Impact of value relevance of accounting information on share price: A study of listed Banks in Sri Lanka

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Abstract

This study aims to examine the impact of value relevance of accounting information on the share price of listed banks in Sri Lanka throughout 2015-2019. The banks' share price was used as the dependent variable whilst the independent variables include Earning per share, Book value per share, Dividend per share,, and net operational cash flow per share. The study made use of secondary data gathered from annual reports of banks. Descriptive and inferential analyses were performed. Regression analysis confirmed a significant impact of value relevance of accounting information on the share price of listed banks in Sri Lanka. Correlation analysis revealed a significant positive relationship between Earning per share, Book value per share, Dividend per share, and the share price of the banks, while operational cash flow per share has an insignificant positive relationship. This study's findings will assist both potential and existing investors in making investment decisions in listed banks in Sri Lanka.

Keywords: listed banks, share price and value relevance of accounting information

Introduction

Accounting information is the language of business used by corporate firms to communicate their financial positions to their stakeholders by the publication of annual financial statements containing the required financial accounting information. Financial accounting information is the product of corporate accounting and external reporting systems that measures and publicly discloses audited, quantitative data concerning publicly held firms' financial position and performance. All accounting information has to meet up with the qualitative characteristics and be prepared for its target users' consumption. Value relevance is defined as "the ability of accounting numbers to summarize the information underlying the stock prices, and it deals with the usefulness of financial statement information in stock valuation. Value relevance seems as proof of the quality and usefulness of accounting information can be interpreted as the usefulness of accounting data for investors' decision-making process. Accounting information will lead the investors to come up with the right investment decision. Based on the information available, the finance managers can make decisions about the

company's future. Stock's price is the most apparent and essential criteria for determining the firm's value. So, stock price maximization is the most important goal for most corporations to maintain their economic growth and credibility in investors' minds. Financial information is the primary source that most investors can use usually as it is usually the specific information that can decide whether investors invest the company's stock or not. For financial reporting to be effective, accounting information should be completed as relevant and reliable (Hendricks, 1976). Accounting information is potentially useful in establishing the probability distribution of expected future earnings, dividends, or prices, hence establishing current prices. This study examines the impact of value relevance of accounting information on the share price of listed banks in Sri Lanka throughout 2015-2019.

Literature Review

Barth, Beaver and Landsman (2001) stated that for financial information to be value relevant, it is a condition that accounting numbers should be related to current company value. If there is no association between accounting numbers and company value, accounting information cannot be termed value relevant and, hence, financial reports are unable to fulfill one of their primary objectives. Theil (1968) defined information as a change of expectations in an event's outcome and proved that the firm's financial statement is value relevant if it leads to a change in investors' assessments of the probability distribution of future returns. Beaver (1968) supported this definition and added that a sufficiently large change should exist to induce a change in the decision maker's behavior. According to Kothari (2001), the impact of financial statement information on capital markets is an enduring and well-documented research area. The value-relevance stream of this research is based on the premise that if the information is useful, investors will adjust their behavior, and the market will respond through changes in stock prices. Francis and Schipper (1999) suggested four possible alternative interpretations of value relevance. The first interpretation considers accounting information as leading stock prices by capturing intrinsic share values. The second interpretation indicates that if the variables used in valuation models originate from financial statement information, the information is termed value relevant. The third interpretation is based on the statistical association between accounting information and market value, where the main objective is to measure whether investors use the information in setting prices. Finally, the fourth interpretation is seen in a long window perspective, where the correlation between accounting information and market values are statistically examined. Francis and Schipper (1999) and Nilsson (2003) define value relevance from four perspectives ;(a) the

predictive view of value relevance. (b) The information view of value relevance: The value relevance is measured in terms of market reactions to new information. (c) Fundamental analysis view of value relevance: (d) the measurement view of value relevance

Methodology
Research Design
This study used a quantitative research approach, and secondary data were used. The data utilized for this study was extracted from the annual reports of listed banks from 2015 to 2019. The study population considers banks listed in CSE and sampling includes all 13 listed banks listed in CSE.

Hypotheses of the study
H_1:   There is a significant impact of value relevance of accounting information on the share price.
H_2:   There is a significant relationship between the value relevance of accounting information and share price.

Results and Discussions
Table 1 shows that share price indicates the mean value of 95.380(SD=74.174), and it varies from 3.4 to 260.4. The earnings per share (EPS) shows the average value of11.188 with a standard deviation of 11.00, and the minimum and maximum value respectively are -.55 and 47.35. The Dividend per share (DPS) shows an average of4.534 with a minimum of 0, and the maximum value is 18.75. The book value per share (BVPS) indicates the central tendency of78.889 (with a standard deviation of60.322), and the minimum and maximum value respectively are 3.4 and 251.38. The Net operational cash flow per share (NOCFPS)indicates the mean value of 7.189 (SD=31.296), and it greatly varies from -106.59 to116.35. These results indicate that maximum and minimum figures are varied among the proxies, which implies a space between Sri Lankan banks in terms of sustaining its businesses.

