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VALUE RELEVANCE AND STOCK PRICES PREDICTON: A NEW INSIGHT FOR FUTURE RESEARCH

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Abstract

Discussions on the importance and contribution of accounting information's relevance in predicting stock prices have always been a hot topic among accounting researchers. This topic is always interesting to discuss because stock prices theoretically reflect the financial information available from companies, contained in the company's accounting reports. Accounting information has the informative ability to describe and predict a company's stock price if presented in accordance with the accounting standards that serve as guidelines for its preparation. Compliance with accounting standards is a crucial point in determining the quality of accounting information's relevance in predicting a company's stock price. Few studies have also investigated the role of corporate governance mechanisms in determining compliance with accounting standards for the preparation of quality accounting reports and their relationship to value relevance and stock price prediction. This study attempts to outline a discussion of various existing research methods to explain the relationship between accounting information's relevance in predicting stock prices and contributes new ideas regarding the comprehensive relationship between corporate governance mechanisms and increasing the relevance of accounting information in predicting stock prices.

Keywords: Accounting Information, Corporate Governance Mechanism, Stock Price, Value Relevance

INTRODUCTION

Financial reports aim to provide a company's financial information through high-quality accounting figures. This information helps creditors, investors, potential investors, and other users make informed decisions regarding their interests, such as investments, lending, and other matters (Ntim, Opong & Danbolt, 2011). Based on the information obtained from the company's financial reports, users should be able to evaluate the size, timeliness, and potential uncertainty of future cash receipts. Whelan (2008) explains that a company's financial data is crucial for providing information on capital flows from investors and demonstrating the management of resources entrusted to management.

Financial reporting information is crucial due to the high complexity of today's business world, which has led investors, potential investors, and other users to rely heavily on financial reports to assess company performance, even managers (Jeroh, 2020). Therefore, the accounting information contained in financial reports must be highly relevant. Profits reported by companies are considered to have relevant value, namely when they are able to significantly reflect share prices, where this value also indicates the value of the company (Dabor & Adeyemi, 2009).

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Previous studies have shown that financial report information with information relevance must be able to reflect a company's value through stock prices, earnings, or other metrics. The better the quality of financial report information, the better it will be able to present earnings information that aligns with the information users use to assess a company (Ogieh & Jeroh, 2022). Therefore, the primary reason for conducting a study on value relevance and stock prices is to determine the usefulness of accounting values in assessing a company's equity.

Another argument supporting the need for a study on the importance of accounting information relevance is the extensive discussion regarding compliance, governance, and the impact of the implementation of International Financial Reporting Standards (IFRS) on the quality of accounting information. Several studies present results showing an increase in IFRS adoption on information quality (Dumontier & Raffournier 1998; Street, Gray, & Bryant 1999; Barth, Landsman, & Lang. 2008; Covrig, DeFond, & Hung 2007; Tarca 2004; Cuijpers & Buijink 2005; Kim & Shi 2007; Hung & Subramanyam 2007; Landsman, Maydew, & Thornock 2012). However, several other research results show a decrease in information quality (Paananen, 2008; Paananen & Lin, 2009) and no effect on the quality of accounting information (Beuselinck, Joos, & Meulen, 2007; Jeanjean & Stolowy, 2008; Jarva & Lantto, 2010).

Studies on compliance, governance, and the impact of the implementation of International Financial Reporting Standards (IFRS) are based on the significant attention regulators and other stakeholders have placed on the fairness and quality of financial reporting. This interest has grown rapidly, especially following the financial reporting scandals in various countries, including those involving Enron, WorldCom, Xerox, Satyam, and several other companies, which have also implicated accountants. This topic has also gained increasing interest among researchers worldwide, partly because most countries have adopted IFRS, making it a significant standard for the development of accounting practices worldwide. However, relying solely on IFRS adoption without improving compliance with existing disclosure standards will result in a lack of value relevance for accounting information. Therefore, further studies on the value relevance of accounting information are necessary.

Based on the two needs outlined in the previous section, the study of the value relevance of accounting information in describing and predicting company performance remains an interesting topic for further discussion. This article, in the following section, will delve deeper into new insights that address a more comprehensive research model of value relevance in efforts to fulfill information needs to predict company stock prices. More specifically, this article will highlight the role of corporate governance mechanisms as controls for the creation of value relevance in accounting information by increasing compliance with standards for producing quality accounting information. Specifically, this paper will demonstrate empirical efforts to publicly demonstrate that accounting information has predictive power for its users' decision-making.

