# APPLICABLE ACCOUNTANCY THEORIES ON THE CAPITAL MARKET

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*Abstract: Traditionally the accountancy theory developed as a structure of principles that describe the practice.The sufficient conditions for a market to be efficient are: the lack of the costs of the title transactions; all the information to be valid, free and balanced for all the market participants; transaction participants in the capital markets to have homogeneous foreseeing regarding the implications of the obtained information.*

*Key words: capital market, accountancy theory, decisions, financial information.*

Traditionally the accountancy theory developed as a structure of principles that describe the practice. This conventional structure evolved step by step in time as a pragmatic ground that makes the role of the user of the accountancy not to be recognised until recently in the literature of speciality.

Ideally the accountancy theory has to provide to those who make the decisions or elaborate the accountancy politics tools that permit accepting the best solutions, in these procedural problems that come in contact with there is a 'collection' of accountancy theories that are frequently in conflict. The difficulties regarding the working out of a general valid and acceptable theory devolve from the discrepancy regarding the accountancy goals.

The accountancy theory can be defined as a logical way of thinking, represented by a set of exhaustive principles that:

- offer a general frame to refer to through the accountancy practice to be evaluated;
- to direct the development of new practices and procedures ( Hendrikson E., 1991)The accountancy theory has to be used for explaining the present usage; the goal is to realise their understanding.

By definition each theory is a set of clauses or sentences interconnected with the help of some logical rules or judgement. The theory has to contain hypotheses or premises that can be tested or conclusions based on valuable judgements. The main test of the theory is its ability to explain and foresee ( Walt and Zimmerman, 1986 ). The traditional orientation of the accountancy theory (before the adopting its standards) was interested mainly in distillation the practical experience. So, at first the accountancy theory was first descriptive concentrating especially on the observation of the accountants' behaviour instead of noticing the real world phenomena (Sterling, 1967). The conventional theory couldn't distinguish between a theory set up and the testing of this theory implications (for example, the accountancy principles are selected as part of the theory, due to the general acceptances, the acceptance is the sole valid condition of these principles).

## Efficient market theory

Efficiency is frequently considered as one of the essential goals in economy and accountancy, But what does the efficiency concept represent and how does it manifests on the capital market, with a strong international character? The answers to these questions come next.

The examination of the capital market reactions at the accountancy data publishing supplies a set of testable theories that don't depend on the individual usage of the investment, because it analyses the aggregate behaviour of all the participants. The capital market study is concentrated on the society as a whole and it would be a mistake to assume that the market ideal behaviour determination can be realised through the concentration of attention at each individual level.

The capital market role is to provide funds for those who make efficient decisions. The importance of the financial information result firstly from the necessity of ideal allocation of the limited resources among the procedures so that the gross internal product to be maximised. Secondly the piece of information is necessary to allow the persons who invested to have an ideal portfolio of titles at an accepted risk level (Hendrikson, 1991).

The efficient market theory is based on the assumption that the capital market is highly competitive. That the price of the valuable titles is moving free, up to the balance point between the demand and offer for each title when new pieces of information are available and liable to alter the expectances. The valuable title price is modified up to a new balanced position (it is about the relative price that modifies when new relevant information appears).

The level of the price will be the result of a certain number of factors regarding the general economic conditions (interest level, inflation level) and some specific factors connected to the situation and evolution of the emitter's title or psychological elements (rumours).

A capital market is considered efficient when the valuable titles prices reflect integral and fast every piece of information considered relevant (irrelevant information are not taken into consideration on the market). As a conclusion, every information that is proved to be relevant is rapid and with accuracy prevailed by the price of the valuable title. In the economic way an efficient market is not necessarily a perfect market.

