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Value Relevance of Accounting Information in Malaysian Listed Firms: Family and Government Ownership Concentration's Perspective

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ABSTRACT

This paper develops a conceptual framework to understand the comparative value relevance of accounting information in the publicly listed Malaysian firms. In Malaysia, the concentration of ownership for corporate control is a common phenomenon. So, ownership concentration is considered the most important corporate governance mechanism to determine accounting information's quality. The model specifies that for the better understanding the value relevance of accounting information in concentrated firms, it is important to identify the type of ownership concentration rather than focusing on generic concentrated ownership, especially the predominant family and government ownership in Malaysia. The rationale behind this is the prevalence of agency conflicts that are different between these concentrated groups such as family and government. These agency conflicts impact the perception of investors regarding the quality of accounting information (i.e. relevance and faithfulness) provided by these concentrated groups and ultimately moderate its value relevance in a different manner.

Keywords: Value Relevance of Accounting Information, Conceptual Framework for financial reporting, Family ownership, Government ownership

INTRODUCTION

The issue of quality of accounting information is under debate among academician, practitioners and regulatory authorities due to the use of accounting information in the investment decision by the investors. According to a recent survey on global economic crime had pointed out that in 2016, 18% of the global economic crime is linked with accounting frauds and in Malaysia, this ratio is 17% (PwC, 2016a, 2016c). The presence of fraudulent accounting practices has been noted in firms with concentrated ownership structure (for example, Adelphia, Parmalat, Pescanova, Cirio) including Malaysia (for example, Transmile Group Berhad and 1Malaysia Development Berhad) (Fong, 2007; Saieed Zunaira, 2016). Recently in 2015, Toshiba Corporation's accounting scandal in Japan highlighted the significance of accounting information's quality (Pfanner & Fujikawa, 2015). The accounting frauds not only diminishes investor's confidence in accounting information's quality but also the corporate governance system in place for their protection (Johnson et al., 2000). Moreover, a study by Claessens and Yurtoglu (2013) highlighted that in Malaysia the listed firm's behaviour towards the quality of accounting information is poor as compared to other developing countries.

The research problem highlighted is that accrual-based earning is the primary information that is designed by the International Accounting Standard Board (hereafter, IASB) to predict enterprise future cash flow to aid investors in decision making (IASB, 2010, 2018). While many studies highlight that the value relevance of earning is significantly reduced or diminished (Arora & Bhimani, 2016; Gan, Chong, & Ahmad, 2016; Kwon, 2009; Saeedi & Ebrahimi, 2010) due to that fact that earning is subject to the managerial manipulation that has reduced its relevance (Marquardt & Wiedman, 2004; Whelan & McNamara, 2004). Therefore, many studies in the recent literature argues that value relevance of earning is reduced in terms of growing reliance of investors on the book value of equity and cash flow from operations (hereafter, CFO) in decision making including Malaysia (Barth, Li, & McClure, 2018; Bo, 2009; Gan et al., 2016; Kwon, 2009; Lev, 2018; Mirza, Malek, & Abdul Hamid, 2019; Tahat, 2017). On the other hand, many studies also claim that book value of equity and CFO are irrelevant in decision making and emphasized that earning is still considered as a primary measure in decision making (Mostafa & Mostafa, 2016; Nejad, Ahmad, & Embong, 2018; Omokhudu & Ibadin, 2015; Subroto, Saraswati, & Purnomosidi, 2018).

The decision associated with the provision of accounting information's quality is dependent on the nature of agency conflict among principal and agent (Jensen & Meckling, 1976). The nature of agency conflict varies among developed and developing countries as developed countries such as the UK and the US, the main conflict is among principal and agents because of the widely held ownership structure (Type 1). While in developing countries such as Asia including Malaysia, ownership structure is concentrated because of the poor investor's protection (Shleifer & Vishny, 1997). Therefore, it has shifted the classical agency conflict between minority and majority shareholder and has increased the risk of expropriation of monitory shareholders (Type 2 agency conflict) (Claessens et al., 2002). A study by Lozano, Martinez, and Pindado (2016) also claimed that the conflicts between majority and minority shareholders are higher for concentrated firms in the poor investor's protection regime such as Asia. Because of poor protection of minority shareholders such as in the Malaysia stated by World Bank (2012), the ownership structure becomes

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concentrated, therefore, ownership concentration became the most significant corporate governance mechanism in Asia including Malaysia (Abdullah et al., 2015; Fan & Wong, 2002; Htay, Salman, & Shaugee, 2013; Singam, 2003). According to La Porta et al. (2000), ownership concentration has given the concentrated owners in Asia with abusive power that resulted in less efficient shareholder's protection mechanism that impact the quality of accounting information (Morck, Shleifer, & Vishny, 1988; Morris, Pham, & Gray, 2011) and ultimately its value relevance (Ayadi & Boujelbene, 2015; Fan & Wong, 2002).

