ISSN: 0976-3104

SUPPLEMENT ISSUE
Molaei et al.

ARTICLE OPEN ACCESS

THE IMPACT OF OPERATIONAL RISK AND FLUCTUATIONS OF THE INTRINSIC VALUE OF COMPANIES ON THE CONDITIONAL CONSERVATISM IN PHARMACEUTICAL AND THE AUTOMOTIVE INDUSTRY LISTED IN THE TEHRAN STOCK EXCHANGE

Hassan Molaei [1], Mojtaba Maleki [2], Saeid Tutunchi [3], Abolhasan Khademi Moghadam [4]

[1]*Master of Financial management, Islamic Azad University Electeronic Branch,IRAN*
[2]*Department of Pharmacoeconomics & Master of Business Administration (MBA), Faculty of Advanced Sciences & Technology, Phamaceutical Sciences Branch, Islamic Azad University, Tehran-Iran (IAUPS), IRAN*
[3] *Master of Business Management- Financial Major, Islamic Azad University North Branch, IRAN*
[4]*Master of Business Management, Islamic Azad University Central Branch, IRAN*

ABSTRACT

This paper investigates the impact of operational risk and fluctuations of the intrinsic value of companies in the pharmaceutical and the automotive industry on conditional conservatism listed on the Stock Exchange of Tehran. For this study, a sample of 50 companies from the pharmaceutical and the automobile industry were selected using random sampling method. In this study, investigating operational risk and fluctuations of the intrinsic value of companies in the pharmaceutical and the automotive industry on conditional conservatism listed on the Stock Exchange of Tehran for the period of 2010 to 2013 took place in Tehran Stock Exchange that a total of 250 observation for the period was used that 125 number years is related to companies with high operational risk and 125 number years related to companies with low operational risk and 125 number years related to the companies with high fluctuations of the intrinsic value and 125 number years related to companies with low fluctuations of intrinsic value. The statistical method used in this research is multiple regression method. The results show that: 1. Companies of pharmaceutical and automotive industry that has low operational risk choose a higher level of conditional conservatism. 2- Companies of pharmaceutical and automotive industry with high operational risk choose lower level of conditional conservatism. 3- Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are lower choose a higher level of conditional conservatism. 4- Companies of pharmaceutical and automotive industry that their fluctuations of intrinsic value are greater choose lower level of conditional conservatism.

Published on: 1st– June-2016

KEY WORDS

conditional conservatism in the pharmaceutical and automotive industry, operational risk, fluctuations of the intrinsic value of companies

***Corresponding author:Email:**Hassan molaei145797@gmail.com;**Tel:** +989113553504; **Fax:** +982142081145

INTRODUCTION

The concept of conservatism

Conservatism is concepts by which accountants use a reasonable degree of caution in the recognition of interactions of subject of economic uncertainty principle.

About accounting conservatism, there are two different views. Some scholars consider conservatism for users and analysts of useful financial statements and consider it as the informational role. Some other researchers not only, not consider it as informational role, but also consider it to the detriment of producers and users of financial statements. In this section, two different views are provided from accounting researchers about conservatism and existing empirical research that support these views.

The first view, conservatism has a positive role and informational load.
Proponents of this view consider informational role for conservatism. According to them, conservatism increases the amount of information reported in the securities market. This increase can help to investors and other users of financial statements to make proper decisions. In fact, this theory has several informational advantages for the conservatism that these advantages are:

Improve the quality of information: conservatism can be effective in improving the quality of information provided by management. In fact, representation theory proves that managers try to increase interests to hide bad news related to company and report good news quickly. Reduce interest of profit management for managers: Chen et al prove that conservatism can play an effective role in reducing the interests obtained of profit management that by senior executives is done.[3]

