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Review paper

ANALYSIS OF THE EARNINGS-RETURN RELATION IN SERBIAN CAPITAL MARKET

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Abstract. *The earnings-return relation has been the subject of numerous studies since the first study of this relation conducted by Ball and Brown in 1968. These studies are relatively rare in transition economies due to specific economic environment and less developed capital markets. Despite the differences in accounting practice and the level of capital market development, empirical studies usually find a significant and positive association between accounting earnings and stock returns both in the developed and transition economies. However, these studies usually find lower level of accounting earnings value relevance in transition economies. This could be due to lower efficiency of stock markets, bank orientation of financial systems, code-law legal system, and lower timeliness of accounting earnings in transition economies. The objective of this paper is to investigate the possible influence of accounting practice and regulatory framework, as well as the level of development of the capital market on the value relevance and the association between accounting earnings and stock returns in the Serbian capital market.*

Key Words: *accounting earnings, stock returns, accounting practice, capital market.*

INTRODUCTION

Accounting earnings are widely used in corporate practice because of the general belief that they are useful internal measures of firm performance and indicators of the change in the common equity value. They are published regularly (annually, semi-annually, quarterly, etc.) and used by investors to make rational decisions, predict future cash

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flows and deal with investment risks. On the other hand, stock prices and stock returns (calculated as the change in the stock price over a period of time including any paid dividends, scaled by the beginning of the period stock price) are important external (market) measures of firm performance. Given that stock prices can be determined by discounting expected firm cash flows, while the cash flows can be estimated using the accounting earnings, many authors set out to investigate nature and significance of the relationship between accounting earnings and stock returns (Nichols and Wahlen, 2004). They usually find a statistically significant relationship between accounting earnings and stock returns which can be explained in the following manner: positive earnings news generate higher expected cash flows, and consequently higher stock prices and high positive stock returns (Sadka and Sadka, 2009).

Starting from the aforementioned theoretical assumptions many studies set out to investigate the relationship between accounting earnings and stock returns. Given the specific economic environment, these studies are rare in transition economies. Filip and Raffournier (2010) suggest that transition economies should be investigated as a specific group of economies, different from developed and other emerging economies. They also add that despite their common recent history, transition economies cannot be seen as a homogenous group, because each country has specificities arising from its pre-communist history, cultural influences and level of economic development. Most South East European (SEE) transition economies initiated real economy reforms with the economic and political stabilization in the mid-1990s, but at a slower pace and with less success than Central East European (CEE) economies due to numerous political and institutional obstacles, macroeconomic instability and structural weaknesses.

Although Serbia also initiated the process of transition in the mid-1990s, widespread economic reforms were initiated later, at the beginning of the 21st century. Like in most other SEE and CEE economies, transition process began with the liberalization of prices and foreign trade and the privatization of small firms. After some good results in the first phase, if compared to other transition economies, poorer results were achieved in the second phase of the transition which included structural reforms, such as privatization of large firms, improvement of corporate governance, the reform of the banking system and development of non-bank financial institutions. One of the consequences of the delay in institutional and economic reforms is underdeveloped, inefficient and illiquid capital market. There is no daily financial press reporting on stock trading or financial analysts providing earnings forecasts on regular basis for investors in the Serbian capital market. Filip and Raffournier (2010) argue that these characteristics of the emerging capital market make the process of incorporating earnings news in stock prices less efficient and result in lower value relevance of accounting earnings.