LITERATURE REVIEW

The definition of value relevance in various previous studies is complex and diverse. Value relevance is always associated with the quality of accounting information in measuring performance and financial position (Barth, Landsman, and Lang, 2008). The quality of accounting information focuses on the reliability of the financial information itself. Highly reliable financial reports should protect investors from opportunistic behavior by company managers (Penman and Zhang, 2002). Accounting quality, on the other hand, is also associated with the benefits a company's financial information provides in meeting the expectations of information users (Watts, 2003). Soderstrom and Sun (2007) agree that the quality of accounting information is determined by the standards used, the legal and political systems, and financial reporting incentives. Therefore, the implementation of IFRS, as a globally applicable standard adopted by many countries, can provide higher information relevance and reliability (Soderstrom and Sun, 2007). This situation shows that the measurement and determinants of information quality are still a matter of debate

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in various previous studies (Liu et al., 2011; Callao, Jane, and La, 2007; Karampinis and Hevas, 2011). For example, accounting quality, which refers to value relevance, is associated with earnings management actions by managers (Liu et al., 2011). Callao, Jarne, and La (2007) emphasize the comparability of financial reports to measure value relevance in determining accounting quality. Meanwhile, Karampinis and Hevas (2011) include aspects of accounting conservatism that are juxtaposed with value relevance to say that accounting information can be said to be quality. Therefore, the conclusion from several information from previous studies shows that the value relevance of accounting information cannot be a single definition that stands alone as a determinant of accounting quality because there are other determinants such as earnings management, comparability, and conservatism that also determine accounting quality.

The FASB (2010) provides a different perspective to complement the conceptual model of other definitions related to the value relevance of accounting information in this study. Relevant accounting information must be presented accurately to be useful. This definition of useful accounting is further clarified by incorporating predictive and confirmatory value. This means that information relevant to users of financial statements for decision-making must be able to predict the future value and trends of an economic entity (predictive value) or correct past predictions made by users (confirmatory value). To accurately represent the actual situation, financial accounting information must possess three characteristics: completeness, neutrality, and freedom from error. If these three characteristics are used to establish value relevance, then achieving accounting value relevance becomes difficult, if not impossible.

Cho, Kim, and Lim (2010) in their study analyzed the definitions of value relevance from FASB Concept Statement No. 2 (May 1980) and the IASB/FASB Exposure Draft (May 2008), both of which were considered contradictory. The results of this study suggest that only one definition should be retained. The first definition, value relevance, relates to the ability of accounting information to influence decision-making. More specifically, relevance is defined as "when accounting information about economic phenomena is capable of producing different decisions from users." This definition refers back to the aspects of predictive and confirmatory value. Furthermore, the second definition, value relevance, focuses more on the suitability and importance of selected economic phenomena for decision-making by users of accounting information. This definition is also used by Sloan (1999) to explain value relevance. The economic phenomenon in this second definition contains a contentious meaning. Economic phenomena are more often interpreted as "what is meant to be represented?" Based on the explanation of these two definitions, Cho et al. (2010) concluded that the meaning of relevance is the relationship between accounting information and the representation of economic phenomena.

The definition of the relevance of accounting information value from various aspects of studies and standard setters then triggered the desire to compile a more complex conceptual definition model than the existing definition. This article suggests that to be able to clarify the definition of value relevance is to start from the emergence of the initial motivation for making financial reports for information users, namely creditors, investors, potential investors, and other users in making decisions. At this point the definition of value relevance can begin to be linked to the ability of financial information to be able to create good decisions for users of financial information. Based on the results of previous studies, it shows that there are several important aspects that make up the word relevant, namely (1) information quality, (2) information reliability, (3) accurate presentation (complete, neutral, and free from errors), (4) predictive value, (5) confirmatory value, (6) suitability, and selection of economic phenomena. Based on these six aspects, the relevance of accounting information value can be achieved if an accounting information presented by a company is able to provide quality information to confirm the company's past performance and predict the company's future performance reliably and accurately according to the phenomena selected by the information users.

