CORPORATE GOVERNANCE AND VALUE-RELEVANCE OF ACCOUNTING INFORMATION OF LISTED HOTELS AND TRAVELS IN SRI LANKA

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ABSTRACT

Today corporate governance has become a global issue and the development of corporate governance practices is considered to be a prominent theme all over the world. This study aims to investigate the impact of corporate governance on the value relevance of accounting information of listed hotels and travels in the Colombo Stock Exchange. Twenty listed companies were analyzed for a period of five years from 2012 to 2016. Corporate governance is measured by board size, board independence and ownership structure whereas EPS and net assets value per share were considered as the variables of value relevance of accounting information. Data was collected from the annual reports of the listed companies, magazines and scholarly articles from academic journals. Correlation and multiple regressions were used to analyze and evaluate the collected data. The results reveal that board independence and ownership structure have a significantly negative influence on value relevance of accounting information of listed hotels and travels in Sri Lanka while firm leverage has a negative influence on value relevance of accounting information. Therefore, firms with strong corporate governance practices exhibit a higher value- relevance of accounting information.

Keywords: board size, board independence, ownership structure, value relevance of accounting information

INTRODUCTION

Corporate governance practices are recognized as one of the most important implications to build market place confidence and to attract positive investors in the organization. Promoting good corporate governance practices is considered to be very important in attracting investment capital, reducing risk and developing firm performance. This research investigated the impact of corporate governance on value-relevance of accounting information in Sri Lanka. The recent spate of corporate collapses around the world has put significant pressure on policy makers and corporate management to initiate and implement good corporate governance practices. From an academic perspective, corporate governance is an extensively researched area in the literature on accounting (Cohen et al., 2004). However, the impact of corporate governance on the value-relevance of accounting information remains unexplored. Agency theory arguments support the view that better structured governance mechanisms should result in better quality financial reporting in the market place.

The United Kingdom Cadbury Report (Cadbury, 1992) defines corporate governance as "the system by which companies are directed and controlled", including board practices and composition and their relationship to firm performance. Corporate governance covers the concepts, theories and practices of boards and their directors and the relationship between boards and shareholders, top management, regulators and auditors and other stakeholders (Huq and Bhuiyan, 2012).

The separation of ownership and control gives rise to information asymmetries that managers could use to exploit outside atomistic shareholders (Berle and Means, 1932; Jensen and Meckling, 1976). Shareholders demand financial reporting from managers in order to evaluate the performance of managers. However, in the absence of strong monitoring mechanisms on managerial behaviour, managers could mislead outsiders by providing financial information which does not portray the true underlying performance of the business. In such cases, accounting information is of little use in valuing companies, and no association between market price and accounting information would be expected. Corporate governance mechanisms are assumed to constrain management opportunistic earnings behaviour and consequently, to make accounting information more credible and relevant to outsiders (Ahsan Habib and Istiaq Azim, 2008).

The role of accounting numbers in company valuation is of fundamental interest to analysts, investors and researchers alike. Prior work on the value-relevance of accounting information has demonstrated that both income statement and balance sheet information are useful in determining equity values (Collins et al., 1997; Francis and Schipper, 1999). Much of the accounting-based valuation has focused on analyzing historical and forecasted accounting numbers (Richardson and Tinaikar, 2004). The work of Ohlson (1995) and Feltham and Ohlson (1995) has produced considerable interest amongst researchers about the role of historical accounting numbers in valuation.

There is no universally accepted definition for corporate governance, although it has been defined broadly as the set of private and public institutions, including laws, regulations and accepted business practices, that, in a market economy, govern the relationship between corporate managers (''corporate insiders'') on one hand, and those who invest resources in corporations on the other (Oman, 2001).

Value relevance is the ability of accounting numbers to explain market price per share. Beisland (2009) describes value relevance as the capability of financial statement information to tap and summarize firm value. Empirical evidence relating corporate governance to value-relevance of accounting information seems to indicate a higher value relevance of accounting information for firms with strong governance structures, although this finding is not consistent across studies (Vafeas, 2000; Habib and Azim, 2008; Dimitropoulos and Asteriou, 2010). Therefore, this study is an endeavor to examine the impact of corporate governance on the value-relevance of accounting information of listed hotels and travels in Sri Lanka during the period of 2012-2016.

In any country, increase of investment in the capital market leads to improvement in strength of the capital market and development of the economy. Investors rely on accounting information in their pricing of shares and firms which provide good quality information have thus an advantage in a lower cost of capital. Investors in developed counties are keen on the accounting information of the intended investing companies. So the investigation of the board structure with value relevance of accounting information is important matter for developing countries like Sri Lanka.

