

Value relevance of the accounting information to determine the share prices in the Colombo Stock Exchange

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Introduction

Value relevance is one of the basic attributes of quality of the financial statements and it can be defined as the ability of accounting numbers to summarize the information underlying the stock prices. In Sri Lanka, few empirical studies have been conducted to establish the relationship between value relevance of accounting information and share prices. Rauf and Lebbe (2015) examined the value relevance of accounting information and stock price reaction of listed banking sector companies in Colombo Stock Exchange (CSE) using some accounting information indexes such as earning per share, dividend per share, net asset value per share and found a positive relationship between the underline variables. However, studies that have focused non-financial companies listed in the CSE failed to established significant relationship between the relevance of accounting information and stock price reactions (Nimalathan & Vijitha, 2014; Perera & Gunaratne, 2015). Therefore, this study aims to study the relationship between the values relevance of accounting information and stock price reaction in the CSE.

Methodology

The research population consists of all listed commercial banks in the CSE in Sri Lanka. The study selected 10 commercial banks as a sample and gathered data from annual reports of the selected commercial banks for six year period from 2011 to 2016. Earnings per share (EPS), Return on Assets (ROA), Return on Equity (ROE) and Core Capital Adequacy Ratio (CCAR) were used as the independent variables and Share prices were used as the dependent variable. Correlation and regression analyses were used in the data analysis.

Results and discussion

Result of correlation indicates that EPS ($r=0.729, p<0.01$), ROA ($r=0.688, p<0.01$) and ROE ($r=0.646, p<0.01$) are positively correlated with share prices while CCAR is negatively correlated with the share prices ($r=-.389, p<0.01$). Regression analysis reports adjusted R Square 0.670 and it indicates that EPS, ROA, ROE and CCAR have ability to explain about 67 percent variation in share

price variation. Durbin- Watson stat (1.803) which is very closer to value to further shows that the regression model is free from serial correlation. The result of regression analysis confirms the positive effect of EPS and ROA on share prices. However, the results show that ROE and CCAR have negative effect on the share prices.

Conclusion

The study found that accounting information such earning per share and return on assets have a positive effect on share prices in the banking industry while return on equity and core capital adequacy ratio have a negative effect on the share prices. In this premise, the study concludes that accounting information has value relevance in determining the share prices of financial companies in the Colombo Stock Exchange of Sri Lanka.

References

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