

The Effect of Financial Statement Comparability on the Cost of Equity Capital: The Role of Managerial Ability

ABDULLAH RAID YASSEN, MUTHANA ROKAN JASIM
College of Administration and Economics
Tikrit University
Salah Al-Din, Tikrit
IRAQ

Abstract: - This research aims to test the effect of financial statement comparability on the cost of equity capital of the company, and whether there are differences in this relationship that can be attributed to the level of managerial ability of executive managers. The study sample consisted of 24 companies listed on the Iraq Stock Exchange for the period from 2010 to 2024, with a total of 360 observations (firm/year). The results of the analysis indicate that financial statement comparability has a negative and statistically significant effect on the cost of equity capital, such that high comparability reduces the information risk faced by investors, and consequently reduces their required rate of return. Meanwhile, there was no statistically significant effect of managerial ability on the relationship between comparability and the cost of equity capital. This may be attributed to the low level of financial and accounting expertise of corporate management and their lack of effective involvement in accounting work, which weakens the element of accountability that could be enhanced by managerial ability.

Key-Words: - Financial Statement Comparability, Cost Equity Capital, Managerial Ability, Firm Size, Financial Leverage, Return on Assets.

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1 Introduction

The cost of equity capital is considered one of the fundamental concepts with a direct impact on the investment decision-making process, as it serves as the main pillar upon which financial decisions are built when comparing investment opportunities. It is defined as the lowest rate of return that an investor accepts in exchange for investing their funds in the company's shares, which reflects compensation for the risks associated with the investment, [1]. One of the main reasons for the high cost of equity capital for a company is information asymmetry between management and shareholders, which consequently leads them to demand a higher return to compensate for the risks resulting from the lack of information available to them, [2]. In this context, the pivotal role of comparability emerges as an effective solution to the problem of information asymmetry. The study [3] indicated that companies whose financial data exhibit higher levels of comparability

achieve greater efficiency in their investments by reducing information asymmetry between management and shareholders. According to Concept Statement No. 8 issued by the Financial Accounting Standards Board (FASB), comparability is considered one of the qualitative characteristics that enable users to base their decisions on informed and logical grounds, [4]. This characteristic provides users with more information, thereby reducing information asymmetry, [5]. This is consistent with the findings of [6], which indicate that comparability decreases information asymmetry, which in turn reduces the cost of equity financing as well as the overall cost of capital, [7]. Despite the great importance of comparability, its actual implementation depends on the efficiency of management in preparing financial statements, [8]. In this regard, managerial ability emerges as a key driver for enhancing this characteristic. According to [9], managerial ability is defined as "the efficiency of managers in transforming the firm's

resources into revenues relative to their peers in the same industry". [10] found that companies with managers possessing similar abilities have more comparable financial statements. This contrasts with the findings of [11], which indicate that a low level of financial statement comparability is attributed to the negative effects caused by managerial ability and managers' investment capacity. In contrast, higher managerial ability leads to a reduction in the cost of equity capital, [12]. The results of prior accounting literature have varied in explaining the nature of the relationship between managerial ability and comparability. Moreover, there are no studies (to the best of our knowledge) that have examined the effect of comparability on the cost of equity capital while incorporating managerial ability as a mediating factor, particularly within the context of Iraqi financial markets. They suffer significantly from the high cost of obtaining the financing necessary to carry out their activities, [13]. Therefore, the importance of this study lies in exploring avenues for reducing this cost to support the investment decision-making process. Accordingly, this study aims to examine the effect of comparability on the cost of equity capital while investigating the mediating role of managerial ability in this relationship, by applying the analysis to a sample of Iraqi companies listed on the Iraq Stock Exchange.

2 Literature Review and Hypotheses Development

2.1 Financial Statement Comparability and the Cost of Equity Capital

Financial statements are the primary source of information relied upon by investors and external users to evaluate corporate performance and make informed investment decisions. On this basis, comparability is considered a key attribute of financial data because it enables investors to better assess companies' investment decisions across different time periods and reporting entities, [14]. The coherent foundation established by the Financial Accounting Standards Board [15] laid the cornerstone for defining comparability as "the qualitative characteristic that enables users to identify the similarities and differences between two sets of economic phenomena".