The Explanation of the Earnings-Return Relationship

About half a century ago Solomons (1961) criticized the use of accounting income as a basis for taxation, challenged its importance in determining corporate dividend policy and the role of a guide in investment decision making. Solomons even predicted “the twilight of income measurement” by the end of 1980s. Solomon (1966) soon after argued that accounting measures, such as the return on assets and return on equity, do not provide adequate guidance to managers for assessing the financial viability of the anticipated investment projects. These arguments were amplified during a number of financial scandals that marked the beginning of the 21st century when some authors advocating non-financial, cash flow and value measures argued that accounting earnings are often subject to manipulations and are poor information base for investors' decision making (e.g. Stewart, 2003). Despite these theoretical arguments, investors and managers still base their decisions on information about the level and changes in accounting earnings numbers like net income, earnings per share and return on assets. A 2006 National Investor Relations Institute study found that 66% of companies provide regular profit guidance to financial analysts (see Rappaport, 2006). Managers justify their commitment to maximize accounting earnings by stressing the view that shareholders appreciate more stocks that have announced larger earnings. They believe that shareholders mostly see the companies that do not achieve satisfactory (expected) earnings as inefficient and poorly guided (Graham et al., 2005).

As summarized by Nichols and Wahlen (2004), the theory linking accounting earnings to changes in the stock prices depends on the following three assumptions: 1) accounting earnings provides information to shareholders about firm's current and expected future profitability; 2) current and expected future profitability provides shareholders with information about the firm's current and expected future dividends; 3) stock price equals the present value of expected future dividends to the shareholder. They add that researchers examine the relationship between accounting earnings and stock returns in order to test these theories with empirical data. In other words, researchers are trying to assess the value relevance of accounting earnings by regressing stock returns over accounting earnings. Ohlson (1995) developed a simple empirical model which expresses stock price P_{jt} as a linear function of book value of common equity B_{jt} and net income X_{jt}: $P_{jt} = \alpha_0 + \alpha_1 B_{jt} + \alpha_2 X_{jt} + e_{jt}$. Regression (slope) coefficients α_1 and α_2 represent measures of the timeliness of accounting information, while the coefficient of determination of the model (R^2) measures value relevance of accounting information.

Sadka and Sadka (2009) explain that empirical studies usually estimate the term $cov(R_{jt}, \Delta X_{jt})$, where R_{jt} denotes stock returns at time t, and ΔX_{jt} denotes net income change (typically scaled by the beginning of the period stock price). These studies usually find that $cov(R_{jt}, \Delta X_{jt})>0$, indicating that stock prices increase (decrease) due to an increase (decrease) in expected cash flows. The positive relationship between accounting earnings and stock returns was first documented in the study conducted by Ball and Brown (1968) on a sample of listed companies from U.S. This finding was confirmed in many subsequent studies on samples of companies from developed economies (Board and Day, 1989; Easton and Harris, 1991; Booth et al., 1997; Dumontier and Labelle, 1998; Chen and Dodd, 2001). However, Chen and Dodd (2001) find that accounting earnings have more value-relevant content than some more contemporary measures, such as residual income and economic value added. However, they also find that accounting based information explains little of the variations in stock returns between firms which led them to a conclusion that more than 90% of the variations are attributable to non-earnings based information.

Given that the market reaction to accounting disclosures differs across firms and countries, several studies analyze the possible determinants of these differences. Dumontier and Raffournier (2002) summarize the results of some previous studies and conclude that: a) larger earnings changes are associated with larger abnormal stock returns, defined as the difference between actual and market-adjusted predicted stock returns; b) the reaction of investors on earnings announcements (abnormal stock returns) is more pronounced for the smaller firms, c) less sophisticated investors react to good news (positive earnings changes) but tend to under-react to negative unexpected earnings in comparison with their sophisticated counterparts. Anandarajan and Hasan (2010) investigate possible influence of the level of mandated disclosure transparency of information, legal environment, accounting standards, and liberalization (the extent of foreign ownership of local businesses and markets). They find that: a) mandated disclosure and source of accounting standard, (especially non-governmental source) are positively associated with earnings informativeness, b) code-law countries have lower value relevance relative to common-law countries, c) the firms that have adopted international financial reporting standards have higher value relevance than firms which adhere to local (national) standards.

