THE ISSUE OF ASYMMETRIC INFORMATION UPON THE CAPITAL MARKET

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Abstract: *The capital market has an important role at the micro and macro economical level, having the capacity to mobilize resources and to place them in a productive manner. The relation between accounting and capital market started to be analyzed from the middle of XXth century, when the investors started to ask more details about the companies' activity and not just general accounting values. The certainty is nowadays a part of the cost of information which is consciously assumed by the users differently in pre-crisis and crisis time. Informational asymmetry plays a double role through the participants on the capital market: positive one for those who use the lack of information of others with economic responsibility and negative when information holders use them to affect the other participants or users. This paper seeks to examine the impact of financial information on the level of the capital value of the companies in order to evaluate the influence and to establish the measures that must be applied to reduce the asymmetries between different users of that information.*

Keywords: financial information; cost of capital; information asymmetry; performance; disclosure.
JEL Classification: E22; M49.

INTRODUCTION

The consequences of information asymmetry on capital market are highly debated, being partially the issue worthy of the Nobel Prize in 2001 (Joseph Stiglitz, George Akerlof and Michael Spence) and our paper examines this problem. The informational asymmetry theory has originally been a concern for the researches in the buyer behavior field (Spence, 1977, Leland, 1979, Heinkel, 1981, Allen, 1984), but the high level of implications extended it to the financial theory as well.

One of the objectives of this research is represented by the relationship between accounting and capital market, a highly discussed topic from the middle of the XX century, when investors express their need for relevant information about the economical activity of the companies and not just raw accounting data. In accounting, we can express asymmetry of information in relationship between managers and shareholders, lenders and shareholders, lenders and managers, but also between managers and public government and employees.

The market is the "place" where billions of individuals act like independent decision-makers. Lambert et al. (2011) shows that it is important to distinguish between information asymmetry and

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information precision as well as to recognize that the effect of information asymmetry on the cost of capital depends on the nature of capital market competition.

On the capital market a large amount of stocks are traded, the activities of issuers of securities are influenced by many factors, and some of them are random like social, political events. In this case they use incomplete information which sometimes becomes irrelevant. Uncertainties in this field have a cognitive origin. Working with probabilities on the capital market don't equals to quality decisions decay. No matter how much information could be got on issuers and on market as to justify recasting original decision to make it better, but we could have just the probability that it would be better.

Accounting, audit and corporate governance must provide relevant and reliable information, and in time to maintain the efficiency of the capital market. The last researches in the field observed that the information systems for financial data should be improved.

The impact of accounting information on the capital market could be observed analyzing the volume of transactions in the period when financial statements are published in the same way. We can observe abnormalities due to the different level of financial information held by the actors on the market. If the revealed information would be perfect, any detail should immediately have consequences on securities transactions.

The approach starts with an analysis of the researches made in the field, but begins to take a valuable shape using real examples about models of analysis of informational asymmetry and how is influenced the cost of capital and volume of securities transactions of Romanian companies. To benchmarking the companies, we used the scientific observation, giving to the paper both qualitative and quantitative approach. We segmented the analyzed companies by their size, so that our research could be relevant on the specific level. Stock market indicator were collected from official website of Bucharest Stock Exchange and statistically processed to obtain results for our applied research, using correlation coefficient.

1. ECONOMICAL CONTEXT FOR INFORMATION ASYMMETRY UPON THE CAPITAL MARKET

Palepu and Healy (2007) consider that a critical challenge for any economy is the allocation of savings to investment opportunities. Economies that do this well can exploit new business ideas to spur innovation and create jobs and wealth at a rapid pace. In contrast, economies that manage this process poorly tend to dissipate their wealth and fail to support business opportunities. The authors also say that savings in any economy are widely distributed among households. There are usually many new entrepreneurs and existing companies that would like to attract these savings to found their business ideas. While both savers and entrepreneurs would like to do business with each other, matching savings to business investments opportunities is complicated for at least three reasons. First, entrepreneurs typically have better information than savers on the value of business investment opportunities. Second, communication from entrepreneurs to investors is not completely credible because investors know entrepreneurs have an inventive to inflate the value of their ideas. Third, savers generally lack the financial sophistications needed to analyze and differentiate between the various business opportunities.

