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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
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CONTRIBUTIONS TO BOOKS

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

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- Kumar S. (2011): "Customer Value: A Comparative Study of Rural and Urban Customers," Thesis, Kurukshetra University, Kurukshetra.

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Garg, Bhavet (2011): Towards a New Natural Gas Policy, Political Weekly, Viewed on January 01, 2012 http://epw.in/user/viewabstract.jsp

COMPARISON OF VALUE-RELEVANCE OF CASH FLOW AND OPERATING PROFIT IN EXPLANATION OF COMPANIES STOCK RETURN WITH CONSIDERING INFORMATION ASYMMETRY: EVIDENCE FROM TEHRAN STOCK EXCHANGE

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ABSTRACT

Evaluation of accounting information efficacy in Value-Relevance of operating profit with the company's value is focused in recent researches. The purpose of this research, relationship between operational cash flow and operating profit is considered in explanation of company's stock return, generally, and considering information asymmetry by regression model of the panel data for 151 companies, members of Tehran Stock Exchange, during 2005-2009. Results of this research demonstrate that generally, there is a positive relationship between operational cash flow and operating profit with return of the companies' stock, but increasing information asymmetry, relationship between operating profit and return will decrease and the operational cash flow explain return of the company's stock better than the operating profit (and vice versa). Thus, applying the methods based on the operating profit is appropriate in such a manner that information asymmetry level was low and we could not apply a similar method for assessment of the companies' function with different characteristics.

KEYWORDS
Cash flow, Information asymmetry, Operating profit, Stock return, Value-Relevance.

INTRODUCTION

Operating profit is a matter that is measured based on the common accounting principles and procedures. Whereas obtaining the operating profit is accrual basis, so accruals items are accounted in it. Then, differences will be established between the operating profit and cash flow; on the other hand, one of the objectives of financial statements is providing data for prediction of the trade unit financial function that some believe that profit is appropriate for such a prediction.

One of the effective factors in decision making, is appropriate information related to the subject, while, if data transmission is distributed unequally between the peoples, it may result in different results for a matter. Thus, before the fact that the information was important for the decision maker, this is quality of information distribution, which should be evaluated accurately. When information asymmetry of a company's stock was increased, its intrinsic value will be different from the value that investors dedicated to it in capital market. Therefore, real value of the company's stock will be different from expected value of the shareholders.

Operating profit and cash flows are two competitive quantities for performance evaluation of the company, which are applied by financial analysts in stock evaluation; and are recognized as two related factors to decision making of the participants. But, actually there are different obstacles that decrease relevance of the variables. The main obstacle in this regard is information asymmetry between the shareholders and management, as well as profit management stimulations, applying by the managers.

Regarding some of the modern measurement methods of function in management accounting are based on cash flow's figures, they try to enjoy operating profit information; thus, a question has arisen here whether the additional information content in the accrual components of earnings improves performance measurement?

To shed light on this question, I examine the correlation of operating cash flows and operating profit with firm's total shareholder returns. In the present research, power of both figures in evaluation of function of the accepted companies in the stock exchange, is studied. Also, information asymmetry effect on explaining capability of stock market function by appliers of the financial statements, using related figures of operating profit and cash flows of the company, were assessed.

LITERATURE REVIEW AND BACKGROUND RESEARCH

PROFIT

Profit is final product of accounting process that different groups, like stockholders, investors, management, staffs and government, use it as performance criterion of the business entity. Emphasizing on profit increases in such a way that sometimes the net profit is introduced as performance index of a business entity; on the other hand, loss and profit statement reports historical performance, while relevance of financial items is determined by its prediction value.

INFORMATION CONTENT OF OPERATING PROFIT

One of the main information resources for evaluation of the business entity's performance is profit, which is an appropriate index for decisions of the investors. The initial aim of financial accounting is providing useful information for the investors to predict performance of the business entity. Necessity of profit reporting, as a primary resource for investors' decision making, was provable and profit reporting assist the society's economy by different methods, like providing a basis for calculation of taxes, a criterion for evaluation of success of a company's function, a criterion for determination of dividends, a criterion for management of dividend, a criterion for management of a business entity and so. Also, because value of a company relates to its present and future profits, determination of profit is very important (Financial Accounting Standards Board, 1985, 46).

