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Exploring Value Relevance: A Comprehensive Literature Review

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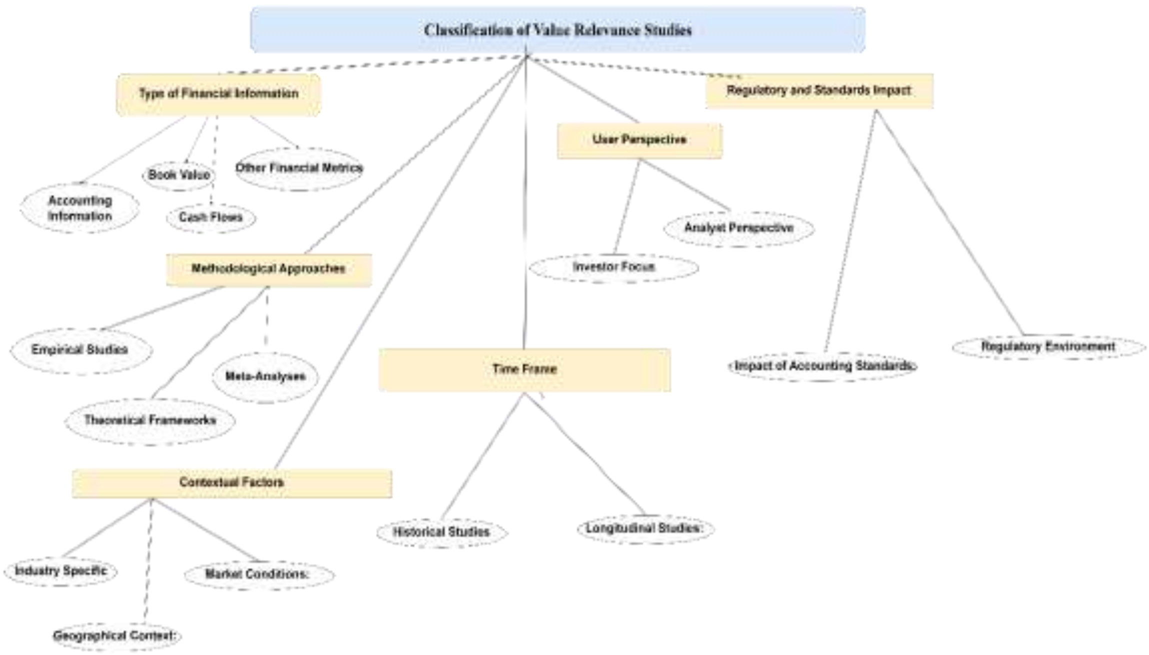


Classification of Value Relevance studies

Value relevance literature principally focuses on the relationship between financial information and the market value of firms. This body of research can be classified into several categories based on different criteria, such as

1. The Type of Financial Information analyzed
2. The methodologies used,
3. and the contexts in which the studies are conducted.

The value relevance literature is also classified on the basis of time frame, User perspective and regulatory and standards Impact.

Type of Financial Information

Accounting Earnings: Studies examining the relevance of net income, earnings per share (EPS), and other earnings metrics.

Book Value: Research focusing on the relevance of book value of equity and its relationship with market value.

Cash Flows: Literature analyzing the relevance of cash flow statements, including operating, investing, and financing cash flows.
Other Financial Metrics: Studies that consider other financial indicators such as dividends, comprehensive income, and non-GAAP measures.

(Bismark badu, 2018) in the paper "Value relevance of accounting information: an emerging country perspective" which was published in the Journal of Accounting & Organisational Change (ISSN: 1832-5912), proposed that stock prices exhibit a positive and significant association with earnings and book value of equity (article publication date: November 8, 2018). According to the findings, earnings, rather than book value of equity, explain a larger portion of the volatility in stock market values on the Ghana Stock Exchange. Nevertheless, the analysis shows that, even after Ghana adopted International Financial Reporting Standards, the importance of book value and earnings has drastically decreased between 2005 and 2014. This study made use of the Ohlson (1995) Price model to evaluate the extent to which accounting information explains changes in stock prices of firms listed on the Ghana Stock Exchange. The goal of this research is to examine the value relevance of accounting information in the context of a rising economy.