REVIEW OF LITERATURE

Value relevance is defined as the ability of information that is presented by financial statements to capture and summarize firm value. Value relevance can be measured by the statistical relations between information that financial statements present and stock market values or returns (Suadiye, 2012).

Ahsan and Istiaq (2008) revealed that firms with a strong governance structure exhibit higher value-relevance of accounting information. Results further show that firm-specific economic variables are important determinants of the value-relevance of accounting information. Vera Ogeh Fiador (2013) found that net asset value per share is value relevant on the Ghanaian market, and even more so when the board size is small or the CEO also doubles as the board chair. Board independence as captured by the percentage of non-executive directors on the board and is relatively irrelevant in the market valuation of shares, and when relevant has a negative effect. Balagobei (2017) investigates the impact of audit committee on value relevance of accounting information of listed hotels and travels in Sri Lanka. The results reveal that audit committee (AC) attributes such as AC size, AC experts and AC meetings have a significant impact on book value per share of listed hotels and travels in Sri Lanka. Further only AC experts influence earnings per share. AC independence is not found to have a significant impact on the value relevance of accounting information.

Tharmika and Nimalathasan (2013) examined the impact of value relevance of accounting information on market vulnerability of the listed manufacturing companies in the Colombo stock exchange. The results revealed that earning per share (EPS) and net assets value per share (NAVPS) significantly impact on market vulnerability. Further EPS and NAVPS are significantly correlated with market vulnerability.

Generally, investors are not in a situation to directly assess the performance of companies in which they intend to invest. They usually depend on financial statements prepared by the management of such organizations. The primary purpose of financial statements is to provide information concerning the financial situation of the company, its operational results, any changes of control in the company and cash flow (Nirmala &

Florence, 2011). The impact of financial statement information on capital market indicators referred to as the value relevance studies and is part of the market-based accounting stream. Information is considered 'value relevant' if stock price movements are associated with the release of such information (Utami & Noraya, 2010).

Investors look up to corporate governance as they are much interested on the effect it has on value creation. Investors are ready to pay more for those firms that they feel are well governed. According to Bushman et al. (2004) and Karamazov and Vafeas (2005), the quality of information improves by having more external directors on board. Many authors argue that a small board size can improve the quality of financial reporting as directors can communicate better and increase the information content and this reduces the scope for earnings management.

Forbes and Milliken (1999) revealed that board size has an outcome on board effectiveness in various ways, such as larger board possesses more skills and knowledge to share, however, since each of them has got a different point of view, it is likely to reinforce cognitive conflict. It also becomes difficult to identify the individual significant contribution of the group members and to effectively use the knowledge and skills of the board members.

Beeks et al., (2004) observed that organizations with a higher percentage of external directors tend to be more conservative. However, Pi and Timme (1993), Adams and Mehran (2008), Belkhir (2006) and Hermalin and Weisbach (1991) identified that there are no benefits from having independent directors on boards. Based on the literature review, the following hypotheses are developed:

H_1: Board size has a significant impact on value-relevance of accounting information.

H_2: Board independence has a significant impact on value-relevance of accounting information.

H_3: Ownership structure has a significant impact on value-relevance of accounting information.

Based on the research question, the following conceptual model has been constructed.
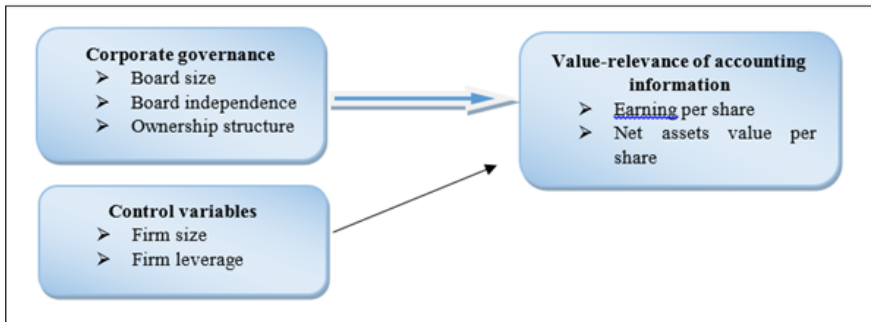

Figure 1: Conceptualization Model

METHODOLOGY

The present study used secondary data for the analysis. Specifically, the financial statements of the listed firms in the sample were collected for the period 2012-2016 and these were obtained from the annual reports of hotels and travels. Further, scholarly articles from academic journals, relevant text books on the subject and the internet search engines were also used.