Given the fundamental importance of comparability as one of the qualitative characteristics, the study of [16] examined the usefulness of this attribute from critical aspects,

such as assisting financial analysts in providing accurate and efficient forecasts by reducing the cost of obtaining information and increasing the amount and quality of information available to different groups of analysts about the firm. This is consistent with the study of [17], which found that comparability increases the amount of firm-specific information (rather than market- or industry-wide information) reflected in stock prices. This is manifested in the role played by analysts in enhancing the informativeness of stock prices by producing firm-specific information when comparability is high.

The study of [18] reported that more comparable financial statements provide better benchmarks for one another, enabling information to be processed at a higher level of effectiveness. [19] indicated that comparability of financial statements contributes to reducing information asymmetry between information producers and users, through its positive effect on the information environment, which leads to a reduction in the cost of firm-specific information. This, in turn, can increase stock liquidity, ultimately lowering the cost of equity financing. In this context, the cost of equity refers to the required rate of return demanded by investors for investing in a company's shares and bearing the associated risks, [20].

Investors are concerned with determining the cost of equity to know the return they will receive for investing in the company's shares, as well as to identify different financing strategies and make various decisions, [21]. Regarding the factors affecting the cost of equity, the study of [7] showed that accounting information, level of disclosure, liquidity level, information asymmetry, and accounting conservatism are among the most important factors influencing this cost. This is supported by [22], who found that high-quality accounting information provides a deeper understanding of transaction-related information, reduces information asymmetry, and lowers the associated risks, thereby decreasing the cost of equity financing.

Conversely, information lacking comparability causes information asymmetry between managers and shareholders, preventing investors from accurately identifying the company's true economic value, which leads to the problem of adverse selection. In contrast, the study of [23] indicated that the quality of accounting information increases the cost of equity capital for shareholders, and this may be because the study used a measure of accounting information quality that differs from the measures

adopted in many previous studies, which justifies the possibility of inaccuracy in the results presented.

Many studies have discussed and tested the relationship between comparability and the cost of equity capital. The study of [6], [24], [25] documented a significant negative relationship between comparability and the cost of equity capital, concluding that comparability reduces the information risk faced by investors and thus the required rates of return, and the comparability captures a dynamic aspect of the institutional information environment that adds to within-firm accounting quality measures. It is evident from the review of previous studies that many studies have tested the effect of comparability on the cost of equity capital in different environments. However, these studies focused on developed financial markets that differ in their structure and regulatory and institutional characteristics. In contrast, no studies have addressed this topic in the Iraqi context, which underscores the need to research and test this relationship. Some relevant studies can be found in [26]. Accordingly, we hypothesize that the comparability of financial statements enables investors to better assess the company's value, predict its future operational performance, and consequently make informed investment decisions. This leads to a reduction in information asymmetry and thus a decrease in the cost of equity financing. Based on the above-reviewed findings, we formulated the first hypothesis in its alternative form as follows:

H1: There is a significant effect of financial statement comparability on the cost of equity capital

2.2 The Interactive Effect of Managerial Ability on the Relationship between Financial Statement Comparability and the Cost of Equity Capital

Comparability is considered one of the most debated topics in the field of accounting despite its apparent simplicity, as the concept of comparability entails the necessity for like items to be presented and measured similarly, and for unlike items to be presented differently to reflect their nature. Accounting literature has converged and elaborated on the effects of this characteristic and the continuous calls for achieving the highest level of comparability, and the approach was evident in the adoption of the International Financial Reporting Standards (IFRS), where this fundamental effect in itself contributes to providing an expandable and reliable investment environment, [27]. One practical method to achieve comparability is to impose a

unified set of accounting standards across companies. When companies are subject to identical standards, their financial statements are assumed to reflect a higher level of comparability. Additionally, requiring companies to apply similar methods, models, and estimates within the standards can further enhance comparability, [28].

At the level of financial users, comparability provides them with the ability to assess the company's performance and better understand its operating environment. It also helps them anticipate economic events and translate them into accurate accounting performance, as it is considered a qualitative characteristic that achieves the objective of financial statements, which is to provide these users with useful information enabling them to make informed investment decisions, [7]. This improvement in information quality leads to achieving the highest levels of comparability sought by the International Financial Reporting Standards (IFRS), which practically translates into an economic benefit for the company by reducing the information asymmetry gap between management and shareholders through its positive effect on the information environment. This reduction in information asymmetry decreases the cost of firm-specific information, which in turn can increase stock liquidity, thereby reflecting a reduction in the cost of equity, [19].