The qualitative features of accounting information were assessed using the FASB/IASB Conceptual Framework and value-relevance studies influenced by accounting information users in a study titled "The Quality of Accounting Information: Relevance or Value-Relevance?" by Nasrin Azar, Zarina Zakaria, and Noor Adwa Sulaiman, which was published in the Asian Journal of Accounting Perspectives Vol. 12 No. 1 (2019). To distinguish between these two domains, this study examined the value-relevance literature and SFAC No. 8, which was released by the FASB in September 2010.

The value-relevance literature, which looks at correlations between accounting figures and common equity prices, has little influence on how accounting information is used, according to the research findings presented in the paper. While some academics argue that the value relevance model implies that accounting data is both relevant and trustworthy, it is difficult to determine whether the observed lack of value relevance is due to relevance or reliability problems because the model does not distinguish between the two.

The study Titled (John Godwin, 2002) " The Relevance of Value" Published 2002 · John Goodwin, K. Sawyer, Kamran Ahmed Journal of Financial Abstracts e Journal suggested a theory of value relevance based on the efficient markets hypothesis (EMH) and information theory. Our paradigm takes heterogeneous information into account, just like the EMH, therefore evaluating value relevance involves looking at price determination, market efficiency, and value relevance itself. We categorise value relevance research into weak-form, semi-strong, and strong-form value relevance by assuming information heterogeneity, which is similar to the classification that Fama (1970) used to define the EMH. In light of this, we provide the Efficient Accounting Hypothesis and classify previous value relevance research in accordance with it. We discuss the related econometric consequences of our proposed theory, which proposes a recursive estimate approach.

The accounting concept of value relevance refers to the extent to which stock prices are influenced by financial data and how investors might use it as a resource when making decisions. Divergent accounting standards, market contexts, and economic conditions are some of the elements that influence different viewpoints on the value and relevance of accounting information.

Accounting regulations and value relevance: A fresh viewpoint from the Italian market is the subject of a 2019 study (Macro Rotili). The goal of the 2019 publication, Corporate Ownership and Control by Marco Rotili, A. Giosi, and Giacomo Ceccobelli, was to critically analyse the notion that International Accounting Standards (IAS-IFRS) are more valuable than Italian accounting practices, especially in terms of their purportedly better ability to represent the value of assets and liabilities.

The literature that examines if and how financial data informs investors and serves as a trustworthy foundation for their investment decisions is referred to as value relevant. When Anglo-Saxon and other European environments are examined, a diverse landscape with varying outcomes is revealed. In contrast to other research, this study uses a sample of Italian listed businesses on the Mercato Telematico Azionario, the main segment of the Italian Stock Exchange, to establish a relationship between market and book values using the price-to-book value ratio.

This study covers a longer time period (1996-2015) and takes into consideration modifications to Italian accounting practices brought about by the introduction of IAS-IFRS in 2005 in order to strengthen the validity of the results. The findings is consistent with research that points to a misalignment between the applicable accounting standards and the objective of reflecting a company's current value in the accounting framework that underpins IAS-IFRS. The results show that the gap between a company's market capitalisation and book value is not significantly lessened by the adoption of IAS-IFRS. As a result, the conservatively orientated Italian national accounting system surprisingly exhibits more value relevance and a better ability to capture the business value that investors perceive.

Value Relevance Tests: Separating Relevance from Reliability Printed on October 18, 2022 According to Efrat Shust and Dan Weiss, profits' value significance declined during the COVID-19 epidemic. The literature has historically used the correlation between stock returns and earnings to gauge value significance. The truth is that these tests are "joint tests of relevance and reliability." This warning has the potential to skew the measurement of relevance, particularly during the COVID-19 pandemic when the extraordinary degree of ambiguity may have had varying degrees of impact on dependability and relevance.

