EXAMINING THE VALUE RELEVANCE OF ACCOUNTING INFORMATION: EVIDENCE FROM NAIROBI STOCK EXCHANGE (NSE)

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Abstract

Prior studies indicate that with the transition of economy from industrial to a technology-driven service-oriented economy, the usefulness of accounting numbers, especially earnings, has reduced. This is shown by the obscurity of the link between market stock prices in accounting figures, especially earnings. Based on his perspective, this study examines the extent of stock price movement explained by the change in key accounting metrics using companies listed on the Nairobi Securities Exchange. The sample comprises 56 listed companies across 23 sectors from 2016 to 2023. Using a panel data fixed effects regression, we examine the impacts of key accounting metrics on market share prices. We find that both (lnEPS $\beta = 0.137$; $p < 0.05$) and (lnDPS $\beta = 0.331$; $p < 0.01$) have statistically significant positive relationships with share prices in the market (lnMSP). In contrast, lnOCF ($\beta = 0.01$, $p < 0.1$) and lnTA ($\beta = 0.013$, $p < 0.1$) have positive but insignificant impact effects. The R-squared of the model is 0.471, indicating that the four accounting variables explain 47.1 % of the movement in stock price. The findings align with the Dividend Signaling Theory and the Bird-in-Hand Theory. Additionally, the findings show the existence of a weak-form efficient market in the Nairobi Stock Exchange. Generally, the study confirms the persistence of accounting information's value relevance in equity investments in Kenya.

Keywords: Market share price; earnings per share; dividends per share; operating cash flows; total assets.

JEL Codes: G14, G15, M41

1.0 Introduction

Accounting information is generated from accounting process which includes recording, summarizing, processing, communicating, and interpreting organizations' activities. A complete set of financial statements[1] offer insights into a company's financial performance, financial position, changes in capital, and cash flows. For the information to be useful, it must be of high quality, characterized by relevance, reliability, comparability, and consistency (Pelekh et al., 2020). For a financial reporting system to be effective, users are also required to possess the competence to understand the significance of the information provided and be capable of making rational decisions (Cohen et al., 2022).

[1] According to IAS 1, a complete set of financial statements comprises the statements of financial position, profit or loss and other comprehensive income, changes in equity, cash flows, and notes to the financial statements.

Stockholders are among the principal users of accounting information, and they differ in preference for one accounting information over another, depending on their investment strategy, risk tolerance, and time horizon (Lukkarinen, 2020). Value investors prioritize fundamentals like earnings and cash flows, while growth investors focus on revenue growth and future potential. Conservative investors seek stable earnings, whereas risk-tolerant individuals might favor volatility for higher returns (Lerman, 2011; Obaidat, 2016). This diversity attracts researchers, including the authors of this paper, to examine the equity investors' behaviors toward accounting information, which is reflected in portfolio investments.

The influence accounting information on market share price has gained considerable interest among researchers, following Ball and Brown (1968) findings that show accounting information influences share prices (as cited by Lugbenga and Atanda, 2014). Therefore, securities exchanges exhibit substantial responses to accounting information disclosures (Eachempati et al., 2021). Therefore, its usefulness can be measured based on its ability to make changes in stock prices (Imhanzenobe, 2022; Outa et al., 2017).

Research by Dontoh et al. (2004) indicates that the usefulness of accounting information, especially earnings, has decreased, which is reflected in the increase of non-information-based (NIB) trading. However, other studies show that accounting information has maintained its relevance across periods despite the change in economic system when it was first developed (industrial economy) till present (high-tech driven service economy) (Barth et al., 2023; Perera and Thrikawala, 2010).

In connection this debate, this study aims to provide empirical evidence to one side of the arguement, by concentrating on the earnings per share (EPS), dividends per share, operating cash flows, and total assets impacts on share prices from the perspective of emerging economies where there is a higher concern on the usefulness of accounting figures for investment decisions due to the believe of low transparency in these markets (Salman et al., 2024).

