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Capital Flow Regulations: The Effects of Liquidity and Dividend on the Financial Reporting Quality Evidence from Middle Eastern countries

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Abstract

Dividend policy has been an influential factor in corporate investment decisions and has been an issue in recent years. The monetary policy began with the creation of economic organizations and free trade markets during the financial crisis. These were the first examples of capital controls in the history of the European Union and had different effects on the financial position of companies. Since the Central Bank, the monetary policy council or any other monetary committee will change the volume of money by declaring and implementing monetary policies, we try to use a sample of the Middle East countries to distinguish between economic austerity and capital control and to assess the effects of the dividend on corporate capital decisions. All sample countries have a common financial reporting framework (International Financial Reporting Standards - IFRS), and some have a range of measures, from low-tight measures such as tax increases to more stringent measures such as enforcing capital controls. They implemented in order to stabilize their economy. To do this, we will specifically use two factors that determine information asymmetry in accounting: conditional conservatism and the level of revenue management.

Keywords

Investment decisions; dividend; Conditional conservatism; financial reporting quality

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Introduction

Although the EU was formed with the aim of increasing cooperation and the union between European countries, but now the financial crisis and the dire situation of some member states, threaten the main goals of the formation of the union. The current financial crisis in Europe is the biggest problem that the European integration process has faced since its inception. Europeans, having experienced the financial crisis of the 1930s, are well aware that if the financial crisis is not contained, the consequences will not only remain on financial institutions and markets, but can also affect the political and social environment of the region as a whole. As the European financial crisis began as a debt crisis and continued as a general financial crisis, it had a huge negative impact on some southern European countries as well as some euro area countries. The inability of these countries to borrow money from the markets due to high interest rates led to some measures aimed at limiting the negative effects of the crisis. These included raising tax rates or reducing wages, pensions and restrictions on capital flows (Cyprus in 2013 and Greece in 2015).

These conditions led to severe measures such as the control of capital used in the European Union, which certainly affected the capital flows of companies located in the countries concerned. In this regard, studies were conducted to investigate how such regulations help capital flows to the economy to get out of the crisis. To this end, the usefulness of the quality of financial reporting is. Emphasized as a safeguard mechanism against the crisis and the phenomenon of "flight to quality" is described.

The relationship between dividend policy and imperfect market investment decisions is very important for managers because one of the main concerns of managers is deciding on the amount of dividends paid or the amount of investment because on the one hand shareholders want to receive cash dividends from On the other hand, company managers are reluctant to distribute profits to compensate for the lack of liquidity, prevent the outflow of funds and make investments. On the other hand, the information required by shareholders is provided to them through financial reports. To this end, capital controls and monetary policy are considered as fiscal policy action to limit market turmoil. For example, Tobin (1978) proposed the use of uniform international taxes on foreign exchange transactions (Edwards, 1999). These practices were particularly prevalent until the 1970s (Johnson & Meaton, 2003). However, due to the ongoing efforts of institutions such as the International Monetary Fund for freer emerging markets, the use of monetary policy systems declined until the financial crisis in Asia (Baguati, 1998). However, despite disagreements over the profitability of monetary policy (Edwards, 1999), there was a tendency to use these measures as the ultimate solution during a financial crisis from a macroeconomic perspective (Krugman, 1998). Monetary policy and accounting information systems have played a very important role in the flow of the organization's activities, so that many economic decisions are made based on information from these systems. For example, during the Asian crisis, Malaysia lost control of capital. Used as a measure to reduce the effects of the crisis (Johnson & Meton, 2003). In addition, in the European Union, the financial crisis affecting southern countries, particularly Cyprus and Greece, has led to the implementation of monetary policy to limit the depletion of their banking systems.

