

Business Strategy and Real Earnings Management

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Abstract

The main purpose of research is the evaluation of the strategy of marketing, competition in market and management of real profit in accepted companies in the stock market of the stock exchange in Tehran. Statistics sample of this research includes 138 accepted companies in the stock market which their data collected and analyzed for a period of 8 years (2008 to 2014). In this study for testing, the hypothesizes, correlation method is used. Statistical data analysis, in the confidence level of 95 percent, and testing of hypothesizes, by using the statistical method of Panel data and the pattern of linear regression is made. The result of hypothesizes testing of this research show that, the strategy of expenses leadership and the differentiation strategy with a direction of profit has positive and meaningful relationships and also market competition causes to improvement between the relation of the strategy of leadership expenses and differentiation strategy with profit management.

Keywords: strategy of marketing, management of real profit, market competition

Introduction

In recent years, the concept of strategy in the organizational literature has been considered by financial researchers significantly. The strategy is defined as will and plan by an organization for achieving their corporate long time aims, and prediction of needed sources to meet those targets. The strategy of commercial units may have different consequences. So selecting a strategy requires analyzing of current data of the company and deep thinking about the results. One of the consequences of selecting different strategies in companies, is its effects on the behaviors of financial reporters, which most of managers and owners consider it. Because, nowadays data is considered as an important tool in decisions, and undoubtedly the quality of decisions depends on accuracy and updating of data at the time of decisions. In the financial markets, these data can reflect in the form of signs, news, different predictions from inside and outside of the company, and be accessible for other shareowners, and cause reactions, so some changes happen in the price of shares (Noor Allhag & colleagues, 2013).

The strategy of marketing provides this motivation in managers to report the profit in a way which causes increasing of the stock market value of the company. There are different researchers who were done about the ability of management of profit for the purpose of saving and increasing of share's price. Achieved results show that the control of profit can save and even raise the prices. (Vadiee & Azimifar, 2012).

About management of profit, there are two general approaches. The first one expresses that managing of profit is suitable and potentially can increase the information content of the profit. In the second approach; researchers believe that the abilities of the managers can give them the chance of manipulating of the profit to deceive the investors (Ahmadi Poor & NAzari, 2000).

Now there is a question that is the strategy of marketing effective on the real managing of profit? The practical results of research can help the users. It is shown that the strategy of expenses leadership, probably increase the management of real profit and that is a motivation for the managers to

manipulate the actual activities of a company for the managing of real profit. So about this issue, if the investors know about this strategy which is used by managers, it will be harmful to the company. It is seen that the competition of products market cause the promotion of positive relationship between the strategy of expenses leadership and management of real profit and it is suggested to the investors that the level of competition in products market reduces the quality of profit, which they should pay attention to it in their decisions.

Theoretical foundations

Managers usually manage the profit because of deceiving the shareholders about a real economic function of the company; this is done by manipulating accounting numbers or manipulating of actual activities, it reduces the accuracy of the profits of products report, also might cause lack of a match in data and reduction of competence of investing. The management of profit not only hides real function of the company but also it obscures the actual process of profit improvement and the income of the company which is useful in the prediction of future development of the company (Mak Nikolzand Steven, 2008).

Some operational decisions, in other words, manipulated real activities refers to the actual management of profit and achieves his own considered profit (Roychowdhury, 2006). They defined the management of real profit as a deviation from routine operational activities by managers by the purpose of misleading of some profit achievers about this issue which the aims of the financial report in the process of common operation evaluated. If the managers are involved in such activities, shows their tendency to the management of real profit, because such actions can affect the current period profit. Reduction of optional expenses is one of the methods of administration of actual profit. Optional costs such as expenses of research and development, advertisement, fixing and keeping, which imposed in a period. So managers of companies can increase the profit and decrease the reported expenses by reduction of optional costs. If the managers of companies reduce the optional expenses for the purpose of providing the purpose of profit, they should report unusual fewer amounts of optional expenses. Optional expenses usually include investing expenses. If these expenses are in the form of cash, reduction of this expenses, release less cash from the company, which this action has a positive effect on the process of cash operation (Roychowdhury, 2006).

