THE MODERATING ROLE OF DUAL CLASS SHARE AND FIRM SIZE ON VALUE RELEVANCE OF ACCOUNTING INFORMATION

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ABSTRACT

The purpose of this research is to investigate the influence of dual class share and firm size on the value relevance of earning and book value, given by firms listed in Istanbul stock exchange from 2016 to 2018. Agency theory is utilized to explain the relationship between this research variable of interest. Utilizing cross-sectional panel data, the research findings indicates that value relevance of book value and earning is higher for firm's issue dual class share. Likewise, earning per share and book value of equity shows higher value relevance for larger firms compare to small firm size in Turkey.

Keywords: Value Relevance; Dual class share; Firm size, Turkey.

INTRODUCTION

Publicly held corporations in the Middle East possess weak levels of disclosure quality and transparency. Some policy advisors suggest that the adoption of international accounting standards is important for enhancing financial reporting transparency (Bank, 1998). Even though efforts to improve standards and rules, the common idea are that the transparency of financial reporting has been decreasing (Hunton et al. 2006). Whereas the new accounting policies and rules might enhances the quality of accounting information, investors still aware about the quality of accounting numbers. Thus, it is important for policy makers and regulators to grasp the reason behind low quality of accounting information. This work addresses the impact of dual class share and firm size on accounting information quality in Turkey. More specifically, the study uses the infomativeness of accounting earning to investor as a proxy of accounting information quality. This work uses two complementary opinions to interpret the relationship between dual class shares and earning informative (Morck et al. 1988). Corporate structure in Turley is characterized with high concentrated ownership (Mustafa et al. 2018). As the entrenched shareholders using their effective control work to increase their interest at the expense of minority shareholders particularly in the environment characterized with weak legal system and ineffective corporate governance for instance the market for corporate control and corporate board (Shleifer & Vishny, 1997; Young et al. 2008). In addition, as a result of cross-holding ownership and pyramidal structure typical of Turkey firms, a huge number of controlling shareholders have more voting right than their cash flow right through share ownership, that further increase the entrenchment impact. Consequently, the entrenchment impact potentially influences financial reporting quality. This is because the controlling shareholders monitor the accounting information policies and is expected to possess high opportunistic behavior to jeopardize minority shareholders' interests, the market preserve that the owners will not report reliable accounting information. The market expectation will minimize the informativness and credibility of accounting earning reports.

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Dual Class Share and Value Relevance of Accounting Information

Entrenched impact

Ownership structure not only explain agency problem, but also influences the firm's financial reporting. When founder control a firm, he/she control firm financial reporting policy and accounting informativeness. When controlling shareholders is entrenched by their voting rights and power and there is large divergence between cash flow rights and voting rights, the reliability of the accounting informativeness is minimized. Consequently, investors are less likely to depend on reported accounting information's; this is because they predict that the controlling shareholders don't disclose information that reflect true underlying economic tractions than information out of self-interest. In specific, outsiders are less likely to trust reported earnings because the entrenched shareholders could manipulate earnings in order to increase their interest at the expense of minority shareholders. Furthermore, outsiders know that the entrenched shareholders are less likely to report accounting information that could attract close oversight by outsiders. That doesn't indicate that there is complete earning management to hid probable influence of wealth abstraction. The entrenched shareholders could hide the wealth influences of her/his expropriation behaviors in combines' earnings without disclosing them as distinct income statement items. Minimizing earning credibility reduce share price informativeness of the earning. Previous literature addressed the significant impact of earning credibility. Teoh & Wong, (1993) show that capital market insight of earning quality as a proxy of auditor size, positively impact on share price informativness of earnings.

The alignment impact

One technique to reduce agency problem of entrenched shareholders is to enhance further the entrenched shareholder's share in ownership. A higher share ownership of entrenched shareholders gives entrenched shareholders higher cash flow and voting rights in the company. Once the entrenched shareholders get adequate control on the company, a small increase in voting rights does not improve controlling shareholders entrenchment, nonetheless this will enhance entrenched shareholder cash rights and this mean that it will cost them more to distract the company's cash right for private interests. Controlling shareholders with high concentrated ownership might work as a reliable commitment that entrenched shareholders are working to build a reputation that they are not going to jeopardize minority shareholders rights (Gomes, 2000). The commitment is reliable because minority ownership recognizes that if entrenched shareholders work to increase their interest when they held substantial stake shares, they will reduce the share price accordingly, and the majority owner's stock value will be cheaper. Accordingly, concentrated shareholders will held large share ownership and the share price of firm will be stronger. Therefore, concentrated ownership possess strong alignment impact, improving shareholders ownership beyond the low level required for strong control enhance the alignment impact between the minority and majority shareholders and mitigate the influence of entrenchment. Accordingly, hypothesis developed for this research is:

H_1: There is a positive relationship between dual class share and value relevance of accounting information.

