CHAPTER – 3
RESEARCH METHODOLOGY

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3.1 Introduction:

Research refers to search for knowledge. According to the American Marketing Association (1960), “Research is the systematic gathering, recording, and analyzing of data about problems relating to the marketing of goods and services”. Business research is the process and the tools required to reduce risk in managerial decision making. According to Cooper, Schindler, & Sharma (2012), “business research is a process of planning, acquiring, analyzing, and disseminating relevant data, information, and insights to decision makers in ways that mobilise the organisation to take appropriate actions that in turn maximise performance”. Research methodology is the process of laying down the various steps that are adopted or taken to conduct the research.

Research Design is a statement of the essential elements of a study which provides the basic guidelines for the research. It is the arrangement of conditions for collection and analysis of data. It is a master plan which gives a general statement of the methods used. This research work is basically descriptive study which has used a descriptive design to discover the relationships between various facts and factors. This study is intended to produce descriptions of variables relevant to the decisions being faced.

During the last two decades we have 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. In this scenario, 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 whether the investors realise
the importance of the financial and non-financial information in the Indian context or not and therefore the study of value relevance of financial and non-financial information, becomes more and more significant and noteworthy from companies as well as investor’s point of view.

3.2 Main Objectives:

- To study the value relevance of financial and non-financial information by studying its impact on various stock market measures.
- To identify whether the financial and non-financial information disclosed by the companies is considered important or not by the investing community.
- To study the perception of investors relating to financial and non-financial variables.
- This research also aims to compare the preferences for financial and for non-financial information held by retail investors and financial analysts.
- To compare the outcome of both secondary data analysis and primary data analysis.

3.3 Research Questions:

In view of the above research objectives, the following research questions emerged:

- Which financial or accounting variables are considered the most relevant and having a significant impact on the share price and market capitalization?
- Are financial and non-financial variables complimentary and what is their combined effect on share price?
- Which factors have an impact on shares traded and level of Investment?
• What is the impact of R&D intensity, market expenditure intensity on market valuation of firms using Tobin’s q?
• What is the impact of financial and non-financial variables with special reference given to intangible assets on market capitalization?
• Which financial variable is considered the most important by the investors?

• Which non-financial information has an influence on the investor and his decision?
• Do investors differentiate between R&D and Non R&D performing firms?
• Which factors investor consider before making an equity investment?
• On which source of information the investors rely on before making an investment.
• Which kind of transactions do the investors undertake?
• Do investors give importance to-financial or non-financial news and which type of news is considered important by them?
• Do investors consider companies for investment with large number of intellectual properties?
• Do investors consider social responsibility as important non-financial variable?
• Which financial statements do the investors give more importance to?
• Which elements of annual report the investors consider the most important?

3.4 Research Hypothesis:

The following hypothesis have been developed and tested in the research.

• **Null hypothesis 1:** There is no significant difference in the perception of investors and analyst towards sensex movements as a factor influencing investment decisions.
• **Alternative hypothesis 1:** There is a significant difference in the perception of investors and analysts towards sensex movements as a factor influencing investment decisions.

• **Null hypothesis 2:** There is no significant difference in the perception of retail investors and analysts with regard to factors such as size of the company, earnings growth of the company, age of the company, ownership concentration, capital structure, profitability, growth of Industry, type of Industry, management of the company, and social performance of the company influencing investment decisions.

• **Alternative hypothesis 2:** There is a significant difference in the perception of retail investors and analysts with regard to factors such as size of the company, earnings growth of the company, age of the company, ownership concentration, capital structure, profitability, growth of Industry, type of Industry, management of the company, and social performance of the company influencing investment decisions.

• **Null hypothesis 3:** There is no significant difference in the perception of retail investors and analysts with regard to accounting variables such as earnings per share, market price per share, book value, net sales, gross profit, profit after tax, dividend per share, cash flow per share, return on investment and retained earnings influencing investment decisions.

• **Alternative hypothesis 3:** There is a significant difference in the perception of retail investors and analysts with regard to accounting variables such as earnings per share, Market price per share, book value, net sales, gross profit, profit after tax, dividend per share, cash flow per share, return on investment and retained earnings influencing investment decisions.