Nowadays most of the organizations instead of having comprehensive and united strategy; they use a collection of related strategy, which each one is designed in different levels in a company. The meaning of strategy in the literature of organization is developed in the decade of 1950 by the researchers of Harvard economy faculty (Snow & Hrebiniak, 1980).

According to Chandler definition strategy means defining of the long-term purpose of investing and using the needed sources for performing these aims. Mintzberg (1987) thinks that an organizational strategy points to a plan, pattern, situation, perspective of a company or the industry. There are three levels of strategy in multi products prominent organizations: 1) organization strategy, 2) Marketing strategy, 3) duty strategy. It should be mention that in small organizations first and the second strategy mixed and make just one level. Each strategy in spite of answering to the environmental situation, by the strategy of other levels, is matched with upsides and competitive abilities of a related trading unit and with the level of the company as a united collection (Walker, 1987).

In the free market economy, companies have the motivation to invest a lot, because if companies able to increase their customers, funding will be profitable for them. Whatever makes the different the modern organizations and companies from past ones is the unstable and complicated environment, high level of competition, sudden changes, development of technology and media. According to the Martez definition, competitiveness is equal with an economic power of a unit against opponents in the market which easily, present goods, services, skills and ideas out of borders (Paghooyan & Nasiri, 2009).

Competitiveness means being able to reach suitable occasions and being stable in the world market. Competitiveness means achieving the ability of competition in the market, which the word of the strength of competition has a different meaning by people, organizations, and institutes in the world. Competitiveness of an economy depends on the competitiveness of companies inside it (Porter & Miller, 2002).

Competition of a market is a crucial criterion for evaluation of the countries success level, industries, in the business, economy, and politics ambitious scope. It means that each country, industry, which has a high level of competitive ability in the competitive markets, we can say has high competitiveness (Begse & Betignis, 2007).

Undoubtedly the strategy which is used in an organization is effective on the financial data of the company. In economy cases, users need accurate and reliable data to do their analysis, and naturally, lack of such a data makes problems in their decisions. Numbers and financial reports are an essential part of data which are needed for decisions. Profit is the most important data source in companies and people who decide rely on the profit more than every other criterion. However, it is possible that profit not to be the reflection of a real function of companies and management, and by a manager is manipulated to increase his income (Khoshtinat, 2006).

To evaluation of the relationship between a strategy of marketing and management of profit, we need three theories which mentioned below: The method of representative (Jensen & Meckling, 1976), the theory of political cost (Watts & Zimmerman, 1978), and the theory of Cost of deals (Coase, 1976). According to Jensen and Meckling (1976), the relation of an agency which on the base of it a person or some owners, select someone else to decide instead of them, has the costs of observation of the owners on the function of the representative, expenses of obligations and resulted in harms

Jensen and Meckling believe that (1976) that managers in their decisions at first consider their profits. As if the profit of managers and owners have the same direction, the manager's decisions will be according to the company's profit, but if not, managers will decide according to their profits. Jensen and Meckling believe that managers, as they are deciding about company's strategy, by manipulating the profit in accounts (profit management) work according to their benefits. Also, the other two theories Political cost (Watts & Zimmerma, 1987) and cost of deals (Coase, 1976) mentioned to the manager's tendencies for using accounting methods for their benefits (Noor Although & colleagues, 2013). According to the theory of political cost, Watts and Zimmerman (1987) think that in management decisions which includes accounting decisions, managers should evaluate huge observation environments, and financial accounting reports for helping in decisions should be presented to public, so they are effective on decisions. When in a society public pay attention to accompany with high level of growth, people and their representative (observers), consider this growth related to the profit searching of the company owners, and will try to find a way to reduce the profit of that company with tax, exclusive claims, production rules or by reduction of helps and state rewards, which all of them will decrease the profit of the company. (Same source). Managers who believe that their companies have the potential of reaching high profits, they may try to impose their ideas on investors and public. These tries can be done by state employees or by increasing of conservativeness of the accountant (Wattz & Zimmerman, 1978).