Despite some differences in accounting regulation and practice, previous studies show that there are no substantial differences in the relationship between stock returns and accounting earnings between different developed economies. Although it could have been expected that specific economic environment of emerging economies and not only differences in accounting practice compared to developed economies would induce differences in the relationship between earnings and stock returns between developed and emerging economies, it seems that these differences do not exist. Empirical studies on samples of firms from emerging economies also find significant positive association between accounting earnings (both level and changes) and stock returns (Vafeas et al., 1998; Chen et al. 2001; Dimitropoulos and Asteriou, 2009; Anandarajan and Hasan, 2010). These results imply that, although there are some studies finding that value relevance increases with the development of capital market and institutional environment (e.g. Anandarajan and Hasan, 2010), accounting earnings are equally value relevant in emerging and developed economies.

Most studies on the samples of listed companies from CEE and SEE transition economies also find the statistically significant relationship between accounting earnings and stock returns (Pritchard, 2002; Hellstrom, 2006; Dobija and Klimczak, 2010; Janjic et al. 2012). Hellstrom (2006) finds significant relationship for Czech companies, but add that value relevance of accounting information is lower in a transitional economy than in a developed economy, and that the value relevance increases over time as a result of the progress in transition. Pritchard (2002) finds similar result for Baltic countries - Lithuania, Latvia and Estonia, and points out that accounting earnings are the most value relevant in Estonia due to the higher capital market liquidity and the high level of accounting system development. Studies on transition economies usually find that accounting earnings are less value relevant in transition than in developed economies, and that value relevance increases with progress in transition. Filip and Raffournier (2010) suggest that it should be expected that accounting earnings are less value relevant in transition economies because of lower efficiency of capital markets, bank orientation of financial systems, code-law legal system, and lower timeliness of earnings. They, however, point out that the possible reason why accounting earnings could be more value relevant in transition economies is that in these economies financial statements are the primary and often the only source of information for investors.

ACCOUNTING PRACTICE AND REGULATORY FRAMEWORK IN SERBIA

Hellstrom (2006) noted that accounting practices are a product of the historical, political, economic and institutional development of each country, while the accounting environment is influenced by the nature of firm ownership, legal system, political system, sources of finance, capital markets, economic growth and development. Starting from this notion and the evolution of Serbian regulatory framework conditioned by changes and characteristics of economic and socio-political environment in the 20th century, it is possible to distinguish three phases of the accounting practice development in Serbia. These are: the period up to 1945, the period from 1945 to 1996 and the period from 1996 to date. The period up to 1945 is characterized by a low level of development and weak institutional regulation of accounting practice. The focus of financial reporting was on meeting the information needs of firm owners, primarily in the field of operational and/or strategic decision-making and control. This cannot be said for the period after World War II, which is characterized by strong state regulation of the accounting profession and practice, and marginalization of the financial reporting. Financial reporting was in the service of state control of firms which resulted in the loss of interest of investors in accounting information. This was contributed by the development of the communist system, the introduction of centralized and planned economy and the abolition of private property.

The reform of the accounting regulation and certain progress in the development of accounting practice occurred after the adoption of the Law on Accounting in 1989. The law has largely been based on the IV EU Directive. In addition to legal regulation, the process of professional regulation development began in 1991 after the adoption of the Code of Professional Ethics for Accountants. In 1993 the Code was complied with the IFAC Code of Professional Ethics. During 1992 thirty national standards largely based on IAS were issued, and in 1993 two more. The standards were developed in collaboration with ACCA from England and were in force until 2002. However, the most significant changes in the accounting regulation and practice occurred in 1996 with the adoption of the new Law on Accounting and Law on Auditing. For the first time the sequence of accounts in the chart of accounts follows the sequence of positions in the balance sheet and not the flow of business operation, while the total cost method was introduced instead of the cost of sales method for the income statement preparation. The 1990s are, therefore, as a consequence of an altered economic and political environment, the turning point in the development of accounting practice and convergence of national accounting regulation to European. The application of IAS in Serbia started on 1 January 2004, while the IFRS were adopted by the Law on Accounting and Auditing in 2006.

