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VALUE RELEVANCE OF ACCOUNTING INFORMATION AND STOCK MARKET VULNERABILITY - A STUDY ON LISTED COMPANIES IN DHAKA STOCK EXCHANGE

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ABSTRACT

Recent empirical work has suggested that Accounting Information (AI) have lost their relevance to investors significantly over the past few decades. Accounting Information contained in financial statements to be accurate and transparent enough to provide an indication of a business performance and financial condition to decision makers primarily investors and creditors. Therefore, this study investigates the extent of association between stock price and two influential accounting variables (i.e. earnings-per-share and net asset value per share) to measure the relevance of accounting information. This study is based on accounting information which are available in DSE data base and published annual reports of 105 companies from 2000 to 2010. It is found that only 6.5% of changes in share price can be explained by changes in defined accounting variables. Through Multiple correlation analysis with the help of user friendly statistical software it is found only 25.4% correlation between share price and the defined two independent variables. On the other hand considering individually there is a negative correlation between share price and NAVPS of the sample company. It is also found that there is only 1.9% relationship between EPS and NAVPS. According to the present empirical evidence, investors tend to focus on information other than the published accounting information such as non financial information, short term capital gains and tend to be speculative or irrational for unusual events.

KEYWORDS

Accounting Information, DSE, EPS, NAVPS, Correlation.

INTRODUCTION

The relation between stock price and accounting earnings has been an internationally popular subject of research for more than thirty years. Since Ball & Brown first documented the aforementioned relation, an extensive number of accounting literature has been published, all trying to best accommodate the incentives of the price-earning association, as well as the ability to forecast future earnings from stock movements and vice-versa (D.E.Panagiotis, A.Dimitrios, 2009). Since accounting information is one of the most prominent inputs to decisions determining pricing, so it becomes natural candidate to consider when examining the efficiency of the price setting process (N.Jiri2008). From the very beginning, it is assumed that role of accounting discipline is to protect the interest of stakeholders. Now a days, major part of stakeholders cover shareholders and creditors who finance the organization at initiation of the entity. Remaining users are not aware of the significance of accounting data on their decision. So accounting discipline has designed their defined role. However in developing countries this hypothesis strongly exists. In some countries like Germany there is no scope to raise capital from market by issuing shares like traditional and risk free source of financing. There is a significant and influential relationship between information produced in accounting and stock price if the market is informational efficient. Although, the dividend policy of the entity has a direct relationship between the share price behavior (Docking and Koch, 2005). In our country macro economic factors (e.g. politics, general economic conditions, government regulations and announcement,) are very crucial for the stock market behavior.

LITERATURE REVIEW

Generally, investors are not in a situation to directly assess the performance of companies in which they intend to invest. They usually depend on financial statements prepared by the management of such organization. The primary purpose of financial statements is to provide information concerning the financial situation of the company, its operational results, any changes of control in the company and cash flow (M.Nirmala & J.Florence). The impact of financial statement information on capital markets indicators referred to as the value relevance studies and it is part of the market-based accounting stream. Information is considered "value relevant" if stock price movements are associated with the release of such information (RSiti Utami, S. Noraya 2010). Since Ball & Brown (1986), study, numerous studies have examined the association between share price and accounting information in different ways. The empirical work in this area examines the ability of accounting earnings to capture or summarize information that affects firm values or share price of that entity. Actually the information content of accounting numbers is inferred from changes in the level or in the variability of stock prices and from changes in the volume of security trades over a short time period during which these data are publicly released (D.Pascal & R. Bernard, 2002). However the review of literature in the concerned research area is of great importance in varying out further research work. This research works reviewed here have been sourced from various journal, internet sites, etc.

