

THE RELATIONSHIPS BETWEEN FINANCIAL ACCOUNTING INFORMATION AND SHARE PRICES: A COMPARATIVE STUDY BETWEEN THE PERIODS OF ECONOMIC BOOM AND RECESSION IN MALAYSIA

Prepared by: Balachandar Ramani

ABSTRACT

In the capital market, share prices are dependent upon the quality of a stock. One of the elements that determine the quality is the performance of a company based on accounting information. Using a measuring tool comprising of a set of a relevant, reliable and representative financial ratio can drive this performance. Therefore this project paper intends to explore the extent to which the financial accounting information and share prices are related. This will be demonstrated by analyzing the relationship between the relevant financial ratios and market prices. The financial ratios chosen are not the traditional kind on which little evidence is available on the credibility of these ratios. Instead, the ratios chosen are based on the recommendation by Robertson (1985) who empirically found that the stated ratios are more realistically represented a company's performance.

The sample of the research to find the relationship between financial accounting information's and share prices of those companies listed in the manufacturing industries. It is ranked according the market capitalization in order to avoid size determination problems. The analysis is conducted for the periods of economic boom (1994-1996) and recession (1997-1999) in order to mitigate a cyclical effect and obtain convincing results.

Subsequently, questionnaire survey is also conducted on investors to find their relationship with financial ratios. The questionnaire also comprises boom period and recession period.

It will be demonstrated that the relationship between accounting information using financial ratios and share prices is stronger in the recession period especially for ratios comprising company profitability, gearing and immediate solvency. However, during the economic boom period, all the accounting information captured by the financial ratios tends to become weak. Similarly, it is also demonstrated that during the economic boom period, hardly any investors seem to apply any financial ratios when purchasing shares. However, in reverse the investors applying financial ratios to purchase shares during the economic recession period.