A comparative analysis of the Serbian and European regulatory bases reveals that there is complete compliance in the area of group reporting. However, the application of IFRS in Serbia is required for large and medium-sized enterprises, while the EU has a different treatment of this issue, ranging from the obligatory, permitted to use or prohibited. As noted by Lalević-Filipović (2010), both in EU and in Serbia management is responsible for preparing financial statements, while the Shareholder Assembly is in charge of their adoption. In Serbia, the annual report includes a balance sheet, income statement, cash flow statement, statement of changes in equity and notes including accounting policies. All statements have prescribed formats, and there is only one mandatory scheme of the balance sheet and income statement. Contrary, the EU accounting regulation is characterized by the existence of a number of possible schemes of balance sheet and income statement. In Serbia, companies are obliged to submit their financial statements for the previous year by 28 February of the current year (i.e., consolidated financial statements by 30 April) to the Business Registers Agency and National Bank of Serbia, and tax balance and financial statements to the Tax Administration by 10 March.

As for differences in institutions for the supervision and control of financial reporting, in some European countries the institution for supervision and control of financial reporting is the stock exchange which indicates that the objectives of financial reporting in these countries are determined by the interests of investors (shareholders). These countries are Sweden, Norway and Switzerland (FEE, 2001). In some countries, the institution for supervision and control is the independent regulator of stock exchange (i.e. the Securities and Exchange Commission). These are Belgium, France, Italy, Spain and Portugal. The third group includes countries where the supervision and control of financial reporting is implemented by governmental agencies. These are Denmark, the Czech Republic and the United Kingdom (where there is also a private organization for control). Serbia belongs to the third group of countries, given that annual reports are submitted to the National Bank of Serbia and Business Registry Agency. According to the Capital Market Law the publicly listed companies have to submit their annual reports to the Securities and Exchange Commission as well. There is also a group of European countries where there is no institution for supervision and control, such as Austria, Finland, Ireland, Slovenia, the Netherlands, Hungary, Luxembourg and Germany.

INFLUENCE OF SERBIAN REGULATORY FRAMEWORK AND ACCOUNTING PRACTICE ON EARNINGS-RETURN RELATION

Problems in the implementation of the overall accounting regulation and a strong political influence on all economic flows, including the accounting, characterize the economic reality in Serbia, which can be connected to the fact that Serbia has a code-law legal system. Code-law legal system is often linked with strong regulation (laws) but weak effective (institutional) protection of investors (La Porta et al., 2002). Ball et al. (2000) argue that strong political influence in countries with code-law legal system weakens the demand for timely (extent to which accounting earnings co-varies with stock returns) and conservative (extent to which accounting earnings incorporate negative stock returns more timely than positive stock returns) accounting earnings and increase the demand for less volatile accounting earnings. Jennings et al. (2004) argue that, unlike common-law countries, code-law countries provide more flexibility to managers to smooth reported earnings. If managers are allowed to smooth earnings, the underlying financial health of a firm can be camouflaged. Starting from these postulates, Ball et al. (2000) and Jennings et al. (2004) empirically proved that value relevance of accounting earnings in common-law countries is greater than in code-law countries.

Measurement basis for financial accounting in Serbia is mixed, and allows accounting conservatism and the historical cost measurement on the one hand and on the other hand the fair value measurement approved by the adoption of IAS/IFRS. Accounting based on the historical cost principle and accounting based on the fair value are two different measurement bases. They are not only competitive, but also mutually exclusive (Škarić-

Jovanović 2012). The decision about integrating these two concepts was made by the IASB, and was based on the facts that creditors' information needs are changing, while the information requirements of investors are constantly growing. The decision was supported by the latest amendments to the Framework for the preparation and presentation of financial statements in 2012. According to the Framework, the objective of financial reporting is providing information useful in making investment and credit decisions. Application of mixed measurement basis leads to a shift of focus from satisfying information needs and protecting creditors' interests to satisfying investor's interests and information needs. By accepting the concept of fair value the realization principle is suspended. Imparity principle remains in force and the matching principle gets a completely different meaning (adjusting the fair value of assets and liabilities in the balance sheet). Direct consequence of applying the fair value concept is increased value of the net income and equity. This increase is a result of the recognition and inclusion of unrealized gains arising from the changes in the fair value of assets and liabilities to the net income (Skaric Jovanovic, 2012).