PROFIT, CASH FLOWS AND STOCK PRICE

Securities like stock papers are valuable; because they have definite characteristics that are assessed by the investors. Information propagation changes stock price. If cash flows and profit result in facilitation of stock return prediction, then correlation of profit and cash flows are provided by return.

Previous researches demonstrated that which of accounting profit and cash flows are more related to stock return. These researches apply operating cash flows instead of total cash flows, since it seems that cash flows of investment (invested amounts and their return) are variable during time (Zimmerman, 1986).

Ball & Brown, in their study that was followed by other researches, evaluated relationship between unexpected profit and average of abnormal rate of return. Results show that there is a relationship between profit and return and profit and rate of non-operating return are correlated; also, profit provides information for the market. They repeated the same research with operating cash flows variable instead of operating commitment profit and declared that there is low relationship between the current cash flow and return (Zimmerman, 1986).

Haw and et al. (2001) investigated the information context of operating cash flows, obligation income and items in China capital market. The results reveal the higher income information context than operating cash flows. Also, in this study, additional information context of optional obligation items was confirmed in front of non optional obligation items.

Asheq Ali (1994) investigated income additional information context, flow capital obtained from operation and cash flows. In this research, he confirmed income additional information context over the flow capital obtained from operation and cash flows. Also, in this examination, flow capital additional information context obtained from income and cash flows operation was confirmed. But, two cases were observed about cash additional information context obtained from operation over other factors: while under studied firms had few changes in cash obtained from operation, additional information context was seen toward others; and while the under studied firms had very changes in cash obtained from operation, additional information context was not seen toward others.

INFORMATION ASYMMETRY

When information asymmetry of the company's stock has increased, its intrinsic value will be different from the value that investors dedicated for the stock in the capital market. Thus, real value of the stocks will be different from expected value of the stockholders. If there were peoples, between investors who are active in capital markets, with better information conditions, and for instance, were inform about notices of profits, they would be able to influence on the market's demand and supply and result in price gap. The main reason is information asymmetry in the capital market, by which the informed individuals of profit notice (and/ or any other important matters) are in better situation rather than others for decision making (Venkatesh, 1986).

In this case, increase of information asymmetry by expansion of difference between suggested range of buying and selling prices of the stocks are provided and brokers enjoy from this increase to compensate contrary selection risk. Generally, when new information of the companies' situation is propagated, the information will be analyzed by analysts, investors and other users and decide based on them about purchase and/or selling of stock. The information and reactions toward them influence on users' behavior, particularly potential and actual stockholders and increase and/or decrease price and transactions. Since, manner of the individuals' treatment with new information form prices' fluctuations; then, providing heterogeneous and confidential distribution of information, we observe different reactions of the stockholders because of information asymmetry in the capital market, which is resulted in false and misleading analyses of the market current situation (Venkatesh, 1986).

Lafond & Watts (2008) indicated that information asymmetry of the firm personnel (like managers) and investors out of firm lead to create conservativeness in financial statements.

Conservativeness decreases the managers' motivations and ability to change the accounting numbers, so it decreases information asymmetry and damages. Whatever there is more information asymmetry between the firm personnel and investors out of firm, therefore request for conservativeness will be more. They used Pin Score's compound index for measuring the information asymmetry and they also used asymmetry time criterion developed by Watts and Richudhary to measure conservativeness.

ACCOUNTING INFORMATION AND IMPORTANT FINANCIAL RATIOS

Banz believed that addition of the company's market value in regression of the return and stock beta result in better explanation of difference of average companies' stock return. Results show that average of small companies' stock return have high estimated beta and average of big companies' stock return have low beta (Banz, 1981).

Chan, Hamao and Lakonishok, declared that book value ratio with market value have a significant role in explanation of average of Japanese companies' stock return, moreover to positive relationship (Chan, Hamao and Lakonishok, 1991). Bhandari demonstrated that there is a positive relationship between leverage and average of return. He believed that the expected relationship between leverage and average is clear; based on his researches, if moreover to book value ratio, leverage degree was added to the market value, changes of the companies' return would be explained better (Bhandari, 2005).

