volume in fixed assets) and conditional accounting conservation (at 95% confidence level and coefficient -1.89). Then third hypothesis is approved.

It means that the industries that need to less capital in fixes assets, increase conditional conservation in financial reporting to avoid entering new competitors.

The results are agreement with results of the researches done by Kordlor and Shahryari (2010), Raith (2003) and Falsam (2009).

Industry Centralization and Conditional Conservation

There is a negative relationship between industry centralization and conditional accounting conservation, but with weak possibility (at 90% confidence level, coefficient -1.86). The finding is similar to findings of Falsam (2009), Raith (2003) and Karuna (2008). Of course, the hypothesis had been accepted in before – mentioned researches at 95 % confidence level.

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Number of Active Companies in Market and Conditional Conservation

There is a positive significant relationship between number of active companies in market and conditional accounting conservation (with coefficient 1.25). It means that fifth hypothesis is supported (at 95% confidence level). The results are compatible with Shahryari's research (2010).

Testing Second Hypothesis

Mixed variable (I-COMP_SCOER) was used to measure competition in the model. As before identified, the coefficient of the variable is positive and significant (at 95% confidence level and coefficient 7.06) and consequently there is a positive significant relationship between competition and conditional accounting conservation. Then general hypothesis is supported. The finding is similar to finding of the researches done by Zmijewski (1979), Raith (2003), Karuna (2008) and Falsam (2009).

Relationship between Financing Structures and Conditional Conservation

Financing via Long – Term Debt and Conditional Conservation

Testing the model indicated that there is a reverse (not significant) relationship between financing via long – term debt and conditional conservation (coefficient -0.177). In another words, the business units that have been financed via long – term debt, have not reduced conditional conservation level in financial reports. It means that first hypothesis is rejected at 95% confidence level. Justified reasons of the result can be stated as follows: firstly, long – term debt only is assigned in form of Islamic contracts for buying machineries and equipment, not other affaires such as share purchase. Secondly, financial service providers have not really been paying attention to business units' financial reports and the bankroll of obtaining long – term debts is the security that banks provide than financial conditions of business units. Then companies do not use conservative tools to obtain facilities.

Financing via Equity and Conditional Conservation

The hypothesis is supported at 95 confidence level and with coefficient – 0.066. In other words, in the period which companies are financed through equity, they identify less bad signs and news (negative return) in accounting income. Because good signs and news shows better financial position of business unit and consequently improve expectations from future performance and improved expectations from future performance leads to reduce capital cost and efficient financing. The finding is compatible with other researches including Falsam (2009), Xi (2010) and Martin and Clarkson (2011).

Conclusion

The purpose of the research is evaluating the relationship between competitive structures of products and financing structures with conditional conservation in financial reporting. Since there are various dimensional competitions in market, then the relationship between competition and conditional conservation are tests in form of 5 specific hypotheses. Using 5 specific hypotheses, mixed competition variable was obtained and the relationship between competitive structures and conservation was tested using the mixed variable.

In second section, financial financing structures have been added to Basu's model (1997) to evaluate the relationship between financial financing structures and conditional conservation and main model of this section was obtained. The results of testing hypotheses in first section indicated that 4 dimensions of 5 dimensions of competition (market size, input costs, intensity of industry centralization and number of companies operating in an industry) have direct significant relationship with conditional conservation and there is only a negative significant relationship between product substitutability and conditional conservation. Although being low sale ratio to operating cost leads to increase competition, higher the ratio can be a motive for more competition. If the ratio is more, companies follow more conservation. Also, testing general hypothesis in the section () indicated that based our expectations, there is a positive relationship between competition and conditional conservation.

In second section, the relationship between financing structures and conditional conservation was evaluated. The results indicated that the companies are financed via long – term debt, conditional conservation level will unexpectedly not reduce. The most important justified reason for this as stating that the security of obtaining long – term loans is the security provided to bank than business unit's financial condition. According to the results of testing second hypothesis, it can be expectedly claimed

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that the companies are financed via equity, reduce conditional conservatism level to improve capital market's expectations from their future performance.

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