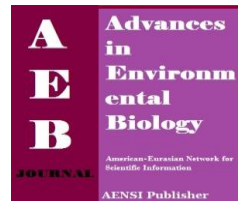




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Growth of Corporate Finance Criteria on Investor Reaction

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ABSTRACT

In current research, we investigated Growth of corporate finance criteria on investor reaction. Therefore, we investigated changes of returns in according to four criteria's. Statistical sample included manufacture companies admitted in Tehran stock exchange during 2004 and 2011 and 113 companies were selected as sample study. We used Portfolio test in order to test hypothesis. Results of analyzing data indicates that investors react too much to the development of criteria for Sale criteria, cash flow operation ad net liquidation and lack of too much reactions to size for growing cash flow.

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INTRODUCTION

It is obvious that investors in stocks are important part of country's economy. Definitely, amount of capital have been transferred by stock markets and national economy substantial is affected by performance the market. Furthermore, stock market is accessible for professional investors and all of people as tool of investment. Stock market is affected by Macro-economic and non-economic parameters and other variables. Multiple factors affecting capital markets lead uncertainty in investment. Some parts of effective factors on stock market emerging from financial information of economical unit that extracted from accounting system. Amount of effect these information is complex and unknown and also making decision in this condition is along with uncertainty and worrying [1].

By expressing efficient market it can be said that if stock market be relative efficient in processing attract information and stock prize always has favorable reflect of companies event. Based on the hypothesis no one can achieve more return in comparison with acceptable systematically risk in long term.

Empirical evidence in recent two decades shows that some of stock markets in world are nit efficient. In other words, market reacts to information too much t too low and this phenomenon leads to company's stock price deviations from their true values. This issue indicates that investors by making investment decision leads to stock markets which are successful for performance criteria and determine as higher level of true value. Consequently, when investors in order to achieve vision of returns. The back returns a response to excessive response to the company's stock. In contrast, stock of companies, which have low performance determine in lower level of true value [2].

Baed on hypothesis of efficient market, investors logically to react to information; however, several empirical research show that stock market from phenomenon " react too much and react lower than normal" as one of equity market anomalies which is contrast of efficient market and time occurs that new information more than must change and in log term. Psychological factors is one of the most important factor than affects on behavior of investors in processing information. This phenomenon explains by favorite financial behavioral theory and link psychology with economical theories and in fact, skewed behavior of investors in the capital markets is due to the above phenomenon.

Literature review:

Alwathainani [2] investigate data of NAZDAQ and AMEX during 1963 an 1990 in order to do back return by strategies of emerging from risk factor or skewed expectations of investors? In orer to classify companies to growth stock and stock value use basic criteria for stock price and then these companies which have returns of high and low in during 5 years.

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Bearing in mind that IFRS requires more disclosure of the companies, scholars studied the relationship between the disclosure practices and the firm's cost of equity. Botosan studied the relevant literature and concluded that the opinions of scholars concerning the problem at hand are confused.

In general, when company is more transparent in its financial statements then the information asymmetry between investors and company is reduced and consequently the cost of equity is declined too. In accordance with the above notion, Daske [5] scrutinized a sample of German companies which from the period 1993-2002 have adopted International Accounting Standards or US GAAP. Using a Residual income model and an Abnormal Earnings Growth.

Model, Daske has proved that in fact the transition from local German GAAP to IAS has raised the equity's cost of capital. Daske postulated that the underlying reason for the above discrepancy was that the investors probably confused by the increasing disclosure of International Standards and therefore the judgments concerning the risk of the companies and consequently the cost of the equity was faded by the fact that there was no prior evidence about the transition. Therefore, the increased transparency from German companies led to an increase in information asymmetry. In contrast to Daske's research, Lambert *et al.* [12] used an extended version of CAPM which compromised future cash flows. Building the above model, the covariance which is the crucial component of CAPM has been changed in order to detect investors' beliefs about the future cash flows of the company.

Skewness of return distribution is a significant characteristic that reflects the price of financial asset. Many a research has found that the distribution of financial asset *always* shows deviation from normal distribution with negative or positive. The probability of loss increases with negative skewness, and that of gain increases with positive skewness. As it is unclear with the reasons for the skewness of the return distribution, there is no agreement on about the formulation of constraints on portfolio optimization and the pricing kernel process.

The original explanation of skew distribution of the return is based on asymmetry of fluctuation, which is mainly leverage effect and feedback effect of fluctuation, but the explanations had not been widely supported by empirical study. Some researches held that the increase of investors heterogeneity could lead to negative skew distribution of the return for there existed short-sale constraints. On the basis of the negative news threshold hypothesis, Ekholm and Pasternack found that different policies about positive and negative news are the cause of return skew distribution mentioned in [8]. Empirical evidence in indicated that the level of a company's management also affects the distribution of return skewness. These theories mainly studied the distribution of return skewness from macroscopic perspectives, but with the development of behavioral financial theory, more scholars came to consider the impact of investors risk attitudes and behavioral biases on the skewness of return distribution from microscopic perspectives.

Harvey and Siddique in [10] suggest that the momentum effect is related to systematic skewness, and winners have substantially lower skewness than losers. Bakshi that investors risk aversion is responsible for the negative deviation of the return mentioned in [8]. Researches in [19] proposed that investors the oversee and trying to avoid regret tend to cause the negative skewness of the return distribution, which is supported by simulation. A point hold in that investors risk aversion would decrease the deviation premium coefficient, and if investors are risk aversion, the premium coefficient will be very small. When and Yang held that risk attitude is an important reason for the skew distribution of the return, and the speculative behaviors on the market can lead to positive skewness. All these researches show that the change of investors risk attitudes will make certain effects on the skewness of return distribution.