The use of fair value may diminish the reliability and usefulness of some of the traditional performance measures (earnings numbers). For example, Skaric Jovanovic (2012) points out that the application of fair value results in a lower rate of return on equity (ROE) and a lower rate of return on total assets (ROA). The opposite is with the earnings per share, which is determined according to IAS 33. Earnings per share (EPS), based on the net income determined using the fair value, is only the possible amount of EPS because the unrealized gains, contained in the net income, may be realized in the future but not necessarily. Such an EPS is not sufficient information for investors, since it does not point to the right way to increase their wealth. Skaric Jovanovic (2012) also argues that the net income which includes the components of other comprehensive income should be used for the purposes of determining EPS in terms of application of fair value. It should also be borne in mind that this indicator, in terms of application of fair value, has the limited practical value for the future corporate performances evaluation and decision making. This is because it does not provide a good basis for the assessment of amount, schedule and riskiness of future cash flows.

Another question is whether financial reporting in Serbia has characteristics that have a negative effect on the value relevance of accounting information. For example, the following characteristics which have a negative effect on the value relevance have been identified in the Czech Republic: a) completeness of information is required without consideration of materiality; b) the main convention is that of historical cost and reevaluations are not permitted, c) the effects of changes in accounting policies are included in extraordinary items of the current period (Hellstrom, 2006). Financial reporting in Serbia does not have these characteristics which have a negative effect on value relevance of accounting information. We can conclude that in Serbia, some important institutional prerequisites for ensuring the quality of financial reporting are designed. However, the problem can be identified in the area of insufficient level of application of IAS/IFRS. The application of IAS/IFRS in Serbia is characterized by several problems including: a lack of financial control mechanisms which are reduced to tax control and imperfect capital market and tax system unadjusted to the international professional regulation. Some authors believe that these problems can be overcome by application of the IV EU Directive, and not IAS/IFRS (Škarić-Jovanović, 2012). Increasingly significant processes of integration into international economic flows actualize the issue of financial reporting as the most important sources of information for many users. The investors are coming to the fore (especially foreign investors) as the users of information.

In 2005 the World Bank prepared a Report on Observance of Standards and Codes on Accounting and Auditing in Serbia based on the analysis carried out in 2004. Conclusions of this report indicated that there was inadequate scope of the IAS application, and the final score of financial reporting was not high. The unsatisfactory rating of the financial reporting quality was the result of inconsistency of the legal and professional accounting regulation, as well as of the national professional accounting regulations and certain laws concerning financial and tax regulations, primarily the Law on Corporate Income Tax. For example, for the purposes of calculating income tax, net income is relevant only as a starting point for determining the taxable base. In addition to other remedial items it must be increased by the accounting depreciation and reduced by tax depreciation. In accordance with the Law on Corporate Income Tax, as an expense in the income tax only depreciation calculated according to tax regulations is accepted. This confirms the aforementioned control role of the state and its strong interest in financial reporting and construction of regulatory framework accustomed to satisfy state information needs. A similar collision of accounting and tax regulations, and accounting and tax reporting, exists in Great Britain, the Netherlands and the United States. The Law from 2006 tries to correct and overcome some of these shortcomings mostly by taking into account the recommendations of the World Bank given in the Report from 2005.

Transition processes and processes of international integration bring to the foreground the question of financial reporting quality. Financial reporting has a great significance on the stability and functioning of financial markets, especially the capital markets. The improvement of the financial reporting quality is a prerequisite for the fair competition in the capital market and for the protection of investors and creditors. Therefore, more efforts should be focused on improving the quality of financial reporting in different ways. One way is to harmonize laws with professional regulation. The Law from 2006 tends to respect the recommendations of the World Bank given in the Report from 2005. Some progress has been achieved in this area, but given the economic environment in Serbia, as well as the ongoing development of EU regulations, much more should be done on the regulatory, educational and institutional level of financial reporting system.