Conservatism can be a kind of signaling of managers to provide personal information: managers as responsible for preparing the financial statements with fully aware on the situation of company and by having a greater awareness to financial statement users, potentially trying to show the picture of commercial unit a favorable. For example, it may be through appropriating costs of a course as asset caused to reduce costs and report more profit in the financial statements. So the purpose of such an operation is to provide a better picture of the true picture of the company between the users of financial statements. The purpose of gaining profit and award of managers and obtain financing through external parties to company, could be the main reason for such behavior. In fact, conservatism can improve the quality of information and reducing information asymmetry. Conservatism can affect the quality of reported profits. The use of conservative practices in accounting reduces profits reported and increases the quality of accounting profit and since many investors make their decisions based on reported profits, it would be useful for them. [4]

Performance of liability contracts: conservatism causes to reduce conflict of division policy between shareholders and bondholders and reduce the cost of financing. Adherence to conservatism procedures and increasing conservatism reduces the tendency of managers to borrowing and so reducing the cost of financing. In the process of signing a liability contract, lender is faced with the risk of losing principal of capital. So they welcome all the mechanisms that could reduce the risk.[5]

The second view, conservatism reduces the quality of information.

Proponents of this view are the opposite of conservatism. They believe conservatism reduces the quality of information provided in the basic financial statements and it would have huge losses for investors and other users of financial statements. According to this group, higher levels of conservatism is directly associated with the urge to report lower earnings. America Association of Certified Public Accountants (AICPA) believes that conservatism reduces the quality of accounting information, because it can lead to systematic bias and real distort of economic events.

It should be noted that the number of researches that indicates informational role of accounting conservatism and prove its usefulness are several times of researches that consider it to ineffective in reducing information asymmetry.[2]

In view of the above it can be concluded that determine the optimal level of conservatism is a relative matterand this is something that is studies in theory proposed by Wang, O Hogartayg and Van Zijyl (2010).[6]

In recent analytical study, Wang, O Hugartayg and Van Zijyl (2010) defined a new theory of conservatism in accounting that emphasized the role of messaging conservative accounting in the liability market with information asymmetry. According to Basu research (2007), they also consider conservative accounting as accountants tend to know bad news than good news faster. According to their model, conservative accounting is used as a message by which a company borrowing can transfer its personal information about operational risk to the credit company before the contract of financing. This model of messaging conservative accounting has a kind of separate balance, so that companies with low operating risk and fluctuation of low inherent value choose a high level of conservative accounting and companies with high operational risk and great inherent value fluctuations choose low level of conservatism. (Wang et al., 2010).[6]

With regard to the interpretation Basu from conservatism and also based on the fundamental principles of the theory of Wang et al (2010), good and bad news are "value shocks" that affect the value of the company. It is analyzed that the future prospect of companies with low risk is less variable and the current poor performance is most likely specific to the company and on the nature is stable (with constant of other factors) and as a result, managers at these companies have less incentive to postpone identify the bad news.Instead, companies with more risk to take advantage of the opportunities at the time of improving economy and optimizing the value of the company, more willing to postpone the identification of bad news, so it can be concluded that the company seeks to optimize its value chooses proper conservatism of themselves, that choosing companies with more fluctuations,

choosing the low level of conservatism and choosing companies with less fluctuation (more stable) is to choose higher levels of conservatism. This research has utilized the model of intrinsic value to determine fluctuations of intrinsic value of the company and the stability criterion of sales as a measure of operational risk.
As mentioned before, conservatism can reduce information asymmetry between the company and the creditors and investors. Wang et al (2010) also showed that conservative accounting can help to solve this problem by sending a message about the actual level of operational risk of companies to lenders. Due to the higher identification measure that conservatism is imposed in accounting for good economic news than bad news, often economic bad news affect more quickly on profit to good news that Basu (1997) remembered it as "time asymmetry of profit".[7]

MATERIALS AND METHODS

The concept of risk

In today society almost all people are familiar with this concept and acknowledge that all aspects of life are faced with risk. Risk in common language is the danger that happened due to uncertainty about the incident occurring in the future and the more this uncertainty is higher, so it is said that the risk is higher (Rai et al., 2004, 45)
Figure-1 Webster dictionary has defined risk "risk exposure". The vocabulary dictionary of Hildreth investment considers risk investment potential lose that can be calculated (The same, 46). Galitz considers risk any fluctuation in any income, it clear that future changes for a particular index both positive and negative faces us with risk. So it is possible that changes make us benefit or harm (The same, 47).