Most of the Malaysian economy is dominated mostly by concentrated by the family and government-owned firms (Claessens et al., 2002; Claessens, Djankov, & Lang, 2000; Claessens & Yurtoglu, 2013; World Bank, 2012). These groups of large shareholders are different from each other in terms of the nature of agency conflicts (Bhatt, 2016; Hope, 2013). While most of the previous literature related to ownership structure focused on value relevance of earning and considered ownership concentration as a moderating variable and ignored the dissimilar agency issues between different types of concentrated groups (Ayadi & Boujelbene, 2015; Fan & Wong, 2002; Firth, Fung, & Rui, 2007; Yeo et al., 2002). While only one study by Chandrapala (2013) analyzed the impact of ownership concentration on book value of equity along with earning, one study exclusively focused on family ownership and value relevance of accounting earning by Cascino et al. (2010) and one on earning and book value of equity by Bae and Jeong (2007) and no study as yet considered the CFO in relation with the ownership structure and ignores the fact that the risk of manipulation of accounting information especially earning is high in the concentrated firms (Fan & Wong, 2002). While CFO is the lack of subject to managerial manipulation (Tahat, 2017).

Therefore, the proposed model suggests that earning, book value of equity and CFO should be considered simultaneously for a better understanding of the comparative value relevance of accounting information. Moreover, dominant family and government-owned firms should be considered as moderators rather than generic ownership concentration in the Malaysian context for better understanding the comparative value relevance in these two groups.

LITERATURE REVIEW

Overview of Malaysian Family and Government ownership

Majority of the Malaysian business was started as a family business. According to Jasani (2002) these businesses rest not only on the founding family's human capital but also hire family members and relatives to manage daily operations. Claessens et al. (2000) stated that, Among nine East Asian countries (Hong Kong, Indonesia, Japan, South Korea, Malaysia, Philippines, Singapore, Taiwan, and Thailand), the control of the firm by the Malaysian families has increased from 57.7 % to 67.2 % as the cutoff level of voting rights jumped from 10% to 20% and also highlighted that 15 business families in Malaysia are contributing to the 76.2% of GDP and 28.3% of market capitalization. Claessens et al. (2002) stated that the families dominate more than half public listed firms on the Malaysian Stock Exchange. Recently, Ibrahim and Abdul Samad (2011) confirmed that family-owned firms in Malaysia hold 43% of the of Bursa Malaysia's main board firms. Claessens and Yurtoglu (2013) and Malaymail (2015) also supported this view that Malaysia is one of the countries with high ownership concentration by families and family business are contributing 76% of GDP. While a recent report by PwC (2016b), it was highlighted that 69% of the family businesses in Malaysia is already passed to the second generation. This interprets that family-owned firms struggle hard to maximize the wealth in the long run and the involvement in the business reduce agency costs. There are some common attributes of family-owned firms in Malaysia e.g. the board of directors is dominated by the members of dominating family, and the same person is appointed as the board of director's chairman and the chief executive officer or, if it is not the case, then appointed from the same family (Zhuang, 1999). These characteristics make family-owned firms different from other ownership structures.

Malaysians' government listed firms are called GLCs (Government Linked Companies). These firms are under the direct control of the Malaysian State (Ministry of Finance, 2009/2010). State appoints members of the board of directors and senior management in GLCs. Moreover, the government keeps in their hands directly or through GLICs (Government-Linked Investment Companies), the core decision making such as awarding the contracts, formulation of the strategies, restructuring and financing, acquisition and mergers and disposal of GLCs (Lau & Tong, 2008). The GLIC have hundreds of billions USD investment in listed firms' shares, and 30% of total market capitalization is held by them. Other than the control of many GLCs, GLICs hold a minority interest in many listed firms. GLICs also invest in many non-listed firms, property, and corporate bonds (World Bank, 2012). There are 33 listed GLCs on Bursa Malaysia, representing 4% of the total listed firms, while the market capitalization of these firms is RM235.5 billion or 49% of the total market capitalization. These firms are contributing approximately 17% of gross capital formation and almost 10% towards GDP (Ministry of Finance, 2009/2010). This review of GLCs and family-owned firms in Malaysia shows that both have a significant presence in Bursa Malaysia, signalling the significance to the economic growth of Malaysia.