• **Null hypothesis 4:** The financial variables have no significant impact on the dependent variable, the level of investment.

• **Alternative hypothesis 4:** The financial variables have a significant impact on the dependent variable, the level of investment.

• **Null hypothesis 5:** The non-financial variables have no significant impact on the level of investment.
- **Alternative hypothesis 5**: The non-financial variables have a significant impact on the level of investment.

- **Null Hypothesis 6**: The financial and non-financial variables are not complementary and there is no significant impact on level of investment when taken together.

- **Alternative hypothesis 6**: The financial and non-financial variables are complementary and there is a significant impact on level of investment.

- **Null hypothesis 7**: There is no significant relationship between the respondents’ exposure to the stock market and the respondents’ perception towards various financial and non-financial variables influencing their investment decisions.

- **Alternative hypothesis 7**: There is a significant relationship between the respondents’ exposure to the stock market and the respondents’ perception towards various financial and non-financial variables influencing their investment decisions.

- **Null hypothesis 8**: There is no significant association between the respondents’ exposure in the stock market and the seven statements given below.

- **Alternative hypothesis 8**: There is a significant association between the respondents’ exposure in the stock market and the seven statements given below.

1. Investors carefully plan, evaluate and allocate funds in order to achieve higher awards.
2. Stock market is gambling and play of destiny.
3. Individuals base their stock base decisions on economic criterion combined with other diverse variables.
4. Nonfinancial information forms or should form an increasingly important part of investor decision-making.
5. Real value drivers’ metrics are like worker’s productivity, corporate innovation and customer satisfaction.
6. Awards or certification for quality adds value to the company.
7. Fundamental analysis is very important for making investment decisions.

- **Null hypothesis 9**: There is no significant association between level of investment and the investors’ perception towards importance of accounting variables.

- **Alternative hypothesis 9**: There is a significant association between level of investment and the investors’ perception towards importance of accounting variables.

- **Null Hypothesis 10**: There is no significant association between the perception of investors towards the socially responsible companies and their investment in socially responsive companies.

- **Alternative hypothesis 10**: There is a significant association between the perception of investors towards the socially responsible companies and their investment in socially responsive companies.

- **Null hypothesis 11**: There is no association between the investors’ perception towards news of R&D and the investor differentiating between the R&D and non R&D firms.

- **Alternative hypothesis 11**: There is a significant association between the investors’ perception towards news of R&D and the investors differentiating between the R&D and non R&D firms.

- **Null Hypothesis 12**: Net Income has no significant Impact on the equity share price.

- **Alternative hypothesis 12**: Net income has a significant impact on the equity share price.

- **Null hypothesis 13**: Earnings per share (EPS), Dividend per share (DPS), Net cash flow from Operations (NCFOPER) have no significant impact on market price of equity share.

- **Alternative hypothesis 13**: Earnings per share (EPS), Dividend per share (DPS), Net cash flow from Operations (NCFOPER) have a significant impact on market price of equity share.

- **Null hypothesis 14**: Accounting variables like book value and earnings yield do not have significant impact on the equity share price.
• **Alternative hypothesis 14**: Accounting variables like book value and earnings yield have a significant impact on equity share price.

• **Null hypothesis 15**: Accounting and financial variables do not have significant impact on the equity share price.

• **Alternative hypothesis 15**: Accounting and financial variables have a significant impact on the equity share price.

• **Null hypothesis 16**: There is no significant impact of the non-financial variables on equity share price.

• **Alternative hypothesis 16**: There is a significant impact of non-financial variables on equity share price.

• **Null hypothesis 17**: The R&D revenue is not more significant compared to R&D capital expenditure.

• **Alternative hypothesis 17**: The R&D revenue is more significant compared to R&D capital expenditure.

• **Null hypothesis 18**: There is no impact of financial and non-financial variables when taken together on share price.

• **Alternative hypothesis 18**: There is a significant impact of financial and non-financial variables when taken together on share price.