It is important to mark that the capital market efficiency is not a perfect predictive power from the behalf of those who invested. The current prices of the valuable titles represent the best evaluation of economic value on the base of the existent information. The sufficient conditions for a market to be efficient are (Hendrikson, 1991):

- the lack of the costs of the title transactions;
- all the information to be valid, free and balanced for all the market participants;
- transaction participants in the capital markets to have homogeneous foreseeing regarding the implications of the obtained information.

These aspects are sufficient in the set up of the theoretic model of the efficient market, but they are not necessary in the real world. The only necessary condition for a market to be really efficient is that every relevant information to be included and without prejudice in the price of the valuable title. When the efficiency of the capital market is discussed in the financial literature, in fact it is about the problem of price set up. The process through which the value of a title is decided is not discussed. In the capital market it has to exist a certain number of potential buyers and sellers of the same titles, the opinions regarding the real value of the title are different. Some of those who invest can be more informed, others will try to estimate the next results, using past pieces of information.

The last price represents the general agreement of these litigious opinions when we notice the homogeneity of the ideas and actions it means that the efficiency of the capital markets is lees certain. Here it is the problem of the way in which we put together the different opinions and individual tendencies of all the participants on the market. If the capital market is efficient then the valuable titles prices should reflect all the available pieces of information.

A market is efficient if, due to a set of information it is impossible to obtain economic benefit from transactions because of knowing some points of view (Watt and Zimmerman, 1986). So that, having a number of pieces of information (for example the accountancy results annually published) this is worldly accepted by all market participants and the competition determines on a certain level the prices to allow the obtaining of an income equal with the market risk ( the economic profit is zero because the profit is the same as the paid price).The market risk can be obtained from the market return. In an uncertain world there are several levels for return instalment for every risk level.

The tests done ignored the costs of the obtaining information. These costs vary considering the wanted set of information (for example the cost for obtaining information referring to the preceding periods is low compared with the costs for obtaining confidential information from the managers of the companies.

We can divide the ways of manifestation of the efficient market into 3 categories (depending on the conclusions resulted from the empirical researches): the weak form, the half strong form and the strong form of the efficient market.

1. **The weak form of the efficient market** considers that the set of information Et contains only the past pieces of valuable titles or only the information about the old values of the title transactions. This kind of information is available for a high number of users at a low cost so that no unusual benefits can be obtained this way. The new information is included in the

price; if the new information will be gradually included in the price, the modification of the price of the title could offer a hint about the size and direction of the next change of the price.

A capital market is efficient in the weak form if it doesn't permit the obtaining of a profitable stock exchange evaluation of the valuable titles, using the included information in the past prices. On such a market all the available information was already used and taken into consideration in the price of the transactional assets. This means that the prices on such a market will have a random evolution because at random means unexpected. This theory comes in contradiction with the chartist thinking which sustains that the practice of shares can be foreseen by studying the past change of the prices, using conventional tendencies and methods.

2. **The half strong form of the efficient market** considers that the information It contains all the available information (both past and the present ones) existent on the market at a determined (t) time. These pieces of information are already available at a low cost, so we can not notice unusual income in this case. Although the accountancy information doesn't represent the only source of public information about the companies it is an important element in the decisions. This form of am efficient market assumes that when the annual accounts are published the information contained in these reporting documents had already been known or anticipated (for example the current profit of the financial activity can appear in the newspapers before the publishing of the annual accounts.

So that the price of the valuable title will reflect the information in the moment when this becomes available through publishing or anticipating, no more price adjustments are necessary when the annual accounts are published (the information was already included in the price. The annual accounts still represent a confirmation of the foreseeing of those who invested and permit checking the relevance of the other alternative sources of information. Empirical researches done to test the efficient forms of the capital markets draw the conclusion that nowadays only the half strong form or the efficient market theory can be revealed in a certain number of value stock exchange around the world (NYSE, London Stock Exchange).

3. **The strong form of the efficient market**: in the empirical tests realised for validating this form the information will have all the pieces of information known by everybody at the t time. All the information about the past, present and future of the companies include the confidential information about managerial plans for interests, price strategies. There are still very few chances for such a market to be real.