Value Relevance and the Firm's Size

Previous research reflects that the size of companies is a crucial factor that drives the

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informative of accounting information (Bae & Jeong, 2007; Brimble & Hodgson, 2007). Brimble & Hodgson, (2007) reports that value relevance of small firms is lower compare to larger firms. The book value and value relevance of earnings has been examined for listed firms' of Australian Stock exchange (ASE) for the period from 1974 to 2001. The research findings show low value relevance of earning, book value information. In addition, the findings show that explanatory power for large firms is lower compared to large firms. Hodgson & Stevenson- Clarke, (2000) investigate the value relevance of accounting earnings and cash flows of listed firms in ASE, the research findings found that earning response coefficients and explanatory power are less pronounced for small firms compared to large firms. Bae & Jeong, (2007) report that the value relevance of information to the share price is larger for the whole sample compared to smaller for chaebol-affiliated companies. The findings show that smaller firms possess small power in explanatory.

Firm size and stock return has been examined by (Yokoyama et al. 2015) and the study findings show positive relationship between firm size and value relevance of accounting information. Whereas other studies by (Krismiaji 2019; Nilsson & Strand, 2015) report insignificant relationship between value relevance of accounting information and firm size. Thus, the hypothesis is developed as follow:

H_2: There is a positive relationship between Firm size and value relevance of accounting information.

RESEARCH METHOD

Firms listed in Borsa Istanbul are used as a population of the present research. Financial companies are excluded from this study sample because they follow different set of corporate governance code (Zulkarnain 2009). This research covers three-year starting from 2016-2018. The sample comprise of 438 firm / year observation of firms listed in Borsa Istanbul. The analysis is relying on data hand collected from companies' annual reports.

Variable definition and measurement

Value relevance

The relationship between share price and book value has been examined using price model (Ohlson 1995). This model links between market value, earning and book value. Abnormal earnings have been used to measure earnings, whereas book value used to measure of present value of expected future earnings. The model is identified as follows:

$$Pit = \alpha + \beta_1 EPSit + \beta_2 BVSit + \beta_3 DUSHit + \beta_4 FSIZit + \beta_5 EPSit*DUSHit + \beta_6 BVSit*DUSHit + \beta_7 EPS*FSIZit + \beta_8 BVS*FSIZit + \beta_9 LEVit + \beta_{10} ROAit + \varepsilon it$$

where:
Pit = stock price firm i at time t, three months after the fiscal year-end at time t
EPSit = earnings per share of firm i at time t
BVSit = the book value per share of firm i at time t
DUSHit = dual class shares of firm *i* at time *t*
FSIZit = firm's size of firm *i* at time *t*
LEVit = total liabilities divided by total assets of firm *i* at time *t*
ROAit = net income divided by total assets of firm i at time t
εit = error term

Dual Class Share

Dual class shares are measured utilizing dichotomous measurement that is equal to 1,

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for firm issue dual class shares, else, it is measured by 0 (Yurtoglu 2003).

Firm size

Total assets have been used to measure firm size. Total assets consist of current and non-current assets. Natural logarithm is used as a transformation of total assets amount (Chen & Wu, 2008). Previous research report positive relationship between firm size and earnings quality because of operating complexity and the difficulty to discover overstatement by the interested parties (Lobo & Zhou, 2006; Ronen & Yaari, 2008).

Control variables

Previous literature report many control variables that have been used to investigate the relationship between ownership structure, firm size and value relevance of accounting information. Therefore, this research include leverage measured using short-term debt and long-term debt divided by total assets (Alfraih et al. 2015). Profitability (ROA) is measured and calculated by dividing net profit before taxes with averaged total assets (Krismiaji 2019).

DESCRIPTIVE STATISTICS AND CORRELATION

Table 2 shows the number of observations, mean, standard deviation, and inter-correlation between the study's variables. Descriptive statistic shows that the price mean is about 1.16 (1.33 percentage the standard deviation) with a minimum of –2.29 and a maximum of 5.57.

