

DOES ACCOUNTING CONSERVATISM AFFECT SHAREHOLDER VALUE IN THE U.S. AIRLINE INDUSTRY?

Bert J. Zarb, Embry-Riddle Aeronautical University, Daytona Beach, Florida, U.S.A.

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ABSTRACT

Conservatism is one of the most important concepts in financial accounting. Over the years, several studies have operationalized the qualitative nature of this concept. Watts (2003) refers to conservatism as “the differential verifiability required for recognition of profits versus losses.” In his seminal work, Basu (1997) studied the timeliness of earnings recognition with respect to stock returns and found that earnings reflect “bad news” faster than “good news.”

Prior studies of accounting conservatism have focused on the banking industry (Alali & Jaggi, 2011), high-tech versus low-tech firms (Kwon, Yin, and Han, 2006), emerging markets (Elbannan, 2011), and a large number of international markets (Anadarajan, Francis, Hasan, and John, 2011) while Kothari, Ramanna, and Skinner (2010), demonstrated the benefits of accounting conservatism in the debt market. Against this background, this study proposes to investigate whether accounting conservatism affects shareholder value in the U.S. airline industry.

Keywords: *Accounting conservatism, shareholder value, and airline industry.*

1. INTRODUCTION

Accounting conservatism is probably one of the most important properties in financial reporting. (Sterling, 1970). It has been said that accounting conservatism is indispensable because various stakeholders in a firm demand it to mitigate agency costs (Zhong, 2017). It is not surprising that over the past few years, accounting conservatism has become the subject of vibrant research. This string of research has resulted in several measures of accounting conservatism including balance sheet measures, income statement measures and earnings/stock return relation measures (Wang, Hógartagh & van Zijl, 2009).

Most significantly, however, has been the identification of five key measures of accounting conservatism namely, Basu's (1997) asymmetric timeliness of earnings measure, Ball and Shivakumar's (2005) asymmetric-accruals-to-cash-flow measure, the common market-to-book ratio method, Penman and Zhang's (2002) hidden reserves measure, and Givoly and Hayn's (2002) negative accruals measure.

Although there are several other measures of accounting conservatism, these five measures have been the most widely-used and despite the lack of consistency among them, have left an impact on the empirical literature of accounting conservatism (Wang, Hógartagh & van Zijl, 2009).

Although measures of accounting conservatism have been used widely in the literature (Zhong, 2017), there seems to be a paucity of their use and application in the airline industry. Therefore, this paper attempts to address the research question as to whether accounting conservatism affects shareholder value in the U.S. airline industry and to assist airline managers.

The rest of this paper is organized as follows: A background of this study is presented followed by a discussion of the hypotheses and methodology. The results are then discussed followed by the limitations and conclusions of this study. A discussion of the recommendations for future research concludes this paper.