Monetary policy is one of the common mechanisms of central banks to regulate economic affairs. During the economic crisis, not only in Europe but also in the world, we saw a decrease in bank interest rates of Central Banks. Thus, unconventional mechanisms were applied to deal with the crisis. The European Central Bank has announced that it will increase the repayment period of its loans. The plan to buy government bonds was another unconventional measure considered by the institution. The US Federal Reserve and the UK also pursued a policy of buying government bonds. However, the implementation of European monetary policy not only affects the economy but also affects people's daily lives and also has negative side effects on capital flows in the economy. Companies face cash liquidity problems that lead to production problems due to limited access to imported raw materials and problems with increasing receivables. These effects primarily affect companies, restrictions on capital flows on the stock market due to reduced market liquidity. As Levin and Zaros (1998) argued, market liquidity increased after market liberalization, and given that liquidity is an indicator of long-term GDP growth (Levin and Zaros, 1998), it can be argued that the impact Negative monetary policy on market liquidity has a negative effect on the real economy.

Under these conditions, investors can rebalance their stocks by resorting to safer investments. Such a phenomenon is called the "flight to quality" and is associated with the transition to lower risk investments (Caballero and Corlatt, 2008). Differently and from a capital market perspective, investors seek to sell risky securities and keep low-risk securities in order to protect their investment from market turmoil. Chen et al. (2018) showed that a critical factor for investors to revive safer investments during a turbulent period is the quality of corporate financial reporting, so that their securities as a forward-looking investment are considered. Under these circumstances, it is important to examine the factors that play a role in this issue and provide investors with valuable information for decision making. In turn, factors such as the quality of financial reporting may be necessary to reduce the negative impact of capital controls.

In this study, we attempted to provide evidence of the effects of capital flow regulations. Therefore, we first examined the relationship between dividend and investment decisions and then examined the role of the quality of financial reporting of companies in the market and limiting the negative impact of capital control. In addition, monetary policy has been used to predict growth and productivity (Levin and Zaros, 1998) and may reflect a reduction in information asymmetry (through the disclosure of higher quality financial information, Graham et al., 2005) and the cost of capital stock (Butler et al., 2005). Also, increasing the quality of information can make companies' investments more efficient and preserve and develop their resources.

The main motivation of our research is to investigate the phenomenon of "flight to quality" as a response to the effects of capital control on capital flows and to investigate the factors that limit their side effects on the stock market with special attention to the quality of financial reporting. The first research question of this study is how the effectiveness of monetary policies is, especially after a long period of austerity measures, which take into account the economic consequences. As Edward (1999) points out, in an imperfect capital market, monetary policies influence investment decisions, and capital controls increase the cost of capital, and countries that intend to deal with the crisis must carefully analyze its effect on capital costs. In this regard, the dividend policy can reduce the problem of over-investment of managers by reducing the cash flow available to managers.

To avoid the problems caused by over-investment, companies should divide the free cash surplus into cash dividends among shareholders; Therefore, according to this hypothesis, dividend policies have an effect on the company's investment and cash flows, so the implementation of monetary policy as a final measure to protect the economy from the banking crisis may usually lead to side effects on companies and also may increase the risk of critical problems. To this end, we analyzed our approach to market liquidity as a variable and used a research framework to examine the effects of monetary policy on market liquidity.

Our second research question arises from the expected effects of liquidity on stock costs (Edward, 1999) as well as information asymmetry. Because the quality of financial reporting reduces information asymmetry and thus reduces stock costs, we examined whether reducing the quality of financial reporting has any (negative) effect on investment decisions or not. To find the answer to this question, we focused on two accounting features related to the quality of financial reporting: conditional conservatism and revenue management. Conditional conservatism was found to be negatively associated with information asymmetry (Guy and Verchia, 2018), while revenue management was positively associated with information asymmetry (Richardson, 2000). We aim to assess whether reporting quality has a limited role in the aggravation of any negative effects due to the implementation of capital decisions.

The purpose of this study is to analyze the impact of capital controls and any favorable effects on the quality of financial reporting using a sample of companies located in euro area countries that have to take strict measures within the austerity measures (Cyprus, Greece, Ireland, Italy, Portugal and Spain) to final measures such as capital controls (Cyprus and Greece). The sample has some interesting features. First, it refers to countries that face financial crises of different intensities at different times. In particular, one of these countries is Cyprus, which faced restrictions on the implementation of capital flows in 2013, while another country, such as Greece, faced some very strict austerity measures that eventually led to the implementation of capital controls in 2015. In addition, Portugal and Spain were affected by the crisis and sought help from institutions (ECB, IMF and EC), while Italy also undertook a number of austerity measures. This led to the assessment of the effects of the crisis on liquidity from less severe to more severe stages.