Improving the financial reporting quality also requires harmonization of national and international regulations (Malinić, Todorović 2012; Lalević-Filipović 2012). Serbian national regulation in the area of financial reporting quality is harmonized with international, but there is still a problem with implementation of the regulation. In order to make some progress in this area, the Serbian government has prepared a draft of the National strategy and action plan for improvement of the quality of corporate financial reporting and auditing for the period 2011-2020. They were prepared in cooperation with the World Bank in 2011, and are based on previously developed regulatory framework compatible with *acquis communautaire* (accumulated legislation, legal acts, and court decisions which constitute the body of European Union law). Creators of the strategy stress that quality financial reporting results in the increase of foreign investments, better assessment of future firm performance, better assessment of managers' decisions and development of the capital market.

INFLUENCE OF SERBIAN CAPITAL MARKET DEVELOPMENT ON EARNINGS-RETURN RELATION

After it was abolished in 1953, the Belgrade Stock Exchange (BSE) was re-established in 1989. In the 1990s, short-term corporate notes and government bonds were the most traded instruments, and only a few stocks were traded. The economic stabilization and progress of privatization after 2000 led to an increase in the number of companies listed on the BSE (Čupić, 2010). The number of stocks increased to 1,353 in 2011, but only 581 were actively traded and 40 were traded using continuous trading method. Municipal bonds and treasury bills were introduced to the market after 2000. Trading at the BSE was carried out by 58 broker-dealer companies in 2011, out of which 5 also operated as market makers for several companies (Belex, 2011). Stock indexes were introduced by the Law on financial instruments in 2003. These are Belex15, a leading index of the BSE which describes the changes in the prices of the most liquid shares and is calculated in real time, and BelexLine, general index of the BSE.

Table 1 Indicators of the Belgrade Stock Exchange in 2006-2011

	Equity market capitalization	Equity market turnover	Number of transactions	Belex15 value	BelexLine value
2006	7,869.49	1,051.76	115,992	21.21	33.65
2007	16,267.76	1,852.63	285,556	29.26	48.35
2008	9,379.59	816.91	110,787	6.38	13.53
2009	8,191.10	387.86	68,503	6.92	13.68
2010	7,320.16	177.02	716,130	6.18	12.16
2011	6,610.94	239.28	2,881,545	4.76	9.34
2012	7,747.02	218.13	483,013	4.61	8.84

Source: Belex, 2006-2012

Notes: Equity market capitalization and Equity market turnover are expressed in € millions, and Belex15 value, and BelexLine value are expressed in €.

As shown in Table 1, until 2007 the BSE growing rate was very high. The largest market capitalization and turnover, as well as the largest liquidity (given the values of the Belex15 and BelexLine indexes) were recorded in 2007. After the long period of very high growing rates the stock market capitalization and turnover plummeted by 52.4% and 88.2%, respectively, in the period from 2007 to 2012. These results are consistent with the trends in the global and regional economic environment and high real GDP growth rate of Serbian economy. Resulting from significant increase in economic activity and export, as well as relatively favourable circumstances in the international financial markets, the average annual real GDP growth rate was 5.4% in the period between 2001 and 2008 (Stošić et al., 2012). The 2007-2008 financial crises, deterioration of liquidity and increasing borrowing rate, led to a slow-down in the Serbian financial system and decrease of aggregate demand. The real GDP growth rate decreased to -3.5% in 2009 (NBS, 2012). It should be noted that, even at its peak, the Serbian capital market was still very small in comparison to other SEE and CEE capital markets. As shown in Fig. 1, equity market capitalization and turnover of BSE are comparable to those of Slovenia, Bulgaria and Slovakia capital markets, but below-average when compared to other transition and developed economies (especially the Czech Republic).