Two main areas of risk management, which each include their own specific objectives, are:

1. Domestic area

• ensuring the management about that the company is aware of current and future risks and controls them.

• Protection of assets and corporate reputation

• help to improve the operational performance of the company and increase shareholder value

• Increase efficiency by reducing the potential losses resulting from risk in the activities of the company

• support the achievement of strategic objectives

2. External area

• Ensure compliance with regulatory requirements

• Create competitive advantage

• Assurance to shareholders and other stakeholders that the company is actively managing risks.

Conceptual model

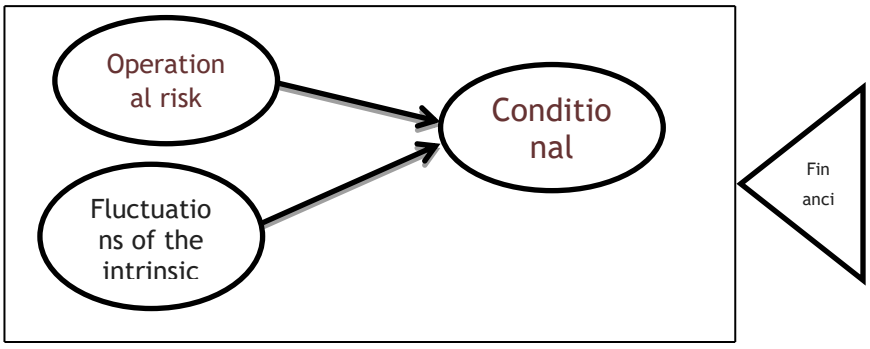

Fig:1. Research's conceptual model [8]

……

Research Hypotheses

- Companies of pharmaceutical and automotive industry that have low operational risk choose a higher level of conditional conservatism.
- Companies of pharmaceutical and automotive industry that have high operational risk choose a lower level of conditional conservatism.
- Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are lower choose a higher level of conditional conservatism.
- Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are greater choose a lower level of conditional conservatism.

RESULTS

In order to better understand the nature of the society that is studied in research and more familiarity with research variables, before the analysis of statistical data, it is necessary to describe the data.

Table:1. Described indicators of research variables, central indicators, dispersion indicators and distribution indicators

Companies with high operational risk						
Symbol	RI	VOL	EPS/P	DR	CV	LEV
The number of data	125	125	125	125	125	125
Mean	0.166546	0.472908	0.161429	0.4	0.239768	0.61898
Median	0.061889	0.442181	0.180129	0	0.212913	0.64506
Mode	-.7846a	-2.2553a	0	0	0.4472	0.2147
SD	0.5569559	1.3027815	0.2758325	0.492	0.1024089	0.2196604
Variance	0.31	1.697	0.076	0.242	0.01	0.048
Skewness	1.986	6	-3.984	0.398	2.176	0.829
Elongation	7.563	52.5	28.715	-1.862	6.831	7.037
Minimum of data	-0.7846	-2.2553	-2.0552	0	0.1396	0.1381
Maximum of data	3.4183	12.7447	1.012	1	0.8287	1.9378
Companies with low operational risk						
Symbol	RI	VOL	EPS/P	DR	CV	LEV
The number of data	125	125	125	125	125	125
Mean	0.180487	0.294941	0.176232	0.44	0.07325	0.640516
Median	0.05198	0.424575	0.154976	0	0.071159	0.643528
Mode	-.7715a	-3.8976a	-.6437a	0	.0095a	0.9441
SD	0.5682364	0.8149234	0.2377381	0.497	0.0406467	0.1580891
Variance	0.323	0.664	0.057	0.247	0.002	0.025