RESEARCH METHOD

This research uses a descriptive qualitative approach. This approach aims to describe, interpret, and analyze in depth the phenomenon of the value relevance of financial information in relation to company stock price predictions and the role of corporate governance mechanisms in improving the quality of accounting information. A qualitative approach was chosen because this research does not focus on testing statistical relationships between variables, but rather on understanding the concepts, theories, and empirical phenomena developed in the accounting and capital market literature.

This research is a qualitative descriptive study with library research. The research was conducted through a systematic review of various scientific literature discussing value relevance, accounting information quality, corporate governance, IFRS implementation, and stock price prediction. The literature review was used to identify theoretical developments, previous research results, inconsistencies in empirical findings, and research gaps, which served as the basis for developing the research's conceptual model.

The data used are secondary data obtained from various scientific sources, including articles in reputable national and international journals; scientific conference proceedings; accounting and corporate governance textbooks; accounting standards (IFRS and PSAK); the IASB/FASB Conceptual Framework; and publications from capital market regulators, as well as other relevant scientific documents. These sources were selected based on their credibility, topic relevance, and contribution to the discussion on the value relevance of financial information. Data collection was conducted through documentation study, namely by identifying, collecting, reading, and reviewing various literature relevant to the research focus.

Data analysis used content analysis, which was conducted through several stages: identifying key concepts related to value relevance; grouping previous research results based on discussion themes; comparing similarities and differences between previous research results; identifying research gaps requiring further study; and developing a conceptual synthesis regarding the relationship between the value relevance of financial information, corporate governance, and stock price prediction. The analysis results were then interpreted descriptively to produce a comprehensive understanding of the factors influencing the relevance of accounting information in explaining company value.

To enhance the credibility of the research, source triangulation was conducted, namely comparing various theories, concepts, and research results from various journals, books, and accounting standards. Furthermore, the consistency of findings across studies was evaluated to ensure that the resulting interpretations had a strong academic basis.

RESULTS AND DISCUSSION

Value Relevance As An Important Criteria Accounting Information In Predicting Stock Prices

This section discusses the key points of the expectation that the value relevance of accounting information can be an important criterion in predicting a company's stock price. The quality of accounting value relevance indicates the transparency of company information to investors, which has attracted research interest in how the provision of more transparent information can influence a company's market value. The relevance of accounting information can provide investors with a window to predict stock prices because the value relevance of accounting information serves as an explanatory factor for accounting variables (Camodeca et al., 2014). The accounting variables in question include book value per share and earnings (Feltham, Ohlson, 1995; Liu, Liu, 2007; Beisland et al., 2010; and Tharmila, Nimalathasan, 2013), cash flow (Bartov et al., 2001), or other relevant accounting variables that researchers may choose to meet their research objectives (Göttsche, Schauer, 2011). Previous studies have found empirical evidence indicating the influence of the value relevance of accounting information on stock price predictions, such as in

China (Bao, Chow, 1999), Thailand (Graham, King, 2000), Europe (Arce, Mora, 2002), Kuwait (Shamy, Kaled, 2005), and Nigeria (Oshodin, Mgbame, 2014; Uthman, Abdul-Baki, 2014). These studies argue that earnings and book value are relevant values for stock prices. However, several other studies have found different conditions (Francis, Schipper, 1999; Lev, Zarowin, 1999; Dontoh et al., 2007; and Cheng et al., 2008). The results of these studies indicate that certain conditions, such as deliberate steps by companies towards high-technology adoption and a service-oriented economy, cause accounting information to be lost, or experience a reduction or decline in its value. Therefore, the hypothesis stating that "the value relevance of accounting information is able to predict company stock prices" needs to be retested under various different conditions.

Research proving the value relevance hypothesis that accounting information can predict a company's stock price can be refocused on accounting variables, as previously described. Gjerde et al. (2005) argue that independent variables such as profit, dividends, book value, and retained earnings have value relevance if they are significantly related to the dependent variable, which is primarily expressed by stock price, return, or abnormal return. These variables are considered important and useful measures for summarizing a company's financial statements (Jeroh, 2016), and book value and profit (Penman, 2010) serve as the bottom line figures of a company's financial position statement.