The progress of BSE is significantly determined by its ability to attract foreign investors. Given the political and economic issues of recent decades and inadequate legal protection of investors, it is not easy to restore investors' confidence and attract foreign investors. Nevertheless, foreign investor participation in stock trading is relatively high, reaching 54.6% in 2006. The foreign investors remained present even during and after the financial crisis with the average participation in daily stock trading of 45.4% in 2011. Hellstrom (2006) argues that internationalization of the transition economy through foreign investors entering capital markets changes the informational environment of transition economies. Entrance of the foreign investors from developed capital markets encourages domestic firms to be more responsive and accountable to a larger number of stakeholders. Hellstrom believe that increased internationalization of business should have positive effects on value relevance of accounting information. Positive influence of foreign equity ownership on value relevance of accounting earnings is found in some empirical studies (e.g. Bae and Jeong, 2007; Khanna and Palepu, 1999).

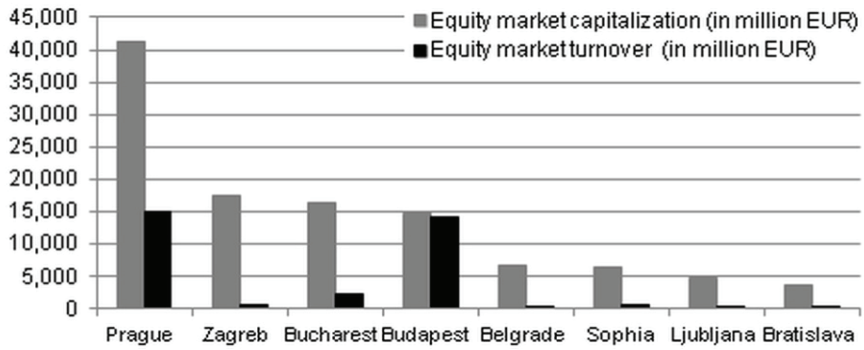

Fig. 1 Market capitalization and turnover of stock exchanges at the end of 2011
Source: Annual reports of selected stock exchanges available on the Internet

Stancic et al. (2012) note that the new Capital Market Law published in 2012 relies on a new market development strategy which will lead to a delisting of shares in which there is no trading interest. The law provides for the establishment of an Investor Protection Fund (already functions as a part of Deposit Insurance Agency) and a Rating Agency. The law also regulates public offerings, which could motivate corporations in Serbia to use this funding mechanism more. It requires more detailed information about the securities and defines conditions under which company needs to have a prospectus. Penalties for manipulation of the capital market, such as insider trading, are much more severe. Therefore, it could be expected that the Capital Market Law will provide better protection of investors and larger investments diversity which could lead to higher level of capital market efficiency and liquidity, and consequently to higher value relevance of accounting earnings in Serbia.

World Bank global report Doing Business 2011 shows that Serbia offers relatively weak legal (measured by strength of investor protection index) and effective judicial (measured by enforcing contracts index) protection of investors. Among 183 economies Serbia is ranked 74th in protecting investors, and 94th in enforcing contracts. The fact that de jure protection is stronger than de facto protection of investors is not surprising given that Serbia has a code-law legal system (La Porta et al., 2002). Kaličanin (2005) argues that Serbian corporations are not motivated to be transparent in business and do not feel pressure from shareholders to deliver the required returns or to create value for them. The shareholders are subjects of attention only if they are dominant (which is often); but then the problem of protecting minority shareholders arises (Stancic et al., 2012; Cupic, 2010). Stancic et al. (2012) find that companies traded on the regulated BSE markets offer more publicly available information than companies traded on the unregulated market which could be due to stricter criteria for listing on the regulated market. The implication of this finding is that the corporations in Serbia are interested in communication with shareholders only to the degree that is required by law or other regulations. Filip and Raffournier (2010) explain that emerging capital markets are generally characterized by low transparency and the lack of information sources about companies implying that the main (possibly the only) source of information for investors is the annual report. They argue that stock prices should thus essentially reflect accounting numbers which should appear as particularly value relevant.

