CHAPTER SIX

CONCLUSION AND DISCUSSION

6.1 INTRODUCTION

In order to improve our understanding of corporate transparency and private information in an international context, it is necessary to examine whether differences in financial reporting transparency lead to significant differences in the value relevance of financial reporting across countries. One way to view the corporate transparency relevance is to examine the relationship between financial reporting transparency and Stock price synchronicity across countries controlling for institutional and structural factors[134]. In general, financial reporting transparency value relevance if the effects on Stock price synchronicity due to transparency overcome the effects of structural and institutional factors in a country.

6.2 RESEARCH QUESTIONS RECAPTURED

This study investigates the relationship between corporate transparency measured by (reporting timliness, financial analyst and credibility of disclosures) and stock price synchronicity. In addition, the study investigates the moderating effects of reporting timeliness on this relationship. Specifically, it examines whether the relationship between financial analysts, disclosure credibility, and stock price synchronicity is stronger or weaker given the range of timeliness of financial reporting.

Therefore, in total, this study aims to answer five research questions. The first three research questions inquire whether stock price synchronicity, as an inverse measure of

[134] Stock price informativeness in this study is proxied by stock price synchronicity

stock price informativeness, is negatively associated with reporting timeliness (frequency and intensity of disclosures), and positively associated with financial analyst following and credibility of disclosures. The next two questions inquire whether financial reporting timeliness moderates the relationship between financial analyst following and stock price synchronicity and the relationship between audit disclosure credibility and stock price synchronicity.

Using 15,920 firm stocks from 40 countries for 1995 and following closely Bushman et al. (2004) set of transparency attributes framework, the study objectives were realized. The empirical results of this study present enough evidence to answer the five research questions.

First, concerning the negative relationship between reporting timeliness and stock price synchronicity imposed by the first question, the empirical findings support significantly this negative association. The results are consistent with prior studies and support the information interpretation of stock price synchronicity.

Second, regarding the positive relationship between financial analyst following and Stock price synchronicity inquiry introduced by the second question, the study findings supports this positive relationship. This result is in consistent with existing evidence either in country or in cross-country levels[135]. The findings also support the analyst competitive advantage in communicating market and industry information.

Third, concerning the positive relationship between disclosure credibility and stock price synchronicity imposed by the third research question of this study, the findings

[135] The study results are consistent with Chan and Hameed (2006) cross-country study. The study also supports Piotroski and Roulstone, (2004) firm level study in US market.

confirm this positive relationship. This finding is consistent with the existing findings that suggest disclosure credibility alone does not signal any information to the market but analysts tend to follow firms that hire credible auditors and spread market and industry information. Therefore, higher (lower) stock price synchronicity is associated with higher (lower) disclosure credibility.

Forth, the study investigates the moderating effects of reporting timeliness (frequency of interim reporting) on the relationship between financial analyst following activities and Stock price informativeness. The results support the hypothesis that reporting timeliness moderates this relationship indicating that the more (less) interim reporting can strengthen (weaken) the relationship between financial analyst and stock price synchronicity.

Fifth, in regard to the fifth research question, the moderating effects of reporting frequency on the relationship between credibility of disclosures and stock price synchronicity, The OLS regression results do not support the moderating effect of reporting timeliness on this relationship. This is consistent with the nature of auditors work and prior literature on audit credibility and information signalling. More or less frequent reporting does not affect the relationship between credibility of disclosures and stock price synchronicity. Higher or lower interim reporting per year is irrelevant to auditors' qualifications effect on Stock price synchronicity. This is because annual auditors issue their reports annually. Besides, credibility of disclosures in itself does not signal any information to the market, it is only associated with more analysts following that spread more market and industry information.

6.3 IMPLICATIONS OF THE STUDY

The findings in this study have some implications for the overall acceptance of corporate transparency in general. The evidence obtained from Jin and Myers (2006), Gul et al. (2009), Hutton et al. (2009) and others indicate that corporate transparency is very crucial in incorporating private information into stock prices. That is countries with better reporting transparency have more value relevance for financial reporting.

This study follows the private information interpretation of stock price synchronicity (Roll 1988; Morck et al. 2000; Ferreira and Laux, 2007). The findings of the study interestingly show that private information incorporation in stock prices is mainly affected by timely reporting as it enhances the arbitraging activities that bring price back to equilibrium or market to efficiency as implied by the efficient market hypothesis (Fama, 1976). Therefore, the financial reporting role is to facilitate arbitrager's role in searching for private information and bringing price back to equilibrium. Roll (1988) indicated that around 70% of price changes of stocks could be linked to private information incorporation in stock prices.