Profit is a key variable in the accounting domain when analyzing value relevance issues. Works such as Beaver and Dukes (1972) examine the ability of profit to explain trends and behavior in stock price movements. Profit is considered to be a value relevance indicator for predicting stock returns (Adaramola, Oyerinde, 2014). Research by Nichols, Wahlen (2004) and Dechow, Dichev (2002) observed that earnings information appears to provide more relevant and reliable information. Other studies on the value relevance of earnings show interesting results across various jurisdictions, countries, and industries. Ball et al. (2000) conducted a study on the value relevance of earnings in seven countries, where the results showed that in terms of timeliness, accounting earnings were significantly greater in common-law countries compared to code-law countries. Dechow (1994) found that earnings have a stronger relationship with returns than with cash flow. Based on these research findings, a derivative hypothesis can be raised from the previous one which states that "the value relevance of accounting information proxied by company earnings is able to predict the company's stock price."

Another variable used to measure the value relevance of accounting information is book value per share. This variable is used due to the perceived lack of reliability in the quality of information obtained from investors' earnings (Jeroh, 2016). Hayn (1995) and Babalola (2012) state that book value can be viewed as a proxy for future earnings expectations for corporate losses and a disregard for companies that are likely to cease operations (Berger et al., 1996). Book value is considered to be able to predict stock prices based on several empirical evidence from previous studies (Ohlson, Penman, 1992; Berger et al., 1996; Dontoh et al., 2004), also showing that book value is relevant because it appears to have a stronger relationship with stock prices when weighed. Based on these research findings, a derivative hypothesis can be raised from the previous one which states that "the value relevance of accounting information proxied by the company's book value per share is able to predict the company's stock price."

Corporate Governance As A Factor In Reducing Conflicts Of Interest Through Increasing Firm Value

Both quantitative (financial) and qualitative (non-financial) company reporting information serve as the basis for investor decision-making. Therefore, the quality of company information is crucial for the accuracy of investor decisions. The higher the quality of the information presented, the better the decisions investors can make (Dabor & Adeyemi, 2009). However, in practice, companies face challenges in producing quality information that contribute to low-quality company reporting. Low-quality reporting results from careless accounting, inadequate regulations, crony capitalism, lagging regulations, and numerous regulations, as well as economic and political factors that influence the incentives of managers and auditors (Liu & Zhang, 1996; Ball et al., 2003; Fox, 1998; and Rask et al., 1998).

The emergence of low-quality company reporting information is likely due to the separation of ownership between company owners and managers. Managers have a tendency to play an active role in reducing the quality of a company's financial reports through fraud committed to protect their interests (Dabor & Adeyemi, 2009). Managers in some situations have the ability related to contingent control rights that can create the potential to act against the interests of investors through information concealment (Oyejide & Soyibo, 2001). The existence of conditions such as this can ultimately erode investor confidence in the business practices carried out by a manager, thus giving rise to pressure to present a form of good corporate governance. Sloan (2002) explains that the credibility of a financial report is largely determined by the existence of a strong corporate governance structure.

Corporate governance is a form of governance established to address agency problems that arise in agency relationships. Jensen & Meckling (1976) explain that the purpose of corporate governance mechanisms is to minimize agency problems by aligning the interests of managers and investors, thereby increasing firm value. Increasing firm value through agency conflicts can be resolved by increasing disclosure of corporate governance practices. The first step in disclosing corporate governance practices is to facilitate the efficient allocation of scarce resources to assist managers and investors in identifying profitable investment opportunities (Bushman & Smith, 2001). Furthermore, providing transparent information about corporate governance practices to shareholders reduces external capital costs, such as manager monitoring and bond costs (Beiner, Drobetz, Schmid, & Zimmermann, 2006), thereby reducing overall corporate risk (Mallin, 2002). Finally, disclosure of corporate governance practices can increase firm value by reducing information asymmetry between managers and investors (Sheu, Chung, & Liu, 2010). Several studies have attempted to find empirical evidence regarding the alleged ability of corporate governance to mitigate the impact of agency conflicts. Research by La Porta, Lopez-De-Silanes, Shleifer, and Vishny (2002) successfully demonstrated that companies with more transparent information about investor rights were able to generate higher value compared to less transparent companies. This statement is also supported by Gompers, Ishii, & Metrick (2003) and Durnev & Kim (2005), who stated that there is a positive relationship between disclosure of corporate governance practices and firm value. Based on the explanations of the existing findings, it implies that corporate governance can increase firm value by improving the quality of information related to investor rights. Therefore, the proposition that "corporate governance disclosure practices can increase firm value by reducing information asymmetry between managers and investors" needs to be tested more thoroughly.

