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# The effects of the Asian crisis, corporate governance and accounting system on the valuation of book value and earnings

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## Abstract

This paper examines the value relevance of earnings and book value in four Asian countries, Indonesia, South Korea, Malaysia and Thailand, in the period surrounding the Asian financial crisis. Specifically, we examine the impact of the economic environment on the value relevance of book value and earnings. We also examine the effects of corporate-governance mechanisms and the type of accounting system together with the economic environment on the value relevance of accounting numbers. Our results indicate that the value relevance of earnings in Indonesia and Thailand was significantly reduced during the Asian financial crisis while the value relevance of book value increased. In Malaysia, the value relevance of both earnings and book value decreased during the crisis. In Korea, neither book value nor earnings was significantly impacted by the crisis. Our results indicate that the level of corporate-governance mechanisms has an impact on the extent of changes in the value relevance of book values, but not earnings. Specifically, the value relevance of book value declines when corporate governance is weak. Finally, our results indicate that accounting systems (i.e., IAS or tax-

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based) also affect the extent of changes in the value relevance of book value resulting from the crisis.


*Keywords:* Valuation; Corporate governance; Financial crisis

## 1. Introduction

This paper examines the effect of the Asian financial crisis on the value relevance of earnings and book value in four Asian countries, Indonesia, Korea, Malaysia and Thailand. Barth, Beaver, and Landsman (1998) find evidence that the relative value relevance of equity book value and net income shifts as the financial health of the firm decreases. First, we extend their analysis of bankrupt firms to examine the value relevance of equity book value and net income in a setting where the overall economy is in financial crisis. Second, we examine the role of corporate-governance mechanisms, interacting with the effect of the economic crisis, on the valuation of equity book value and earnings. Finally, we examine the effect of the interaction between accounting systems and the economic crisis on the valuation of equity book value and earnings.

Bushman and Smith (2001, 240) suggest that cross-country designs represent a powerful setting for investigating issues relating to the economic effects of financial accounting information and corporate governance because of significant cross-country differences in both financial accounting regimes and economic performance. In addition, vast cross-country differences in the legal protection of investors' rights, communication networks, and other institutional characteristics enable researchers to explore how the economic effects of financial accounting information vary with other factors (Bushman & Smith, 2001, 240). Bushman and Smith (2001, 241) argue that future research on the connection between governance use and capital markets use of financial accounting information is important for developing a more complete understanding of the effects of financial accounting information on economic performance. While governance research typically focuses on a particular governance mechanism in isolation, a more complete understanding requires an explicit recognition of the interactions across governance mechanisms (Bushman & Smith, 2001, 286). Therefore, we identify several country-specific institutional factors that influence the total economic effects of financial accounting information, as well as factors that influence the economic effects of financial reporting through its governance role. Since corporate governance is the means by which minority shareholders are protected from expropriation by managers or controlling shareholders (Mitton, 2002), we investigate the mitigating effects of shareholder rights, creditor rights, the rule of law, ownership concentration and audit-report quality on the relation between stock prices and earnings and book value during a financial crisis.

Barth, Beaver, and Landsman (2001, 88–89) state that value-relevance research provides evidence about how accounting amounts are reflected in share prices and thus, can be informative for accounting standards. Three of our sample countries, Indonesia, Malaysia, and Thailand, are classified as IAS (International Accounting Standards) countries while Korea's accounting standards are classified as tax-based. Because IAS are geared toward