With the acknowledgment of many previous studies regarding the positive role of comparability in rationalizing decisions and reducing the cost of capital from its various sources, achieving these economic benefits remains contingent upon the effectiveness of the human element leading the company. From this standpoint, the pivotal role of executive managers emerges in achieving comparability in financial statements through the use of their discretionary authority in applying accounting standards, [10]. The executive manager is viewed as the principal source and highest strategic decision-maker responsible for preparing the financial statements and disclosing accounting information in accordance with the adopted standards. Therefore, executive managers continuously strive to present high-quality financial statements that can be easily compared, and their ability to achieve this is considered an important determinant of the accuracy of the financial statements and their impact on investment decisions within companies, [29].

It is consistent with this proposition that the study of [10] found that managers with higher managerial abilities are associated with higher-quality earnings, and this quality provides the basis

for evaluating investment opportunities and choosing among alternatives, indicating that managers influence the quality of the judgments and estimates predicted in forming earnings. Our study also examines whether managerial ability affects the cost of equity capital. The study of [13] showed that managerial ability has a potential effect on the factors that investors consider when determining the cost of equity capital, namely the information environment and perceived risk. Specifically, managers with higher managerial abilities improve the quality of information contained in financial reports by improving the information environment within firms. Therefore, high managerial ability is expected to contribute to reducing the cost of equity capital by improving the informational content and constraining perceived risks. The study of [30] found that the effect of managerial ability on the cost of capital exhibits a significant negative relationship, as more competent managers lead to a lower cost of capital. Additionally, managerial ability plays a crucial role in determining the company's strategic direction, managing resources, and leading the organization toward achieving its objectives, based on the echelons theory, [31].

The findings of [32] contradict the aforementioned results, and in accordance with Agency Theory, high managerial ability may increase private information risk, as greater managerial incentives may lead managers to withhold available information to maximize their personal interests at the expense of other stakeholders. Consequently, managerial ability may contribute to increasing the opacity of financial reports and raising private information risk, which ultimately leads to an increase in the cost of equity capital. However, the empirical result of her study did not confirm this direction. Since managers exercise authority delegated by investors and bear responsibility for the company's investment choices, [33]. Thus, their ability is considered one of the determinants that affect the company's pursuit of obtaining the necessary financing from capital providers. Based on prior literature, we examine the integrated relationship between comparability and the cost of equity capital, with managerial ability serving as a mediator. Thus, it can be inferred that managerial ability may influence the cost of equity capital directly and indirectly through enhancing comparability. Since previous studies have not tested this tripartite relationship together, this highlights an important research gap whose impact will be explored theoretically and empirically within the current study. Accordingly, the second

hypothesis can be formulated in its alternative form as follows:

H2: The effect of comparability on the cost of equity capital increases when managerial ability is moderated.

3 Study Model

Model 1 (H1): Test the relationship between comparability and the cost of equity capital by running the following regression model:

$$COE_{i,t} = \beta_0 + \beta_1 COMP_{i,t} + \beta_2 SIZE_{i,t} + \beta_3 LEV_{i,t} + \beta_4 ROA_{i,t} + \varepsilon_{i,t} \quad (1)$$

Model 2 (H2): Testing the effect of financial statement comparability on the cost of equity capital when managerial ability is moderated, by running the following regression model:

$$COE_{i,t} = \beta_0 + \beta_1 COMP_{i,t} + \beta_2 MA_{i,t} + \beta_3 COMP \times MA_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 LEV_{i,t} + \beta_6 ROA_{i,t} + \varepsilon_{i,t} \quad (2)$$

4 Study Result

4.1 Descriptive Statistics

It is noted from Table 1 that the average comparability (COMP) over the study period reached (0.010), a value close to zero, indicating the presence of comparability among the companies, but the standard deviation was high. As for the cost of equity capital (COE), it reached (0.065), which is close to the risk-free rate provided by the Central Bank of Iraq, and is also close to the return on assets, which reached (0.031). While the average managerial ability (MA) reached (0.014) with a low standard deviation. As for the average leverage (LEV), it was about (0.469), which means that about 46% of the companies' assets are financed by debt, and this is because the majority of the study sample consisted of banks.