Conceptual Framework

Accounting information, especially earning is the most superior information for decision making, while the information from the statement of financial position and statement of cash flows is also useful for decision making (IASB, 2010, 2018). Marquardt and Wiedman (2004) argued that when a firm provides lower quality earning, it weakens the association between accounting earning and value relevance. In that case, investors focus on the other accounting information for decision making i.e. CFO and book value of equity along with earning for decision making (Bo, 2009; Kwon, 2009; Tahat, 2017; Vichitsarawong, 2011). Therefore, this model suggests assessing simultaneously the value relevance of earning, book value of equity and CFO.

However, according to the agency theory, the nature of agency conflict between principal and agent determines the quality of accounting information. In the concentrated firms, there is a lack of separation between owner and management (Type 2 agency conflict) that may result in a better alliance of interest (Jensen & Meckling, 1976; Shleifer & Vishny, 1997). While the opponents of agency theory had argued that ownership concentration can motivate the concentrated owner to entrench the minority shareholders (Friedman, Johnson, & Mitton, 2003; Morck et al., 1988). Apart from this, it is arguable that ownership concentration is not a homogenous group, it is important to identify the type of concentrated group. The main reason behind this is the dissimilar agency issues between different concentrated groups such as family and government (Bhatt, 2016; Hope, 2013). These dissimilar agency issues may lead to different managerial practices to manipulate earning and book value of equity. Accordingly, for the better understanding the role of accounting information in the decision making in the family and government-owned firms, CFO should also be analyzed along with earning and book value of equity. Moreover, the perception of investors regarding the quality of accounting information may be different about family and government-owned firms that ultimately results in higher or lower value relevance of accounting information. Therefore, the relationship between earning, the book value of equity, CFO and firm value is moderated by family and government ownership.

Value Relevance

The term "value relevance" is used for the first time in the literature by (Amir, Harris, & Venuti, 1993). While, origins and foundations were placed in the 1960s and afterwards, most of the value-relevance work, as it is known currently, is predominantly based on research from the past twenty years. As per the definition that is given by Francis and Schipper (1999), a statistical relationship among accounting information and firm value/ stock returns. According to this, value relevance is considered as the ability of accounting information to capture or summarize information affecting firm value/ stock returns, irrespective of the source. This is called the measurement perspective of the value relevance and most of the research is dominated by the measurement perspective (Hellstrom, 2006). Value relevance is also defined as a combined test for the qualitative characteristics of financial statement information i.e. relevance and faithful representation (formally known as reliability) (Barth, Beaver, & Landsman, 2001; Kothari, 2001).

Value Relevance of Earnings, Book Value of Equity and Cash Flows from Operations: P1

IASB (2010, 2018) supports the notion that earning contains value relevant information and specifies that accrual-based earning is the most relevant variable because it gives a better picture of current revenues and expenses. While book value of equity and CFO also provide value-relevant information. Recent literature also provided evidence concerning the significant role of earning for decision making (Ali et al., 2018; Jadah, Murugiah, & Adzis, 2016; Kwong, 2010; Lev, 2018; Mostafa & Mostafa, 2016; Nejad et al., 2018; Subroto et al., 2018; Tahat, 2017). While literature also supported the insignificant role of earning in decision making or reduced value relevance including Malaysia (Arora & Bhimani, 2016; Gan et al., 2016; Kwon, 2009; Mirza et al., 2019; Saeedi & Ebrahimi, 2010). The main reason behind this is the manipulation of earning has made it less value relevant variable (Marquardt & Wiedman, 2004; Whelan & McNamara, 2004).