Table 1
DESCRIPTIVE STATISTICS AND CORRELATION MATRIX OF THE STUDIED VARIABLES

Variable	Mean	SD	Min	Max	1	2	3	4	5	6	7
PRIC	1.167	1.33	-2.29	5.57	1						
EPS	0.527	2.45	-5.39	52.11	0.42	1					
BVS	4.618	10.39	-11.1	110.27	0.6	0.68	1				
DUSH	-	-	0	1	0.47	0.59	0.6	1			
FSIZ	1.904	1.78	1.43	2.61	0.34	0.39	0.09	-0.18	1		
LEVE	0.247	0.24	0	7.23	-0.12	-0.09	-0.17	-0.07	-0.09	1	
ROA	0.03	0.455	-0.641	0.387	0.27	0.06	-0.14	0.21	0.12	0.101	1

The mean of earnings per share is about 0.527 with a range from about -5.39 to -5.39 and standard deviation of 2.45. The percentage book value per shares is 4.618, the standard deviation is 10.39, and the range is from a minimum of -11.10 to a maximum of 110.27. The minimum of dual class shares is 0 and the maximum is 1. Firm size mean is 1.904 (1.78 percentage the standard deviation) with a minimum of 1.43 and a maximum of 2.61. The average ratio of LEVE of the companies is 0.247 (0.241 percentage the standard deviation) with a minimum of 0 and a maximum of 7.23. Table 1 illustrates the correlation between all variables of this study. The correlation values are less than 0.80. This shows that multicollinearity problems don’t exist among the variables of interest. The finding shows that there is a positive correlation between EPS, BVS, DUSH, FSIZ and ROA, while LEVE has negative correlation with PRIC.

MULTIVARIATE ANALYSIS

The research examines informativeness of accounting earnings contingent on dual class share and firm size utilizing time-series cross-sectional (Panel data) regression model.

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Table 2 REGRESSION MODELS				
Item	Model 1		Model 2	
	Coefficient	t-value	Coefficient	t-value
EPS	0.473	1.78*	0.031	1.08
BVS	0.183	1.81*	0.003	0.06
DUSH	0.145	1.72*	0.216	3.4
FSIZ	0.127	1.69**	0.156	2.47
EPS*DUSH	-	-	0.288	3.21**
BVS* DUSH	-	-	0.22	2.17**
EPS*FSIZ	-	-	0.521	1.92*
BVS*FSIZ	-	-	0.168	2.12
LEVE	-	-	0.288	-3.21**
ROA	-	-	0.071	1.53
Wald chi2=	0.58		0.69	
Prob > chi2	0		0	
Notes: * = significant at 10%, ** = significant at 5% and *** = significant at 1%.				

Ordinary Least Square (OLS) regression has been used to examine the study hypotheses, and all assumptions tests used and the finding show that the residual data is normally distributed, no autocorrelation, no multicollinearity, and no heteroscedasticity are detected in the data. The direct regression result shows R2 is 58% while interaction model shows R2 is 69% (Table 2). This indicates that explanatory variables drive explained variable about 58% and 69% for both models. Further explanation means that 58% of the differences in value relevance of accounting information derived by EPS, BVS, DUSH and FSIZ. The moderating impact of DUSH and FSIZ is about 69% on the relationship between value relevance of accounting information EPS, BVS and PRIC. Hypothesis 1 suggestions, that there is a relationship between DUSH and PRIC. The result for this variable is significant at the 10% level of significance. In addition, the degree of influence on PRIC is about 14%. This designates that DUSH positively influence the value relevance of earnings and book value. The result of this study is in the same line of that provided by Zhang (2012) who stated that concentrated ownership are more likely to form a reputation for not jeopardizing minority shareholders rights. Consequently, entrenched shareholders work to enhance the quality of accounting information and then improve value relevance of accounting information. Therefore, hypothesis 1 is supported. Hypothesis 2 proposed that there is a relationship between firm size and PRIC. The findings of the study show that firm size positively impact the value relevance of accounting information. This indicates that large companies possess higher value relevance than small companies. The study by Yokoyama et al. (2015) reports the same result that larger firms report high value relevance of accounting information than small firms.

CONCLUSION

This study examines the impact of dual class shares and firm size on value relevance of accounting information in Bursa Istanbul for the period 2016-2018. Ordinary Least Square regression and cross-sectional time-series regression are utilized to test this study hypotheses and to control for autocorrelation and heteroscedasticity in a sample of 438 Turkish firms. The study finding reflects that dual class share and firm size have strong impact on value relevance of accounting information. It indicates that the value relevance of firms issue more

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than one class of share is higher compare to firms don't produce more than one class of share. In addition, larger firms are more likely to improve the value relevance of accounting information than small size firms. The research proposes accompanying more research and includes more variables, inclusion of further characteristics of corporate governance.

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