• **Null hypothesis 19**: The factors chosen have no significant impact on the shares traded.

• **Alternative hypothesis 19**: The factors chosen have a significant impact on the shares traded.

• **Null hypothesis 20**: There is no significant impact of non-financial variables on Tobin’s q - the representative of firm’s value

• **Alternative hypothesis 20**: There is a significant impact of the independent variables on the dependent variable, Tobin’s q.

• **Null hypothesis 21**: There is no significant impact of the variables on market capitalization.

• **Alternative hypothesis 21**: There is a significant impact of the independent variables on market capitalization.

• **Null hypothesis 22**: The intangible Assets have no significant impact on market capitalization.
• **Alternative hypothesis 22**: There is a significant impact of intangibles on market capitalization.

• **Null hypothesis 23**: There is no significant difference among the three groups, large, medium and small on the basis of capitalization with regard to various financial and non-financial variables

• **Alternative hypothesis 23**: There is a significant difference among the three groups large, medium and small on the basis of capitalization with regard to various financial and non-financial variables.

### 3.5 Data Collection, Data Collection Tool, Sampling and Sample size:

The research work is based on primary as well as secondary data. The primary data was collected from respondents – retail investors and financial analyst to understand the perception of retail investors and financial analyst towards the various financial and non-financial variables. As per SEBI-NCAER survey of Indian Investors 2003, the investors in equity in the western region (8.2%) are the highest and hence the targeted area was major cities of Gujarat and Maharashtra. A sample of 100 respondents each was taken from Baroda, Ahmedabad and Surat in Gujarat and Mumbai, Pune from Maharashtra.

The study has used the convenience sampling followed by snowball sampling, a non probability sampling technique in which an initial group of respondents is selected on a convenience basis. Subsequent respondents were selected based on the referrals or information provided by the initial respondents. This process may be carried out in waves by obtaining referrals from referrals.

A structured questionnaire was prepared with both open ended and close ended question after the extensive literature review for collection of data. The questionnaire was pre tested with 30 respondents and the suggestions and feedback of investors and analyst were incorporated in the questionnaire. In the questionnaire, ranking questions as well as 5 point Likert scale were used to represent the degree of agreeability on a
number of statements and were given numerical weights as -2, -1, 0, 1 and 2.

3.6 Reliability and Validity Test

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<tr>
<td><strong>Total</strong></td>
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* Listwise deletion based on all variables in the procedure.

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The test was conducted for all questions and the Cronbach’s alpha was found to be .732 which means the data is reliable.

The questionnaire was then administered to a sample of 520 investors, out of which 20 were rejected due to incomplete details and hence the rejection rate came to approximately 3.8%. Hence the net sample size was 500, out of which 336 were retail investors and 164 financial analysts (including portfolio managers, equity analysts, chief investment officers and academia).

Secondary data was collected from online prowess data base of the Centre for monitoring Indian economy (CMIE) for BSE 100. The financial data covered by the database includes the information which the companies are required to disclose in annual reports like Profit and loss account, balance sheet and schedules, cash flow details and so on.
The secondary data was collected for the period 2003-2013. This period is considered because there was a tremendous growth in Indian financial markets in this period.

3.7 **Data Analytical Tools:**

The data is analysed from various aspects to know the impact of various financial and non financial variables. The primary and secondary data is analysed by using various analytical tools and statistical techniques like Regression analysis, Correlation, Anova, Simple weighted average ranking method, Chi square and t test.

3.8 **Definition of Variables**

The various variables of financial and non financial nature for the study are discussed below:

- **Earnings per share (EPS):**

  Earnings per share are the monetary value of earnings per outstanding share of common stock for a company. Investors usually buy shares in order to earn dividend and for capital gains and these in turn depends on the earnings of the company. Conventionally earnings and net income has been the prime variables used in testing the relevance in various researches. Supposedly or in theory a firm’s earnings are more value relevant if they are from operations and permanent in nature. According to Deshow (1994), earnings are important because they are used as a summary measure of firm performance by a wide range of users.