Many studies in the prior literature also found the book value of equity and CFO as significantly value relevant variable (Barth et al., 2018; Bo, 2009; Gan et al., 2016; Kwon, 2009; Pervan & Bartulovic, 2014; Tahat, 2017; Tanaka, 2015). Meanwhile, some authors claimed that book value of equity and CFO does not contain value relevant information (Mostafa & Mostafa, 2016; Omokhudu & Ibadin, 2015; Saeedi & Ebrahimi, 2010; Vishnani & Shah, 2008). Bartov, Goldberg, and Kim (2001) and Barton, Hansen, and Pownall (2010) explained the reasons for the above findings that there is no universal principle that can define that which accounting information is more relevant rather it lies on the accounting regime and institutional factors. These arguments support the notion that earning, the book value of equity, CFO is value relevant but relative value relevance may vary. Thus, the following proposition can be developed:

P1: There is a difference between the value relevance of earning, book value of equity and CFO.

Moderating Role of Family and Government Ownership on Value Relevance of Accounting Information

Past studies assessed the moderating role of different type of ownership structure on the value relevance of earning such as: managerial ownership (Gabrielsen, Gramlich, & Plenborg, 2002; Warfield, Wild, & Wild, 1995), ownership concentration (Ayadi & Boujelbene, 2015; Chandrapala, 2013; Fan & Wong, 2002; Firth et al., 2007; Yeo et al., 2002) and family ownership (Bae & Jeong, 2007; Cascino et al., 2010) and supported both alignment and entrenchment effect of agency theory. While agency theory argues that the nature of agency conflicts between concentrated groups such as family, government ownership and minority shareholders is different from each other (Hope, 2013; Peng et al., 2016). In turn, the impact on the value relevance of accounting information may differ from each other. Generic ownership concentration is unable to explain the behaviour of different concentrated groups, therefore, for better understanding, the value relevance of accounting information in the Malaysian context, concentrated government and family ownership should be taken as moderators.

The conceptual underpinning of moderator was introduced by Baron and Kenny (1986), the author stated that the desirable condition for a moderating variable is a weak or inconsistent relationship between independent and dependent variable. It should be an independent variable and zero correlation with the dependent variable for the clear interpretation of the moderation effect. Many studies examined the value relevance of earning, book value of equity, CFO and findings are inconsistent in international and Malaysian literature as well that highlight the need for a moderator. Concentrated ownership is the most important monitoring mechanism in the Asian and Malaysian environment to determine accounting information's quality, while due to different agency conflicts, family and government ownership should be taken as separate moderators rather than generic concentrated ownership. A study by MacKinnon (2011) explained the reasons for the taking a moderator in research framework and stated that moderator may be introduced before conducting a study as a test of theory and understanding the complex behaviours. For example, this model proposes that earning, book value of equity and CFO is value relevant. While the theory claimed that, the agency conflict among concentrated family and government ownership is different from each other that may moderate the relationship that is entirely different from each other. So, for the better understanding of this complex issue and test of the agency theory, family and government ownership are introduced as moderators between earning, book value of equity, CFO and firm value.

Family Ownership as Moderator: P2

According to Chen, Chen, and Cheng (2008) and Wang (2006), family-owned firms have active involvement in management and desires to carry the family business as a long-term investment. These factors decrease the agency conflicts among owners and managers that will lead to lesser incentives to manipulate earning (Achleitner et al., 2014; Ali, Chen, & Radhakrishnan, 2007; Setia-Atmaja, Haman, & Tanewski, 2011; Wang, 2006). However, family owners monitor the business directly and they possess better knowledge of the business of the firm that may result in increased risk of expropriation of minority shareholders through improper accounting information (Prencipe, Markarian, & Pozza, 2008; Yang, 2010). The accounting information such as earning and book value of equity are subject to the flexible accounting choices. Therefore, quality of the earning and book value provided by family-owned firms may also influence the investor's perception and consequently its value relevance (Bae & Jeong, 2007; Cascino et al., 2010). This argument is further supported by the studies that argued the quality of accounting earning impacts value relevance of the earning and book value of equity (Christensen, Hoyt, & Paterson, 1999; Marquardt & Wiedman, 2004; Whelan & McNamara, 2004). However, it doesn't affect the value relevance of the cash component of earning that highlight the importance of CFO.

