CHAPTER – 1
INTRODUCTION

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1.2 CONCEPT OF VALUE RELEVANCE, FINANCIAL INFORMATION AND NON FINANCIAL INFORMATION.
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The literature pertaining to economics is not new to India. Way back in 350BC, Chanakya, who was a pioneer in the field of economics in India wrote a book in economics “Arthshastra”. His work is considered as important precursor to classical economics. In October 2012, almost 2000 years, after his work Arthshastra, Indian National Security advisor, Shiv Shankar Menon praised Arthshastra for its clear and precise rules which apply even today as stated by Yelegaonkar (2010). But during these 2000 years, with foreign invasion and foreign rulers, India lost its economic direction and the rules laid down by Chanakya.

Even after Independence the Indian economy was a caged bird and not until 1990 was it liberalised. The period of 1960’s to the early 1990s was regarded as the period of administered interest rates, industrial licensing and controls, dominant public sectors, and limited competition. This led to uneconomic and inefficient production systems with high costs.

For 40 years, India's growth rate remained very low, less than 4% per annum as compared to other developing economies. Countries like Japan and other East Asian countries tried to catch up with the industrialised economies by adopting market oriented pattern of industrialization. The Indian government did initiate some deregulations in 1980's which resulted in a relatively high growth but its pace could not be sustained.

In the 1990's, there was a paradigm shift in development from a state dominated to a market determined strategy and this transformation could be possible only when there is a well established financial system. Financial system is the most important institutional and functional vehicle for economic transformation. It helps in the acceleration of rate of savings, mobilization of savings belonging to those who save a part of their income and channelization of the same into the productive activities.
The financial system of most developing countries are characterised by the coexistence of formal and informal financial sectors. Formal financial system consists of financial Institutions, financial markets, financial instruments and financial services.

Financial markets are an important component of the financial system. They provide a mechanism for the exchange and trading of financial products under a policy framework. Financial markets comprise two distinct types of markets, money market and the capital market. The money market is the market for the short term securities while the capital market is a market for long term securities.

Capital markets can also be classified as primary and secondary markets. While the primary market deals with new issues, the secondary market is meant for trading in outstanding or existing securities. In order to boost and capture the world market a country needs to have developed primary and secondary markets. These markets are necessary for providing liquidity to the corporate sector and to the investors. Liquidity in the market improves the distribution of resources and aids in the economic growth and development of the country. During the British rule, capital market was not well organized and developed. Even after the independence the size of the market remained small. India’s financial markets were dormant from 1960s to 1980. It was only at the end of 1980s that there were certain developments and it witnessed an explosive growth of the securities market in India, with millions of investors discovering lucrative opportunities. Major market scams took place in the 1990s which shook the Indian markets and drove away small investors from the market.

The securities scam of March 1992 was one of the biggest scams in the history of the capital markets which shattered the confidence of the investor. The scams exposed the inadequacies and inefficiencies which incited reforms in the stock market. In the interest of the investing public and for the healthy development of the capital market a number of
measures were undertaken by the government in order to reactivate and rejuvenate the capital market. The same views were reflected by the India's official Economic Survey 1992-93, in which it was mentioned by Chapati Rao, Murthy, & Ranganathan (1999) that the process of reforms in the capital market needs to be developed to bring about faster completion of transactions, making them more transparent, for providing improved services to investors, and greater investor protection while at the same time boosting corporate sector to raise resources directly from the market on the large scale. Even the world bank's report (1996) echoed the same view and stated that capital markets needs to be strengthened and fortified in order to attract external flows and for the successful implementation of the privatisation programmes.

Thus statutory recognition was given to the Securities and Exchange Board of India (SEBI) in 1992 which was set up in early 1988 to frame rules and guidelines for various operations of the Stock Exchanges in India as stated by Rao, Murthy, & Ranganathan (1999).

The Over the Counter Exchange of India (OTCEI) became operational in September 1992 and the National Stock Exchange was set up in Mumbai in 1994. Major modernisation of the stock exchanges took place to bring them in line with world standards in terms of transparency and reliability as it was necessary if foreign capital is to be attracted on any significant scale (Finance, 1992-1993, p. 67).

To streamline and reactivate the stock market in India, SEBI took the measures like periodical inspection of stock exchanges, registration of intermediaries, and compulsory requirement for companies to make material disclosure about the risk factors in their offer documents, mandatory rating of debt instruments, and compulsory dematerialised trading by institutional investors.

