The Relationship between Economic Value Added with Liquidity and Returns in Companies Listed in Tehran Stock Exchange

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ABSTRACT

Background: Economic Value Added is one of the most useful measures for managers' performance evaluation. Another economical criterion used for distinguishing between company’s market value and invested capital in the company is market value added. Objective: In this paper it has been tried to study the relationship between economic value added with liquidity and returns of listed companies in Tehran Stock Exchange. For this purpose we have a sample of 510 companies who have been present in exchange market during the years of 2005-2010. The companies selected for our sample are those which their financial statements are available for the mentioned period, their fiscal year hasn’t been changed during the above mentioned period, the end of their fiscal year is the same, i.e. the last month of each year and their stock have been traded during the mentioned years. With application the above mentioned conditions the number of research sample reduces to 98 companies. Liquidity and returns are dependent research variables, economic value added is independent variable and controlled variables include company size and the ratio of book value to market value of equity. In this paper the regression model has been used. Results and Conclusion: The results of the research indicate that there is a positive and significant relationship between economic added value and stock liquidity. Also there is a significant and positive relationship between economic added value and returns. Finally the results indicate that there is a significant difference in the relationship between economic added value with liquidity in listed companies in Tehran Stock Exchange and returns.

INTRODUCTION

The managers’ of takeover companies, recognize takeover as the fastest way for acquiring growth, acquiring new markets, entering global trading zone, increased profit and creating economic added value. On the other hand there is another view based on negative effect of companies’ takeover on the wealth of the shareholders of purchasing companies and the companies which have been taken over. The opponents of this belief believes that growth through internal development (starting new projects and newly established companies) is more desirable comparing to purchasing active companies and due to the conducted studies, they claim that most of takeovers and merging companies after takeover faces some kind of decrease in the performance from the point of view of financial indicators. One of the motivations and reasons that discourages companies top managers to adopt takeover and merging strategies is economic added value (Piqueira, 2006).

Stock return volatility is one of the controversial financial topics which has attracted the attention of capital market researchers in new emerging markets (KielGeoffrey et al., 2003). The reason of this inclination goes back to the relationship between price volatility and in turn on return and its effect on the financial section performance as well as the whole economy. On the other hand, the usefulness of stock return volatility on the side of investors is due to the fact that they consider stock return volatility as a risk criterion and also strategy makers of capital market can use this criterion as a means for measuring vulnerability rate of stock market (Yang, 2006).

On the other hand, liquidity is one of the desirable characteristics of competitive markets. Liquidity is defined as the possibility of performing deals in a fast manner with small expenses and without severely affecting the price and has been named as the main determinant of the possibility of markets’ survival. This phenomenon in future markets is also the source of durability and an important indicator for studying efficiency.
and maturity of these markets (Ravenscraft & Scherer, 1978). On one hand, stock return is one of the most important and complicated concepts which is affected by a variety of factors. Stock return is affected by factors including changes in economical, political, cultural, social conditions, sentiment reactions in purchasing stock, risk, assets return and especially financial statements items and information provided by them and so many other factors such as these. Today analysis of accounting variables is a powerful technique and a proper instrument for investors toward a far better recognition and evaluation of past and present performance as well as prediction of future performance and return.

Also since the time of Adam Smith the predominant view regarding organizations is that they derive their forces from investors, employees and suppliers to produce and provide their products and services to their customers. In this view organizational performance refers to the financial return which is received by shareholders (Deuskar, 2006). Therefore the importance of stock return prediction has make scholars to try to find the variables and indicators which have a significant relationship with stock return as well as the variables which are influential on this relationship. They have always tried to find the influential variables on returns and base their decisions making on them. The obtained results from studies in this field indicate that financial and non-financial information both have effect on stock return (Mehrani et al., 2004).

Understanding the mechanism of Tehran Stock Exchange from different aspects and angels can reduce the risk of investment and in the meantime can predict the future of the market and its changes in a better way. Stock return is one of the most important factors in selecting the best investment. Investors in addition to considering so many company internal and external financial and non-financial factors for prediction and decision making, with awareness of effective factors on stock return can determine stock price behavior with more accuracy and a better quality and as a result can make more effective decisions. Hence, one of the criteria for organization’s performance evaluation in this study is stock return.

A Review of Theoretical and Research Background:

Normally the works which are studying the information content of variables make their assumption on complete reflection of accounting information and then study the connection between liquidity and stock return. Most of the previously conducted studies indicate to a relationship between economic added value and stock return and in this section we will review some of these works.

Austin (2006) in his work has studied the economic added value as an indicator of performance evaluation of New Zealand Airlines during the years 1995-2003. The findings of his study indicate that economic added value is used as an indicator for pricing the company products (Aitken, Comerton Forde, 2003). Piqueira (2005) believes that trading activities can describe expected return changes in a cross-sectional manner. Evidences of this study indicate the existence of a relationship between the expenses of illiquidity and the size of the company. Also the effect of the stock of large companies with high liquidity on trade volume is significant. In this study he introduces trading activities as the only indicator of liquidity (Piqueira, 2006).

Marshal and Yang in (2006) have studied the relationship between normal stock return in Australian market and factors such as: Beta risk and the size of company, price offer to buy and sell, flow rate and ratio of illiquidity and their findings indicate that among different indicators of illiquidity, the ratio proposed by Amihood justifies surplus of stock returns better (Marshal & Martin, 2006). Marcello & Quiros in (2006) have studied the illiquidity risk factor in Spain Stock Market during 1994-2002. In this study they have used the control factor of size and ratio of book value to market value as the illiquidity indicator proposed by Amihood (2002). The findings of this study indicate that illiquidity factor should be considered as one of the key elements of assets pricing (Marcello, Quiros, 2006).

Deuskar in (2006) have proposed a model for liquidity behavior and stock price volatility. In this model, the investors predict the recent price changes for the changes of an asset with risk. When the asset changes are high, the risk premium of it will be high and the current return of the asset will be low, the return rate of assets with risk will also also low and market will face illiquidity (Deuskar, 2006). Du to conducted studies in Iran also, Yazyazadeh and Khoramdin in (2008), have studied “the role of liquidity factors and illiquidity risk on stock return surplus in stock exchange”. In this study due to the importance of the relationship between risk and return, the effect of illiquidity risk and liquidity factors including market return surplus, company size and ratio of book value to market value as the illiquidity indicator proposed by Amihood (2002). The findings of this study indicate that illiquidity factor should be considered as one of the key elements of assets pricing (Marcello, Quiros, 2006).

Mahdavi and Goyande in (2009), have studied “the relationship between economic added value and refined economic added value with stock return”. The main aim of this paper has been to study the relationship