Corporate Governance Mechanism As A Control Of Value Relevance Accounting Information To Predict Stock Prices

The role of corporate governance mechanisms is triggered by the agency relationship between the principal and the agent. Jensen & Meckling (1976) explain that an agency relationship is a contractual relationship between one or more principals and an agent, delegating decision-making authority to the agent. Corporate governance has also become an interesting issue due to the legal system in force in a country regarding investor protection, capital market regulations, and accounting. Corporate governance, later abbreviated as CG, aims to create a more liquid capital market by reducing information asymmetry. Laporta et al. (2000) and Renneborg et al. (2006) explain that corporate governance is a combination of traditional and new aspects of the governance and control of corporate units. The final trigger for corporate governance was a number of corporate scandals that demonstrated failures in corporate governance processes in the 1990s and 2000s. These scandals demonstrated fraud and inadequate control systems, which led to a decline in corporate credibility, particularly in corporate governance.

Corporate governance consists of two mechanisms: internal and external. Denis (2001) explains that the internal mechanisms of corporate governance are the Board of Directors, management compensation, ownership, etc. Melón-izco, Ruiz-Cabestre, & Ruiz-Olalla (2020) argue that corporate governance mechanisms, such as board diversity, can improve a company's reputation by being more open to stakeholders. Furthermore, external mechanisms of corporate governance include takeovers and product market competition (Denis 2001), and managerial labor markets (Byrd, Parrino, & Pritsch 1998; Weir, Laing, & Mcknight 2002).

Several studies have attempted to demonstrate that a company's corporate governance quality correlates with the quality of its financial reports. Byard et al. (2006) found empirical evidence that good corporate governance results in better quality earnings information. Therefore, this study's findings imply that high-quality corporate governance can produce more reliable and transparent information. McKinsey's Global Investor Opinion Survey (2002) found that more than 50% of investors in Western Europe and North America view corporate governance disclosure as equally important as other financial issues, such as profit, performance, and growth potential.

Previous research demonstrating that corporate governance impacts financial reporting quality suggests that corporate governance can help investors protect against decision-making failures. This is because financial information produced by companies with good governance produces more transparent and reliable information. Therefore, the next argument that can be tested is that "corporate governance can increase the value relevance of accounting information through information reliability." Investors who use reliable financial reporting information from a company with good governance will ultimately be able to make accurate predictions about future stock prospects.

This hypothesis has been substantiated by several previous studies, such as Mingzhu & Khaled (2013), which examined the impact of corporate governance on the disclosure of forward-looking statements in annual reports and their impact on future earnings. The study concluded that companies with good governance are able to improve reporting quality, thereby enhancing the stock market's ability to anticipate future earnings through forward-looking statements from well-managed companies. Therefore, the next testable argument is that "corporate governance impacts the quality of future stock price predictions by increasing the value relevance of accounting information."

CONCLUSION

Based on the previous explanation that research on the topic of value relevance of accounting information is still an interesting topic to be studied based on two arguments, namely (1) the need for financial report information that has information relevance value must be able to describe the company's value through stock prices, profits, or other measures and (2) the issue of compliance with the application of financial reporting standards. The results of the first article review that has been conducted show several arguments that need to be proven empirically regarding the relevance of accounting information to stock price predictions, namely (1) the relevance of the value of accounting information is able to predict the company's stock price "needs to be retested in various different conditions, (2) the relevance of the value of accounting information proxied by the company's profit is able to predict the company's stock price", and (3) the relevance of the value of accounting information proxied by the book value of the company's shares per share is able to predict the company's stock price. The results of the next review show that the disclosure of corporate governance practices is able to improve the quality of financial reports by finding a testable argument that disclosure practices can increase company value by reducing information asymmetry between managers and investors. The results of the final review found important findings that need to be followed up in further research, namely the role of

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corporate governance in stock price predictions by improving the quality of financial reports through testing the arguments, namely (1) corporate governance is able to increase the value relevance of accounting information through information reliability and (2) corporate governance has an impact on the quality of future stock price predictions by increasing the value relevance of accounting information.

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