It is thought that conservativeness can change the name of a company from being lucrative to a less profitable company. Managers of the company by using the strategy of explorative marketing, have less emphasis on the reduction of deals expenses, but they preserve the potential profit for the future accounting periods which is more suitable for company and the managers. Such an approach causes to an increased level of conservativeness in the companies with the strategy of exploration. This attitude of investment market to the explorative companies may cause that the managers of these companies instead of trying to show high level of their current profits, keep them to the future periods. This approach potentially will increase the level of conservativeness (Same reference). From another side, the owners of the companies which use the strategy of resistance tend to emphasize on current

financial function, because naturally these companies are more stable and have less risk for investing. So when it is the time of deciding about accounting process, the companies with the strategy of resistance, for keeping the special level of their profits, by manipulating the commitment issues, try to keep the current situation. Companies with the strategy of resistance consider short-term profit achievement and they manage the profit. Also, the managers of profitable units should consider the environmental and economic condition as they are selecting company's strategy. Because changes in the economic conditions, can change the forces of demand and ask in the competitive situation. So the trading strategy of the companies which response the environmental changes, relatively depends on environmental changes and other companies strategy (Minberge, 1978).

La Porta and colleagues (2000) claimed that the companies accounting process could be affected by a condition of the company according to its geography and observation situation. So the changes out of the companies affect the relation between the companies with their financial report process. (Lueez & colleagues, 2003). So it seems that changes in the situation of the huge economy (as a part of outer condition) potentially affect the relation of marketing strategy with management of the profits of the companies.

Literature review

Noor Alhag and colleagues (2013), searched about the relation between explorative and resistant strategy with the quality of profit in the huge economy and they get on this conclusion that at the time of high economy condition, explorative companies, have conservative accounting, and resistant companies have a high management of profit. At the time of less growth of an economy, explorative companies, become conservative as they want to report while resistant companies wildly get involved with the management of profit.

Denis and colleagues (2013) searched for the relation between profit management and lack of matching in information according to the lack of certain condition. Results show that in complicated and active condition, that relation between optional commitment issues and lack of matching of data, which is considered as price changes of share and development of measuring, becomes weak.

This issue emphasizes on the investors' problem for evaluation of profit management in an uncertain condition. Finally, on this occasion, commitment issues are optional. Park and Jung (2013) evaluated the relation between the structures of investment; free cash movements, the strategy of variation, and company's functions, at the same time. Results show that free cash movements cause the improvement of variation in companies. Also, results show that financial instrument, is one of the effective ways in decreasing of free cash movements, and this role of a financial instrument is more observable in the companies with the strategy of variation.

Khodami Poor and Bazrami (2013) reached on the conclusion that there is a meaningful and negative relationship between the index of each Findal Hirshman and the index of bans of an entrance with the quality of the release, which means there is a positive relationship between competition and quality of the release. Also, results show that the index of each Findal – Hirshman and the index of entrance bans do not have a meaningful effect on the relation of between independence of the management board and quality of the release.

ArabSallehi and colleagues (2011) in research titled the effect of environmental risk, the strategy of the company and structure of the investment on the function of companies; they searched the relation between environmental risk, the strategy of the company and structure of finance with the function of companies. Results show that there is a meaningful relation between ecological risks and the free cash movement of each share, between the risk of the environment and rate of output of shareowners' income and between a structure of investment and free cash movement of each stock.

Rezaee and Azem (2011) evaluated the effect of intensity of the competition and trade guideline on the relation between financial instrument and function of companies. Results show that the effect of a financial instrument on function, for the companies with the following guideline of the leadership of cost, is negative rather than the companies with the differentiation attitudes. From another side, there is a meaningful and positive relation between competition intensity and company's function.

Ghasemi and Ebrahimi (2007) evaluated the effect of suitable competitive guidelines on the competence of the companies. According to this research, the guideline of cost leadership had the most effect in the competence of the trading company, and after that, the guidelines of the best way of spending money, differentiation and concentration, in order have an important role.

Hypothesis of the research

H1: There is a positive and meaningful relationship between the strategy of cost leadership and management of real profit.

H2: There is a positive and meaningful relationship between the strategy of differentiation and management of real profit.

H3: Competition in the market will improve the positive relation between the strategy of cost leadership and management of real profit.