This study utilizes companies quoted on the Nairobi Securities Exchange, the largest stock market in East Africa, with a market capitalization of $13.6 billion and 65 listed companies as of 31st May, 2024 (dabafinance.com, 2024). It was established in 1954 and it is a member of the World Federation of Exchanges, the African Securities Exchanges Association (ASEA) and the East African Securities Exchanges Association (EASEA), the Association of Futures Markets, and the United Nations' Sustainable Stock Exchanges (SSE) initiative (nse.co.ke, n.d.). Moreover, the country was first in the region in adopting the International Financial Reporting Standards (IFRS), with the Capital Markets Authority of Kenya requiring it of all listed companies in 2001 (Atsunyo et al., 2017). All these stated characteristics of the market make it suitable for this research. To assist in the understanding of the market performance from 2017 to 2024, the exchanges' all-share index is presented in Figure 1.

Source: African Financials

Figure 1. Nairobi Securities Exchange All Share Index (NSE-ASI). The NSE-ASI is a weighted index of free-float market capitalization that is used to evaluate the performance of the listed firms. Investors, market participants, and analysts use the NSE-ASI as a gauge of overall NSE performance and as the benchmark index of the Kenyan stock market. It is a real-time index and is calculated by the market capitalization of publicly traded businesses.

The study has several potential contributions. First, this study can help companies formulate financial strategies that align with shareholder interests by revealing how key accounting information influences investor perceptions. Second, it equips investors with essential insights into the metrics that drive price movements, thereby enhancing their ability to assess market timing and risks, which is essential for portfolio management. Third, this research provides evidence which may help in addressing inconsistencies regarding the persistence or decline in usefulness of accounting numbers overtime. Additionally, the findings may pave the way for future research in the area.

The remaining part of this research article is structured as follows: Section 2 contains review of relevant literature and research hypotheses. Section 3 shows research methodology, incorporating a description of data source and sample selection techniques, variables, and model specifications. Section 4 presents research findings and discussions. Section 5 shows conclusions drawn from the research findings.

2.0 Literature Review

Dividend Signaling Theory

This theory was introduced by Bhattacharya (1979) and states that dividends are informative about future earnings. Subsequently, Miller & Rock (1985) further developed the notion in "Dividend Policy Under Asymmetric Information", in which dividend changes signal management's profit expectations.

Bird-in-Hand Theory

This theory was first proposed by Gordon (1959) and later developed by Lintner (1962). It challenges the dividend irrelevance theory of Modigliani-Miller by arguing that an investor

would prefer to receive a certain dividend to an uncertain capital gain, aligning with the proverb that says a bird in hand is worth more than two in the bush.

Efficient Market Hypothesis (EMH)

The EMH was introduced by Fama (1970). It states that financial markets efficiently incorporate new information, meaning it's hard to earn above average market returns. It comes in three forms: weak (prices only include past information), semi-strong (prices reflect all public information), and strong (prices incorporate private information as well). EMH implies that passive investing is preferred because active strategies can't consistently do better. But market bubbles and behavioral biases serve as a counter to perfect efficiency, critics argue. Although EMH is not perfect, it is an essential concept in finance, affecting both investment strategies and market theories.

Empirical Studies

The key findings and their implication of the reviewed empirical studies on the significance of accounting numbers are presented in Table 1.

