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Extended Abstract

An Investigation of the Relationship between Accruals and Information Asymmetry in Tehran Stock Exchange (TSE)

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Introduction

Information is the basis of decision-making of securities market participants that is published by the stock exchange, securities publishers and financial intermediaries of these markets. Use of information and correct decision-making in the securities market is possible when information is timely, relevant, complete and understandable. On the other hand, the type and how to access information are also important. Unequal and asymmetrical data transmission between individuals can cause different results from a subject. Information asymmetry has various undesirable consequences such as decreasing market efficiency, increasing trading costs, low liquidity and generally decreasing the profits of trading in capital markets. These subjects can reflect the importance of information asymmetry and its undeniable influence on economic decisions. The purpose of this study is to investigate the relationship between Accruals and information asymmetry in Tehran Stock Exchange.

Research hypothesis

Accounting accruals convert cash flows into net income by matching expenses with revenues in the period in which they are earned regardless of when the actual cash flow occurs. Accounting accruals also constitute items that represent managements' expectations of uncertain future events, and thus are liable to some degree of measurement error. They may also be biased to the extent that managers intentionally misrepresent their expectations to achieve private gain (i.e., "manage earnings") or

convey their private information. Therefore, investors must incur significant information processing costs to fully understand the valuation implications of the accruals.

Studies have shown that investors may be slow in reacting to the information in accruals and therefore, misprice them. Mispricing indicates that, on average, investors are not able to discern the information in accruals. This evidence of mispricing coupled with the evidence of selective accrual comprehension by certain sets of informed investors suggests that accruals create informational inequalities in the market, increase the informed traders' informational advantage and exacerbate information asymmetry in the market. On the other hand, Glosten and Milgrom (1995) suggest that information asymmetry in the market leads to increased bid-ask spread. Hence, we expect that with increasing accruals and abnormal accruals, bid-ask spread will increase. To determine this relationship we defined following hypotheses:

- 1) There is positive and significant relationship between bid-ask spread and absolute magnitude of total accruals.
- 2) There is positive and significant relationship between bid-ask spread and absolute magnitude of abnormal accruals.
- 3) After controlling the effect of liquidity, firm size, institutional holding and volatility, there is positive and significant relationship between bid-ask spread and absolute magnitude of total accruals.
- 4) After controlling the effect of liquidity, firm size, institutional holding and volatility, there is positive and significant relationship between bid-ask spread and absolute magnitude of abnormal accruals.

Methods

This research is of descriptive-correlative type. The study sample includes 101 companies listed in Tehran Stock Exchange for a period of seven years (2003-2010). We used Panel Data simple and multiple linear regression analysis to examine the hypotheses. The significance of the models and coefficients has been examined using F-statistic and t-statistic at the 0.05 levels. In order to test the poolability and determine whether the Fixed Effects or Random Effects is appropriate we used Chow Test and Hausman Test.

In this investigation, the information asymmetry and the components of accruals have been estimated by bid-ask spread and Jones adjusted

model based error estimation. The variables being considered are: bid-ask spread as the dependent variable, absolute magnitude of total accruals and absolute magnitude of abnormal accruals as the dependent variable; and the control variables are liquidity, firm size, institutional holding and volatility.

Results

According to the results of Chow Test and Hausman Test, all hypotheses have been examined using Fixed Effect Panel Data model. The result of statistical test show that the Bid-Ask spread is positively related to the absolute magnitude of abnormal accruals. However, the results do not show significant relationship between absolute value of total accruals and information asymmetry. Furthermore, the findings revealed the existence of a negative and significant relationship between stock liquidity, firm size and percentage of institutional ownership and information asymmetry. Also, the results indicated that there is a significant positive relationship between information asymmetry and volatility of stock returns.

Discussion and Conclusion

In this paper, we investigate whether the heterogeneous response among investors to accruals exacerbates information asymmetry in the market. We test this argument by studying the relation between absolute magnitude of total and abnormal accruals on the bid-ask spread. The results of study provide empirical evidence of a positive association between the bid-ask spread and abnormal accruals. Based on the results we find that in the capital market of Iran, abnormal accruals create informational inequalities, increase the informed traders' informational advantage and exacerbate information asymmetry. However, the results do not show significant relationship between absolute value of total accruals and information asymmetry.

Existence of a negative relationship between firm size and information asymmetry suggests that in Iran, small companies have less transparency for outside investors but larger firms generally have greater media coverage and higher analyst following. Hence, large-sized firms are associated with a more information-rich environment, which results in lower information asymmetries among investors. With regard to

negative relationship between trading volume and information asymmetry it seems that in asymmetric conditions, Iranian investors are faced with the adverse selection problem, so that the risks resulting from this phenomenon leads to reduced liquidity. The findings of the study also show that there is less information asymmetry in the companies with high percentage of institutional holding.

Keywords: Information Asymmetry, Bid-Ask Spread, Accruals, Abnormal Accruals.