This study extends the value relevance test to separate relevance and dependability. We analyse company categories using this extended test in two ways: intensive vs scarce use of accounting estimates and profits against losses. The findings indicate that when both are high enough, reliability and relevance work well together, but when relevance is low, reliability has no discernible effect on earnings' usefulness.

Changing value relevance Published Jan 11, 2013 · A. Zapantoulis investigates value relevance in France, Germany, the Netherlands, and the United Kingdom from 1991 to 2011. Unlike most prior research, value relevance is assessed through coefficients of determination and abnormal pricing errors (Gu, 2007). The study reports three primary findings. First, value relevance remains stable in the sample countries from 1991 to 2004; however, a significant increase is observed post-2005, attributable to the mandatory adoption of International Financial Reporting Standards (IFRS). Second, firms with substantial business changes demonstrate significantly lower value relevance compared to those with minimal changes. Finally, the analysis indicates no significant difference in the value relevance of financial statements between the Netherlands and the United Kingdom—both with market-oriented financial systems—and Germany and France, which have bank-oriented financial systems.

(Kristian, 2003)An International Study on Disclosure Practices, Accounting Standard Enforcement, and Analyst Forecast Accuracy · Printed on May 1, 2003 Using a sample of 22 countries, Ole-Kristian Hope Journal of Accounting Research Copyright University of Chicago on behalf of the Institute of Professional Accounting, 2003 examined the relationship between forecast accuracy and the degree of accounting standard enforcement and the accuracy of analysts' earnings forecasts and the level of annual report disclosure.

The results show that forecast accuracy and firm-level disclosures have a favourable correlation, indicating that analysts can learn a lot from these disclosures. Strong enforcement is linked to improved forecast accuracy, according to a complete measure of enforcement that is created. This lends credence to the idea that enforcement motivates managers to follow established accounting guidelines, which lowers analysts' doubts about future profits. Evidence also suggests that compliance is more crucial when accounting methods are more flexible and that disclosures are especially crucial when analyst coverage is limited.

Methodological Approaches

Essentially, research emphasizes the use of quantitative methods—like regression models, event studies, and other statistical tools—to gauge the importance or impact (value relevance) of certain variables or events. Quantitative analyses allow for objective, measurable insights, and applying these to value relevance which can reveal meaningful relationships and trends.

Empirical Studies:

Various studies have been focussed on

Quantitative analyses using regression models, event studies, and other statistical techniques to assess value relevance.

Theoretical Frameworks:

There has been a prodigious contribution of Conceptual papers that develop models or frameworks explaining the mechanisms of value relevance.

Meta Analyses:

Studies that synthesize findings from multiple empirical studies to draw broader conclusions about value relevance.

(C. Liu, 2014)

According to a study titled, "Value-relevance of financial statements: evidence from A- and B-share markets in China (2014)" by C. Liu, G. Gould, B. Burgan*http://dx.doi.org/10.1108/ijmf-02-2011-0016* [link]: http://hdl.handle.net/2440/108708

A-shares are traded by domestic investors, while B-shares are traded by foreign investors. Companies issuing A-shares must prepare accounting reports according to Chinese Accounting Standards (CAS), while those issuing B-shares comply with International Accounting Standards (IAS). The objective of this paper is to examine the comparative value-relevance of accounting information within the Chinese capital markets, specifically to determine whether the value-relevance attributed to IAS surpasses that of CAS. This study employs a capital market research methodology. Two statistical models are used to assess the value-relevance of competing accounting information in relation to share prices: the Price Model and the Return Model. The research capitalizes on the parallel reporting frameworks governing both A-share and B-share markets by analyzing the same firms that issue both types of shares.The analysis reveals that both CAS and IAS information are value-relevant to investors in the Chinese capital markets; however, IAS provides more pertinent information. Additionally, reconciliation variables, which reflect the discrepancy between IAS and CAS-based accounting figures, do not significantly contribute to explaining market valuation or stock returns.This study presents evidence regarding the value-relevance of accounting reports within the Chinese capital markets for the period from 1999 to 2005. This timeframe captures significant developments in China's accounting regulations that occurred in 1998 and 2001. The recent transition from CAS to IAS is anticipated to enhance the dissemination of financial information by publicly listed Chinese companies.This study investigates the reporting requirements within the Chinese capital markets during a period characterized by evolving accounting standards.