In this context, we introduce the notion of the ensemble of the information and procedures for collecting and recovering the information from the perimeter of the economic activity, named the economic informational system. In this system, accounting information is recognized by the theorists as a fundamental part of the control system of the company and the financial-accounting information is a basis for the decisional process, in the help of economical activity. Those two branches of accounting, financial and managerial systems, generate useful information for internal and external users.

The users of financial-accounting information are different and have different objectives, this being the reason why accounting must ensure relevance, faithful representation, comparability and verifiability. In the framework of IASB we can find that financial information is useful when it is relevant and represents faithfully what it aims to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable (Standards, 2013).

The employers and their representative groups search for the stability and the profitability of the economical activity to determine the companies' capacity to pay salaries, premiums and to identify professional opportunities. The investors, the bidders of the capital, are preoccupied by the securities' value the return of their investments. Taking in account the nature of the loan, the creditors are interested in the continuity of the economic activity, in the interest payment and in the rates payment at maturity. The suppliers and the clients are, in general, preoccupied in the continuity of the activity for future collaboration, also in the solvability of their partner. The government request, through his institutions, financial-accounting information which must help to determine the fiscal policy of the country or the region, to calculate statistical indicators and to evaluate and organize national accounting. Baek et al. (2008) reveal that managers consider that they provide full information that is required, but most analysts and investors claim that they should make more effort to do so.

In the financial literature, the term of *capital cost* refers to the cost which companies must pay to obtain funds (such as debt or equity) (Souissi and Khlif, 2012). From the perspective of an investor, the cost of capital is the income that he expects by holding a stock portfolio. This indicators is not directly observable and there is not a generally valid determination model, it's undeniable the importance of the subject in the financial environment. Whether it's about a financing decision for a new project, whether it is about corporate-level strategic decisions that are reflected in and out, this indicator is almost always present in financial equations (Cormier et al, 2010).

The capital cost variations have generally been interpreted by an inverse relationship, decisions aimed to improve the company's image abroad and better information investors, lead to a beneficial effect in reducing the cost of capital (Christopher et al, 2011). However, this mechanism may be seized by various factors that reduce the expected yield or can just cancel it. Therefore, the analysis should always be made with caution, taking into account the individual, local or national context of the economy.

Another study made by Christensen et al. (2010), shows that the most recent researches paid attention to the relationship between financial disclosure and the cost of capital like a result of the financial communication, naming it suggestively: ex post cost of capital. The study shows that reducing ex post cost of capital is covered by an equal increase registered by the capital cost in the run of communication of information. The discrepancy of the information held by the participants in the capital market is a big problem that implies a huge risk of the signed transactions. The relevant information is hidden, transforming the target of a perfect market into impossible to realize.

In 2001, the Nobel Prize was given to George Akerlof, Michael Spence and Joseph E. Stiglitz. Akerlof said that "lemons" deal with a problem as old as market themselves. It concerns how horse traders respond to the natural question: *if he wants to sell that horse, do I really want to buy it?* Extending the field of the problem, if for a product the consumers can not know enough information about the quality, they will pay a medium price for it and this situation will advantage bad product and will disadvantage good products, bad products being lemons in this context.

It will be a difficult task for managers to achieve all the important information about the company which equity they will buy. They will meet the lemon problem of the capital markets, dealing in this case with the risk to do inappropriate investment.

The elements which differentiate the companies with performance management and poor management (Stancu and Stancu) are the sustainable rise of the enterprise evaluated through reinvestment of profits and priority participation of managers in financing of efficient investments, the operating leverage highlighted in renewal of technology and management, and financial leverage, by providing a high leverage ratio for financing investment projects.

2. FACTORS AND CONDITIONS MAINTAINING THE LEVEL OF INFORMATION ASYMMETRY

Using information power on the capital market can be strongly punished, but there are a lot of factors which increase information asymmetry or other just maintain the same level, affecting the level of development of the market.