THE IIOAB JOURNAL
ISSN: 0976-3104

Skewness	1.79	-0.57	2.75	0.262	-0.028	-0.103
Elongation	4.344	8.633	22.883	-1.949	-1.199	0.272
Minimum of data	-0.7715	-3.8976	-0.6437	0	0.0002	0.2147
Maximum of data	2.7544	4.6145	2.0977	1	0.1386	1.0924
Companies with high fluctuations of the intrinsic value						
Symbol	RI	VOL	EPS/P	DR	CV	LEV
The number of data	125	125	125	125	125	125
Mean	0.141977	0.857865	0.180743	0.44	0.167434	0.626725
Median	0.051333	0.447213	0.172617	0	0.151081	0.637287
Mode	-.7715a	.4358a	0	0	0.4472	0.25416
SD	0.5182914	1.1356752	0.2785243	0.497	0.1119117	0.1837739
Variance	0.269	1.29	0.078	0.247	0.013	0.034
Skewness	1.463	7.23	-1.224	0.262	1.049	1.182
Elongation	3.187	65.969	30.368	-1.949	1.608	12.271
Minimum of data	-0.7715	0.4358	-2.0552	0	0.0002	0.12254
Maximum of data	2.4085	12.7447	2.0977	1	0.6273	1.9378
Companies with low fluctuations of the intrinsic value						
Symbol	RI	VOL	EPS/P	DR	CV	LEV
The number of data	125	125	125	125	125	125
Mean	0.193539	-0.131402	0.157587	0.42	0.142608	0.630494
Median	0.070381	0.175182	0.166278	0	0.129605	0.652519
Mode	-.7846a	-4.1580a	0	0	0.4472	0.32154
SD	0.6005729	0.7790633	0.2266727	0.494	0.1094334	0.2019802
Variance	0.361	0.607	0.051	0.244	0.012	0.041
Skewness	1.977	-2.582	-0.775	0.336	1.963	-0.335
Elongation	6.19	8.158	12.408	-1.904	7.403	0.212
Minimum of data	-0.7846	-4.158	-1.291	0	0.0026	0.13254
Maximum of data	3.4183	0.4356	1.3293	1	0.8287	1.1437

[Table-1] shows that the study variables have what characteristics, the first line of this figure suggests that the number of all data for all variables studied is equal to 250 number-year that 125 number- year related to companies with high operational risk and 125 number- year related to companies with low operational risk and 125 number -year related to the companies with high fluctuations of the intrinsic value and 125 number years related to companies with low fluctuations of intrinsic value and the second line shows the mean of collected variables separately, as an example, the mean of return on shares in companies with low fluctuations of intrinsic value is 0.193539. Sixth line of variables' dispersion and variance around the mean show that return on shares in companies with low fluctuations of intrinsic value is 0.361. Seventh and eighth lines of data skewness and elongation to the normal bell-shaped curve show that among the variables of research, return on shares in companies with low fluctuations of intrinsic value with number 1.977 has skewness to the right side and ninth and tenth line describe changes in the largest and smallest numbers as range changes, which for return on shares in companies with low fluctuations of intrinsic value has minimum of data equal to -0.7846 and maximum equal to 3.4183

DISCUSSION

The results of hypothesis testing in [Table-2]