H4: Competition in a market will improve the positive relation between the strategy of differentiation and management of real profit.

Research methodology

Present research is done on the base of aim, practical type and by using correlation. Considered method to do this research is semi-experimental, and post-event (by using past information), in the branch of positivity researches of accounting and based on real data. After selecting sample companies and classifying them, for doing some of the calculations Excel software was used. And for analyzing the data, multi-variation linear regression is used.

To test the assumption of the research in this research, a multiple-variable regression model was used as it follows:

$$|RM| = \beta_0 + \beta_1 ATO + \beta_2 PM + \beta_3 CHHI + \beta_4 CSHARE + \beta_5 ATO \times CHHI + \beta_6 PM \times CHHI \\ + \beta_7 ATO \times CSHARE + \beta_8 ATO \times PM + \beta_9 ROA + \beta_{10} LEV + \beta_{11} SIZE \\ + \beta_{12} GRWTH + \varepsilon$$

In which we shall see that

|RM| = absolute value of managing real interest

ATO= Leading cost strategy

PM= Product distinction strategy

CHHI= competition extent at the industry of product market

CSHARE= competition extent at the product market

ROA= asset returns

LEV= financial lever

SIZE= company size

GRWTH= asset growth

Research variables & the way of measuring it

1. Dependent variable

The dependent variable is the management's real interest in the research. To achieve the real interest of management, ROUCHODARI method is used. To study the level of manipulation of real activities as the similar research, in this research, there are three standards including cash abnormal flow level of operational activities, abnormal level of optional & production costs. The executed researches after ROUCHODARI (2006), such as Zung (2007) & Gani (2005), presented some proofs to support these standards.

1.1. Cash abnormal flows of Operational performance

In this project, like Dichoo's research (1998), to estimate the abnormal flow of cash eventuating from operational activities in such a way that the remainder of it considered as operational activities' cash abnormal flow, the following model was used.

$$\frac{CFO_{it}}{TA_{it-1}} = \beta_0 + \beta_1 \frac{1}{TA_{it-1}} + \beta_2 \frac{Sales_{it}}{TA_{it-1}} + \beta_3 \frac{\Delta Sales_{it}}{TA_{it-1}} + \varepsilon_{it}$$

In which:

CFO= net operational cash flow

TA_{it-1} = all assets of last year

$Sales_{it}$ = All sales' revenue of the company

$\Delta sales_{it}$ =Changes of total sales' income of the company in the year t & t-1

ε_{it} = Model error that the error amounts consider as abnormal cash flows eventuating from operational activities.

1.2. Production abnormal costs

In this research, like Dicho's research (1998), to estimate abnormal costs of production in such a way that the model's remainder considers as production's abnormal costs, the following model is used.

$$\frac{PROD_{it}}{TA_{it-1}} = \beta_0 + \beta_1 \frac{1}{TA_{it-1}} + \beta_2 \frac{Sales_{it}}{TA_{it-1}} + \beta_3 \frac{\Delta Sales_{it}}{TA_{it-1}} + \beta_4 \frac{\Delta Sales_{it-1}}{TA_{it-1}} + \varepsilon_{it}$$

In which:

$PROD_{it}$ = production costs of the company equal total final price of the sold product in addition to inventory changes

CFO_{it} = net flow of operational cash sums

TA_{it-1} = All assets in the previous year

$sales_{it}$ = Total sales income of the company

$\Delta sales_{it}$ = changes of total sales' income of the company in the year t & t-1

ε_{it} = Model error that the error amounts consider as abnormal costs of production.

1.3. Abnormal optional costs

In this research, like Dicho's research (1998), to estimate abnormal optional costs in such a way that the model's remainder considers as abnormal operational costs, the following model is used.

$$\frac{DiscExp_{it}}{TA_{it-1}} = \beta_0 + \beta_1 \frac{1}{TA_{it-1}} + \beta_2 \frac{Sales_{it}}{TA_{it-1}} + \varepsilon_{it}$$

In which:

$DiscExp_{it}$ =Company's optional costs

TA_{it-1} = All assets in the previous year

$Sales_{it}$ = Total sales income of the company

ε_{it} = Model error that the error amounts consider as abnormal optional costs

2. Independent variables

In this research, the independent variables are cost leadership and product distinction strategy.