For example, Martha Stewart, CEO of Martha Stewart Living Omnimedia Co., has been charged with obstructing an investigation into insider trading. She has not been charged with illegal insider trading, but she did sell 3.928 shares of stock in the biopharmaceutical company InClone Systems, earning 228.000 dollars, the day before the FDA (Regulation Fair Disclosure) rejected approval of its anti-cancer drug Exbitux and its stock fell.

The issue of whether and how information differences across investors affects prices and the cost of capital cannot be addressed in conventional models of asset pricing, such as the Capital Asset Pricing Model, because these models generally assume investors have homogeneous beliefs. Hidden management practices increase informational asymmetry. Alchian and Demsetz (1972), Williamson (1985) searched for solution for vertical integration and different strategies not just for financial field, but also for other areas which can affect public health.

There a lot of companies which do not use their websites to communicate relevant information to the external users of financial information. A recent study that has a sample with 30 traded companies revealed that a lot of companies use their website in inappropriate way, especially to communicate information considering corporate governance (Yabing et al., 2010).

3. MODELS OF INFORMATION ASYMMETRY EXTENDED TO THE CAPITAL MARKET AND CASE STUDY

Akerlof said that perfect competition is only one model among many, although itself an interesting special case. To help the development of the supreme objective of any market, he presented the theory about the lemon problem. The main idea of Akerlof's theory, extended to the capital market, is that if investors cannot tell the true value of the company, they will pay only an average price for it and will attract more companies that are less valuable (i.e., lemons). If it is not, this model can lead to a breakdown of the capital market. The outside investors should pay attention on the effect to the question why the entrepreneurs want to sell equity? Some authors think that an investor should not buy equity from a company which offers him to buy its equity.

The managers benefit by means of the asymmetry of information in relation with the other categories of users, but even so, they pay a huge attention to the way the other perceive the published information (Mihalciuc, 2008). Usually, investors don't know the intrinsic value of the firm, but in different moment this fact can affect or not the result of transactions. For example, in Myers and Majluf model, where X is the intrinsic value of the company, R is the value of investment and I the amount of money received by the company to do the investment, are two situations:

1. Full information benchmark: The wealth of the firm in the final moment is equal to X + R – I, and since R > I, if the entrepreneur does not issue equity, his wealth will be equal to X, but if he will issue equity, the cash flow of the company will be in excess and will go to him, because outsiders will receive the money they paid for the investment;

2. Outside investors do not know the true intrinsic value of the company: If the firm has a low intrinsic value, the wealth of the company is larger than R-I because the cost of investment is smaller giving away less equity to investors which think that this equity worth more than it actually does and this is the situation where the investment decisions of the company is not affected by the presence of asymmetric information. If the company has a high intrinsic value and outsiders will believe that it has a low intrinsic value so that they will require a larger equity participation to be safe. In this case the cost of investment is bigger than the full information. The main idea is that the equity of companies with low intrinsic value is overprices while the equity of companies with high intrinsic value is underpriced. So, if outsiders will think that the company has a high intrinsic value, the under pricing will not be acute, but if they will think that the company has a low intrinsic value and the probability tends to 1, is better for the entrepreneur to not invest.

Spence's (1973) model is classic and describe how asymmetry problem between uninformed buyers and informed suppliers can be resolved. His model shows how employers want to hire productive employees having access just to their job application where is detailed their educational route. In this case, most credible element for the future employees is the cost of their education. This is why ISO adoption can provide a credible signal to the market. Indeed, empirical evidence suggests that environmental management system adoption costs are lower among organizations with more management system experience and higher in companies with poor environmental performance.

Merton (1987) present a model with a part of investors well informed and with others less informed, where the second type of investors are not aware of the existence of some firms. The author argues that information that increases uninformed investors' awareness can lower the cost of capital of these firms.

O'Hara (2003) and Easly and O'Hara (2004) developed asset pricing models, showing that because of information asymmetries, some traders will choose to hold their securities. For example, the less informed ones will hold their assets where their disadvantage is less, conducting to the rise of the cost of capital for companies with high level of asymmetry.

