CHAPTER I

INTRODUCTION

1.1 Background

Managerial discretion plays a role in the development of a company, a manager should be prudent to make the right decisions about the company's fund allocation and management so the company could achieve its goals to maximize profit. The greater a company has developed, the greater investors that would come and purchase the company’s stocks. Accordingly, the stock price and company’s value will increase through the investment from investors. There are several factors that can be used as a competitive advantage for a company. Investors can use accounting information such as earnings, book value, and research and development to assist them in making decisions by analyzing the company's financial statements.

The information presented by a company through financial reports has to be value relevant for the investor’s decision-making. The content of financial reports must reflect the current condition of the company in order for the report to be of benefit to the public. The market response at the time of the company’s disclosure that leads to change in the movements of the company’s securities price is an indicator that accounting information disclosed by the company has quality relevance. The necessity of a company’s accounting information is supported by Information Asymmetry Theory. Dierkens (1991) states that information asymmetry is an imbalance in the information received from management to investors. This event could occur as the management knows the actual condition of the company better than the investors. To this matter, information on the condition of the company must be reported by management through a relevant company's financial report to help the investment decision making. Moreover, a decrease in the value relevance of accounting information can also happen due to changes in the reporting system that do not reflect the company's operating activities and the actual condition of the company so that the benefits from earnings and book value of the company will get worse.

Corporate financial reporting has the main purpose of providing useful accounting information for investors and stakeholders. The company's share price that is sold in the capital market will change when the company reports the latest accounting information. The information disclosed can be in the form of good news or bad news. Stock prices will increase when the company provides good news and conversely will decrease when it is bad news. Investor reactions to the announcement of accounting information are the core concept of value relevance of financial statements. Investor reactions will prove that the content of accounting information is useful when making decisions for investment that could be benefit for them (Puspitaningtyas, 2012).

Accounting information including earnings and book value of equity commonly is used to measure the value relevance of the company's financial statements (Alfraih, 2017). Generally, when observing the capital market, the value relevance of reported accounting information is measured in the income statement (earnings) and the statement of financial position (equity or net assets) with the company's share price (Permana, 2015). According to Hartono (2017), the number of shares outstanding in the market indicates ownership rights to the company. Based on this information, earnings per share and book value per share have value relevance in measuring the management’s success in achieving profit and wealth for each shareholder. This is supported by Ohlson (1995) in the concept of value relevance, where it relates to how big the role of accounting information is in influencing investor decision-making and company stock prices. The model used is the Price Regression Model which is to test the effect of accounting information (EPS and BVPS) on the company’s stock price. Accounting figures are considered relevant values if they are significantly related to the dependent variable and Adjusted R^2 of the regression model which has a value greater than zero. The measurement of adjusted R^2 value will identify if the value relevance of financial statements increases with the publication of the accounting information. If the value of adjusted R^2 increases continuously then it is considered that value relevance also rises.

Research and development (R&D) is related to the value relevance of accounting information because it can deliver the changes in business, particularly by creating new products and processes or improving existing products and adding new knowledge that can be useful for the company in the future. By conducting this process, the company gathers innovation so it could continue to survive and achieve its objectives. In addition, the company also gets a competitive advantage from the process which influences investors' decisions to invest their funds in the company. Besides aiming to maintain the company in economic competition, R&D is also one of the activities aimed at increasing company profits. The creation of new products or improvement of existing products will attract consumers so that they will be loyal to the company and brings an impact on the company's revenue to increase. According to Sujoko and Subiantoro (2007), an increase in company earnings indicate good company prospects in the future. This good prospect will be responded positively by investors so that it can increase stock prices and company value.

The awareness about the allocation of R&D has been carried out by several large companies abroad, it has been proven through the release of the ten companies list with the largest R&D in 2018 by PricewaterhouseCoopers. However, in Indonesia, only a small proportion of companies have allocated R&D expenditures (Mahdita, 2008). There are only a few companies that include the cost of R&D because there is still debate about recording R&D expenditures (Buchdadi, 2018). According to PSAK 19 and IAS 38, the cost of R&D must be recorded as an expense in the period incurred and is not allowed to be recognized as an asset in a future period. Recognition as an asset can only be done if it meets all the criteria from criteria listed in the regulations.