As a result of these measures, the Indian capital market has grown and growing continuously to boost Indian economy without doubts. It has
been reflected in the number of stock exchange which has gone up to 22 by 1995 from a meagre number of seven. Not only this, the number of listed companies increased from 2265 in 1980 to 9077 in 1995, market capitalization increased from 5722570 in 1997 to 30929,738 in 2010-11, sensex which was at 3366.61 reached the unprecedented height of 9708.50 in 2010-11 and value of shares sold and purchased has considerably increased. (Indian Capital Markets - An Overview)

Since 2003, Indian capital markets have been receiving global attention too, especially from sound investors, due to the improving macroeconomic fundamentals. The presence of a great pool of skilled labour and the rapid integration with the world economy increased India's global competitiveness. No wonder, the global ratings agencies Moody's and Fitch have awarded India with investment grade ratings, indicating comparatively lower sovereign risks.

With these measures by the SEBI, the investor's confidence was boosted and consequently the composition of savings started shifting from bank deposits to shares and debentures. These measures taken by SEBI also boosted the confidence of institutional investors, mutual funds and the foreign investors due to which there is a considerable increase in the trading volumes.

With this increased interest of the investors in the stock market, it becomes imperative to study the various factors that affect the performance of the company and its impact on the stock market price and thus helping the investors to take a more informed decision before investing in a particular company. Akerlof (1970), states that information asymmetry might cause markets to disappear. Securities may be mispriced due to information problems and may have the negative impact on the resource allocation of the participants of stock market and hence it is necessary to study the value relevance of information which provides helpful insights to stock market authorities and the various participants of the stock market.
1.2 Concept of Value relevance, Financial Information and Non financial information

Barth & Beaver (2001) states, “Value relevance research assesses how well accounting amounts reflects information used by equity investors and provides insights into questions of interest to standard setters”. Value relevance is the accounting amount which is associated with some measure of value. HellStron (2005), mentions that Value relevance is understood as the ability of financial statement information to capture or summarise information that affects share values and empirically tested as a statistical association between market values and accounting values.

According to Vishnani & Shah (2008), “Value relevance” implies ability of the financial information contained in the financial statements to explain the stock market measures. It is the evaluation of the relationship of accounting information and capital market values. Accounting information which may be reported in money terms is known as financial information. Financial information relates to cash flows, results and balance sheet positions associated with them. The information has a direct link with the financial registration system and can be historical or prospective. Financial information is expressed in monetary units and can be measured exactly.

By value, we mean creation of wealth & relevance means the information that has the ability to influence decisions. An accounting amount is defined as value relevant if it has a predicted association with equity market values. Modi (2015), refers value relevance as the capacity of information to influence the decision making process of users. The users should be in a position to make predictions about the future with the available information. Information in order to be relevant should be made available to the user before it loses its capacity to influence decisions and therefore it should be apt and well-timed. Not only this, information should also be reliable that is free from bias and error.
According to Ou & Penman, (1989,1996), the information or variable is value relevant if it enables prediction of stock prices by capturing the intrinsic value of the stock. The information can be considered as value relevant if it reflects some aspects of the firm’s economics.

Beaver (2002) points out that value relevance research investigates the association between a security price, the dependent variable and a set of independent accounting variables. The valuation research which aims at investigating the empirical relation between stock market values (or changes in values) and particular accounting numbers for the purpose of assessing an accounting standard are broadly categorized as the “value-relevance” literature by Holthausen & Watts (2001).

Francis, LaFond, Olsson, & Schipper (2004) specify value relevance as one of the most important attributes of accounting quality. They argue that value relevance is a more important attribute of accounting quality than conservatism or timeliness. Relevance refers to the capacity of information to influence the decision making process of users. Users can make predictions about the future that is predicting value of information and to confirm or revise previous estimates (feedback value of information). In order for information to be relevant, it should be made available to the user before it loses its capacity to influence decisions that is it should be timely.

FASB (1980), states information should be reliable also, that is, it assures that information is reasonably free from bias, error, and it is verifiable, faithfully represents what it rationales to represent.

From the above definitions, it is revealed that financial information is one of the major and important aspects of value relevance but what about non-financial information? Is it important? Is it taken into consideration by investors or not?

Non financial information includes various aspects of companies policies, processes and systems which may be directly or indirectly associated
with the financial information. It does not concern uniform measurable monetary units but rather numbers or processes and systems. Non financial information comprises all quantitative and qualitative data on the policy pursued, the business operations, and the results of this policy in terms of output or outcome, without a direct link with a financial registration system as mentioned in a study by Michel, Royal, & Rudi (2009).