In an analysis of Nigerian Stock Market consisting top 30 companies from 2001 to 2004 (Germon and Meek, 2000) found that the relationship between share price and Earnings per share is high but the Return on equity is very low. A similar picture is found in the study on stock exchange of Germany, Norway and The United Kingdom (King and Langli, 1998). A different scenario is found in another study on Colombo Stock Exchange taking 6 commercial banks from 2005-2009 that Return on equity is significantly related with the share price (Perrera and Thrikawala, 2010). Kumar and Hundal (1986) examined the impact of dividend per share, earning per share net asset value per share, leverage ratio on market price of share by using the linear regression model. But they found dividend policy was the more sensitive factors in affecting share price. However, the relationship is also affected by the following: (i) persistence of earnings (ii) positive earnings or negative earnings (iii) frequency of reporting (iv) efficiency of market. There is a number of evidence existing that relationship between earnings and share price is affected by the persistence of earnings. Specifically earnings associated with lower persistence have lower value relevance than earnings associated with higher persistence (Kormendi & Lipe, 1987; Collins & Kothari, 1989). It is assumed in built-in that with positive accounting figures of an entity will convey a good message to its investors. If market is informational efficient this message will be reflected in share price of that entity. It means positive unexpected earnings lead to positive abnormal returns, while negative unexpected ones cause negative returns (Gajewski and Quere 2001). It is also evident that the frequency of reporting is responsible for changing the share price. Contrasting information is also noticeable. Rippington and Taffler (1995), said that stock price reactions to annual reporting are small enough. Share price is also influenced by different announcement from Govt. or regulatory agency time to time. In Bangladesh, Govt. also made quarterly reporting mandatory for listed organization to help all types of investors to make wise and informed investment decision. But unfortunately market has not been working in a desired mode. Although a different scenario is found in French study that turnover data disclosed in quarterly reports do not cause significant market reaction (Gajewski and Quere, 2001).

OBJECTIVES OF THE STUDY

The overall purposes of this paper are to investigate the importance of accounting information for stock market responsiveness. It means whether accounting data provide value-relevant information to investors and other users which are reflected in share price. In country, Bangladesh stock market has become too much vulnerable. In our country 99% of market participants are retail investor and remaining are institutional where our neighboring country India where 80% of

investors are institutional. Investors of DSE have already lost their confidence in market. It has been of course occurred not due to a shorter unexpected event rather due to outflow of huge amount capital from the market and due to unwise decisions of investors or lack of information. Govt. has been trying to make the market stable but still not to as expected. We all know that accounting information is audited and thus relative to other information sources accounting figures can be seen as more reliable.

So I will try to seek out whether there is any relationship between accounting information and share price. If my findings show relationship is absent, then we can infer that no need to issue users trusted audited financial statements with huge cost in every financial year.

DETERMINANTS OF STOCK PRICES IN STOCK MARKET

Factors affecting asset prices are numerous and inexhaustible (C.O.T.Somoye, R.I.Akintoye & E.J.Oseni 2009). On the basis of review of related literature I have categorized the factors affecting stock price in the following ways.

1. Macroeconomic factors (i.e. internal politics, Govt. announcement and regulations, and supply and demand conditions of money)
2. Firm specific variables (i.e. ownership structure, management quality, labor force quality, net book value, dividend policy, P/E ratio, EPS, changes in EPS and P/E ratio, size of the organization and sales revenues or Turnover)
3. Gross Domestic Product, Inflation rate, interest rate prevail in the economy,
4. International Factors (i.e. pressure from different donor organization like WB or IMF, ADB, perception of Different countries and announcement from them, after all diplomatic relationship)

RESEARCH METHODOLOGY

This study is based on the secondary sources of information. Mainly this study will examine the empirical relationship between accounting information or variables like Earning per Share (EPS), NAVPS, P/E ratio and equity share price in the market. I have gone through the financial data of listed companies for the period of 2000-2010 in DSE database. Besides I have gone through different articles in these areas. Other relevant data have been gathered from Working Papers of Bangladesh Bank, different dailies and quarterly reports, and DSE and CSE websites, finally different websites of sample companies to make the research useful for readers.

I will define the research hypothesis, sampling and data collection techniques as well as the statistical techniques used to test the data.

HYPOTHESES

H₀₁: The earning per share significantly affects the stock price.

H_{a1}: The earning per share does not significantly affect the stock price.

H₀₂: The net asset value per share significantly affects the stock price.

H₀₂: The net asset value per share does not significantly affects the stock price.

SAMPLE

There are over 260 companies whose shares are being traded in the Dhaka Stock Exchange (DSE). Initial sample contained more than 150 companies with partial data for the period under investigation but I restricted it to companies with full data and registered in 2000 or before limiting the final number to 105 (annexure-A) from 10 sectors. A company has been regarded as eligible for inclusion in sample if it satisfies following conditions:

- The necessary financial data required for calculating the measures of dependent and independent variables pertaining to all the years 2000-2010 is available.
- The average earning per share of any three successive years is not zero or negative during the period 2000-2010
- Further, only those companies whose price data is available are retained in the sample size.
- It is listed in the Dhaka Stock Exchange. The following list shows the numbers of companies are included in sample from different industries.