Keim studied effect of size of the company and ratio of profit to price (E/P) on stock return. Companies, according to the market value, are classified as size, in ten portfolios that the smaller companies are in the first class, and the biggest ones are placed in the tenth class. Kim, applying regression, studied relationship and correlation of size and E/P return. He found that average of return have reversed relationship with market value and a direct relationship with E/P rate. In other words, low market value companies have higher return towards high market value companies and also, portfolio of the smaller companies, which have lower E/P rate, towards those with higher E/P rate, have higher return average (Keim, 1990).

Fama and French, regarding previous researches on the factors, have studied relationship of return average with five factors of beta risk, size, leverage, E/P ratio, and market to book value. Results demonstrate that there is a negative relationship between size of company and average returns. Also, they found that there is a positive relationship between ratio of book value with market value and average returns. They declared that size factor should be more concentrated and ratio of book value with market value have stronger role between average returns (Fama & French, 1992).

Ball & Brown (1967) and Bior & Dux (1972) defined operating cash flows as profit plus depreciation; they found that profit, towards cash flow, is stronger in explanation of stock return.

Ston & Olson (1992) studied relationship between operating profit and stock return. The study has been done for accepted companies in New York Stock exchange between1968 to 1986. They assessed relationship between stock return and operating profit, hypothesizing that if the period was extended, mistakes would be decreased and accurate and real profit of the company could be calculated. They applied one to ten time intervals. The independent variable was EPS/P and the results demonstrated that in longer intervals correlation of two variables increased and explain higher profit.

Rapp (2010) study influence of information asymmetry on relevance of cash flows and accounting figures in explaining stock return of German stock companies. Results show that, increasing of information asymmetry will decrease accounting figures' power in explanation of companies' stock towards cash flows

RESEARCH METHOD AND STATISTICAL

This research is of correlation and regression type. Considering the information, it is done as aggregation of data analysis about type and number. Data historical information is used in the present paper, thus it is of simulated experimental type.

The research methodology is comparative-deductive in which theoretical foundations related to the study have been obtained through library studies and comparative methods. The related data was collected through observation of financial statements and the accompanying notes as found on www.rdis.com.

Testing research hypotheses, OLS technique and regression method was used level of significant 95%. For data gathering, compressed files, published by Tehran Stock Exchange, and Tadbirpardaz Software were used. Eviews Software- Version 7- was applied for statistical tests.

Statistical population of the research includes all of the accepted companies in Tehran Stock Exchange for five years, as of 2005 to 2010, regarding the following restrictions, the statistical sample was selected:

1- The company was accepted in the Stock Exchange before 2005;

2- Required information of the research, about the companies from 2005 to 2010, was available;
3- End of financial year of the company was 20 March, and did not changed during 2005 to 2010;
4- The company's stock was transacted between 2005 to 2010;
5- It was not included in investment and intermediary companies, because nature of these companies is different.

After application of the above restrictions, 151 companies remained that were studied as statistical sample.

RESEARCH HYPOTHESES

The following hypotheses are compiled according to the theoretical basis and research background.

***H1*:** Operating profit explain stock market of the company better than net items of (operating) cash flows.

Although, theoretically, operating profit is superior to cash flows figures in explanation of stock market performance, practically, there are several obstacles. The main obstacle is information asymmetry of stockholders and management; also, there are various stimuli for profit management by the authorities.

Considering this view that operating profit has information content, this is logical that existence of information asymmetry relates to increase of information in commitment items. This view is summarized in the second hypothesis:

***H2*:** Increasing information asymmetry, operating profit could explain return of stock market better (towards the case that only cash flows are considered).

Increasing of information asymmetry will result in increase of opportunistic profit management motivation; because there is low possibility that the outside stockholders punish it. So, adding discretionary information as accounting commitment figures will be valuable for management; this view is summarized as follows:

***H3*:** Increasing information asymmetry, power of cash flow figures will increase in return of stock market (towards the case that only operating profit is considered).