Table: 2. Summary of the results of testing hypotheses

Number of hypothesis	Describing hypothesis	Result of hypothesis	Compare the results of other research
1	Companies of pharmaceutical and automotive industry that have low operational risk choose a higher level of conditional conservatism.	Accepted	The results of the study of Richard and others in 2013 that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis and also Mashayekhi and Motmaen (2013) examined the effect of operational risk on accounting conservatism and argued that in companies with higher operational risk, managers are more motivated to postpone identify the bad news with the hope of good news they concluded that there is a significant negative correlation between operational risk and accounting conservatism as well as the results obtained of this research hypothesis.
2	Companies of pharmaceutical and automotive industry that have high operational risk choose a lower level of conditional conservatism.	Accepted	The results of the study of Richard and others in 2013 that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis and also Mashayekhi and Motmaen (2013) examined the effect of operational risk on accounting conservatism and argued that in companies with higher operational risk, managers are more motivated to postpone identify the bad news with the hope of good news they concluded that there is a significant negative correlation between operational risk and accounting conservatism as well as the results obtained of this research hypothesis.
3	Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are lower choose a	Accepted	The results of the study of Richard and others in 2013 that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive

	higher level of conditional conservatism.		industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis.
4	Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are greater choose a lower level of conditional conservatism.	Accepted	Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are greater choose a lower level of conditional conservatism. The results of the study of Richard and others in 2013 that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis.

CONCLUSION

The first hypothesis test result

Companies of pharmaceutical and automotive industry that have low operational risk choose a higher level of conditional conservatism.

The results of the study of Richard and others in 2013[8]that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis and also Mashayekhi and Motmaen[1] examined the effect of operational risk on accounting conservatism and argued that in companies with higher operational risk, managers are more motivated to postpone identify the bad news with the hope of good news they concluded that there is a significant negative correlation between operational risk and accounting conservatism as well as the results obtained of this research hypothesis.

The second hypothesis test result

Companies of pharmaceutical and automotive industry that have high operational risk choose a lower level of conditional conservatism.

The results of the study of Richard and others in 2013 [8]that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis and also Mashayekhi and Motmaen[1]examined the effect of operational risk on accounting conservatism and argued that in companies with higher operational risk, managers are more motivated to postpone identify the bad news with the hope of good news they concluded that there is a significant negative correlation between operational risk and accounting conservatism as well as the results obtained of this research hypothesis.

The third hypothesis test result

Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are lower choose a higher level of conditional conservatism.

The results of the study of Richard and others in 2013[8] that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis.

The fourth hypothesis test result

Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are greater choose a lower level of conditional conservatism.

The results of the study of Richard and others in 2013[8] that investigated the impact of operational risk and fluctuations of the intrinsic value of companies on conditional conservatism in the pharmaceutical and the automotive industry in America Stock Exchange during years 2000 and 2012 and the results of this study suggest that there is a significant relationship between conditional conservatism with operational risk and fluctuations of the intrinsic value of companies as well as results obtained of this hypothesis in **[Table-3]**.

Offers

Table:3. Offers based on results of research hypotheses

Number of hypothesis	Description of hypothesis	Suggestion
1	Companies of pharmaceutical and automotive industry that have low operational risk choose a higher level of conditional conservatism.	In this study, the relationship between conditional conservatism with operational risk and fluctuation of the intrinsic value is investigated. Operational risk and higher fluctuations of the intrinsic value of companies reduce the manager's incentive to delay the bad news, increase as well as demand for conservatism from the auditors, investors and creditors. Based on these hypotheses and using statistical analysis, significant negative relationship between operational risk and fluctuations of the intrinsic value of companies of automotive and pharmaceutical industry and conservatism were found. This result is consistent with the findings of the 2013 Richard and others. Also, when the results exposed to additional controls that the proxy of demand are for conservatism, including leverage, size and returns retain their explanatory power In other words, a negative correlation between operational risk and fluctuation of intrinsic value of companies of automotive and pharmaceutical industry and conservatism are not subject to the effects of limiting of factors removed, such as leverage, firm size and productivity of the company's stock. The results of these tests were as follows that the effect of operational risk and fluctuation of intrinsic value of companies in the pharmaceutical and automotive industry on conservatism is due to identification postponement of the bad news not due to the accelerated in recognition of good news.
2	Companies of pharmaceutical and automotive industry that have high operational risk choose a lower level of conditional conservatism.	
3	Companies of pharmaceutical and automotive industry that their fluctuations of the intrinsic value are lower choose a higher level of conditional conservatism.	The findings of this study can be interpreted as that operational risk and fluctuation of intrinsic value of companies of pharmaceutical and automotive industry play an important role in shaping the behavior of financial reporting of managers. On the other hand, because managers obtained different returns as a result of recognition of good news versus bad news in profits, for opportunistic reporting have a lot of motives. Conservative limited managerial opportunism and increases the efficiency of liability contracts and reward. Therefore, identification of factors that can be associated with conservatism helps investors in making decisions and facilitating control in policies of investments in companies of the pharmaceutical and automotive industry. Therefore, it is recommended to investors when making economic decisions pay attention to factor of operational risk and fluctuation of intrinsic value of