TABLE 1: LIST OF SAMPLE COMPANIES UNDER STUDY

SL.No.	Industry	No. of Companies
1.	Banking	16
2.	Insurance	14
3.	Foods	7
4.	NBFIs	2
5.	Cement	8
6.	Engineering	11
7.	Oil and Gas	3
8.	Medicines and Chemicals	12
9.	Textiles	16
10	Miscellaneous	16
	Total	105

ANALYSIS, RESEARCH MODEL

From the sample companies I have computed the changes in EPS and NAVPS over the experimental period. Then I computed changes in share price of all sample companies over the same period. To ascertain the association between these two independent variables and share price (dependent variable), correlation and linear multiple regression models through user friendly software (SPSS) have been selected. The analysis has been employed to study keeping in view that this method has certain advantages which are not available in any other statistical or multivariate discriminate analysis.

DESCRIPTIVES STATISTICS

Through statistical mechanism I have the following data of sample companies. In the following Table- 2 I have shown statistical data including Coefficient of determination, calculated value of F-test. And in the following tables I have shown coefficients of all independent variables and finally correlation matrix.

TABLE 2: STATISTICAL DATA

Model Summary	Output
Number of companies	105
R	.254 ^a
R Square	.065
Adjusted R Square	.063
Calculated Value of F test	32.3333
Tabulated value for above F test (when $\alpha=.05$)	19.50

*share price is dependent variable and EPS and NAVPS are two independent variables

COEFFICIENTS

Model	Unstandardised Coefficients		Standardised Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	88.285	215.349		.410	.682
Changes in EPS	9.621	1.198	.254	8.028	.000
Changes in NAVPS	-.237	.816	-.009	-.291	.771

a. Dependent Variable: Changes in Share price

CORELATION MATRIXS

	Changes in share price	Changes in EPS	Changes in NAVPS
Changes in share price	1	.254	-.004
Changes in EPS	.254	1	.019
Changes in NAVPS	-.004	.019	1

Research Model: Since the share price is the dependent variable and changes in EPS and changes in NAVPS are two independent variables, I can fit these variables in to regression model. It stands for

$Y = \alpha + b_1 X_1 + b_2 X_2$ where α is the constant, b_1 and b_2 are the regression coefficients and X_1 and X_2 are the two independent variables referring changes in EPS and Changes in NAVPS respectively.

So our regression model will be:

$$Y = 88.285 + 9.621 \text{EPS} - .237 \text{NAVPS}$$

INTERPREATATION OF FINDINGS

From the above statistical data it is obviously apparent that is a remarkable question regarding the relationship between the changes in share and changes in accounting variables (i.e. EPS and NAVPS). Because sample companies show that there is only 25.47% relationship between changes in EPS and changes in share price of those companies. And negative relationship between changes in NAVPS and changes in share price. There is only 1.9% relationship between EOS and NAVPS. So it is very clear to us that there is poor relationship between predefined accounting variables and share price. We all know that R^2 measure how much of the variation in the dependent variable can be explained by the independent variables i.e. strength of relationship. In this study, I have found $R^2 = .065$, it means 6.5% of variation of share price can be explained by the changes in EPS and changes in NAVPS. Besides this, adjusted R^2 is very closure to R^2 it suggest the addition of one independent variable makes a contribution in explaining the variation in changes in share price (M.K.Naresh). Now if we see the hypothesis testing scenario it is found calculated value is out of accepted region (calculated value $F = 32.33$ is greater than the tabulated value $F = 19.50$). So, predefined null hypothesis (H_{01}) is rejected. On the other hand there is a negative relationship between changes in share price and changes in share price. So, second null hypothesis (H_{02}) is also rejected. However, when I analyzed the above data in sector wise it is found that in case of Insurance sector there is only 29.11% association between accounting components and share price. Similar scenario is appeared in cement and ceramic sector and miscellaneous sector. Only in food sector more than 50% relationship exist between changes in accounting variables and changes in share price. Hence it is apparently assumed that accounting information is not properly reflected on share price or investors do not use the accounting information to make their investment decision in Bangladesh. And share price is not significantly influenced by the changes in accounting variables. Rather other qualitative factors play an important role in this aspect. It may be for example, appointment or dismissal of key personnel in the regulatory authority like Security Exchange Commission (SEC) and DSE, changes in major policies of the organization affecting investors economic well being, declaration of dividend, changes of chief staff in commerce ministry, or Finance Ministry, etc.