There are three implications for the study. First, in terms of theory, the findings show significant support for the current debate regarding stock price synchronicity as a measure of share price informativeness. This goes with the findings of the extant literature in this area [136]. The study is consistent with the private information interpretation of stock price synchronicity that indicates a possible extension of Stock price synchronicity to be a measure of market efficiency.

[136] Over thirteen empirical studies support the share information interpretation of stock price synchronicity. Review chapter two for more details.

Corporate financial reporting can be related to the agency theory and management incentives embodied in the positive accounting theory (Zimmerman and Watts 1986). Importantly, this study draws on the efficient market hypothesis in explaining the role of public information in facilitating private information flow into stock prices. The findings of the study reemphasis that annual reporting disclosures are not related to stock price synchronicity. Further, this study demonstrates that financial analyst following activities spread more industry and market information rather than private firm-specific information. The findings notably illustrate the effects of timely reporting in incorporating firm- specific information into stock prices.

Second in terms of practice, the main objective of financial reporting according to (SFAS 1-7) of the Financial Accounting Standard Board (FASB) in the United States as well as the International Accounting Standard Board (IASB)[137] and their proposed joint framework (2006) is to serve current and potential investors in the international stock market[138]. If best resource allocation and lower cost of capital is associated with related lower Stock price synchronicity, then standard setters should consider the frequency of interim reporting and the effects of credibility of disclosures to meet the usefulness criteria of accounting information reporting. The findings also have significant applications for regulators such as stock commissions and corporate executives who may initiate more voluntary interim reporting for their firms to minimize cost of capital and have better stock prices.

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[137] IAS Framework was published in July 1989(IAS 8.11), and adopted by the IASB April 2001. Paragraph {F9} states that the general purpose of financial statements is for the use of present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the general public.
http://www.iasplus.com/standard/framewk.htm

[138] In U.S. Statement of Financial Accounting Concepts No. 1 (November 1978), Objectives of Financial Reporting paragraph 32–54. The objectives in Con. 1 begin with a broad focus on information that is useful in investment and credit decisions.
http://www.fasb.org

Finally, the study forward that regulators in emerging markets can look at corporate transparency differently from developed countries. Regulators as well standard setters and corporate executives in emerging markets may have more incentives in extending voluntary interim reporting. In other words, if these markets experience high cost of capital due to risks involved with less effective institutions and low private property protection, they may capitalize on corporate financial reporting transparency such as more interim reporting, and auditors that are more credible.

The findings in the international research arena build the theoretical foundation for this study methodology and hypothesis. This study interestingly extends prior accounting empirical research in capital market research in accounting on emerging markets. In particular this study has contributed to the limited database and research in the value relevance on corporate transparency..

6.4 LIMITATIONS AND SUGGESTIONS

Global distinction in financial markets and accounting is an issue that has been researched progressively more in accounting and economics. The theory of interpreting current literature on how transparency covaries in economies and how they relate to government role in the economy are incomplete and in sometimes is conflicting (Miller 2004). This study has several limitations, particularly with regard to cross-country research in which data from different countries are obtained.

6.4.1 Theory limitation

Test of a plain theory concerning how economies develop and use corporate transparency would make it easier in addressing the research questions; but such theories are lacking in accounting and economics[139]. Bushman et al. (2004) indicate that

[139] Watts and Zimmarman (1986) state that "The theory, as it currently exists, is far from complete. In fact, the investigation into the factors affecting accounting and auditing practice is just beginning and the causes of the empirical regularities that have been

this is a new area in accounting. Furthermore, they argue that looking at finance and economy to expand the current theory in accounting offers modest theory to be borrowed since these fields have only recently started work in this area. This study as well as Bushman et al. (2004) classifies corporate transparency into ten items that cover up firm reporting, equity analyst and the media. According to Miller (2004), one might argue why not adding debt rating agencies, regulatory reporting or government enforcement. However, the study is an additional empirical study to bring more evidence for corporate transparency by testing its association with stock price informativeness. Debate concerning the role of theory is likely to recue as this literature expands (Miller, 2004).

6.4.2 Data constraints

This research, as many others in cross-country studies, faces cross-country data constraints. In many cases, the option would be not to study this issue, or at least to postpone until more data becomes available. However, exploring the issue with current data and being aware of the limitation is a better off option (Miller 2004). The available data for corporate transparency comes from the *International Accounting and Auditing Trends, Center for International Financial Analysis and Research (CIFAR).*

Further studies on transparency like Jin and Myers (2006) used pooled cross sectional data but the source of the data was of a general nature from the Global Competitiveness report from 1999- 2000 which is based on survey about the level and effectiveness of financial disclosures in different countries[140]. *CIFAR* data was created by examining and rating companies' 1990 annual report in their inclusion or omission of the required

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observed are still debated. This is expected because the world is complex and continually changing. Complexity and change in our world ensures that we will never have a complete theory of accounting".