According to a study titled Value relevance of earnings and book value: evidence from Jordan (2012) by (Dhiaa Shamki, 2012) Dhiaa Shamki, Azhar Abdul Rahman[link]: https://repo.uum.edu.my/id/eprint/12674/ it was examined the value relevance of earnings and book value of equity, both individually and collectively, in relation to price and return models for Jordanian industrial companies over the period from 1992 to 2002. The primary findings of this research are twofold. First, with respect to the price model, the value relevance of both earnings and book value individually has increased; however, when considered in combination, the value relevance of earnings has risen while that of book value has become irrelevant. Second, with regard to the return model, the value relevance of earnings—whether considered individually or in aggregate—has increased, whereas the value relevance of book value has declined. Overall, the findings indicate that earnings are more significant in explaining the variance in share price and returns compared to book value. Furthermore, the results suggest that earnings and book value demonstrate greater value relevance within the price model when examined individually. In contrast, when considered in aggregate, these variables exhibit greater value relevance in the return model. This study illustrates that earnings are more effective in explaining market values for Jordanian industrial companies. Notably, this paper represents the first attempt to employ both price and return models within a single study in the Jordanian context.

Contextual Factors

Industry

Specific Studies: Research focusing on specific industries (e.g., technology, finance, manufacturing) to give an insight and understanding of how value relevance may vary across sectors.

Geographical Context: Studies that examine value relevance in different countries or regions, considering local accounting standards and market cond itions.

Market Conditions: Research that investigates how economic cycles, market volatility, or crises impact the value relevance of financial information.

Time Frame

Historical Studies: Research that looks at historical data to assess changes in value relevance over time.

Longitudinal Studies: Studies that track value relevance across multiple periods to identify trends and shifts in investor behaviour.

User Perspective

Investor Focus: Literature that examines how different types of investors (institutional vs. retail) perceive and utilize financial information.

Analyst Perspective: Studies that analyze how financial analysts incorporate value-relevant information into their forecasts and recommendations.

Regulatory and Standards Impact

Impact of Accounting Standards:

Research examining how changes in accounting standards (e.g., IFRS vs. GAAP) affect the value relevance of financial information.

Regulatory Environment:

Studies that consider the influence of regulatory frameworks on the reporting practices and their subsequent value relevance.

Research study, by Mary E. Barth (2001) Value relevance research evaluates how well accounting amounts reflect information used by equity investors and offers insights into issues of concern to standard setters, according to the consequences of accounting conservatism. Equity investment is one of the main topics of financial statements. The significance of value relevance research is not diminished by other applications of financial statement data, such as contracting. Existing valuation methods can be used to answer issues about value relevance. Value relevance studies can accommodate and be used to investigate the implications of accounting conservatism. They also solve econometric difficulties that might otherwise limit results. All rights reserved. Copyright 2001 Elsevier Science B.V. JEL classification: G12, M41, and M44