Second, all of these countries had a common financial reporting framework (IFRS). Therefore, any financial reporting measures that are related to reducing the severity of the financial crisis should act as safeguards because of the ability of these measures and not because of differences in financial reporting. In this regard, this example provides a research environment through which we can examine the effects of financial reporting quality on limiting the negative effects of capital controls.

The results of the study indicate a negative relationship between austerity and the quality of financial statements. During the period of capital control for the affected countries, this relationship is even greater. In other words, the quality of financial reporting reduces the impact (intensity of impact) of dividend on investment decisions by increasing liquidity. Among other factors affecting the investor, in addition, we found a positive relationship between conditional conservatism and liquidity, which will be negative during periods of austerity and capital control. Another analysis showed that these findings are probably related to the "flight to quality" phenomenon, in which investors resort to less risky investments as a response to the effects of the crisis. This result indicates that investors maintain higher financial reporting quality in their stocks, which in turn leads to less liquidity for these companies. However, we found that revenue management is negatively correlated with liquidity. Therefore, the empirical analysis of the study showed that capital control may have significant effects on information asymmetry and this reduces liquidity. As a result, investors are turning to conservative companies as a last resort against these tough financial measures. These results should be particularly useful for legislators.

Who see capital control as a measure of ultimate defense against a financial crisis, and suggest that capital control may have a (positive) effect on information asymmetry.

The rest of this study is organized as follows. The second part presents the review of litrature and develops research hypotheses. The third part presents the model of this research, the fourth part describes the data and the fifth part analyzes the experimental results. Finally, the sixth part of this article presents the conclusions of the study and discusses the implications of this study for further research.

Review of literature and hypotheses

Free flow of capital (capital mobility) is the focus of the debate on merit and their role in increasing financial vulnerability (Edward, 2007). On the one hand, some proponents of restricting capital movement emphasize the role of monetary and liquidity policies in the

Asian crisis in Malaysia, arguing that dividend will help reduce the negative outcome of the crisis and enable a country to grow faster (Kaplan and Roderick, 2002).

On the other hand, Chanda (2005) argued that from a long-term perspective, the implementation of dividend has a negative impact on growth in more than half of the countries that use this method. Levin and Zaros (1998) also provided evidence for the potential negative effects of dividend on the real economy. Researchers have argued that market liquidity increases after market liberalization. Therefore, since liquidity can be considered as an example of long-term GDP growth (Levin and Zaros, 1998), it can be argued that the negative impact of capital control on market liquidity should also have a negative effect on the real economy. Therefore, market liquidity seems to be a good option for achieving corporate well-being, as key information about firm growth and productivity (Levin and Zaros, 1998), reducing information asymmetry (through higher quality financial disclosure, Graham et al., 2005) and reducing the cost of capital stock (Butler et al., 2005).

Sanchez and Gomariz (2014) in a study on the quality of financial reporting, debt maturity and investment efficiency showed that the quality of financial reporting reduces the problems of over-investment and under-investment. Using short-term debt also increases the efficiency of the investment.

Santosh et al. (2013) in a study entitled The role of financial reporting quality in reducing the effect of dividend restrictions on investment decisions examined the relationship between financial reporting quality and the effect of dividend on investment decisions by companies. The results of their research showed that high quality financial reporting significantly reduces the negative effect of dividend on investment decisions. This declining role of financial reporting quality is also stronger among companies where a larger share of that company's value is affected by growth opportunities. The results of this study showed that the quality of financial reporting plays an important role in reducing the conflict between investment decisions and dividend decisions, so that companies are less likely to avoid valuable investment projects due to interest payments.