Table 1. Descriptive Statistical

Variables	Obs.	Mean	Std. dev.	Min
COMP	360	0.010	1.154	-3.258
COE	360	0.065	0.138	-0.282
MA	360	0.014	0.887	-2.656
SIZE	360	26.092	2.179	19.218
LEV	360	0.469	0.242	0.120
ROA	360	0.031	0.069	-0.165

Source: Prepared by the authors based on Stata

4.2 Normality Test

Both the skewness and kurtosis coefficients were relied upon to test the normality of the data and to

verify the extent to which the condition of normality is met in these data. It is judged that the study variables' data are normally distributed if the skewness value falls within the range of (+1 to -1) and the kurtosis value falls within the range of (+3 to -3). By reviewing Table 2, it is noted that the values of skewness and kurtosis fall within these ranges, which confirms that the study data approximate a normal distribution, allowing the researchers to rely on parametric statistical methods in conducting statistical tests.

Table 2. Skewness and Kurtosis Coefficients

Variables	Skewness	Kurtosis
COMP	-0.09889	2.834935
COE	.1663844	2.804733
MA	-.1024087	2.94203
SIZE	.0631882	2.026011
LEV	-.0740046	2.611623
ROA	.0296765	2.066426

Source: Prepared by the authors based on Stata

4.3 Correlation between Variables

This study uses the Ordinary Least Squares (OLS) method to test the hypotheses. Before conducting the regression analysis, preliminary tests were performed, including the correlation test between the Variables. Table 3 shows the Pearson correlation results, which indicate that the relationships between the independent variables are relatively small and below the correlation level of (0.80), at which multicollinearity problems are expected to appear. Additionally, the correlation levels between variables are not significant, which means that there is no multicollinearity problem.

Table 3. The correlation between the study variables

Variables	COMP	COE	MA	SIZE	LEV	ROA
COMP	1.000					
COE	-0.737	1.000				
MA	0.766	-0.694	1.000			
SIZE	0.411	0.320	0.406	1.000		
LEV	-0.009	0.008	0.003	0.035	1.000	
ROA	0.757	0.517	0.721	0.333	0.032	1.000

Source: Prepared by the authors based on Stata

4.4 Multicollinearity Test

The results presented in Table 4 indicate that all Variance inflation test (VIF) values for the independent variables were less than (5), which suggests the absence of a Multicollinearity problem among the independent variables. This result

confirms that the model does not suffer from Multicollinearity and that the variables are relatively independent of one another, indicating that the estimated coefficients are not adversely affected by Multicollinearity.

Table 4. Variance inflation test

Variables	VIF	1/VIF
MA	1.89	.5291
COMP	1.76	.5682
SIZE	1.48	.6757
ROA	1.31	.7634
LEV	1.25	.8000
Mean VIF	1.54	

Source: Prepared by the authors based on Stata

4.5 Cross-Sectional Dependence, Heteroskedasticity and Autocorrelation Tests

The results presented in Table 5 show that the value of Pesaran's cross-sectional dependence test is (1.235), while the corresponding probability value is (0.2168), which is greater than the adopted significance level of (0.05). Accordingly, there is no statistical evidence of cross-sectional dependence among the units, suggesting that the observations may be independent of one another. This result has important implications when selecting statistical models, including the possibility of using conventional regression estimators such as Ordinary Least Squares (OLS).

Table 5. Results of Cross-Sectional Dependence, Heteroskedasticity, and Autocorrelation Tests

Test	Test Statistic	(P-value)
Pesaran's Test of cross-sectional dependence	1.235	0.2168
Breusch Pagan/Cook-Weisberg Test for Heteroskedasticity	$\chi^2(1) = 2.45$	0.1175
Wooldridge Test for Autocorrelation in Panel Data	$F(1,23) = 2.18$	0.1532

Source: Prepared by the authors based on Stata

Regarding heteroskedasticity, the results reported in Table 5 indicate that the Chi-square value $\chi^2(1)$ equals (2.45), while the probability value is (0.1175), which exceeds the adopted significance level of (0.05). This indicates acceptance of the null hypothesis of homoskedasticity (constant variance) and rejection of the alternative hypothesis of heteroskedasticity. Therefore, the model does not suffer from a heteroskedasticity problem.

Concerning autocorrelation, the results presented in Table 5 show that the computed F-statistic equals (2.18) with a probability value of (0.1532) and degrees of freedom (1, 23). Since this probability value is greater than the adopted significance level of (0.05), there is no strong statistical evidence to reject the null hypothesis of no first-order autocorrelation. In other words, the data do not exhibit first-order serial correlation. Based on this result, it can be concluded that the model does not suffer from an autocorrelation problem.