  Institute of Chartered Accountants of India (ICAI) has issued AS20 which states EPS has become mandatory with effect from 01/04/2001 in respect of enterprise whose equity shares are listed on recognized stock exchanges in India.
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• **Book value (BVPS):**

There are various macro economic factors which may be responsible for the uncertainty with earnings and hence book value is considered more reliable. Book value is also considered significant because it serves as an indicator for a company's ability to avoid bankruptcy as it is based on reserves of the company. Investors may value book value or place more weight on book value as the risk of liquidation is reduced. Book value represents more of the tangible components and completely ignores the intangible assets created by the company. In BSE 100 index, book value is calculated as the value determined by relating the original value of a firm's common stock adjusted for any outflow (dividends and stock buybacks) and inflow (retained earnings) modifiers to the amount of shares outstanding. It is value of common equity divided by shares outstanding.

• **Net cash flow from operations (NCFOPER)**

In accounting, it is a measure of the amount of cash generated by a company’s normal business operations. It is important to know as it indicates whether a company is able to generate sufficient positive cash flows to maintain and grow its operations. Cash flows from operating activities are derived from the principal revenue producing activities of the enterprise and therefore considered value relevant by investors as these activities have a bearing on determination of net profit or loss. The availability of cash generated from operating activities assumes importance for the payment of dividend. Investors usually examine a company’s cash flow from operating activities separately from the other two components of cash flow. Cash flow from operations does not include dividends paid to stock holders and the expenditure to purchase long term capital such as equipment and facilities as these are one time or infrequent expenses. Cash flow from operations is the cash version of net income as it does not include any non cash item. These expenses are directly taken from PROWESS for
calculating net cash flow from operations of the firms in BSE 100 index.

- **Net Income (NI):**

  Net income includes non cash cost such as depreciation and excludes other cash expenditures such as purchases of plants or equipments. It represents the amount of money remaining after all operating expenses, interest, taxes paid and preferred stock dividends. These expenses deducted from a company's total revenue. Investors look at it closely because it is the main source of compensation to shareholders. Market capitalization is determined by many variables and one of those variables is net income.

- **Dividend per share (DPS):**

  The amount of dividend that a stockholder will receive for each share of stock held. It can be calculated by taking the total amount of dividends paid divided by the total shares outstanding. The dividend income varies with the earnings of the company.

- **Earnings yield (EY):**

  The earnings yield is the ratio of a company's earnings per share to its stock price. It is the inverse of the price to earnings ratio. It is a measure that helps investors to evaluate whether returns commensurate with an investment risk. It is a critical component which evaluates whether stocks are overvalued or undervalued.

- **Tobin’s Q:**

  The dependent variable of my analysis is firm value proxied by Tobin’s q. Tobin’s q has been used extensively for the measurement of the market valuation and market performances of firm. Griliches, 1981; Hirchey, 1982; Hirchey 1993; Hall, 1993; Munari and Oriani, 2002;
Pandit and Shiddharthan (2003); Connolly and Hirschey(2005); Chadha and Oriani (2009) have used this measure. From an investor's point of view, Tobin’s Q is the statistic which can be used as a substitute for firm’s value. It is the ratio between the market value of firm’s financial claims (installed capital) and the replacement value of assets. If q is greater than 1, the firm has good investment opportunities and better growth potentials. It also leads to the better management practices adopted by the company which further contributes to the better marketing performance of a company. No doubt, the calculation of Tobin’s q is practically difficult as the cost of replacement assets is not available as in India assets are reported at historical cost as rightly said by Sarkar and Sarkar (2005). This is the major reason for not taking the replacement cost. However, many studies used a proxy for Tobin’s q by taking the book value of debt and the book value of assets in place of their respective market value to resemble the original q. In this study, Tobin’s Q is expressed as a ratio of total market value of firm divided by Total asset value of firm. The market value of firm is defined as the sum of market capitalization and the book value of debt capital. In certain studies such as the one done by Griliches (1981) who examined the impact of R&D on firm market value by constructing the Tobin’s Q measure. A total sample of 157 firms from US for the period of 1968 to 1974 was drawn for the analysis. The empirical results showed that there is a positive and significant relationship between R&D intensity and Tobin’s Q.