If the accountancy would serve social functions then it should publish all the relevant information as soon as possible to minimise the possibility that some participants to use the advantage of holding some private information, information that permit them to obtain an outstanding gain. Here we deal with the gain's transfer from one participant to another. Another consequence of the using of the private information by a small group of participants would be the fact that in this case the resources aren't ideally allotted.

The next question is on what level the available information analyse on the market is appealing for emitting a high income if the efficient market theory proves to be real? Many statistics resulted from empirical researches proves that this theory is valid only in some stock exchange in the world, at least in its half powerful form (Samuels and others, 1995). In 1985 Jensen sustained that ' the efficient market theory is the best-settled fact among the social studies. No theory was better documented than the efficient market theory. And there are several scientific studies which indicate that in stock exchange from USA the price of the valuable titles contain all the existent information (Jensen, 1986).

It also has to be noticed the difference between the American and European stock exchange. The New York and London stock exchanges proved to be efficient while the Paris and Frankfurt had provided little proves and about the other European stock exchanges can't be said anything ( Samuels and others, 1995 ).

Scientists on both sides of Atlantic keep analysing for more than twenty years the way in which the price of the title react at new information. It could be considered a blasphemy that the stock exchanges are not efficient. That the valuable title price reflects all the available information on the market it doesn't mean that the price is equal with the fundamental value of the title. The essential problem here is that we don't know what does the fundamental value of a title is (we have to count on evaluating methods which are based on assumptions).

Other difficulties result from the lack of understanding or misunderstanding of the efficient term in the efficient market theory context. Efficiency in these theories means that the price of the valuable titles is adjusted to reflect all the available information and that not everybody interprets in the same way the information.

We also have to present the importance of information asymmetry. In the 80's the managerial policy of reflecting the company results in the most attractive way it became a subtle art representing a frequently used practice in USA and in Great Britain

The manipulation of the results can determine that a small group of participants on the market to have information of which the others can't benefit. In a world in which information is transmitted through multitude channels the capital market learns to make the difference when a company has money problems which can't be hidden forever through accountancy subterfuges. If the difficulties about the cash of some companies become known and the capital market is efficient at least in its half-strong then the present price of the valuable title includes the implications of the difficulties connected by cash flow over the results.

The price will be decided so that those who invest to earn on average the adjustment rate of the market, adjusted at its risk (in the half strong form of efficiency the capital market isn't tricked by the accountancy sums.

Modigliani a Nobel Price winner for economy expressed his concern regarding the capital market efficiency, pointing that there still are irrational participants who make the 'high rationalism' theory of all the valuable market participants, which is the base of the financial models, to be false (Modigliani, 1988). Modigliani thinks that the market failed in evaluating the valuable titles in the important inflation period, which concluded to predictable and repetitive mistakes. Modigliani and Cohn provide a scientific explanation of the capital market shortcomings – the irrationality of a group of participants (Modigliani and Cohn, 1978).

The assertion that the best stock exchanges in the world are efficient was, for a long time accepted as the ultimate truth. To sustain the contrary would have been a conceptual misunderstanding or the agreement with the numerous empirical researches that sustained these rules. But recently these were analysed again and a number of anomalies were repeated.

Fama and French also proved that it is possible to foreseen the shares price from the small companies, contrary to the tests results concerning the efficient market theory done on big companies (Fama and French, 1988). The statistical tests can't detect the possible inefficiency of the market – there are differences between the valuable title prices and their real value.