CONCLUSION

Theoretical studies point to many characteristics of the transition economies which make the process of incorporating earnings news in stock prices less efficient and lead to a lower value relevance of accounting earnings. Transition economies usually have inefficient capital markets, bank-orientated financial systems and code-law legal system. Nevertheless, some authors suggest that the accounting earnings could be more value relevant in transition economies because in these economies annual reports are the primary and often the only source of information for investors. Empirical studies on the samples of listed companies from Central and South East European transition economies usually find the statistically significant relationship between accounting earnings and stock returns. These studies also find that accounting earnings are less value relevant in transition than in developed economies, and that value relevance increases with progress in transition.

Due to the fact that Serbia has initiated institutional and economic reforms with a great delay, Serbian capital market is relatively underdeveloped, inefficient and illiquid which could lead to a lower level of value relevance of accounting earnings in Serbia. Recently some efforts have been made to improve the level of legal and judicial investor protection, transparency of the company operations and investments diversity. After the adoption of the new Capital Market Law, Investor Protection Fund was established as a part of Deposit Insurance Agency. Membership in the Investor Protection Fund is mandatory for all the investment companies and banks providing portfolio management, as well as for the management companies providing these services to the clients other than investment funds. These changes in the legal and institutional framework of the Serbian capital market could lead to an increase of its efficiency and thus result in higher value relevancy of accounting earning.

Implementation of IAS/IFRS also has potentially positive effect on the value relevance of accounting earnings in Serbia. The application of IAS started in 2004, while the Law on accounting and auditing from 2006 provides for implementation of IFRS. The fact is that the firms (and countries) which have adopted international financial reporting standards have higher value relevance than firms (and countries) which adhere to national standards. Therefore, the main institutional requirements concerning the financial reporting quality are fulfilled in Serbia. However, from this perspective Serbia has two major problems in the area of value relevance of accounting information. The first one is the insufficient level of application of IAS/IFRS and the second one is incompatibility and inconsistency of legal and professional regulation. Having in mind recommendations from the World Bank - Report on Observance of Standards and Codes on Accounting and Auditing in Serbia from 2005, efforts towards improving of financial reporting quality and increase of the value relevance should go in these two directions.

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ANALIZA VEZE IZMEĐU DOBITKA I PRINOSA NA TRŽIŠTU KAPITALA U SRBIJI

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Veza između dobitka i prinosa je bila predmet brojnih studija nakon objavljivanja prve studije ovog odnosa koju su sproveli Bol i Braun (Ball and Brown) 1968. Ove studije su relativno retke u tranzicionim ekonomijama zbog posebnosti ekonomskog okruženja i nerazvijenosti tržišta kapitala. Uprkos razlikama u računovodstvenoj praksi i stepenu razvijenosti tržišta kapitala, empirijska istraživanja uglavnom ukazuju na postojanje značajne i pozitivne veze između računovodstvenog dobitka i tržišnih prinosa, kako u razvijenim, tako i u tranzicionim ekonomijama. Ipak, ove studije ukazuju na niži stepen uticaja dobitka na tržišne prinose u tranzicionim zemljama. Ovo može biti usled slabe efikasnosti tržišta kapitala, orijentisanosti finansijskog sistema na banke, evropsko-kontinentalnog pravnog sistema i slabe blagovremenosti računovodstvenih informacija u tranzicionim ekonomijama. Cilj ovog rada je da istraži mogući uticaj računovodstvene prakse i regulatornog okvira, kao i stepena razvijenosti tržišta kapitala na prirodu i jačinu veze između računovodstvenog dobitka i tržišnih prinosa na tržištu kapitala u Srbiji.

Ključne reči: *računovodstveni dobitak, tržišni prinos, računovodstvena praksa, tržište kapitala.*