Table 1.
Summary of empirical studies

Study by	Key Findings	Value Relevance
Dontoh et al. (2004)	Increase in non-information- based trading reduces the usefulness of accounting figures in the US.	Declined relevance
Barth et al. (2023)	Despite the economic transition from the industrial to a high-technology driven service-oriented economy, there was no evidence of a decline in the usefulness of accounting information from 1962 to 2014 in the US.	Maintained relevance
Busari and Bagudo (2021)	Both separate and consolidated financial statements are relevant for investment decisions, with the consolidated being more relevant in Nigeria.	Relevant
Bhatia and Mulenga (2019)	Reviewed 90 empirical studies conducted across different countries during 1993-2016 and found that the majority of the studies conclude that accounting reports were relevant both before and after IFRS adoption.	Maintained Relevance
Imhanzenobe (2022)	Reviewed prior studies and found that most of the studies indicate a decline in value relevance of accounting metrics in the US, and suggested that adoption of IFRS enhances the relevance.	Declined relevance
Badu and Appiah (2018)	Earnings and book value metrics have a significant influence on stock price movements in Ghana	Strong Relevance
Amahalu et al. (2018)	EPS and DPS have significant positive impacts on MSP in Nigeria.	Strong Relevance

Tahat and Alhadab (2017)	Assessed the influence of book value, EPS, and cash flows on MPS and found that there is no evidence of decline in value relevance of accounting numbers over time in the UK.	Maintained relevance
Onyango Odhiambo (2013)	Dividend and earnings announcements have an insignificant effect on share prices in Kenya.	Weak relevance
Ali and Chowdhury (2010)	Dividend declarations have an insignificant influence on share prices in Bangladesh	Weak relevance
Arsal (2021)	Limited impacts of EPS and DPS on the firm value in Indonesia	Weak relevance

Source: Authors' construction

Empirical Gaps

The existing literature could be viewed as inconclusive. Some scholars argue that accounting metrics have lost their usefulness for investment decisions (Dontoh et al., 2004), while others argue that they have maintained their relevance since their development (Barth et al., 2023). Additionally, while earnings and dividends are among the most common metrics researched, cash flows and total assets have received relatively less attention. Furthermore, while efficient market hypothesis (EMH) is well-studied in developed economies, African markets are often believed to lack efficiency due to lower transparency, which requires empirical validation.

Hypotheses Development

Previous studies show mixed results about the influence of EPS on share price. As EPS is the fundamental measure of a company's profitability and the primary determinant of the company's intrinsic value, it is believed to influence stock price. Thus, we hypothesize;

H1: EPS has a significantly positive impact on market share price in Kenya.

Research on the influence of dividend payouts and share prices also shows divergent views.

As dividends frequently indicate financial health and potential for future earnings, we hypothesize that;

H2: DPS has a significant positive impact on share prices in Kenya.

Existing literature shows that cash flows are significantly associated with MSP. Therefore, we hypothesize;

H3: Operating cash flows have a strong positive influence on market share price in Kenya.

Total assets indicate the resources and business scale of a company, which have a significant relationship with market valuation. Therefore, we hypothesize;

H4: Total assets have a significant relationship with market share price in Kenya.

3.0 Methodology

Data Source and Sample Selection

This study utilizes the audited consolidated financial statements of the companies quoted on the Nairobi Securities Exchange obtained from AfricanFinancials. Data for 56 companies in 23 sectors were available as of August 2024. All the selected companies prepare financial statements in Kenyan shillings (KES)[2] and in accordance with IFRS.

Two firms were excluded due to insufficient reports, and two others were excluded because their reports are prepared in foreign currencies. Consequently, the sample consists 392 observations covering the period from 2016 to 2023. This study year begins in 2016 because share price data before 2017 were unavailable. Nevertheless, the number of observations is sufficient for robust analyses.

Variables

Market share price (MSP) is the dependent variable, and it data is sourced from AfricanFinancials, with the closing price of shares on the annual reporting date of each company. The independent variables are: earnings per share, dividends per share, operating cash flows, and total assets. All financial information, in KES, was manually collected from the audited annual financial reports. The statistical software used for data processing is Stata 17.

Table 2.
Descriptions of Variables

Variable	Abbreviation	Explanation
Market Share Price	MSP	Market value per ordinary share.
Earnings Per Share	EPS	Basic earnings per share.
Dividend Per Share	DPS	Annual dividend per ordinary share.
Operating Cash Flow	OCF	Cash flows related to operating activities.
Total Assets	TAS	Total assets of a company

Source: Authors' Design

Model Specification

Panel data is a type of data for several entities that are observed across different periods (Rizka Zulfikar, 2018). These entities can include countries, firms, and so on (Oscar Torres- Reyna, 2007). And the periods can be days, weeks, months, quarters, semi-annually, annually, and so on.