2.1. Cost leadership strategy

In the cost leadership strategy, the company produces & presents standard products with decreased final prices for the customer (one who is sensitive when it comes to price). To calculate this strategy, the proportion of total operational sales to the average operational assets is used & the operational sale is eventuated from the difference in total assets, cash flow & short-term investments.

2.2. product differentiation strategy

Differentiation strategy means that some products or services which are considered as unique product or service to be presented to customers who are not sensitive about price. This strategy is composed of total operational revenue with R&D ratio on total sales.

3. Moderator variable

A degree of competition in the industry's product market is the moderating variable.

Degree of competition in the product market

In this research, the moderating variable is a competition of the product market. This indicator measures concentration degree in a specific industry. HERFINDAL-HIRSHMAN indicator is composed of the total sum of the second power market share in all active enterprises in industry & is gained based on the following formula (Chen et al. 2012).

$$HHI = \sum_{i=1}^K S_i^2$$

In which HHI is HERFINDAL-HIRSHMAN indicator, K is the number of active enterprises in the market & S_i is the market share of a company I which is explained the following relation:

$$S_i = X_j / \sum_{L=1}^n X_j$$

In which X_j shows sells of company M & j indicates a type of industry. HERFINDAL-HIRSHMAN indicator measures the industry focus. In the industry; the larger the indicator, the larger the focus which leads to smaller competition & vice versa.

4. Control variables

In this study, asset returns, finance lever, company size & sells growth are considered as a control variable.

4.1. Asset return

Asset return ratio springs from dividing net interest out of the whole assets.

4.2. Financial lever

To calculate it, total ratio of debts to assets is used.

4.3. Company size

In this research, assets' natural logarithm was applied to state the size of the company.

4.4. Assets Growth

Office value changes' percent of total assets at the end of the term in comparison to the previous fiscal year.

Results

1. Descriptive statistics results of the research

Research variables for the results of the descriptive statistics are shown in table 1, in which 106 companies were investigated. Data collected in the form of a panel and were analyzed by using 636 observations out of year-company & year-industry basis. Results of the descriptive data analysis indicate that the average financial lever shows more than 57% of companies, finance their assets from their debt sources. Descriptive statistics show that there is optional sample variation & thus the gained results could be extended to the whole society. Since descriptive statistic observations' extent are close to each other; then, average & medium imply that data of the research enjoy of an almost normal distribution.

Table 1. Descriptive statistic results of the research variables

Variables	Average	Medium	Standard deviation	Min.	Max.
Abnormal optional costs	0.085	0.008	0.862	-0.0085	0.567
Abnormal production costs	0.057	0.002	0.752	-0.0067	0.862
Abnormal cash flow	0.036	0.006	0.964	-0.016	0.537
Cost leadership strategy	0.652	0.528	0.532	0.057	0.861
Product differentiation strategy	0.235	0.019	0.237	-0.084	0.768
Product competition market	0.097	0.052	0.756	0.652	0.395
Asset return	0.251	0.157	0.362	-0.265	0.457
Financial lever	0.583	0.562	0.542	0.085	0.861
Company size	14.852	12.863	8.651	9.631	17.541
Asset growth	0.953	0.562	0.627	-0.153	5.261

2. Test results of hypotheses

In table 2, the research hypotheses' test results using research variables' test are shown. The results indicate that statics F of the models is positioned at an optimal confidence level of 99%. The determinant tempered coefficient indicates that the dependent variable's changes are illustrated by descriptive variables. Watson camera's static confirms the correctness of the regression paradigm about the fact that all relations between variables & observation dependency are linear. The coefficient figures for cost leadership strategy variables in terms of all three real interest management standards (abnormal optional cost, abnormal production cost & abnormal cash flow) are positive & at the confidence level of 99% is significant; thus, these results imply that there is a significant positive relationship between cost leadership strategy & real interest management. Therefore the first hypothesis of the research is confirmed at the confidence level of 99%. Besides; coefficients of the product differentiation strategy variable for the three standards of real interest management (abnormal optional cost, abnormal production cost & abnormal cash flow) is negative & significant at the confidence level of 99% which represents a significant negative relationship between product differentiation strategy & all three real interest management standards. Hence, at the confidence level of 99%, the second hypothesis is refuted.