This research will examine the difference in the effect of all variables on the value relevance of financial statements before and during the Covid-19 pandemic. When this virus started to spread around the world in 2020, many countries' economic and financial activities were heavily disrupted. The global financial crisis caused by the global pandemic can be seen in the fall in the index on the Indonesia Stock Exchange. Many local and foreign investors involved in the exchange immediately withdrew their funds to prevent continued losses. The infectious disease news may induce uncertainty and affect investor behavior, resulting in increased stock volatility. Because of uncertainty on the company's condition during the financial crisis, investors will hesitate and distrust the company's performance and the information that will be presented in the financial statement.

In addition, when companies face unstable economic conditions and suffer losses, there is a change in the value relevance of financial information (Almilia and Sulistyowati, 2007). The impact of the Covid-19 pandemic on the company's financial performance is critical, this puts pressure on management giving rise to the potential for manipulation of accounting information to meet market targets and expectations. The existence of this manipulation can reduce the value relevance of a company's financial statements because it does not reflect the actual financial condition of the company. According to Lev and Zarowin (1999), the value relevance of accounting information declined over time which is believed due to significant changes in the business environment, economic situation or crisis, and accounting system that failed to face the changes. Findings by Belesis (2016) regarding the value relevance of financial statements during a financial crisis show that there was a decline in value relevance due to the rise of uncertainty about the company's financial position. From the research, it is stated that investors distrust accounting information when they make investment decisions during a financial crisis. When the variables of accounting information are compared, it appears that earnings have more significance in terms of value relevance than book value in both periods. However, Shahbaz (2019) has completely different findings. Their research shows that during a financial crisis book value can reflect stock price hence helping the investors in decision making compared to earnings that reduce significantly after the crisis.

This study then aims to test whether accounting information (earnings, book value of equity, and R&D) has value relevance in the period before and during the

Covid-19 pandemic crisis and to see whether there is any increase or decrease in the value relevance during the period. The results of this study will provide information on whether there is any impact on stock prices. The sample used in this study are manufacturing companies in Indonesia that disclose consistent R&D before (2018-2019) and during (2020-2021) the Covid-19 pandemic.

1.2 Research Problem

Accounting information such as earnings, book value, and R&D could reduce the information asymmetry that occurs between companies and investors through the disclosure of a company's financial statements. For that reason, they are essential matters that could reflect the market response and affect the company's stock price to change. In addition, the uncertainty caused by the Covid-19 pandemic raises questions about whether these accounting data would still influence the value relevance of a company's financial statement. Based on the descriptions that have been mentioned and as stated also in the background, the problems in this research will be developed as follow:

1. Will the company's earnings have any effect on the stock price before and during the Covid-19 pandemic?
2. Will the company's book value of equity have any effect on the stock price before and during the Covid-19 pandemic?
3. Will the company's research and development expenditures have any effect on the stock price before and during the Covid-19 pandemic?

1.3 Research Objective

The purpose of this study is to provide empirical evidence regarding the value relevance of earnings, book value, and R&D in explaining the company's market value and observing the condition around the Covid-19 pandemic.

1.4 Research Contribution

If this research has been successfully conducted, the researcher hopes this research could give a positive insight into the development of the academic world and society. Thus, this research is expected to provide benefits such as follows:

1. Contribution to academic theory as an education reinforcement, a reference, and a conceptual contribution to related research, such as the examination of the value relevance of earnings, book value, and R&D.
2. Practical Contribution for Investors provides additional helpful and relevant information for investors to make excellent decisions in the capital market in regard to earnings, book value, and R&D, particularly during a financial crisis owing to the Covid-19 pandemic.

1.5 Writing Systematic

The outline of the research will be written systematically as follows:

CHAPTER I	**Introduction** Chapter I consists of the research introduction that includes background, research problem, objective, contribution, and the structure for systematic writing.
CHAPTER II	**Literature Review** Chapter II is the literature review of the research consisting of theoretical background and hypothesis development. There will also include previous research that is related to the research and the logical reasoning for hypothesis development.

CHAPTER III **Research Methodology**

Chapter III includes the methodology used in the research explaining the type of research, population and sample collection criteria, data collection and analysis, and measurement of variables.

CHAPTER IV **Result and Analysis**

Chapter IV is the result and discussion that includes descriptive statistics, classic assumption test, hypothesis testing, and discussion.

CHAPTER V **Conclusion and Suggestions**

Chapter V consists of a conclusion, limitations, and suggestions for future research.