4.6 Regression Analysis and Hypothesis Testing

Results of Model 1 (H1): The results of Table 6 (Appendix) indicate that the regression model (Model 1) is overall statistically significant based on the F-value of (107.69) at a significance level lower than the reference level (0.01). This result is supported by the R² value of (0.543), which means that there are effects of the independent variables on the dependent variable.

And considering the remaining regression analysis tests, it is clear that the estimated regression coefficient for comparability (COMP) reached (-0.0959) at an acceptable significance level, lower than the reference value (0.05), as indicated by the t-value of (-14.17), meaning that- there is an effect of comparability on the cost of equity capital. This indicates that investors rely on comparability for purposes of evaluating the firm and determining the return on their investments. As for the estimated regression coefficients of the control variables, they were very small and insignificant. This means that investors rely only weakly on firm size and leverage in determining the return on their investments, that is, the cost of equity capital. From the above, it is inferred that the first hypothesis (H1), which states that “there is a significant effect of the comparability of financial statements on the cost of equity capital”, is accepted.

Results of Model 2 (H2): It appears from Table 6 (Appendix) that Model 2 is overall statistically significant based on the F-value of (73.14) at an acceptable significance level and lower than the reference value (0.05), which means that there are effects on the independent variables on the dependent variable. The results of the regression analysis showed that both comparability and managerial ability have an effect on the cost of equity capital, but there is no effect of managerial ability when it is introduced as an interaction variable (COMP×MA) to express managerial effectiveness in accounting information

characteristics, and no effect was found. This lack of significance may be attributed to the low financial and accounting expertise of the company’s management and its limited involvement in accounting work, which consequently reduces the accountability element provided by the board of directors when discussing the financial statements in its annual meetings. Based on a set of considerations and statistical tests, this indicates the rejection of the second hypothesis (H2), which states that “The effect of comparability on the cost of equity capital increases when managerial ability is moderated.”

5 Conclusion

Our study examines whether financial statement comparability affects the cost of equity capital of the company, and the direction of this effect. According to the joint conceptual framework of the FASB and IASB, comparability is considered one of the desirable qualitative characteristics of accounting information. Since the prevalent view states that high comparability would reduce the cost of equity through reducing estimation risk and narrowing the information asymmetry gap among investors, which ultimately contributes to mitigating the problem of adverse selection, our results came in line with this view. More precisely, we find that financial statement comparability is negatively associated with the cost of equity capital. This indicates that investors fully perceive the effect of comparability in reducing information deficiencies resulting from inconsistency in the information environment, and they rely on comparability for firm valuation and determining the return on their investments. The study also reveals that managerial ability does not have a statistically significant effect on the relationship between financial statement comparability and the cost of equity capital. The lack of significance of these results may be attributed to the low level of financial and accounting expertise of company management, which limits their ability to accurately understand financial reports and to intervene effectively in accounting work. As a result, the element of accountability and transparency that is supposed to be provided by the board of directors when discussing the financial statements through its annual meetings is weakened, as these discussions often become formal rather than substantive, and do not tangibly reflect an improvement in the quality of financial reporting or an enhancement of its comparability.

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APPENDIX

Table 6. The results of the regression analysis

Variables	Model 1			Model 2		
	Coefficient	t-Statistic	Sig.	Coefficient	t-Statistic	Sig.
(Constant)	0.8638	2.39	0.0017	.0876716	2.42	0.016
COMP	-.0959356	-14.17	0.000	-.129824	-7.35	0.000
MA				.0459378	2.14	0.033
COMP*MA				.0014881	0.40	0.692
SIZE	-.0008485	-0.59	0.558	-.0009635	-0.67	0.505
LEV	-.0068756	-0.34	0.736	-.0074558	-0.37	0.714
ROA	.0423806	1.77	0.077	.0423585	1.68	0.093
N	360			360		
Adjusted R ²	0.543			0.5466		
F-statistic	107.69		0.0000	73.14		0.0000

Source: Prepared by the authors based on Stata

Contribution of Individual Authors to the Creation of a Scientific Article (Ghostwriting Policy)

The authors equally contributed in the present research, at all stages from the formulation of the problem to the final findings and solution.

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Conflict of Interest

The authors have no conflicts of interest to declare.

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