Cost leadership strategy coefficients at the product market competition are positive for all three (abnormal optional cost, abnormal production cost & abnormal cash flow) real interest management standards & significant at the confidence level of 99%. Hence, product market competition enhances the relationship between cost leadership strategy & real interest management for all the three standards. This was illuminated when coefficients grew bigger. Concerning the stated, at the confidence level of 99%, the third hypothesis of the research is accepted. Furthermore; coefficients of the product differentiation strategy variable at the product market competition for the three standards of real interest management (abnormal optional cost, abnormal production cost & abnormal cash flow) at the confidence level of 99% is positive & non-significant. Although; product market competition variable made the relationship between product differentiation strategy at the product market

competition to become positive for all three real interest management, one cannot conclude it statistically. Therefore; at the confidence level of 99%, the fourth hypothesis of the research is refuted. The control variable results show that asset return & sell growth variables of the company have a positive & significant relationship (at the confidence level of 95%) with all three real interest management standards. This is while at the confidence level of 99%, the company size variable has a reversed relationship.

$ RM = \beta_0 + \beta_1 ATO + \beta_2 PM + \beta_3 CHHI + \beta_4 ATO \times CHHI + \beta_5 PM \times CHHI + \beta_6 ROA + \beta_7 LEV + \beta_8 SIZE + \beta_9 GRWTH + \varepsilon$							
Variable	Abb.	DicExp		PROD		CFO	
Fixed amount	β_0	0.742	0.000	0.651	0.000	0.857	0.000
Cost leadership strategy	ATO	0.358	0.000	0.453	0.000	0.259	0.000
Product differentiation strategy	PM	-0.215	0.000	-0.952	0.000	-0.037	0.000
Product market competition	CHHI	0.235	0.000	0.445	0.000	0.862	0.000
Cost leadership strategy at the product market competition	ATO \times CHHI	0.918	0.000	0.852	0.000	0.529	0.017
Product differentiation strategy at the product market competition	PM \times CHHI	0.627	0.527	0.152	0.368	0.334	0.452
Asset returns	ROA	0.512	0.621	0.923	0.000	0.753	0.000
Financial lever	LEV	0.837	0.851	0.562	0.058	0.921	0.627
Company size	SIZE	-0.952	0.000	-0.663	0.000	-0.562	0.000
Sells growth	GROWTH	0.415	0.000	0.448	0.000	0.328	0.000
Modifying determinant coefficient		0.37		0.35		0.32	
Watson camera		2.26		2.23		2.16	
Static F		98.562		67.653		78.653	
Significance level		0.000		0.000		0.000	

Conclusion and suggestions

This study was aiming at finding an answer to this question; “whether business strategy affects real interest management”. The first hypothesis’ results show that there is a positive & significant relationship between cost leadership strategy & real interest management. Hence, cost leadership strategy affects real interest management of the company significantly. These results imply that managers in companies that follow cost leadership strategy intend to pay more attention to tempering real activities for interest management & achieving their goals & positions. These results are comparable to those of GAO research (2015).

Results show that based on this hypothesis; there is a negative & significant relationship between differentiation strategy & real interest management. This may mean that managers in companies that follow differentiation strategy are highly unlikely to choose the method of tempering real activities of the company for interest management. These results are comparable to those of GAO research (2015). Results of the study's hypothesis show that product market competition leads to an enhanced positive relationship between cost leadership strategy & real interest management. This may imply that product market competition presented managers with the option of using cost leadership strategy to decrease potential problems resulting from competing over product market & intend to temper with interest thru

tempering with the real activities of the company. These results are comparable to those of GAO research (2015).

Results of the hypothesis reveal that competing in the product market leads to a positive relationship between cost leadership strategy & real interest management. According to these results, competition in the product market was a reason for managers to aggravate non-consistency of information by tempering real activities of the company & consequently follow suit differentiation strategy. These results are comparable to those of GAO research (2015).

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