According to the agency theory, the ownership concentration by the families may result in alignment of interest among controlling and minority shareholders or entrenchment of minority shareholders. These two opposite effects may influence the quality of accounting earning and book value of equity. Alternatively, it is arguable that investors in family-owned firms may also use CFO for decision making because accounting earning and book value of equity in family-owned firms may be subject to the managerial bias. So, it supports the notion that the presence of concentrated family ownership can moderate relationship earning, book value of equity and CFO and firm value. Thus, the following hypotheses can be developed:

P2A: Family ownership can moderate the relationship between earning and firm value.

P2B: Family ownership can moderate the relationship between the book value of equity and firm value.

P2C: Family ownership can moderate the relationship between CFO and firm value.

Government Ownership as Moderator: P3

According to Peng et al. (2016) government-owned firms are suffering from the influence of bureaucracy, the weak incentive structure and the lack of competition in the market. Shleifer (1998), Nhut H (2009) and Wang and Judge (2012) stated that there is the poor corporate governance, less corporate efficiency, misallocation of resources, corruption and fraud in the government-owned firms. Moreover, conflict of interest between government and government employees and average citizen as a minority shareholder leading to the increased information asymmetry and aggravated agency problems (Peng et al., 2016). These all prevailing factors in the government-owned firms lead to the distorted alignment of interest, in this case, there is more chance that managers will use their discretion to influence accounting information (Wang & Yung, 2011). Contrary to the above, Wang and Yung (2011) also argued that the government acts as a powerful external monitoring mechanism that protects against the opportunistic behaviour of managers. Instead, the government protection of their firms might have decreased the stress on managers to manipulate firm-specific information that reduces multiple agency conflicts between government, government agents and minority shareholders that makes it unique from other ownership structures, which in turn, results in higher quality of accounting information.

In government-owned firms, the control of the firms is maintained by significant shareholdings. Moreover, there is a significant presence on the board by the government through bureaucrats (agent) that gives them the ultimate power to manipulate the earning and book value of equity and ultimately its value relevance. This argument is further strengthened by the studies that argued the quality of accounting earning impacts the value relevance of the earning and book value of equity (Christensen et al., 1999; Marquardt & Wiedman, 2004; Whelan & McNamara, 2004). However, it doesn't affect the value relevance of the cash component of earning. So, it is arguable that in the government-owned firms, outside investors may also consider CFO for the decision making because accounting earning and book value of equity in government-owned firms may be subject to the managerial bias. These two-agency perspectives may determine the quality of accounting earning and book value of equity in the government-owned firms and consequently its value relevance. So, it leads to the notion that government ownership can moderate the relationship earning, the book value of equity and CFO and firm value. Thus, the following hypotheses can be developed:

P3A: Government ownership can moderate the relationship between earning and firm value.

P3B: Government ownership can moderate the relationship between the book value of equity and firm value.

P3C: Government ownership can moderate the relationship between CFO and firm value.

CONCLUSION AND POLICY IMPLICATION

Earning, book value of equity and CFO provides relevant information for decision making but previous studies provided inconclusive result regarding comparative value relevance because earning, and book value of equity is subject to managerial manipulation while CFO is lack of subject to managerial bias. Therefore, the proposed model suggests that all three variables should be analyzed together for better understanding of the relative value relevance of accounting information in Malaysian listed firms. Agency theory further discusses that the accounting information's quality depends on the conflict of interest between minority and majority shareholders (type 2 agency conflict) in the concentrated firms. While generic ownership concentration does not represent of all type of concentrated groups due to the different agency conflicts that result in the different motivation behind earning and book value of equity's manipulation. Therefore, in the Malaysian context, rather than generic ownership concentration, concentrated family and government ownership should be taken as moderator. The conceptual model developed in this study offers a more nuanced analysis of comparative value relevance of the accounting information in the presence of concentrated family and government-owned listed firms from an investor's perspective.

From the policy implication's perspective, Malaysian regulators have undertaken multiple initiatives: the adoption of the Corporate Governance Codes and application of a full set of IFRS to improve accounting information's quality. Therefore, the proposed model will support to assess, whether the efforts to enhance the accounting information's quality is effective in Malaysian listed firms. It will also provide valuable information for the standard setters, regulators, and other agencies of Malaysia for the further enhancement of accounting information's quality in concentrated family and government-owned firms as well. Additionally, the proposed model may also have broader implications for other countries and jurisdictions where share ownership structures resemble those found within the Malaysian context.

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