PREVAILING MARKET CONDITIONS, GOVERNMENT INITIATIVE STOCK MARKET STABILIZATION

Recently Dhaka Stock Market has been experiencing a long decline in stock price i.e. stock market index. It may be occurred due to speculation done by some clever and hoggish minded investors. As a result lots of small investors have lost their life motive capital. A number of days they have demonstrated a human chain and demanded the resignation of high authority of regulator and DSE even finance minister. Consequently, govt. made the desired changes. But no improvement we have seen although exception was seen in following day of announcement. Rahman and Hossain (Rahman and Hossain, 2006) conducted their study to seek evidence whether DSE is efficient in the weak form or not. They found market is not efficient in weak-form. They also explained that the absorption of good and bad news or any other price forming information may take late effect of share price because of available advance technology, control system and publication of business journal and due the poor institutional infrastructure, weak regulatory framework, lack of supervision, and lack of accountability, poor corporate governance and slow development of the market infrastructure and low level of capacity of major players and lack of transparency. However, Govt. consulting with other different concerned authority has taken the following initiatives time to time to make the market stable to attract new investors and to keep the current investors in the market. These are:

- Tax at source on brokerage commission will be cut by half to 0.05%
- Sources of undisclosed money will not be questioned if invested in stock market
- The 10% tax on mutual funds will be withdrawn
- Formation of 3 member committee to introduce a flawless index computation method on the bourses
- Govt. plan to formulate Competition Law without keeping the provision of a
- surveillance level over the market manipulation with the help of competition commission
- Encouragement to institutional investors to invest their in capital market.
- Sponsors of all the listed companies will have to hold at least a combined 30% percent stake in those companies all time
- Sponsors and directors of a company will only be able to sell their shares in "block market" instead of public market.
- A general investors who holds 5 percent or above shares of a company would be eligible to be a director of his or her company
- The companies that sold shares through direct listing must buy back if the prices of those securities fell below the issue price.
- Formation of six-member committee to the find the ways to compensate the retail investors who traded with small investment or in credit.
- Bank's investment in subsidiary would not be included as their exposure to capital market and that long term equity investment of bank will not be counted in its exposure limit.
- Removal of capital gain tax on foreign institutional investors and Bangladeshi Expatriates.
- The merchant banks and their stock market related subsidiaries, non banking financial institutions and insurance companies can raise funds equivalent to 49% of their paid-up capital from anywhere. It will reduce the dependency on parent companies.
- SEC allows advisory services to develop a rumor-free market. it will compel the institutions and brokerage houses to appoint professional efficient and experienced investment manager.
- Formulation of guidelines for corporate governance to endure transparency and accountability of the listed firms.
- Formulation of financial reporting act to make qualitative improvement in accounting and auditing disclosures.
- Update of small investors protection act following the developed country's rules and regulations.

- Demutualization of stock exchange i.e. adopting necessary steps to make the mutual fund sector stronger and more attractive.
- Ensure the intensified supervision activities of capital market by establishing enhanced surveillance system.

However despite the above motivational package market was seen hardly stable in the observation period. Rather terrible situation was seen in the recent years.

FUTURE PLAN TO GOVERNMENT

- To set up a special court to fast track cases tied to the capital market
- To form a financial reporting council
- To form a clearing and settlement company to protect the interests of investors
- To enact the financial reporting laws
- To set up international standard surveillance software
- To reform the securities market laws to make the stock vibrant and transparent