Nowadays the idea of a efficient market in its strong and half strong forms is weaker because the critics have at least two directions. The firs one refers to the question if we can test the efficiency or inefficiency of a capital market. The new mathematics analyse techniques shows us that there is always an unexplainable foreseeing of the market (the software models offer the opportunity to exceed in performance the market, at least for a certain period). The second direction of the critics is based on the existence of black wholes that are exploited by sophisticated participants:

- Unusual changes of prices on short terms – the market has the tendency to exaggerate on short terms. Highly evaluating the information and low evaluating the base data (for example those who invest exaggerate the income sum and determine the gap between the price and the real value of the share because they have a restrictive orientation about the close future). Those who sustain of the efficient market sustain that these short-term anomalies are rectified or adjusted in a longer period of time.
- Temporal and temporary anomalies – researches from USA demonstrated the modifying tendencies of the prices of the valuable title determined by a set of astonishing elements. When the transactions take place ( the prices rise in the first 15 min from the opening of the stock exchange meeting then decrease in the next 45 min – an explanation could be the wick-end effect); the days of the week ( it was proved that the income obtained from the transaction of the titles on Mondays are lower than during the rest of the week); months of the year (January demonstrates that the highest income can be obtained due to transactions done in this month; in Great Britain was demonstrated the same phenomena on April, an explanation can be connected with the end of the fiscal year when the necessity of decreasing of the tax base comes and rises the need fir cash)
- Companies size anomalies. On long term the income obtained by share holding of small and medium companies are higher than the average performances of these companies. If the

market is efficient this should happen only when the risk is higher than the average risk of the market. Do the small and medium companies' shares have a higher risk than that of the market? There was an attempt to explain this phenomena from the lack of information point of view. The small and medium companies offer less information than the big ones, so the price of the title doesn't reflect the real value of the companies. The small companies risk, paradoxically its tendency is to rise the average risk of the market but it is not a complete explanation, yet.

- The successful foreseeing possibility of future prices using indicators of price earnings or dividend yield.

On the other hand the theoretical conditions for a market to be efficient are not valid in practice. For example the available information on the market aren't equally given to all the participants. There are confidential pieces of information that are known by the managers of the companies or a small group of persons. The valuable title transactions on the capital market imply high intermediate costs that decrease the hypothetical income. Not all the market participants have a rational behaviour, there are the so called noise traders who use transactions at random or those who take into consideration only the numbers of the economic result.

But which are the conditions for a market to be efficient? The efficiency dynamics is determined by competition: the capital markets will become competitive when there will be several buyers and sellers on which will evaluate the titles trying to obtain unusual high income. The market efficiency doesn't mean that it isn't possible to obtain abnormal income but impossibility of getting them only with the published information. As a conclusion, the role of the market efficiency is that the valuable titles won't be over or low evaluated due to a set of published information. The changes that appear because of the accountancy embellishing of the financial situation of the companies don't modify those title markets.

Even in the functional fixation theory the participants are concentrated on numbers and not on the information content. In the case of the efficient market the content and the meaning of the information will be included in the price and not in the accountancy sum. The efficient market will read only those pieces of information that have a meaningful signification.

Without a direct evaluating method of the benefits supplied by accountancy information to the capital market, the attention will concentrate on the costs. Several types of costs should be taken into consideration:

- the direct costs of the production and publishing information;
- the direct costs of the alternative sources of information;
- the evaluating and analysing costs of the information;
- the cost that those who invested should pay if they would produce the information;
- the indirect costs – for example the negative aspects of publishing the information over a company activity.

The statement cost-benefit indicates that the information which is understood and used by only few persons, it should not be produced. Also the synthetically accountancy documents shouldn't exclude relevant information because the understanding difficulties for some of the users .

In the last years a new research area developed surprisingly – the behaviourist science. This study the way in which the persons look for, modify evaluate and combine the information to draw a conclusion and make a decision. This new subject on the psychology, statistics and management borders is extremely relevant in specific areas like accountancy, marketing and finances.

With all the importance of the economic theories that offer an objective point of view in such a debated domain of the decisions is still important to understand the way individuals evaluate and use information. Of course the economists and psychologists will agree (that is very seldom) that the individuals don't react rationally all the time and in contact with the environment they learn to become more propitious.

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