RESEARCH VARIABLES

Dependant Variable**:** in the present study, stock return is accounted as dependant variable, which is calculated as relation 1:

Relation (1)

$$stock\ return = \frac{Receivable\ cash\ profit +\ stock\ price\ at\ the\ beginning\ of\ period +\ priority\ right\ privileges +\ stock\ dividend}{stock\ price\ at\ the\ beginning\ of\ period}$$

Independent Variable**:** in the present study, operating profit and operating cash flow are independent variables that are defined as follows:

Operating Profit: Difference between income and expenses, in the purposed period, which was related to the company's main subject of activity

Operating Cash Flow: the input and output cash flows that are as results of the company's operating activities. Also, those cash flows that were not correlated directly with other cash flows levels are accounted as operating cash flows.

For controlling inflation effect on two variables of operating profit and cash flows, we divided these two variables to the average of that year's average assets.

Control Variables**:** in this research, they are size of company, beta index, ratio of market value to book value, ratio of income to value of each stock and financial leverage, which are calculated as relation 2:

$$\text{Size of company} = \log \frac{(assets\ at\ the\ beginning\ of\ period + assets\ at\ the\ end\ of\ period)}{2} \qquad \text{Relation (2)}$$

Beta: Refers to relationship between return change of a kind of securities or return of a big portfolio of market return that is established according to modern theory of securities portfolio; for calculation of it, we should determine relationship between rate of return on a stock and rate of return of market portfolio that demonstrate coefficient of a share price from percentage of total index of stock price; which is calculated as relation 3:

$$\beta_i = \frac{(cov\,(R_i, R_m))}{var_m} \qquad \text{Relation (3)}$$

In which, R_I refers to company's return; R_m refers to return of market;

Market-To-Book Ratio: it is obtained from division of market value on book value of the company in each financial period.

Earnings-To-Price Ratio: it is calculated by division of each stock on market value of that stock in each financial period.

Financial Leverage: it is calculated by division of total debts of each period on total assets of that period for each company.

Moderator Variable**:** in the present research, role of information asymmetry influenced on relationship of dependant and independent variables that is accounted as follows:

To split the sample into subsamples, the following model is used based on the following model. This model was initially used by Chiyang and Wincatsh in 1986 to determine range of stock ask price and bid price. Then, others benefited from this model in their research. The said model is as relation 4:

Relation (4)

$$SPREADit = \frac{AP-BP}{(AP+BP)/2} * 100$$

In which,

$SPREAD_{it}$ = difference range of stock asks price and bid price of i company's stock in t year;

(Ask price) AP_{it} = average of ask price of i company's stock in t year;

(Bid price) BP_{it} = average of bid price of i company's stock in t year;

Gathering the above model information, first, all dates of companies' predicted profit declaration to the market, were extracted from archive software of stock exchange issuers notice, and then the ask price and bid price, 30 days before declaration of the predicted profit, were gathered from Tadbirpardaz Software and Technology Company of Tehran Stock Exchange. In the next stage, the best offered buying and selling prices of companies was calculated for each day; the average of 30 day period will be accounted as index of the company for that year.

To separate the sample to two subsamples, at first, the offered buying and selling difference prices of each year were calculated. The companies with higher index than index of the average offered buying and selling difference prices is accounted as companies with high information asymmetry, and those with less or equal average offered buying and selling difference prices will be accounted as low information asymmetry.

HYPOTHESES TESTING AND DATA ANALYSIS

Hypotheses testing of the present research have been done by the following two models. The first hypothesis was studied in both models, and the second and third hypotheses in the second model, were analyzed.

$RET_{it} = \alpha + \beta\ EARA_{it} + \beta_2 CF_{it} + \varepsilon_{it}$ Model (1) (main model)

$RET_{it} = \alpha + \beta\ EARA_{it} + \beta_2 CF_{it} + \beta_3 BETA_{it} + \beta_4 SIZE_{it} + \beta_5 MTB_{it} + \beta_6 ETP_{it} + \beta_7 LEV_{it} + \varepsilon_{it}$ Model (2) (Generalized Model)

FIRST HYPOTHESIS TESTING

The first hypothesis stated that the operating profit explain stock market of the company better than net items of (operating) cash flows.