[140] Based on Geloes and Wei (2002), Jin and Myers (2006) use of Global Competitiveness report to measure Transparency. Recent study by Hutton et al. (2009) uses discretionary accruals as a measure of opacity.

items. A minimum of three companies in each country were studied. 1000 companies were used in the survey. The companies represent a cross-section of various industry groups where industrial companies represent 70% while financial companies represent the reminder. Therefore, this is the most reliable data that can be found for cross-country data.

6.4.3 Cross-sectional country level studies

This study utilizes a pooled cross-section of country-level characteristics. The limitation of the cross-country design is well acknowledged in the economic literature (Bushman et al. 2004). However, Levin and Zervos (1993) concluded that cross-section studies could be "very useful as long as the empirical regularities are interpreted as suggestive of the hypothesized relations". They also argued, "not finding hypothesized relations would shed "meaningful doubt" on the hypothesized relations". According to Bushman et al. (2004) "This methodology is popular in the economics literature (e.g., Kormendi and Meguire,1985; Barro 1991; Levine and David,1992; La Porta et al.,1997, 1998, 1999, 2000), and is becoming more common in the accounting literature (e.g., Leuz, Nanda et al., 2003).

Although cross-sectional country-level studies are a good way to create a broad view of an issue, particularly in relatively new literatures, future studies must build on the foundations using methods that have more ex ante ability to provide valid tests and statistical power (Miller ,2004). Overgeneralization of seminal research is common problem in the accounting literature (Bamber et al. 2000).

6.5 FUTURE STUDIES

There is definitely more scope for future research. Future studies can explore more in the area with additional improvements in methodology, design and extended sample size. The study can be extended to examine the informativeness of Stock price synchronicity. Taking to consideration the private information interpretation of firm idiosyncratic volatility, further studies can test the market efficiency since more private information incorporated in stock prices is supposed to indicate that market moves from semi-strong form of efficiency to strong-form efficiency. Strong-form efficiency according to the efficient market hypothesis (Fama 1976) means that share prices incorporate historical share price information, public information including accounting information, and private information. Since semi-strong incorporates historical share price information and public information, incorporating more private information or having more firm-specific information in stocks is likely to indicate that stock prices reflect or closely to reflect all information. If stock prices in a market incorporate all available information in the market, we refer to that as the strong-form efficiency type of market.

It is recognized that the interpretations, although supported by the study results, still conjectures. Further studies are invited to provide alternative explanations for the econometrics findings of this study if any. The study can be extended in terms of methodology and design. Specifically additional research questions can be investigated such as the effects of interim reporting in developed markets versus emerging ones. It can also be focused down into regional basis similar to the study carried by Kothari et al. (2000) for the pacific region countries of Malaysia, Indonesia, Singapore, Hong

Kong and Thailand. Another regional area could be Middle East and North Africa Region (MENA) or the Gulf Cooperation Council (GCC) group of countries.[141]

Further studies can be extended to explore new dimensions in the design. Politically connected firms, government owned, capital structure and family ownership could have some effects on both corporate transparency and stock price informativeness. The incorporation of these variables in the research design is likely to pursue better understanding of the underlying relationships of the determinants of Stock price synchronicity.

Finally, this study used stock price synchronicity as measure of stock price informativeness. If stock price movements in emerging economies are mainly due to politically driven shifts in property rights and level of opaqueness or noise trading, a proxy for market volatility can be involved to control for such noise. Firm Idiosyncratic component can be used instead of stock price synchronicity to reflect the effect of opacity on stock price informativeness.

6.6 SUMMARY AND CONCLUSION

The purpose of this study is to investigate the value relevance of accounting numbers within the broader concepts of corporate transparency on stock price informativeness. Five hypotheses were tested in this study. The results show high significant effect of firm interim reporting on the flow of firm private information. Financial analysts and auditors are intermediaries in the market and tend to spread and communicate market and industry information. Surprisingly, the results document insignificant role for

[141] GCC: The Cooperation Council for the Arab States of the Gulf (CCASG) also known as the Gulf Cooperation Council
MENA: The term generally covers an extensive region, extending from Morocco in northwest Africa to Iran in southwest Asia.

private property protection in facilitating the flow of private information. The results show that it only helps decreasing market risk noise. The results of this study can have significant implications to standards setters, regulators and corporate executives. Further studies are encouraged to investigate the issue of corporate transparency specifically the role of auditors, financial analyst and interim reporting on the informativeness of stock prices.