

Research Paper

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# The effect of profit management and business strategies on the company's bankruptcy risk

Morteza Kiei<sup>1</sup> , Mahmoud Samadi Largan<sup>2\*</sup> 

1- M.Sc., Accounting, Tonekabon Branch, Islamic Azad University, Tonekabon, Iran.

2- Assistant Professor, Department of Accounting, Tonekabon Branch, Islamic Azad University, Tonekabon, Iran

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**Abstract**

Bankruptcy forecasting models are one of the techniques for predicting the future state of companies that estimate the probability of bankruptcy by combining a group of financial ratios. Early warning of the possibility of bankruptcy enables management and investors to take preventive action and distinguish favorable investment opportunities from unfavorable ones. The purpose of this study is to investigate the impact of profit management and business strategies on bankruptcy risk in companies listed on the Tehran Stock Exchange. For this purpose, 114 companies were selected as the research sample during the period of 2012-2019 through a systematic method. The research method is descriptive-survey. The results of the research showed that profit management has a positive and significant effect on bankruptcy risk. Business cost strategy has a negative and significant effect on bankruptcy risk. Business strategy has a negative and significant effect on bankruptcy risk.

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**Corresponding Author:** Mahmoud Samadi Largan

**Email:** mstlargani@gmail.com

## Extended Abstract

### Introduction

Bankruptcy forecasting models are one of the techniques of predicting the future status of companies that estimate the probability of bankruptcy by combining a group of financial ratios. Early warning of the possibility of bankruptcy enables management and investors to take preventive action and distinguish favorable investment opportunities from unfavorable ones (Bahramfar et al, 2014). The increasing expansion of economic activities and their increasing complexity on one hand and the necessity of paying attention to accurate accounting information and financial statements on the other hand, has led to the creation of new analytical and management methods in accounting. One of the most important methods is a category called profit management (Dadashi & Amiri Lolaki, 2019). Profit management is defined as taking conscious steps within the scope of accepted accounting principles to bring the reported profit to the desired level (Cohen & Malkogianni, 2021).

Bankruptcy prediction models are among the tools for estimating the future status of companies (Rezaei Pitenoiei, 2019). Investors and creditors have a great desire to predict the bankruptcy of companies because in case of bankruptcy, they will be charged a lot of costs (Hajiha, 2018). Business strategy as a means to achieve goals in the form of different methods that are used depending on the main goal of the companies, divides the companies into different types. Many studies have stated some factors affecting the risk of bankruptcy, but few empirical studies have examined the reliability of these criteria (Keyghobadi & Damankeshideh, 2020). Considering that there is no measurement of companies with high financial risk and considering the research in the field of earnings management and business strategies, few analyzes has been done on how earnings management and business strategies influence the company's financial decisions and, consequently affects the risk of bankruptcy. The company's business strategy shows how the company competes in its chosen market. To strengthen its business strategy, the company can use a set of policies and activities that can achieve a sustainable competitive advantage in its chosen market (Rostaei Darehmiane et al, 2015).

According to the mentioned materials, the main problem of the research is whether profit management and business strategies have an effect on the risk of bankruptcy in companies admitted to the Tehran Stock Exchange.

### Theoretical framework

Determining the exact cause or causes of bankruptcy and financial problems in each specific case is not an easy task. In most cases, several reasons together lead to the phenomenon of bankruptcy. But according to Don and Bradstreet's research (2000), the main reasons for bankruptcy are financial and economic problems. In some cases, the reasons for bankruptcy are determined by examining financial statements and records (Moradi & Sepahvandi, 2015).

Earnings management is biased financial reporting, based on which managers intervene in the decision-making process with a previous decision in order to gain some special benefits. Earnings management occurs when managers use their personal judgments in financial reporting and manipulate the structure of transactions to change reporting (Robati, 2013).

Business strategy is an integrated set of activities aimed at increasing the long-term strength and capability of the organization in relation to its competitors. Developing a business strategy (trade) is related to the orientation of the organization's territory or the way of businesses competition in the desired area of the organization and improvement of the competitive position of the products or services of a company or business unit in an industry or a specific market sector (Lin et al., 2021).

Agustia et al. (2020), conducted a research titled "Earnings Management, Business Strategy and Bankruptcy Risk: A Case Study of Indonesia", and concluded that there is no relationship between earnings management and bankruptcy risk.

Shariati (2019) conducted a research titled "The relationship between financial bankruptcy and accrual profit management and real profit management". The statistical population was the companies admitted to the Tehran Stock Exchange in the period of 2013-2017. The research method was correlative and the sampling was systematic. The research results showed that institutional ownership does not have a moderating effect on the relationship between financial bankruptcy and accrual profit management; but institutional ownership has a moderating effect on the relationship between financial bankruptcy and real profit management.

### **Research methodology**

This research, based on the method and nature, is placed in the correlative and descriptive research group, and scientific based on the objective. The research methodology is correlative. The time scope of this research has been determined for an eight-year period from 2012 to 2019. Its geographical area is the companies accepted in the Tehran Stock Exchange and over-the-counter.

### **Research findings**

In order to investigate the hypothesis of the research and analyze the information, Eviews software was used, and the results obtained from the first hypothesis of the research show that profit management has a positive and significant effect on the risk of bankruptcy. Because profit management hides investors' rational calculations and leads to a decrease in the quality of profit information presented in the financial statement. As a result, the low quality of the information contained in the financial statement will have a negative effect on the financial performance of the company and lead to an increase in the risk of bankruptcy of the companies. The second hypothesis of the research shows that the cost business strategy has a negative and significant effect on the bankruptcy risk. In cost leadership strategy, by reducing its cost, the company creates a competitive advantage in providing products and services at a price lower than the competitors, and as a result, it will find the possibility to compete in the intense competitive conditions prevailing in the industry. The results obtained from the third hypothesis of the research show that business strategy has a negative and significant effect on bankruptcy risk. Managers of business units are always looking for a solution to improve the performance of their business unit, and diversification strategy as a solution while creating a range of business activities for companies also helps to improve their performance.

### **Conclusion**

The current research was conducted with the aim of investigating the impact of profit management and business strategies on the company's bankruptcy risk. The results of this research are consistent with the results of research findings Arab Salehi et al. (2015); Wu et al. (2016); Hajiha (2018); and Shariati (2019); bankruptcy forecasting models are one of the techniques of predicting the future status of companies that estimate the probability of bankruptcy by combining a group of financial ratios. An early warning of the possibility of bankruptcy enables management and investors to take preventive action and distinguish favorable investment opportunities from unfavorable ones.

According to the present research, it is suggested to company managers to reconsider their business policies and to make decisions that, in order to improve the company's performance, choose managers who are risk-takers and prevent the company from going bankrupt by

moving towards product customization, give priority to the production of products with high added value, increase the amount of advertising with a focus on product quality information, use up-to-date technology in the production of new products will.