H_0= Operating profit does not explain stock market of the company better than net items of (operating) cash flows;

H_1= Operating profit explain stock market of the company better than net items of (operating) cash flows;

Judging about the first hypothesis, in tables 1 & 2 Adjusted R-squared, both main independent variables are compared with the dependent variable.

TABLE 1: PANEL RESEARCH RESULTS OF THE FIRST HYPOTHESIS, APPLYING MODEL 1 (THE MAIN MODEL)

Independent Variables	State 1		State 2		State 3	
Constant	-0.17	(-2.05)	0.33	(46.54)	-0.14	(-1.64)
Operating Profit	2.61	(6.31)	--	--	2.87	(6.68)
Cash Flow Operating	--	--	0.14	(4.13)	0.55	(2.12)
F-statistic	2.38		1.99		2.39	
Durbin-Watson stat	2.32		2.28		2.31	
Adjusted R-squared	0.253		0.19		0.258	

Table 1 shows Panel Data Regression results of Model (1)(the main model) in three different states, in which two figures are provided for each independent variable; the figure in parenthesis demonstrates significant level and the other figure represents variable coefficient. The first state, operating profit variable, second state, cash flow variable and the third state, both main variables of cash flow and operating profit, are considered coincidently as explaining variables.

As you see in Table 1, significant level of the three states are higher than 1.96, i.e. all of the variables are in significant reliance level of %95 and comparing Adjusted R-squared in the first state is 0.253, in the second state, it is 0.19; the first state (when the operating profit is considered as explaining variable) towards the second state (when cash flow is considered as explaining variable), has higher explaining capability. Thus, null hypothesis, based on the fact that the operating profit does not explain company's stock market better than cash flow items (operating) was not accepted, and this hypothesis is accepted.

TABLE 2: PANEL RESEARCH RESULTS OF THE FIRST HYPOTHESIS, APPLYING MODEL 2 (THE GENERALIZED MODEL)

Independent Variables	State 1		State 2		State 3	
Constant	7.30	(2.93)	5.86	(2.17)	9.42	(3.64)
Operating Profit	3.21	(7.18)	--	--	3.58	(7.73)
Operating Cash Flow	--	--	0.25	(01.98)	0.80	(3.03)
Size of Company	-0.57	(-3.05)	-0.37	(-1.84)	-0.73	(-3.72)
Beta Risk Index	0.003	(4.60)	0.003	(4.29)	0.003	(4.62)
Ratio of Market Value to Book Value	0.0005	(3.23)	0.0004	(2.42)	0.0005	(3.46)
Ratio of Profit to Stock Value	-0.24	(-0.86)	-0.23	(-0.79)	-0.17	(-1.06)
Financial Leverage	0.48	(1.13)	-0.70	(-1.67)	0.45	(-2.12)
F-statistic	2.68		2.12		2.39	
Durbin-Watson stat	2.19		2.09		2.24	
Adjusted R-squared	0.299		0.225		0.31	

Table 2 shows Panel Data Regression results of Model (2)(the generalized model) in three different states, in which two figures are provided for each independent variable; the figure in parenthesis demonstrates significant level and the other figure represents variable coefficient. In this model, operating profit and cash flows variables are two main variables of the company and size of the company, beta index, ratio of market value to book value, ratio of income to each stock value and company's financial leverage are secondary variables, as explaining variables. The first state, operating profit variable, second state, cash flow variable and the third state, both main variables of cash flow and operating profit, are considered coincidently as explaining variables.

As you see in Table 2, in the first state significant level of all of the explaining variables, except ratio of income to value of each stock and financial leverage, are higher than 1.96 and are in significant level of %95. In the second state significant level of all of the explaining variables, except size of company, ratio of income to value of each stock and financial leverage, are higher than 1.96, thus they are in significant level of %95. In the third state, significant level of all of the explaining variables, except ratio of income to value of each stock are higher than 1.96 and are in significant level of %95. Comparing Adjusted R-squared in the first state is 0.299, in the second state, it is 0.225; Adjusted R-squared in the first state is bigger, so it is more explanatory in operating profit. Thus, null hypothesis, based on the fact that the operating profit does not explain company's stock market better than cash flow items (operating) was not accepted (based on model 2 (the generalized model)), and this hypothesis is accepted.