Balakershan et al. (2015) examined the effects of financial market liberalization on the cost of capital stock. Liberalization, from the researchers' point of view, means the elimination of capital control over foreign investors, so that these investors can invest in a company's domestic companies. Researchers have found that liberalizing financial markets reduces the cost of capital stocks (Chain and Ito, 2006). However, this reduction is economically beneficial for companies based in countries with lower political risk, better institutions, and a more positive attitude toward investing. In addition, Chain and Ito (2006) argued that market liberalization may reduce information asymmetry. Therefore, it is expected that the implementation of capital controls will lead to conflicting results compared to liberalization and in particular will increase the information asymmetry and the cost of capital stocks. Edward (1999) argued that the implementation of capital control as a crisis response should be done after careful consideration of the effects on the cost of capital. This is due to the effect that the exercise of capital controls may have on the severe consequences of the financial crisis.

The first set of research hypotheses is related to the effect of evaluating the factors affecting the policy of dividend and capital control on market liquidity during periods of austerity and capital control. In addition, hypotheses about the additional effects of monetary policy implementation on the economy, which is suffering from a severe financial crisis and their use as a financial measure, were also examined in this study. For this reason, we seek to examine the economic consequences of liquidity and its impact on companies by controlling the effects of austerity. Therefore, the first set of research hypotheses was formulated as follows:

H1A: Austerity measures reduce market liquidity.

H1B: Dividend leads to reduced market liquidity.
H1C: The implementation of monetary policy has negative additive effects on liquidity in relation to austerity.
In this study, we examined two factors that determine information asymmetry in accounting, namely conditional conservatism and the level of income management. Conservatism is one of the concepts of realism and one of the limitations of financial accounting and reporting that can be a moderating factor to prevent managers' optimistic measurements. On the other hand, preparing overly conservative financial statements is also undesirable; because it will lead to the presentation of unrealistic information and distortion of quality features, impartiality, and the ability to compare financial statements. The results of Garcia Lara (2011) showed that conditional conservatism is associated with reducing information asymmetry and reducing the cost of capital stocks (Garcia Lara et al., 2011). In this regard, conditional conservatism is associated with higher quality financial reporting (Ball and Shivakumar, 2008). Assuming that an increase in conditional conservatism leads to a reduction in information asymmetry, we expect companies with a high level of conditional conservatism to experience less information asymmetry due to the exercise of capital controls, which in turn have higher liquidity they will be in the market. However, as Vianos (2004) showed, during high volatility periods, venture capitalists may make lower risk investments. This phenomenon, known as the "flight to quality," has led to claims that investors may be looking for higher quality financial reporting companies to invest in. In this regard, Chen et al. (2018) showed that during periods of political instability characterized by higher volatility, managers tend to move to higher quality financial reporting companies due to less risk-taking. Chen et al. (2018) also found that information uncertainty increased during the period with political uncertainty, while Baluria and Mamo (2017) found that the analyst's predictive accuracy decreased during the period of political uncertainty. In addition, Yang and Ruth (2019) found that political uncertainty is also associated with higher income management. Given the positive relationship between revenue management and information asymmetry, the results of Yang and Ruth (2019) study pointed to the positive relationship between information asymmetry and political instability. Because conditional conservatism is associated with higher quality financial reporting due to lower asymmetry, managers expect Carter companies to resort to Carter conservatism during periods of instability such as austerity and capital control. In this way, investors maintain a higher percentage of conservative companies conditioned on their profitability, and the liquidity of their stocks decreases. Therefore, the second set of our research hypotheses includes the effects of conditional conservatism on liquidity and is formulated as follows:
H2A: Conservative companies have higher liquidity in the market.
H2B: Conservative companies have lower liquidity in the market during more volatile periods.
Some researchers have suggested that institutions are one of the factors that affect the efficiency of capital control. In particular, Johnson and Mayton (2003) argued that political relations and partisanship played an important role in Malaysia during the Asian crisis and the implementation of capital controls in the country, however, after the implementation of capital controls, companies with Political relations management will perform better. Based on studies by Johnson and Meyton (2003), these results support the argument of Blanchard (2000), who points to the importance of short-term effects of institutions on macroeconomic dynamics.
Similar findings about the importance of incentives in law enforcement can be found in accounting literature. Ball et al. (2003) argued that the existence of incentives may affect the implementation of accounting standards. Accordingly, it can be argued that incentives to prepare financial statements for participation in revenue management may also be important

during capital controls. In such cases, the quality of revenue decreases and this leads to higher information asymmetry. Therefore, revenue management incentives are expected to affect the implementation of capital controls, which makes revenue more ambiguous. However, lower revenue quality leads to information asymmetry and has a negative impact on liquidity. Therefore, the third hypothesis of the research is formulated as follows:
H3: The liquidity of companies with higher revenue management in the market is more affected by capital control.