Pooled OLS Regression

Pooled OLS regression is a simple panel technique that pools together cross-sectional and time-series observations without adjusting for individual- or time-specific effects. The model is expressed as:

[2] The Kenyan Shilling (KES), symbolized as KSh, is issued by the Central Bank of Kenya. It was introduced in 1966, replacing the East African shilling. As of May 6, 2025, the exchange is approximately 1KES=129 USD, reflecting its value in international markets.

$$Y_{i,t} = \beta_0 + \beta_1 X_{i,t} + \epsilon_{i,t} \quad (1)$$

Where:
$Y_{i,t}$: Dependent variable
β_0: intercept
β_1: coefficient of the regressor.
$X_{i,t}$: regressor
$\epsilon_{i,t}$: residual

Random Effects (RE)

The RE model takes into account the panel structure by including entity-specific effects. It assumes the unobserved entity effects are not correlated with the regressors and are randomly distributed (Khalid Ahmed, 2024). Thus, it is included with the regressors as shown in equation 2.

$$Y_{i,t} = \beta_0 + \beta_1 X_{i,t} + u_i + \epsilon_{i,t} \quad (2)$$

Where: u_i denotes the individual entity-specific component that is uncorrelated with X

(1) Fixed Effects (FE)

The fixed effects model assumes that unobservable entity-specific effects are correlated with independent variables and is constant over time, but vary across entities (Nwakuya & Ijomah, 2017). The model is expressed as:

$$Y_{i,t} = \beta_0 + \beta_1 X_{i,t} + \beta_2 Z_i + \epsilon_{i,t} \quad (3)$$

Where: Z_i denotes the individual entity-specific component that is correlated with X

Model Selection Approaches

Torres-Reyna (2007) presents a clear direction in selecting a model in panel data analysis. When there is an indication that entity-specific features affect the independent variables, the fixed effects model is preferred because it effectively controls for this unobservable heterogeneity. When this relation is unclear, diagnostic tests should be conducted to choose the suitable approach.

The Breusch-Pagan Lagrange Multiplier test helps to choose between pooled OLS and RE models, and Hausman test to choose between RE and FE.

4.0 Results and Discussions

The summary statistics for the sample, which comprises 52 listed companies, are detailed in Table 3. The monetary value of the variables is in Kenyan shillings.

Table 3.
Descriptive Statistics

Variable	Obs.	Mean	Std. Dev.	Min.	Max.
MSP	393	47.628	64.438	2.07	200.5
EPS	413	4.873	7.950	-2.05	23.49
DPS	412	3.287	7.429	0.00	52.00
lnOCF	412	24.31	0.357	23.479	26.339
lnTAS	413	23.677	2.439	15.753	30.73

Source: Authors' Computation

All the variables are winsorized at the 1st and 99th percentiles to reduce bias from outliers. Additionally, OCF and TAS are also transformed to their natural logarithmic value as their values are too large for the analysis.

Regression Analysis

Before running regression, we perform several diagnostic tests to ensure the satisfaction of conditions necessary for the estimation.

Diagnostic Tests

Multicollinearity Test

To test multicollinearity problem in variables, which is a crucial assumption in regression estimation, we conduct the variance inflation factor (VIF) test.

Table 4.

VIF Test Result

Variable	VIF	1/VIF
lnEPS	2.36	.423700
lnDPS	2.09	.477486
lnTAS	1.30	.770470
lnOCF	1.07	.932396
Mean VIF	1.71	

Source: Authors' Computation

The test result shows that each independent variables have values below 5, a level that is not a concern for multicollinearity and is often considered acceptable. Therefore, we decided to retain all these variables for regression analysis.