A study (Munteanu, Ionașcu, & Ionașcu, 2011) based on a sample of 33 traded companies at the Bucharest Stock Exchange revealed that in Romania does not exist a relationship between the cost of capital and the quality of financial reporting. Romanian companies which provided more information on their websites did not benefit from a reduction in the cost of the capital. In the same sense, we selected Romanian companies from hotels and restaurants field traded on Bucharest Stock Exchange in the section BVB and through our research we analyze their cost of capital in the last 180 days (19.08.2012-15.02.2013 period). We took into account the medium price of the stock, the number of transactions, the value of transactions and the volume of transactions. To determine if between this indicators exist or not a relationship, we used correlation coefficient because it is relevant in this case having data for more than 100 days, it can be used regardless of the units and it's easy to interpret.

The results of research revealed that between the medium value of stock and number of transaction, between the medium value of stock and the volume of transactions and between the medium value of stock and the value of transaction don't exist a relationship. The correlation coefficient varied between 0.13 and -0.14 values, mining that there are other factors that influence the movement of stock transactions, not financial disclosures because in selected period were made a lot of publications about financial situation of the companies, including estimate data for the 2013.

For some companies, the biggest medium prices were registered in August - September 2012, and for the other in January 2013 and this fact means once again that the cost of the securities is not dependent on the publication of financial information.

Hence, for Romanian companies which activate in hotels and restaurants field traded at the Bucharest Stock Exchange on the main section the communication of financial data do not influence the transaction on the capital market. Investors are not determined by financial disclosures to make securities deals with these firms. In comparison, the investment situation of foreign companies which were analyzed in time is influenced by the financial publications during the year, outsiders using all the useful information in their advantage to make good and valuable decisions.

4.WAYS TO REDUCE THE INFORMATIONAL ASYMMETRY

More researchers, like Francis et al. (2005), Leuz and Verrecchia (2000), revealed that disclosure quality lowers information asymmetry, share price volatility or stock liquidity. Lang and Lundholm (1993) document a positive relationship between the need for financing and voluntary disclosure. Diamond and Verrecchia say that voluntary disclosure by a firm reduces information asymmetry and lowers its cost of capital, because greater transparency enhances stock market liquidity and reduces transactions costs for a firm's stock. Voluntary disclosure may complement a firm's governance attributes in reducing stock market asymmetry. Implying a complex informational-decisional system, corporate governance can distribute information on internal and external level, contributing to the reduction of informational asymmetry.

In the case that information asymmetry exists, it's imposed a control system, which implied agency costs (Boisselier, 1999) like monitoring and stimulation, ordering costs and residual costs. Independent auditor must verify if management implemented procedural requirements. The companies can also use individual attributes for monitoring the informational asymmetry in order to reduce capital market asymmetry. Instruments offered in principal-agent theory are considered proper to reduce informational asymmetry between them (Wiedenhofer and Krahnke, 2007).

For the lemon problems, Akerlof pointed out that many free-market institutions can be seen as ways of solving or reducing lemon problems. One solution Akerlof noted is warranties, because these give the buyer assurance that the car (i.e.) is not a lemon, and the buyer is therefore willing to pay more for the car with a warranty. Also, the sellers who are willing to offer the warranty are those who are confident that they are not selling a lemon. Akerlof went beyond cars and showed that the same kind of issue arise in credit markets and health insurance markets, and also capital market.

In banking, authorizing banking institutions reduce information asymmetry that exists between shareholders and managers of funded bank, on the one hand, and potential depositors and investors on the other hand, which cannot distinguish in the start between a potentially viable entity and one doomed to failure (Moinescu, 2013).

The cost of capital can be influenced by the quality of the accounting standards, the efficiency of the capital market, the importance and relevance of the capital market in companies' financing and corporate governance. There is a relationship between accounting information and effective administration, and this relationship can be positive and negative. Positive when managers don't have nothing to hide, and negative when they search to hide a lot of data, in this way increasing the level of asymmetry and hiding the true value of the company in the eyes of outside investors. By adopting IFRS, an improvent of the quality of financial reporting of companies was espected, that have the effect of reducing information asymmetry and risk and, therefore, a decrease in the cost of capital (Munteanu et al., 2011).