- **Market capitalization:**

In this study, market capitalization is the Number of shares outstanding multiplied by the share price. The growth of market cap or market value is an indicator for the growth of the company and it is expected to be positively correlated with various other variables. Market capitalization of a firm reflects the current value of the intangible assets, as much as that of the tangible assets.
• **Research and Development:**

Research is an activity which creates, invents new method, system and new product. Development is also an activity which converts the results of the research into a marketable product. According to Chan, Lakonishok, & Sougiannis (2001) investment in R&D is, in real terms, an investment in intangible assets that contribute to the growth of a firm in the long-term. In BSE 100 Index, R&D expenditure has been categorized into two heads:

- R&D Capital expenditure and
- R&D Revenue expenditure.

• **R&D intensity:**

R&D intensity is measured by the R&D expenditure of a firm as a percentage of net sales. According to William N. Leonard (1971), Research and Development intensity or simply, R&D intensity is "a measure of company R&D spending in knowledge and technology to increase factor productivity and saleable output.

• **Square term of R&D intensity:**

The square term of R&D intensity shows huge investments in R&D by the company. In studies by Huang and Liu (2005), the squared R&D intensity is used which demonstrate a curvilinear relationship between R&D intensity and firm value. The study used the squared R&D intensity term in the regression assuming that there are diminishing marginal returns to R&D expenditures which exhibits a curvilinear relationship between R&D intensity and the performance variable. Krishnan & Bracker (2011) also demonstrated the curvilinear relationship with Tobin’s q indicating diminishing marginal returns to each dollar invested. In their study, the results extend their findings to the US and to a value-based measure of performance (Tobin’s Q).
The curvilinear relationship is also consistent with expectations regarding R&D expenditures. R&D spending is designed to generate benefits in the future. If a firm spends too little on R&D, then they are passing up positive Net Present Value opportunities. If a firm spends too much on R&D, then they are undertaking negative Net Present Value opportunities. Too much R&D spending can be just as harmful as not enough R&D spending as mentioned in various studies.

- **Marketing expenditure intensity:**

  In BSE 100 index this intensity is measured by the advertisement expenditure and other promotional expenditure of a firm as a percentage of net sales. We expect a positive and significant relationship between marketing expenditure intensity and firm value as advertising creates awareness and pursue the customer to buy the product; it should have a positive impact on the firms’ value. Advertising or marketing expenditure for promotion of product influences the perception of buyer and consequently his decision and plays an important role in determining the stock prices. Marketing managers always try to enhance financial performance through marketing expenditures.

- **Royalty, license and technical fees intensity:**

  The expenses incurred on royalty, technical fees and license fees divided by net sales measures the royalty, license and technical intensity.

- **Employee cost:**

  Employee cost involves the cost incurred on training and development expenses in BSE 100 index.
• **Retained Earnings:**

Retained earnings are an important source of internal financing. It is the portion of the earnings which are preserved for reinvestment purposes. Its impact is studied on shares traded.

• **Leverage:**

Debt/Equity indicates the degree of leverage. Leverage, if favourable maximises the wealth of shareholders and allows greater potential returns to the investor but if it is unfavourable, then the possible loss is also greater because if the investment becomes worthless the loan principal and all accrued interest on the loan still need to be repaid. So there is a risk of non payment and therefore with this risk market value of firm may fall. The impact of leverage on firm’s value is found to be negative in various studies. Studies like Feng and Rong (2007), Chadha and Oriani, (2009) found a negative and significant coefficient of leverage. Highly leveraged firm are not able to perform better in the financial market as also indicated in a study by Naik, Krishnan, & Padhi (2012).

• **Liquidity:**

The current ratio has been used to measure the liquidity position of the company. It is expected the liquidity would have a positive effect on the firm’s value as more liquidity can commit more funds towards the R&D investment. It is measured by a ratio of current assets to current liabilities.