Selecting the Appropriate Model

We employed a two-stage model selection approach for this study. First, we conducted the Breusch-Pagan LM test. According to the result ($p<0.05$), we reject the null hypothesis of no panel effects, supporting the application of panel data methods over pooled OLS. Second, we conducted the Hausman test, and the result ($p<0.05$) showed us that the FE model implementation is more suitable than the RE model implementation. Therefore, based on these diagnostic tests we choose FE for the regression analysis.

Table 5.

Breusch and Pagan LM, and Hausman Tests Results

Test	Chi-Sq. Statistic	p-value
Breusch-Pagan LM	678.00	0.0000
Hausman	86.5	0.0000

Source: Authors' Computation

Test for Heteroscedasticity

To determine whether the standard errors of the variables are heteroscedastic or homoscedastic, we conducted the modified Wald test. The null hypothesis for this test posits that the variances are constant (or homoscedastic).

Table 6.
Wald Test for Heteroskedasticity

Test	Chi-square statistic	P-value
Modified Wald test	1.1e+05	0.0000

Source: Authors' Computation

As the p-value is less than the critical value (0.05), we reject the null hypothesis and conclude that the standard errors are heteroscedastic. To address this issue, we opted to employ robust standard errors when running regression.

Serial Correlations and Cross-sectional Dependency Tests

This paper uses the Wooldridge and Friedman test to check for serial correlation and cross-section dependence, respectively. The Wooldridge test tests for first-order autocorrelation in the residuals (null hypothesis: no autocorrelation). A significant result ($p<0.05$) suggests that the estimators are biased and need to be adjusted, such as in clustered standard errors or FGLS. The Friedman test tests for the cross-sectional dependence (null hypothesis: independent residuals). Rejection ($p<0.05$) indicates potential bias and the need to use methods such as PCSE or spatial models. The two tests validate the regression estimators.

Table 7.
Wooldridge Test and Friedman Test Results

Test	F-statistic	p-value
Wooldridge test	1.326	0.252
Friedman test	31.904	0.9834

Source: Authors' Computation

As shown in Table 7, the p-values > 0.05 of both tests show that the regression model does not have serial correlation and cross-sectional dependence issues.

Unit Root Test

As the non-stationary data can induce spurious regression, we conduct the Fisher-type panel unit root test which aggregates p-values from ADF tests across cross-sections. The test's null hypothesis is that all the different panels have unit roots. As shown in Table 8, the p-values for all variables is less than, we reject the null hypotheses for all the variables and conclude that all the variables are stationary at level.

Table 8.
Fisher-Type Unit Root Test Result

Variable	Inverse chi-squared (P)	p-value	Modified inv. chi-squared (Pm)	p-value
lnMPS	333.9185	0.0000	15.9420	0.0000
lnEPS	189.8902	0.0000	5.9554	0.0000

lnDPS	146.2693	0.0040	2.9309	0.0017
lnOCF	210.3306	0.0000	7.3727	0.0000
lnTAS	199.7169	0.0000	6.6368	0.0000

Source: Authors' Computation

Test for Need of Time Fixed Effects

To decide whether time effects were necessary in our fixed effects model, we performed a joint significance test of year coefficients using the Stata command "testparm". Based on the result, we rejected the null hypothesis of no fixed time effects ($p < 0.05$), indicating that it is appropriate to control for time effects in our specification. This result indicates that macroeconomic factors or time effects also substantially affect our dependent variable and should be explicitly included in our regression model.

Table 9.
Test for the Need of Time Fixed Effects When Running FE

Test	F-Statistic (6, 51)	Prob > chi^2
testparm	10.02	0.0000

Source: Authors' Computation

Fixed Effects Regression Analysis

Based on the diagnostic tests conducted in the previous section, we conduct FE regression to test our hypotheses. The regression results are presented in Table 10. The standard errors are clustered by firm ID, with 52 clusters, to account for potential heteroscedasticity and within-cluster correlation, and the statistical significance of the coefficients is denoted by ***, **, and * for 1%, 5%, and 10% level, respectively.