Table 1. Descriptive Statistics for Variables

Variables	Obs	Mean	Std.Dev	Min	Max
Share price	65	95.380	74.174	3.4	260.4
EPS	65	11.188	11.00	-.55	47.35
DPS	65	4.534	4.532	0	18.75
NAVPS	65	78.889	60.322	3.4	251.38
NOCFPS	65	7.189	31.296	-106.59	116.35

Table 2 shows that share price is 88% positively associated with earnings per share and significant at 1% level. This signifies that the higher the firm's earnings, the higher the share price. At the same time, it could be noted that earnings are very significant in the firms' growths, diversification practices,

investments, and shareholders' wealth maximization. There is a positive correlation between share price and book value per share, which is 90%, which is significant at the 1% level. It indicates that those firms with high book values experience an increase in their share price. Also, the dividend per share is positively associated with the share price of listed banks in Sri Lanka at 87% and significant at 1%. This signifies that increase in dividend per share results in to increase in the share price of listed banks in Sri Lanka. BVPS has the highest positive correlation of 90% with the share price, which is significant at 1% level. Moreover, there is an insignificant relationship between NOCFPS and Share price with a positive sign of p>0.05(r=-0.1835).

Table 2. Pairwise Correlation Analysis of Variables

Variables	Share price	EPS	DPS	BVPS	NOCFPS
Share price	1.000				
EPS	0.8859 *** 0.0000	1.000			
DPS	0.8754*** 0.0000	0.8742*** 0.0000	1.000		
BVPS	0.9032*** 0.0000	0.8280*** 0.0000	0.8592*** 0.0000	1.000	
NOCFPS	0.1835 0.1434	0.3363*** 0.0062	0.2666*** 0.0318	0.1839 0.1426	1.000

*** Correlation is significant at the 0.01 level, ****Correlation** is significant at the 0.05 level

Table 3 shows that the R^2 value of four performance proxies indicate that 88.5% of the observed variability Share price is explained by selected value relevance information. The *F*-statistics and significance levels (Table 4.8) show that the model generates statistically significant outcomes. The adjusted r^2 value of 0.8782 with the p-value of 0.000 and this model indicates there are significant variations of value relevance of accounting information on the share price. It means that 87.82 percentage of influence is created by EPS, DPS, NAVPS, and NOCFPS, whereas the remaining 12 percent (approximately) of impact is made by other proxies that are not depicted in the model recommendation.

Table 3. Regression Model Summary

Number of observations	65
F(4,60)	116.36
Prob>f	0.0000
R-squared	0.8858
Adj r-squared	0.8782
Root MSE	25.887

Table 4 displays the results of the coefficient estimation for each performance measure studied. The impact of EPS (*t*=4.08 and *p*=0.00), (*t*=4.91 and

p=0.000), and share price of these firms are significant at the 1 percent level. The changes in EPS and BVPS affect the share price. Whereas if the EPS or BVPS increases, the share price will increase. On the other hand, DPS and NOCFPS indicate an insignificant impact on share price, DPS has a positive sign (*t*=1.57 and *p*=0.122), and NOCFPS has a negative sign (*t*=-1.62 and *p*=0.110).

Table 4. The relationship between the value relevance of accounting information and share prices

Share price	Coef.	Std.Err	T	P>(t)	95%	conf. Interval
EPS	2.69	0.66	4.08	0.000	1.37	4.01
DPS	2.66	1.69	1.57	0.122	-0.73	6.05
BVPS	0.549	0.11	4.91	0.000	0.32	0.77
NOCFPS	-0.181	0.11	-1.62	0.110	-0.40	0.042
Cons	11.13	5.37	2.07	0.042	0.39	21.87

Conclusions and Recommendations

This study examined the impact of value relevance of accounting information on the share price of listed banks in Sri Lanka over 2015-2019 by using the secondary data gathered from annual reports of banks. Data were analyzed using descriptive statistics, correlation, and regression analysis. It is concluded that the value relevance of accounting information such as EPS and BVPS has a significant impact on the share price at a 1% significance level, and DPS and NOCFPS indicate that there is an insignificant impact on the share price.

The researcher suggested that the management of listed banks in Sri Lanka should maintain their earnings stability and consistency. The management should make a public offer of ordinary shares and, if possible, a bonus offer to boost their shareholders' funds. This may give the firms more opportunities to have funds for diversification of their investments and increase their net book value. Investors should consider using net book value for investment decisions when earnings are negative since book value compensates for negative earnings. Investors should use book values of equity to evaluate firms with small-sizes and high intangible assets.

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