Non-financial information relates to all information other than the financial information that does not have a direct link with a financial registration system. Even though it has the potential to add significant value to the company there is no comprehensive registration system for non financial information and does not have direct financial impact.

There is a comprehensive registration system and generally accepted principles for presenting financial information since long but the system is not as well developed for the non-financial information and comprises fewer safeguards for reliability. Public sector users are especially interested in non-financial information, which reflects the results and effects of government policy. Therefore, the reliability and relevance of this information are highly important and hence requires special diligence in its reporting.

The nature of non-financial information can be qualitative or quantitative: Quantitative means that the information is numerical. The information is capable of being expressed in numbers or figures, for instance in quantities or periods. Quantitative non-financial information is akin to financial information, but is usually of a less uniform nature. Often it is measurable and an indirect link can be made with a (financial) registration system. Qualitative information is of a descriptive nature. Pertinent examples are performance, the functioning of systems and processes, physical characteristics or compliance with codes of conduct. The information indicates a quality. Usually, there is no comprehensive
The importance of non-financial information cannot be undervalued in an economy which has gradually moved into a knowledge based fast-changing, technology intensive economy in which investments in human resources, information technology, research and development, and advertising have become essential in order to strengthen the firm's competitive position and ensure its future viability.

The large economic transformation from the industrial economy to the knowledge economy causes the growing intangible assets (IA) base of companies, such as goodwill, patents, and brand names. Compared with tangible assets of companies, intangible assets are associated with more complex information related to measurement and value.

Scrips of companies like Infosys, Wipro and Satyam dominated the Indian bourses in the late 1990s even though they did not have high value tangible assets and mainly were knowledge intensive. This fact reflects the importance of non-financial variables and investment in intangibles in the growth of the company.

H.kang (2006) reported that the current financial reporting model seems to be no longer sufficient to capture the company values and performance mainly due to the fact that it ignores many of the non-financial intangible factors.

Many claim that the shift from an industrial economy to a high-tech service oriented economy (such as telecommunication, pharmaceuticals and bio-technology, software development) has rendered traditional financial statements less relevant for assessing shareholder value and hence firms feel a growing need of disclosure of non-financial variables. Even the manufacturing companies realized the importance of non financial information as compared to the bricks and mortar model.
Since intangibles are playing such prominent role in creation of value, firms feel a growing need to make investments in intangibles, that in most cases are not reflected in the balance sheet but on which the future success of the company is based to a large extent and therefore the study of value relevance of financial and non-financial information, becomes more and more significant and noteworthy. This information is affecting the capital market and the decision making power of investors.

The study needs to be done as it will benefit the various user groups like investors, lenders, suppliers & other trade creditors, government and their agencies and the public. Such a study of value relevance would gain more importance as it has a direct bearing on the objective of wealth maximization.

The subject of value relevance has not been extensively discussed in our standard text books nor has it been studied in depth. With the changing economic scenario world over and more so in India, the importance of understanding this subject has greatly increased and hence provided the impetus to study the value relevance of financial (tangible) and non-financial (intangible) variables especially in Indian context. Moreover, in light of the dot-com bubble that shook the world’s stock markets at the end of the 1900’s and the beginning of the 2000’s, when high technology companies were valued at millions of dollars without having anything of substance on their balance sheets and without showing any profits, the question of value relevance had become even more important with an additional focus on non financial variables.

In the recent time, the value relevance of financial information has been increasingly criticized by the stock market researchers in accounting. In the accounting literature, lots of studies have been done in the area of value relevance of financial reporting. Different studies have explored the value relevance of various financial data reported in corporate financial statements but the area related to non-financial information has remained unexplored.
From the above discussion, it is understood that value relevance is the study of relevance of financial and non-financial information for investors and other groups and the non-financial information is gaining importance with the financial information.

To make appropriate investment decisions, it is necessary that the total information should be disclosed but the fact is most of the non-financial information is not recognized in income statements due to which there exist discrepancies in book value and market value. Research has been done in this aspect in the international context but in Indian context the area remains unexplored. The research would investigate the impact of selected financial variables as well as impact of non-financial information on security prices in Indian stock market. This study focuses on value relevance of financial as well as non-financial information. The research has been categorized into two parts: 1) Understanding investors’ perception as to which information they consider important for taking an investment decision 2) Analysing the financial and non-financial information provided by companies included in BSE 100 index using prowess for the time period 2003-2013.

The study also aims to make a meaningful comparison of primary and secondary data.
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