

Modeling factors affecting the corporate profit response coefficient by combining behavioral finance components

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Abstract

The aim of this research is to model the factors affecting the profit response coefficient of companies by combining behavioral finance components using the structural equation method. This research is applicable in terms of its purpose, descriptive-correlational in terms of collecting data, and with a survey method. Using data from 153 companies listed on the Tehran Stock Exchange during the period 2013 to 2022 and through the structural equation modeling method, the factors affecting the profit response coefficient were identified and ranked. The results of the research showed that the financial condition and performance factor with a path coefficient of -0.19, the capital market condition and performance factor with a path coefficient of 0.167, and the investment environment factor with a path coefficient of 0.12 have a significant effect on the profit response coefficient at the 0.05 error level. Accordingly, the structures of earnings per share, financial leverage, information asymmetry, market index return, inflation rate, free float shares, stock turnover rate and stock trading frequency were identified as structures affecting the profit response coefficient. Among the aforementioned structures, the absolute value of the coefficients of the structures showed that the inflation rate has the highest, and earnings per share has the lowest impact on the profit response coefficient.

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Extended Abstract

Introduction

In investment activity, investors need information to make decisions. The required information can be seen in the company's published financial reports. Financial reports are an excellent tool for obtaining information about the company's financial status and performance. One of the financial statement information used in decision-making is the company's profit. Profit is a comprehensive element for evaluating the overall performance of the business unit (Azizi et al, 2016). Agency theory (Jensen & Meckling, 1976) states a relationship between the owner (the principal) and the delegation of authority and decision-making to management (the agent) to optimize profits. There are opportunities for disagreement between the two sides of this relationship, which leads to information asymmetry. Information asymmetry occurs when a management (agent) has more information about the company's situation and prospects than the owner (principal) (Baroroh et al, 2022). Therefore, information asymmetry occurs when two parties to a contract or transaction have access to different information. Signaling theory is generally useful for explaining the behavior of individuals when two parties have different access to information. According to signaling theory, information asymmetry can be reduced when one party (the sender) chooses what information to send and how to send it (signal), and the other party (the receiver) must choose how to interpret the signal (information) (Nurfadilah et al, 2023). One tool that can be used to measure investor reaction to accounting earnings information is the earnings response coefficient. The earnings response coefficient is an estimate of the changes in a company's stock price as a result of the company's earnings announcement to the market. The earnings response coefficient is another measure of abnormal returns observed in response to unexpected elements of earnings reported by the company. In other words, the earnings response coefficient measures the sensitivity of stock markets to earnings reports through the regression slope coefficient between abnormal returns and unexpected earnings (ViDiat Moko & Indarti, 2018).

The importance of research on the earnings response coefficient primarily stems from the need to increase the trust of company shareholders in the disclosure of accounting information, which allows them to make informed decisions about investing in stocks. Therefore, the main goal of this research is to model the factors affecting the earnings response coefficient of companies by combining behavioral finance components in the Iranian stock market. Considering the above, the researcher tries to address the main question of how to model the factors affecting the earnings response coefficient of companies by combining behavioral finance components using the structural equation model.

Theoretical Framework

Corporate Earnings Response Coefficient

One of the tools that evaluate the quality of earnings is the earnings response coefficient. The earnings response coefficient is significantly related to earnings or the responsiveness of the information interpreted or contained in earnings. The earnings response coefficient is another measure of abnormal returns observed in response to unexpected elements of earnings announced by a company that publishes its earnings report. In other words, the earnings response coefficient measures the sensitivity of stock markets to earnings reports through a regression slope coefficient between abnormal returns and unexpected earnings (Nurfadilah et al, 2023).

Behavioral Finance Components

Investor behavior to buy stocks is influenced by the availability of information that can be used in stock valuation. However, there is still doubt whether the availability of this information, namely earnings information, has been well received by investors. Earnings

quality can be shown as the ability of earnings information to respond to the market. In other words, reported earnings have the power to respond. Strong market reaction to earnings information is reflected in a high earnings response coefficient, which indicates that the earnings are reported with quality (Paramita, 2020).

Adib Fard & Khan Mohammadi (2024) investigated the effect of management ability on earnings response coefficient considering the role of information asymmetry. The research hypotheses were tested based on a statistical sample of 164 companies over a 10-year period from 2012 to 2021 using multivariate regression models with mixed data. The results indicate a positive effect of management ability on earnings response coefficient; However, the results showed that increasing the difference between the bid and ask price as a measure of information asymmetry leads to the adjustment of this relationship, in a way that weakens the effect of management ability on the real profit response coefficient.

Ramineh (2024) examined the effect of conditional conservatism and comparability of financial statements on the profit response coefficient. The statistical population of the study is companies listed on the Tehran Stock Exchange and the sample under study includes 152 companies listed during the years 2018 to 2022. The results obtained from data analysis show that the comparability of financial statements has a positive and significant effect on the profit response coefficient, and conditional conservatism has a positive and significant effect on the profit response coefficient.

Research Methodology

This research is applicable in terms of purpose, descriptive-correlational in terms of data collection, and with survey method. Using data from 153 companies listed on the Tehran Stock Exchange during the period 2013 to 2022, and through the structural equation modeling method, the factors affecting the earnings response coefficient were identified and ranked.

Research findings

SPSS software and structural equations were used to analyze the data. The results of the research showed that the financial condition and performance factor with a path coefficient of -0.19, the capital market condition and performance factor with a path coefficient of 0.167, and the investment environment factor with a path coefficient of 0.12 have a significant effect on the earnings response coefficient at the 0.05 error level. Accordingly, the structures of earnings per share, financial leverage, information asymmetry, market index return, inflation rate, free float shares, stock turnover rate, and stock trading frequency were identified as structures affecting the earnings response coefficient. Among the aforementioned structures, the absolute value of the coefficients of the structures showed that the inflation rate has the highest and earnings per share has the lowest effect on the earnings response coefficient.

Conclusion

The present study aimed to model the factors affecting the profit response coefficient of companies by combining behavioral finance components using the structural equation model. The results of this study are consistent with the results of Adib Fard & Khan Mohammadi (2024), Ramineh (2024), Ahmadi Olyaei (2023), Zareian Kalkhouran & Zareian Kalkhouran (2023), Hajannejad et al, (2022), Kordestani & Abdoli (2022), Bahaghighat & Rezaei (2018), Sandy & Mulya (2024), Kim et al, (2023), Elviani et al, (2022), Niswah et al, (2022), Sun et al, (2021), Awawdeh et al, (2020), and Wijaya et al, (2022). Sandy & Mulya (2024) showed that high earnings quality attracts high investor sentiment in stock trading; good news is quickly processed in the price and the price increases in a short period, while bad news can also lead to price corrections and investor sentiment. Also, a positive relationship was

observed between return on equity and earnings reaction coefficient, which strengthens investor sentiment in this relationship.

According to the research results, the following suggestions are made:

It is suggested that actual and potential investors pay attention to earnings per share and financial leverage as indicators of company performance results at the time of earnings announcement, in order to predict the market reaction to unexpected earnings, as well as the percentage of free float shares and the stock turnover rate and the frequency of stock trading as indicators of the atmosphere prevailing in stock trading in the market, as factors affecting the earnings reaction coefficient.