UNIVERSITI TEKNOLOGI MARA

EARNING RESPONSE COEFFICIENTS OF PUBLIC LISTED COMPANIES IN MALAYSIA

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Candidate's Declaration

I declare that the work in this thesis was carried out in accordance with regulations of Universiti Teknologi MARA. It is original and is the result of my own work, unless otherwise indicated or acknowledged as referenced work. This thesis has not been submitted to any other academic institution or non-academic institution for any other degree or qualification.

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ABSTRACT

This paper investigates the relationship between reported earnings and share prices, focusing on the slope coefficients resulting from a regression of earnings and share price over a twelve-month period among Malaysian companies. The regression slope referred to as earning response coefficient (ERC) measures investors' response to accounting earnings reported in the financial statements and also a proxy o the investors' perception of the level of earning quality. In consistent with previous studies, the study found that reported earnings are significantly associated with share prices throughout the study period except for 1999. It is also found that there is evidence to show that the level of earnings quality has improved with the implementation of MCCG in Malaysia commencing March 2000.

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INTRODUCTION

1.1 Introduction

1.1.1 Accounting Earnings

Accounting earnings are used internally by firms to evaluate the impact of company's policy. For non-public listed company sometimes it is used to represent market perception of firm value to outsider (potential investor), or when the market data of a listed company is not available. Such reference of accounting earnings, as representing market perception of the firm share price is correct, if accounting earnings produced by firm is related (correlated) to its price as perceived by investor.

Accounting earnings are also believed to be the premier information provided in financial statements (Lev, 1989) and it represents the "bottom-line" accounting measure of firm performance.

The focus on earnings is so great that it has been suggested that the market fixates on firms' bottom line income, to the exclusion of other indicators of operating performance. Such single-minded attention fails to recognize that reported net income is the final result of an extended accounting process with considerable room for managerial discretion at every step. Given the heightened attention to accounting earnings, managers may have an incentive to be aggressive in applying accounting rules in order to maintain steady growth in earnings. Earnings manipulation is prevalent and