RECOMMENDATIONS

1. To change the ratio of institutional investors to retail investors in the market
2. Banking sector should maintain their investment on a sustaining and in a long term concentration (i.e. 10% of total deposit should be restructured)
3. Participants should be pro-active not to reactive considering the pre and pro action of decision.
4. Interference of Foreign Donor organization like IMF or WB should also be in through govt. consult. They should not be allowed to make a comment on recklessly.
5. Entity should follow liberal dividend policy and should pay regular dividend. Because dividend per share is the strongest determinant of market price (S.Sanjeet).
6. Investors are suggested to take care of accounting variables of companies before investing (S.Sanjeet).
7. Each and every investor should go through financial information affecting his or her economic well being before making investment decision.
8. Regulatory authority should not comprise irregularities in the time of listing. For example overlooking the 3 years operational performance.
9. Company should make a balance between retention ratio and dividend pay out ratio so that investors can get chance to improve their investment balance. It means company should follow generous dividend policy. Because dividend increases the investors' confidence on the market. Sometimes stock dividend is more effective than cash dividend.
10. Govt. should mandate the requirement that each and every investor should have minimum business and economics knowledge so that he can bear the consequence unfavorable decision or situation

CONCLUSION

The present study has been undertaken to assess the extent of association between two influential accounting variables (EPS and NAVPS) and market price of share. It is found there is poor relationship between these two. There is also a negative correlation between NAVPS and Share Price. Rather, it is found that a number of other qualitative factors affect the market price. Although, it is awfully unexpected in a developing country like ours, since, where economy is not so strong and sustainable enough. So, in that case Govt. becomes in an awkward situation and consequently retail and individual investors become helpless. From this study it is suggested that investors should have basic knowledge of business and economics. They should be well informed when making their investment decision. They should not depend on the information from speculators or other co investors who have the similar interest on the identical phenomenon. Rather they should go through the audited annual reports which provide the mirror of the company's performance, financial position and changes in control of the owners.

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WEBSITES

16. <http://www.dsebd.org/displayCompany.php?name>
17. www.google.com

ANNEXURE

ANNEXURE – 1: LIST OF COMPANIES UNDER STUDY

Sector	No. of companies	Companies covered
Banking	16	AB bank Ltd., Al-Arapah Islami Bank Ltd., The City Bank Ltd., Dhaka Bank, DBBL, Eastern bank Ltd., iCB, IFIC bank, MTBL., NCC bank, Pubali Bank Ltd., SIBL, Southest bank Ltd., UCBL. Uttara Bank ktd.
Insurance	14	Agrani Insurance comp. ASIAPACINS, MERCINS, PURABIGEN, Sonarbangla Insurance United Insurance Ltd. PRIMEINSUR , Eastern Insurance Ltd, Federal insurance, Green Delta Insurance, Janata Insurance Ltd., , Eastland Insurance Ltd., BD General Insurance company, Central Insurance.
Foods	7	AMCL, Apex foods, Bangas, BATBC, Fuangfoods, Geminisea, National Tea
Cement and Ceramics	8	Aramit, Confidence cement, Heidelbergh Cement, MeghnaCement, Monno Ceramics, Standard Ceramic, Fuang Ceramics,, Crown Cement
Engineering	11	Aftab Automobiles ,ANWARGALV , Atlas BD, BDAUTOCA, Singer Bangladesh, EHL BD Lamps, KAY&QUE, National Tubes, Olympic Industries, ECABLES
Oil and Gas	3	Easterlub, SUMITPOWER LINDEBD,
Medicine & Chemicals	12	ACI Ltd., Ambee Pharma, BEXIMCO Pharma., Square Pharmaceuticals , KOHINOOR , LIBRA INFUSIONS LIMITED., GLAXOSMITH, IBNSINA, KEYA COSMETICS., National Polymar, Orion Pharam., Pharma Aid.
Textiles	16	Altex, ANLIMAYARN, MITHUNKNIT, PRIMETEXT, Sonarbangla Insu Square Textiles, Rahim Tex, Saima textile , Apex Spining & Knitting, BEXIMCO Synthetic, HRTEX, MODERNDYE, Metrospinnig, Dulacotton, DELTASPINING , DESHGARMENTS.
NBFI	2	IDLC, Prime Finance & Investment Ltd.
Miscellaneous	16	Agni system, Boc Bangladesh, KARNAPHULI MIRACLEIND, Bandladesh Service Ltd Samorita Hospital ,Sino Bangla, Bd WeldingElectronics, SAVAREFR, Samata Leather, JUTESPINN , GQBALLPEN ,Apex adelchi, BEXIMCO Bata shoe, Apex Tanary

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