Hypotheses:

- H1: Mean of changes in stock returns in companies, which have higher growing sale, is lower than in compare with companies which have lower growing
- H2: Mean of changes in stock returns in companies, which have higher growing cash flow, is lower than in compare with companies, which have lower growing
- H3: Mean of changes in stock returns in companies, which have higher growing cash flow of financing, is lower than in compare with companies, which have lower growing
- H4: Mean of changes in stock returns in companies, which have higher growing net liquidity, is lower than in compare with companies, which have lower growing

Variables:

In the research, financial criteria are: net sale, cash flow operation, cash flow of financing net liquidity.

Net sale: sales after deducting discounts and sales returns

Cash flow operation: net cash flow of operational activity and other activities that are not in cash flow.

Calculating cash flow operation is as following:

Cash flow operation= Change in current debt+ changes in cash flow changes in current assests

Change in current portion of long-term debt= Changing in tax payment- Depreciation

Financing cash flow: Flow of financing from outside of commercial units (like shareholders) and calculate as following:

Financing cash flow= Loan- Repayment of financial liabilities

Net liquidity: it calculates as entry and exit of cash in five available activities in cash flow and in fact net changes of cash flow during one year of the company.

Stock return: it calculates as following:

Changes in stock price + Cash dividends + Priority Benefits + Benefits of bonus shares

Stock returns = -----

Stock price at the beginning of the year

Methodology:

This research is applicable and it can be used for process of making decision and aim of current research is investigate reaction too much about investment to growing financial criteria. Information of the research is collected by comprehensive software of Tehran Stock Exchange. Final analyzing was done by software of SPSS. Due to number of companies available in portfolio of winner is not equal with portfolio is loser; we use dual t student.

While, p-value is more than error level α and hypothesis of H_0 is not rejected. Similarly, if p-value is less than error level of α and hypothesis of H_0 is rejected.

Following of most researches about reaction too much, in the research, sample study was divided to two groups of loser and winners. Period of the research is during 2004 a 2007 and following period 2008 and 2011. Then, we investigated return of portfolio winner and loser.

In current research, test of hypotheses are as following:

$$\Delta RL : H_0 : \Delta RW \leq 0$$

$$H_1 : \Delta RL - \Delta RW > 0$$

If H_1 is approved that reaction is too much

Where:

ΔRL : Mean rate of changes in companies that have the lowest growth rate for each variable in the past

ΔRW : Mean rate of changes in companies that have the highest growth rate for each variable in the past

$$\Delta RL = RL2 - RL1$$

:2RL Arithmetic average stock returns in the period following the establishment of a failed portfolio

RL1: Arithmetic average rate of return on the stock portfolio of the failed portfolio formation

$$\Delta RW = RW2 - RW1$$

RW2: Arithmetic average rate of return on the portfolio of stocks in the period after portfolio formation

RW1: Arithmetic average rate of return on the portfolio of stocks in the portfolio formation

Statistical sample:

Period of the research is during 2004 and 2011. Sample study included companies listed at Tehran stock exchange:

1. They are investment firms and other financial intermediation
2. Companies do not have stop at least once during the study period had a trading halt in its shares to be traded during the year
3. Information about companies should be accessible

Findings:

We used mean and level error of 5% in order to test the hypotheses.

Table 1: Mean of hypotheses test.

Description	Standard Deviation		Mean		T student	P-value	Results
	Rl	Rw	Rl	Rw			
Variables							
Sales	50.46	59.87	23.23	-10.07	2.227	0.03	Reject H0
Cash flow operation	55.71	24.97	29.27	-1.1	2.647	0.011	Reject H0
Financing cash flow	32.36	39.97	11.39	6.7	0.429	0.67	Approve H0
Liquidity	61.31	66.01	31.32	-7.42	2.05	0.046	Reject H0

Results of test hypotheses:

In according to the table above mentioned:

First hypothesis is approved: Mean of changes in stock returns in companies, which have higher growing sale, is lower than in compare with companies, which have lower growing

Second hypothesis is approved: Mean of changes in stock returns in companies, which have higher growing cash flow, is lower than in compare with companies, which have lower growing

Fourth hypothesis is approved: Mean of changes in stock returns in companies which have higher growing net liquidity is lower than in compare with companies which have lower growing

Conclusion and discussion:

Results of hypotheses test indicate that investors react too much about growing criteria of sale, cash flow operation, net liquidation. oru results is consistent with results of Lee Siminafan and Valid Saleh.

Results of this research is consistent with investors, vision of future high growing economical unit (low) higher than (lower than). Inventors mistakenly make extended previous financial performance of the company to the future. Thus, stocks of commercial units pricing that have financial strong performance (weak) more than (lower). Consequently, when investors recognize that their assessment is incorrect, stock of commercial units has strong financial performance in past has lower return in comparison with stock of commercial unit which was weak in past. In present research, we confirm that react too much to size of growing sale and cash flow operation and net liquidity.

There are certain situations, such as disasters and political conditions that affect stock returns that was not using in the article.

Recommendation:

1. We recommend that when investors are going to make portfolio should pay attention to net sale, cash flow operation and net liquidity. Due to this research shows significant and positive relationship between these criterias and reaction of investors.
2. Investors can use good opportunity from investment in stocks which have weaker performance of net sale, cash flow operation and net liquidity in past.

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