		companies of automotive and pharmaceutical industry; Because operational risk and fluctuation of intrinsic value of companies of automotive and pharmaceutical industry caused to reduce conservatism. As well as recommended to managers and other stakeholders to increase on conditional conservatism in the companies of pharmaceutical and automotive industry under their management because by increasing levels of conditional conservatism; Operational risk and fluctuations of intrinsic value of the companies will reduce, which ultimately leads to growth and excellence in the companies of automotive and pharmaceutical industry .

Suggestion for future researches

By doing any research, the way will open to future researches and the need for further researches will be felt. The following topics for study by other researchers are suggested that:
Investigating the relationship between operational risk and fluctuations of intrinsic value of companies with accruals quality in the companies of pharmaceutical and automotive industryInvestigating the relationship between operational risk and fluctuations of intrinsic value of companies with return on investments in the companies of pharmaceutical and automotive industryInvestigating the relationship between operational risk and fluctuations of intrinsic value of companies with abnormal returns and value added market in the companies of pharmaceutical and automotive industry Investigating the relationship between operational risk and fluctuations of intrinsic value of companies with abnormal returns and value added market in the companies of pharmaceutical and automotive industryInvestigating the relationship between operational risk and fluctuations of intrinsic value of companies with voluntary disclosure in the companies of pharmaceutical and automotive industry
The relationship between operational risk and volatility inherent value of companies with voluntary disclosure research in the pharmaceutical industry and automotive companies

REFERENCES

[1] Mashayekhi, Bita and Mohsen Motmaen, 2013, "systemic risk and conditional conservatism", Financial Research, Volume 15, Number 1, p109-128.

[2] Shurvarzi, MR,AbedinBarzegarKhanduzy. [2009] lack of information asymmetry and informational role of conservatism", accountant, Year 24(210):56-63.

[3] Rai R, A Talangy. [2004]Advanced Investment Management", Samt publishing,

[4] Paek W, Chen, L, Sami L. [2007] Accounting Conservatism, Earnings Persistence and Pricing Multiples on Earnings, Working Paper, Sungkyunkwan University, Arizona State University-West Campus, and Lehigh University,

[5] Pervin Shroff, Ramgopal Venkataraman, Suning Zhang. [2004] The Conservatism Principle and the Asymmetric Timeliness of Earnings: An Event Based Approach, University of Minnesota, Carlson School of Management,www.ssrn.com

[6] Zhang J. [2008] The Contracting Benefits of Accounting Conservatism to Lenders"www.ssrn.com

[7] Wang Rz, O hOgartaigh, C, and vanZiji, T .[(2010] A signaling theory of Accounting Conservatism in proceeding of the 2010 European Accounting Association Annoul Meeting . Available at SSRN: http:/ssrn.com/abstract =1415305:European Accounting Association.

[8] BASU S. [1997] The Conservatism Principle and the Asymmetric Timeliness of Earnings. *Journal of Accounting and Economics 24 conditional Conservatism*. Working paper, Xiamen University.

[9] Richard Zhe Wang. [2013] Eastern Illinois University " OPERATING RISK AND ACCOUNTING CONSERVATISM: AN EMPIRICAL STUDY" *The International Journal of Business and Finance Research* , 7 (1)