

Market based accounting research impacts



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Market-based Accounting Research

Introduction

Accounting provides financial data about the performance of a company. This data enables accounting information users, including investors, to take their decisions about investing in the shares of a company. Similarly, accounting research evaluates the usefulness of this accounting data to investors and other users. The relationship between the two can be examined through market-based accounting research. Market-based accounting research is a search into relationship between publicly disclosed accounting information and the consequences of use of this information by equity investors. In other words, market-based accounting research examines the association between accounting numbers and security return and tests whether or not accounting data carry any information content to security market.

Rationale for the Research

Market-based Accounting Research is extremely relevant to the study of capital market efficiency, CAPM, information economics and regulation. The main drive of market-based accounting research comes from major developments in finance theory during the last few decades, especially in late 50s and early 60s. These developments include portfolio selection theory, Capital Asset Pricing Model (CAPM), and the concept of information-efficient capital markets followed by developments in information economics, agency theory and optimal incentive-signaling models.

The rationale of this study has its basis in the research in this area in the past. Over the past three decades, a significant amount of research in market-based accounting research has emerged to evaluate the usefulness of accounting data to investors and the association between the accounting numbers and security return. In fact in the recent years due to development of capital markets, globalization and increase in stock trading, market-based accounting research has become even more important. Contemporary market-based accounting research has primarily focused on its international dimension which has had important policy implications for regulators and others who deal with disclosure requirements in different stock exchanges.

The focus of this dissertation will be on examining how market-based accounting research impacts the kind of common stock traded in major stock exchanges. In light of this, the study will examine the relationship between accounting numbers, stock market returns and market valuations.

Key Aims & Objectives

As indicated above, the prime focus of the study is to examine contemporary accounting theory and research with an emphasis on market-based accounting research and its impact on capital markets. As market based accounting research is based on the valuation of firms and their securities, the use of financial statements for valuation purposes, and the implications for financial reporting and corporate governance, all these areas will form a part of this study.

The study aims to:

- Describe the concept of market based accounting research

- Identify the information content of market-based accounting research
- Provide an insight into local market conditions as well as comparative international state of market-based accounting research.
- Examine the role of market-based accounting research and the importance of disclosure of accounting information on capital markets
- Examine how published information is used by investors for designing their trading strategies
- Describe how market-based accounting research information impacts the capital markets efficiency
- Describe accounting based valuation and relate it to the content of brokers' reports

Key Research Questions

The three key research questions proposed to be examined by this study are:

- What is the role of accounting information in capital markets?
- What is the information content of accounting information?
- What is the market-based accounting research hypothesis in context of influence on investors investing in stocks?

Another key research question is how the market reacts to reported earnings, as well as the impact of reported earnings on the properties of analysts' forecasts.

These questions, especially the information content of accounting information, can be measured by the influence of the information on security prices. While measuring the influence it is assumed that investors can

understand the differences in earnings that are due to differences between accounting methods. In other words, the study is based on efficient market hypothesis or the assumption that stock prices accurately and quickly adapt to all available information and therefore prevent individuals from getting abnormal return.

Proposed Research Methodology

Sources of Data / Information

The study will be both exploratory as well as descriptive and will rely on both primary as well as secondary sources of information.

Sampling for Primary Information

Primary data will be collected from a sample consisting of both brokers as well as individual and institutional active investors who have invested in equity shares in a few pre-selected companies listed on the US or European stock exchanges. The period of investment will be from 2000-2006 as 6 years is a sufficient time to analyse the impact. These investors will be chosen on the basis of the frequency with which they invest in the securities.

Data will be collected by administering questionnaires seeking information on how these investors make an investment decision.

Sources of Secondary Information

The prime source of secondary data will be:

- Annual reports of the selected companies under consideration. The variables that will be focused upon will include stock returns, dividends, net income on sale, return of equity, return on asset, debt ratio, interest coverage, current ratio, Price-earning ratio and price.

The final report will be supplemented with information from:

- Literature searches (*refer list of references at the end of the document*)
- Past articles and research in the area
- Internet searches: Searching specific data from Yahoo and Google search engine

Data Analysis

Data will be compiled into data master sheets. The statistical description for all the variables will be presented in a separate table. The various sets of information pooled over the five year period of study will be clearly presented in the table in context of the various variables. The standard deviation and also correlation between the variables and the stock return will be determined and analysed. Correlation will be based on Karl Pearson's method of correlation.

In addition to standard deviation and correlation, regression analysis will also be used for examining the market reaction to reported accounting information. Regression is used for analysis of impact of independent variables on the dependent variable. The dependent variable for regression analysis will be stock returns while the independent variables will be dividends, Net income on Sale, return of equity, return on asset, debt ratio, interest coverage, current ratio, and price-earnings ratio. Regression equations will be solved using Ordinary Least Square method (OLS).

Qualitative data gathered from the investors may include opinions of respondents on a certain issues, reasons for certain behaviour and

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descriptions of certain procedures, practices or perceptions with which the researcher is not familiar. The data can be analysed by classifying all answers into a few categories.

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