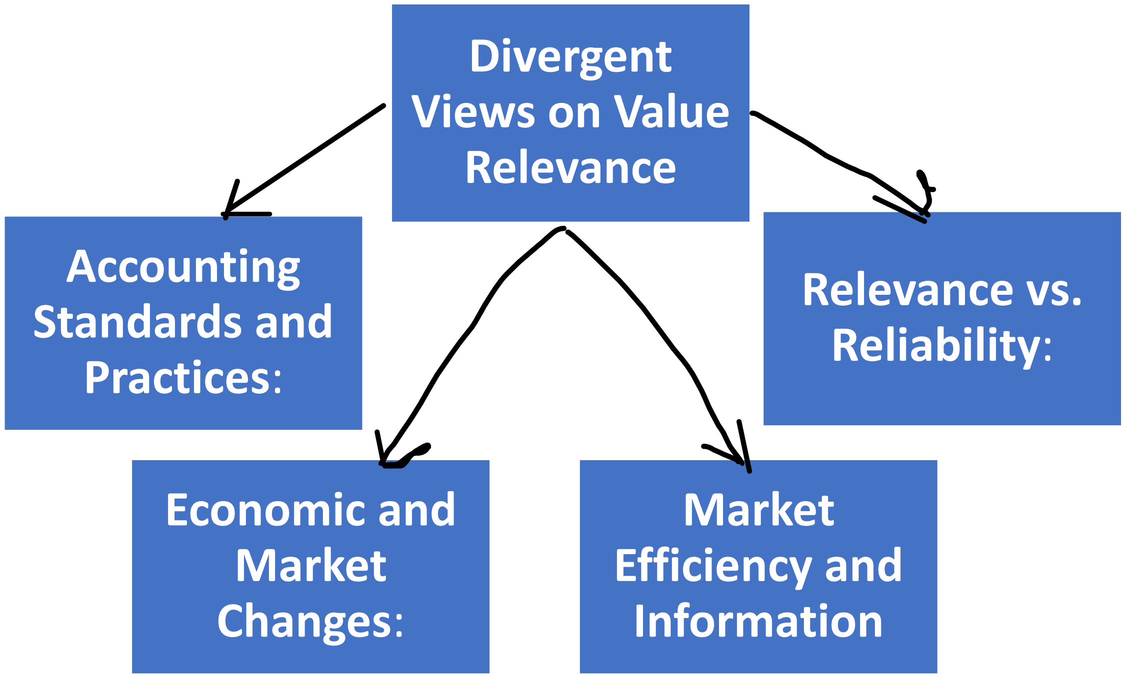
A study by (Beisland, 2009) examines the usefulness of accounting information for stock investors. It determines if there is a statistical relationship between accounting numbers and market values of equity. This review comprehensively analyzes the value relevance literature. It primarily focuses on high-quality research from the past two decades, but also includes important studies from the late 1960s. While the main emphasis is on U.S. financial data, some international evidence is also discussed. The articles are selected from top accounting journals. The review introduces the methodology used in this research tradition and presents key findings on the value relevance of earnings and book equity, which are summary measures used in financial reports. Additionally, it describes studies on the changes in value relevance over time and compares value relevance across different accounting methods. Overall, this review provides in-depth information on the value relevance literature for readers interested in empirical accounting research.

(F A Bilgic, 2018)This study examines the extent to which the value relevance of earnings and book values in Turkey has changed during periods of financial uncertainty. In contrast to existing literature, which assumes a one-way relationship between the quality of firm accounts and stock prices, we explore the divergent effects of various accounting value relevance components from 1997 to 2012. Our findings reveal a shift in dominant value relevance from earnings and negative interest rates during a time of hyperinflation to the balance sheet following the implementation of International Financial Reporting Standards (IFRS) in 2005. Additionally, we observe a decrease in the overall value relevance of accounting variables during the global financial crisis (GFC). These findings raise important policy considerations regarding the consistency of value relevance, the use of negative or low interest rates in fiscal policies, and the asymmetric application of market-based valuations in emerging economies.

(Barth, Mary E., 2019)We look at how the value relevance of accounting data has changed over time in connection with the growth of the new economy. According to earlier research, accounting data—especially earnings—has become less important. We look at a wider variety of accounting elements in our analysis, and we don't see any indication that their total value relevance decreased between 1962 and 2018. We also evaluate how the value relevance of each individual accounting item has changed, and we see a rise, especially for items pertaining to growth prospects, alternative performance metrics, and intangible assets—all of which are critical in the context of the new economy. Furthermore, over time, there have been more and more pertinent accounting components. We go into these patterns further by looking at businesses that make money or lose money in the old economy and businesses that operate in the new economy separately. Although the trends are more noticeable for new economy businesses, they are not limited to this industry. We use a non-parametric method that does not necessitate the definition of a particular valuation relation in order to arrive at our conclusions. In conclusion, our research shows that there has been a shift towards a more complex relationship between accounting data and stock prices, but that their overall significance has not decreased.