• **Size:**

Size of the firm is one of the major factors that influence the relevance of financial and non financial variables. The whole sample is divided into small, medium and large firms on the basis of market capitalization. The advantage of using total market value (market
capitalization level) at the end of the financial year is that firm size is an objective market criterion. The use of net sales or total assets as the criterion of firm size would not be reliable because they can be affected by the accounting policies practiced by the firm. The use of total market value as the criterion of firm size is the most common approach in research on financial accounting.

- **Intangible Assets:**

  According to IAS 38 an Intangible asset is an identifiable non monetary asset without physical substance held for use, for rentals or for administrative purposes. Intangibles from research are treated as expense of the period. Intangible assets cannot be seen and touched for example, goodwill, patent, advertising expenses, training etc. In order to identify the intangible asset, there are three yardsticks

  - Whether it poses characteristics of an asset
  - Whether it provides future economic benefits
  - Whether it can be measured reliably

  As mentioned by Edvinsson & Malone (1997) intangible assets are described as hidden capabilities of an organization or as knowledge based resources that contribute to the creation of a competitive advantage for the firm stated by Ordóñez de Pablos (2005). Intangible assets is calculated as the summation of debt and stock over the tangible assets (debt + Stock – Tangible assets).

- **Age of the company:**

  We measure age as the number of years since incorporation of the company in BSE 100 index to the date of observation.
• **Share price:**

Share price is the dependent variable in our study. A share price is the price of a single share of a company’s stock. Share prices in a publicly traded company are determined by market supply and demand. Share price is volatile because it largely depends upon the expectations of buyers and sellers. For the purpose of this study, the share price refers to the average of the closing prices of the shares of the firms in BSE 100 index from December 31, 2003-2013.

### 3.9 Significance of the study:

• Indian capital market has undergone a sea change since 1991, after the adoption of liberalization and globalization policy by the Indian government. As a result, the Indian capital market is growing continuously to boost our 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, market capitalization and value of shares sold and purchased considerably increased. More and more investors are taking interest in the capital primary and secondary market and therefore looking for more and more information and hence the study of value relevance of accounting information together with non financial information in Indian perspective becomes imperative.

• With the various investment options available, it becomes difficult for the investors to make decisions as to where he should invest his money with so many companies listed on BSE index when many companies with big names have not done well after the IPO. In such a dynamic scenario, it becomes all the more important for the investors to know which factors would influence the growth of the company and thus be able to make an informed or educated investment.

• As the Indian economy is getting transformed from agricultural economy to industrial and to service economy, the non financial information is becoming more and more important and hence the
study of both financial and non financial information becomes altogether important and its impact cannot be ignored. Moreover such a study is of its first kind as far as Indian markets are concerned as it incorporates the investors’ perception towards the financial and non financial information and a comparison of the investors’ perception with the secondary data or information revealed by the companies and its impact on share price, Tobin’s Q and market capitalization. While there have been a number of studies on this topic in the developed countries, at the time of this work, no study was found that has explored directly in this title in Indian context. On 4th Dec 2014, 2,25,000 electronic thesis titles were checked on Inflibnet and Shodhganga and such a study was not found.

- This study will help the accounting standard setters in setting the standards. The study will also have policy implications for the companies, institutional investors and government. The companies would have a better insight as how the information on intangibles should be provided in companies’ financial statements that help in decision making.

- It is true that so many parties are interested in knowing the value relevance of financial and non financial information. The small and medium investors can be motivated to save and invest in the capital market only if their securities in the market are appropriately priced and they have the information which will help them in making an informed decision.

- It will not only help the players of the stock market but also the various other stakeholders and indirectly would affect areas as pension, fair value estimation, derivatives and so on. This in turn will also help the small investors who invest through these stakeholders.

3.10 Limitations of the study:

The study relates to 100 companies which are included in BSE100 index and the primary data is of 500 respondents only which is a small
representative sample. Value relevance is a very broad area and hence the study of all the financial and non-financial variables is not possible and hence, only few variables have been studied. Limitations associated with the sampling technique are also applicable to this study. All the limitations of the tools used are applicable to this study. The data relates to only one decade from 2003-2013.
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