Table 10.
Fixed Effects Regression Result

Regressor	Coeff.	Std.Err.	t-stat	p-value	[95% Conff. Interval]		Sign
lnEPS	.137	.054	2.55	.014	.029	.245	**
lnDPS	.331	.076	4.36	.000	.179	.484	***
lnOCF	.010	.018	0.53	.600	-.027	.047	
lnTAS	.013	.06	0.21	.833	-.108	.133	
2016b	0	.	.	.	.	.	
2017	.115	.067	1.73	.089	-.018	.249	*
2018	-.138	.064	-2.16	.035	-.265	-.01	**
2019	-.307	.075	-4.07	.000	-.459	-.156	***
2020	-.347	.079	-4.38	.000	-.506	-.188	***
2021	-.429	.089	-4.83	.000	-.607	-.251	***
2022	-.547	.091	-6.00	.000	-.729	-.364	***
2023	-.519	.094	-5.55	.000	-.707	-.332	***
Constant	2.151	1.532	1.40	.166	-.924	5.226	

Mean dependent var.	2.882	SD dependent var.	1.491
R-squared	0.471	Number of obs.	392
F-test	9.086	Prob > F	0.000

Akaike crit. (AIC)	149.046	Bayesian crit. (BIC)	192.730

*** p<.01, ** p<.05, * p<.1

Source: Authors' Computation.

The FE regression result shows that earnings per share (EPS) have a positive impact on market share price (MSP). A 1% increase in EPS causes a 0.137% increase in MSP. This coefficient is statistically significant at the 5% level. Similarly, dividend per share (DPS) positively affects MSP: a 1% increase in DPS causes a 0.331% increase in MSP. The coefficient is statistically significant at 1%, indicating a strong impact on MSP, a level higher than that of EPS. The confidence intervals for EPS (0.029 to 0.245) and DPS (0.179 to 0.484) do not contain zero, further confirming the statistical significance of both coefficients.

Conversely, operating cash flows (OCF) exhibit a weak positive relationship with MSP. A 1% increase in OCF leads to only a 0.01% increase in MSP. This coefficient is statistically insignificant. This finding aligns with Mostafa (2016) a finding in the study of the value relevance of accounting information in the Egyptian stock market, which finds that cash flow information is not among the stock price drivers. Similarly, total assets (TAS) have a weak positive impact on MSP. A 1% increase in TAS causes a 0.013% increase in MSP, which is statistically insignificant. The confidence intervals for OCF (-0.027 to 0.047) and TAS (-0.108 to 0.133) include zero, reinforcing the statistical insignificance.

The year variables, with 2016 as the base year, show a statistically insignificant increase in market share prices for 2017, followed by a consistent and significant decline starting from 2018 onward, worsening in 2019. This trend aligns with the destructive economic effects of the COVID-19 pandemic (Baker et al., 2020). While our findings document this decline, identifying its precise causal mechanisms falls beyond the scope of this study.

The 0.471 R-squared value shows that the four-accounting metrics used together explain 47.1% of the change in MSP. The model's F-test (prob > F= 0.000) confirms that the independent variables jointly have a significant influence on the dependent variable.

Based on these results, we accept the hypotheses H1 and H2, whereas we reject H3 and H4.

5.0 Conclusion

This study provides evidence that accounting information, particularly EPS and DPS, has not declined in its usefulness for investment decisions in Kenya. The findings are consistent with the dividend signaling theory and, bird-in-hand theory. Moreover, they also indicate that the existence of a weak-form market efficiency in the Kenyan Stock Exchange.

Finally, based on the findings, we propose that further research into sectoral analysis and ESG disclosure should be carried out, and given the significant decrease in the market share prices after 2019 found in this study, future research is essential to investigate the reasons for this phenomenon.

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