(Yong, 2013)In recent years, despite facing considerable criticism, the study of value relevance has continued to generate a significant body of literature from both domestic and international sources. This paper aims to enhance academic understanding by conducting a thorough review of the theoretical models and early research, and classifying the subsequent developments into two categories: increasing correlation research and relative correlation research. Furthermore, this paper systematically examines the literature and its advancements over the past decade. The findings of this study suggest that market effectiveness is not always present, which provides valuable insights for future research on value relevance, particularly in the context of behavioral finance and its incorporation of heterogeneous beliefs.

There have been divergent views on value relevance which is depicted in the form of diagram



Divergent Views on Value Relevance

- **Accounting Standards and Practices**: The impact of International Accounting Standards (IAS-IFRS) adoption on value relevance has been discussed. IAS-IFRS adoption in Italy did not substantially reduce the gap between market capitalisation and book value, suggesting that conventional Italian accounting methods may be more valuable. On the other hand, value relevance increased in other European nations since IFRS was made mandatory in 2005.
- **Relevance vs. Reliability**: Earnings' value relevance decreased during times of extreme uncertainty, as the COVID-19 pandemic. This emphasises how difficult it is to separate relevance from reliability in value relevance evaluations because both qualities are necessary for financial information to be useful.
- **Economic and Market Changes**: The increasing ubiquity of one-time items and negative earnings over the past few decades has caused the value relevance of earnings to shift towards book values. The new economy has also resulted in a greater focus on alternative performance metrics and the value relevance of intangible assets.
- **Market Efficiency and Information**: The assessment of value relevance is heavily impacted by market efficiency and information heterogeneity. According to research, market inefficiencies can affect value relevance assessment, requiring adjustments to take into consideration both immediate and delayed market reactions.

Key Insights on Value Relevance

Evolution Over Time: According to research, accounting information—especially earnings—has remained valuable and relevant over time. Rather, other accounting elements like growth prospects and intangible assets have become more relevant, particularly in light of the new economy.

Impact of Market Conditions: The significance of differentiating between relevance and reliability in value relevance tests was brought to light by the COVID-19 epidemic. Earnings' perceived relevance can be greatly impacted by their dependability during times of high uncertainty.

Theoretical Frameworks: The Efficient Market Hypothesis (EMH) is frequently used as the theoretical foundation in the value relevance literature, which divides research into weak-, semi-, and strong-form value relevance categories. This categorisation aids in comprehending how various forms of information are represented in market prices.

Standard Setting Implications: The implications of value relevance research for standard setting are up for debate, despite the fact that it sheds light on how investors interpret accounting information. Some contend that the correlations discovered in value relevance research have little bearing on standard setting because they are not always indicative of accounting procedures.

Methodological Considerations: To guarantee reliable conclusions, value relevance studies frequently address econometric concerns. Additionally, they investigate how market inefficiencies and accounting conservatism affect value relevance metrics.

Conclusion

A complicated and ever-changing idea, the value relevance of accounting information is impacted by market dynamics, economic situations, and accounting standards. Some studies highlight the increased significance of book values and intangible assets in the setting of the new economy, while others suggest that traditional accounting methods may produce better value relevance. The assessment of value relevance is made more difficult by the interaction of relevance and reliability as well as market efficiency

A organised approach to navigating the vast body of research on value relevance is offered by this classification method. Researchers and practitioners can gain a better understanding of the gradations and implications of value relevance in financial reporting and analysis by classifying studies according to the type of financial information, methodology, context, time period, user perspective, and regulatory influence.

The concept of value relevance in accounting refers to the extent to which financial information impacts stock prices and is useful to investors. Several studies have explored this topic, providing insights into its evolution and implications.

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