SECOND HYPOTHESIS TESTING

The second hypothesis declares that by increasing information asymmetry, the operational profit could explain stock market return better.

H_0= Capability of operating profit does not increase in explanation of stock return by increasing information asymmetry;

H_1= Capability of operating profit increase in explanation of stock return by increasing information asymmetry;

THIRD HYPOTHESIS TESTING

The third hypothesis declares that by increasing information asymmetry, capability of cash flow increase in explanation of stock return.

H_0= Capability of cash flow does not increase in explanation of stock return by increasing information asymmetry;

H_1= Capability of cash flow increase in explanation of stock return by increasing information asymmetry;

TABLE 3: PANEL RESEARCH RESULTS OF THE SECOND & THIRD HYPOTHESES, APPLYING PANEL REGRESSION

Model 2 (the generalized model) and Comparison of the Results in Two Samples by high & Low Information Symmetry

Subsamples	Low Information Asymmetry		High Information Asymmetry	
Independent Variables	Stock Return		Stock Return	
Operating Profit	2.81	(6.50)	1.19	(3.21)
Operating Cash Flow	1.02	(1.98)	2.67	(2.13)
F-statistic	2.45		2.61	
Durbin-Watson stat	2.33		2.19	
Adjusted R-squared	0.267		0.293	

Divided the sample, according to the model stated in the third chapter, to two subsamples. A sample with High Information Asymmetry and a sample with low Information Asymmetry towards the sample with high operating profit as % 27 volumes and the same ratio for sample with low operating profit is % 73. Judging about the second and third hypotheses in Table 3, coefficient of both main independent variables is compared with two different states.

Table 3 shows Panel Data Regression results of Model (2)(the generalized model) in two different samples (sample with high operating profit against sample with low operating profit), similar to Table 2, two figures are provided for each independent variable; the figure in parenthesis demonstrates significant level or P-value or Level Of and the other figure represents variable coefficient. Comparing, operating profit of the sample with low operating profit as 2.81 and the same sample with high operating profit as 1.19, it is obvious that increasing information asymmetry, the operating profit will decrease. Comparing coefficient of cash flows in the sample with low operating profit as 1.02 and the same for the sample with high operating profit as 2.67, it is clear that increasing information asymmetry, coefficient of cash flows will increase. Thus, H_0 (null hypothesis) in the second hypothesis is accepted about the fact that increasing of information asymmetry does not increase operational profit explanatory capability; and H_0 (null hypothesis) in the third hypothesis is not accepted about the matter that increasing of information asymmetry does not increase cash flows explanatory capability***.***

DURBIN–WATSON TESTING

These statistics estimate the presence or absence of autocorrelation in the Residual is used.

As shown in Tables 2 and 3 on any of the Durbin–Watson statistic between 7/1 to 3/2. Therefore, their lack of autocorrelation in the Residual is approved.

DISCUSSION ANA CONCLUSION

Results of the testing are as follows:

Statistical results of the first hypothesis analysis by panel regression demonstrate that operating cash flow and operating profit variables have significant relationship with company's stock return. And comparison of the Adjusted R-squared showed that the operating profit could explain company's stock return better than net cash flows.

Results of the second hypothesis testing demonstrate that increasing of information asymmetry explain operating profit of the company's stock return better, is ignored (towards cash flows).

Results of the third hypothesis testing demonstrate that increasing of information asymmetry explain cash flows of the company's stock return better, is ignored (towards operating profit).

Results of the second and third hypotheses demonstrate that information asymmetry, as a moderating variable, influence on relationships between independent variables and operating profit and cash flows with dependant variable of stock return. Its influence is in such a way that in the companies with high information asymmetry, cash flows are explained better than operating profit of the company's stock return; but, in the companies with low information asymmetry, the result is vice versa.

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