Financial disclosure obligations imposed by IFRS in order to improve the quality of financial statements presented by companies located where local standards are low disclosure requirements, and this can be translated by reducing information asymmetry, allowing investors to better monitor their investment performance (Munteanu et al., 2011), in addition to increasing the transparency of financial information. SEC Chairman Arthur Levitt said that it is known that high quality accounting standards reduce the cost of capital. IASB Chairman Sir David Tweedie said that IFRS will reduce the capital cost and will open new opportunities for diversification and improved investment results.

In Great Britain, Latridis (2010) examined the problem studied by Barth et al. (2008), the effect of IFRS adoption upon the quality of financial information. He concluded that the Standards strengthened the quality of data through decrease of revenues practices of management and improving the relevance of financial information in investment decisions.

For Beaver (1981), Healy and Palepu (2001) and Scott (2009) in ordet to encourage the participation on the capital market, the use of IFRS can be a convenient choice, especially for emerging countries where capital markets do not function on a proper level. For these systems to fulfill their positive role in evaluation and financing, traded companies must communicate sufficient information necessary for decisional process of users.

To verify and control managers, shareholders use financial control which has the mission to verify and express the opinion about the true and fair value of the company, about the financial position and performance, showing the real intrinsic value of the firm. Financial audit can verify the managerial performance of entrepreneurs, observing the way their actions contributed to the company's benefits or losses. This way of control can sometimes make managers reveal more relevant information, useful for investors, reducing information asymmetry. In the last 20 years a lot of financial and audit scandals, meant to present the companies in a good light when they was just a *lemon*, discussed the ethical issues in relation to the functioning of the capitalist economy. The response if the audit is a good method to reduce informational asymmetry depends on the professional ethic engaged in financial control.

Recent researches revealed that the transparency of financial statements significantly influence investors decisions (Hodge et al., 2004; Bushman et al., 2004). Using the eXtensible Business Reporting Language to communicate financial information through electronic ways may contribute to assure transparency and to reduce informational asymmetry. Financial statements available on the internet raise the efficiency of corporate governance through transparency and dissemination, facilitating the communication between managers and investors.

CONCLUSIONS

One of the most important question for this research is: Is financial information useful in investment process and the cost of capital?

The capital market is influenced by a large number of factors quantifiable and non-quantifiable, probabilistic type of thinking being required to obtain reasonable performances. Elements that quantify the market operators, uncertainty, risk, indeterminacy should be considered a permanent basis, in fact unattainable outside capacity to operate in conditions of uncertainty. This competitive and complex market is unpredictable, like we could give example: Romanian traded companies are not influenced by the financial disclosure like the foreign ones are. It can be because outsiders do not receive information in time, so they could use it for their decisions. Maybe they not always find relevant information in financial disclosures and ca not differentiate which ones are more pertinent for their needs in given conditions. This is why, investors sometimes apply action characterized by extra cognitive origin.

Accounting-financial information is produced by corporative accounting and complex systems for financial reporting. Data are audited to confirm companies' position and performance. Maintaining performance level of financial disclosure costs and this costs are big, but sustainable and justified to get and kip a good position on capital market.

Information asymmetry generated by the financial statements, also called opacity of financial statements, transform the securities market in a very sensitive game where outside investors must guess the intrinsic value of the companies, affecting the future cash flows of the companies in which ones they invest in a good or bad sense. Economical models created during the time sustain the main idea of this research, economical studies confirming the importance of the theme.

The independent certification can reduce informational asymmetry and improve management practices. Good companies can demonstrate the value of their companies to the capital market by keeping a large traction of equity in their property. In this case, willing to retain equity, they will show that the returns are high enough to compensate the risk they exposed themselves. The literature provides sufficient arguments to encourage a wider disclosure of information necessary for decisions.

Informational asymmetry has as a consequence the fact that better informed partners can take advantages by the lake of information of the others. In the future, we will extend our approach to a more detailed level to support present research and to contribute to the development of applied scientific literature.

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