Definitions of variables variables	**Definitions of variables** variables
A proxy for liquidity following Bekart et al. (2007) as a quarterly ratio of zero daily returns	LIQUIDITY
Company-specific conditional conservatism score following Khan and Watts (2009)	C_SCORE
Income Management Louise et al. (2003) Calculated based on their EM3 and EM4 measures	EM
A binary variable whose value is equal to one and otherwise zero for companies located in a particular country and in a particular quarter, which is 50% lower than the revenue management action of that country.	LOW_EM
A binary variable whose value is equal to one and otherwise zero if it is 50% lower than the companies of a country based on the EM level in a particular quarter. Less than 50% of companies in a country based on the level of fluctuation in a particular quarter is equal to one and otherwise zero.	LOW_VOL_EM
Logarithm of the total quarterly daily trading volume.	TRADE_VOL
Standard deviation of daily returns over three months.	STDEV
Logarithm of closing stock prices every three months	PRI
Quarterly average absolute amount of daily stock returns	ABSR
The proxy for business developed by Beedles et al. (1988; Tea et al., 2010) is calculated as follows: {100- (100 / (n-1))} / 100 Where: n is the difference between the last trading day of the quarter and the last day with a stock price.	BEEDLES
Market investment logarithm at the beginning of each quarter	SIZE_Lag
The ratio of book value to market value at the beginning of each quarter	MTB_Lag
Return on quarterly assets ratio	ROA
A fictitious variable whose value is equal to one and otherwise zero during the period when a country is under austerity measures (Cyprus, Greece, Ireland, Italy, Portugal and Spain).	AUSTERITY
A structural variable whose value during a period when a country is under capital control (Greece and Cyprus) is equal to one and otherwise zero.	CAP_CONTROL

Results

This study examines regulations related to capital flows and especially the effect on stock liquidity. Examples used by companies

It is located in the countries of the Eurozone and therefore includes countries under austerity measures (Cyprus, Greece, Ireland, Italy, Portugal and
Spain) or capital control (Cyprus and Greece). The investigated variable is stock liquidity due to the role that this variable plays in the summary
Extraction of information for the welfare of a company and its ability to predict growth and productivity (Levin and Zaros, 1998), reduction in asymmetry (from
Through higher quality financial disclosure (Graham et al., 2005) and cost of equity capital (Butler et al., 2005). In addition, liquidity
It is directly affected by restrictions on capital flows. We claimed that the quality of financial reporting by the conservative
Higher conditional labor and lower income management are measured, acting as a buffer against the negative effects of capital controls.
The results of the study show a negative relationship between austerity and the quality of financial reports. That during the capital control period for the affected countries,
This relationship is more. In other words, the quality of financial reporting through the increase in liquidity of the effect (intensity of the effect) of profit sharing on
It reduces investment decisions. Among other influencing factors on investors, in addition, a positive relationship between conservatism 8 Conditional and liquidity, we found that this relationship will be negative during periods of austerity and capital control. Another analysis in this field showed
These findings are probably related to the phenomenon of "flight to quality" that investors resort to less risky investments.
They are the measures to deal with the effects of the crisis. This result indicates that investors prefer higher financial reporting quality
They keep their shares, which in turn leads to less liquidity of these companies. However, we observed that
Earnings management has a negative relationship with liquidity. Therefore, the empirical analysis of the study showed that capital control may have effects
There is a significant effect on the asymmetry of information and this problem reduces liquidity. As a result, investors turn their attention to
Conservative companies are turning to these tough financial measures as a last resort. These results should be especially for legislators
Which consider capital control as a measure of final defense against a financial crisis is useful and shows that capital control may have a (positive) effect on information asymmetry.

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