The Colombo Stock Exchange (CSE) has 295 companies representing 20 business sectors as at 31st January 2017. Out of 38 listed hotels and travels the sample of this study composed of only twenty firms listed in Colombo Stock Exchange over a period of 5 years from 2012 to 2016. From the 20 sectors; the hotels and travels sector was selected for the study.

The following methods were chosen to derive the results in this study are based on data analysis.

- Board size : Number of the directors on board
- Board independence : Number of the independent directors/ Number of the directors
- Ownership structure : Number of the shares held by directors/ total number of shares.
- Firm size : Log of total assets

Firm leverage   : Long term debt / Total assets
Earning per share   : Net profit after tax/ Number of ordinary shares
Net assets value   : Net assets/ Number of ordinary shares

According to the hypotheses developed, a regression model was constructed for carrying out an empirical analysis. The following regression model was developed to analyze corporate governance and the value-relevance of accounting information.

Model I: $EPS = \beta_0 + \beta_1\,BS + \beta_2\,BI + \beta_3 OS + \beta_4\,FS + \beta_5\,FL+$
Model II: $NAV = \beta_0 + \beta_1\,BS + \beta_2\,BI + \beta_3 OS + \beta_4\,FS + \beta_5\,FL+$

Where,

$\beta_0, \beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ - Regression co-efficient
BS - Board size
BI - Board independence
OS - Ownership structure
FS - Firm size
FL - Firm leverage
EPS – Earning per share
NAV – Net assets value

FINDINGS AND DISCUSSION

Correlation Analysis

Table 1 presents the Pearson correlation coefficients between corporate governance and value-relevance of accounting informatio

Table 1: Correlation Matrix

		Board size	Board independence	Ownership structure	Firm size	Firm leverage	EPS	NAV
Board size	Pearson Correlation	1						
	Sig. (2-tailed)							
Board Independence	Pearson Correlation	-.096	1					
	Sig. (2-tailed)	.342						
Ownership structure	Pearson Correlation	.066	.092	1				
	Sig. (2-tailed)	.514	.365					
Firm size	Pearson Correlation	.197*	-.242*	-.302**	1			
	Sig. (2-tailed)	.049	.015	.002				
Firm leverage	Pearson Correlation	.185	-.292**	.066	.026	1		
	Sig. (2-tailed)	.066	.003	.512	.779			
EPS	Pearson Correlation	-.040	-.160	.257**	.068	-.238*	1	
	Sig. (2-tailed)	.695	.113	.010	.501	.017		
NAV	Pearson Correlation	-.084	-.249*	.276**	.093	-.189	.844**	1
	Sig. (2-tailed)	.404	.012	.005	.358	.059	.000	

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

The findings show that ownership structure has a significant positive relationship with EPS and a net assets value at the 0.01 level while firm leverage has a significant negative relationship with EPS. Further there is a significant negative relationship between board independence and net assets value at the 0.05 level. Board size and firm size are not significantly correlated with value relevance of accounting information measured by EPS and NAV.

Multiple Regression Analysis

A Multiple regression was carried out, in order to assess how well the EPS and net assets value can be explained by knowing the value of board size, board independence and ownership structure.

Model I

Table 2 presents the multiple regression summaries. In this model the specification of five variables (board size, board independence, ownership structure, firm size and firm leverage) revealed the ability to predict the EPS. Respective R^2 value of 0.220 denotes that 22 % of the observed variability in EPS can be explained by the differences in variables namely board size, board independence, ownership structure, firm size and firm leverage. The remaining 78 % is not explained which means that the remaining 78 % of the variance in EPS is related to other variables not depicted in this model.

Table 2: Coefficients for Predictors of EPS

Model	Beta	Standard Error	t value	Significant
Constant	-39.966	89.362	-.447	.656
Board size	-.891	1.648	-.541	.590
Board independence	-108.587	40.758	-2.664	.009
Ownership Structure	71.438	20.024	3.568	.001
Firm size	11.523	9.078	1.269	.207
Leverage	-76.275	22.331	-3.416	.001

$R^2 = 0.220$

Further, this model reveals that the coefficient for all three variables such as board independence, ownership structure and firm leverage are significant at the 0.05 level which indicates that these variables have a

significant impact on EPS. For the other two variables such as board size and firm size t values are insignificant at 0.05 levels and it means that these variables do not contribute to the value-relevance of the accounting information measure of EPS.

Model II

Table 3 presents the multiple regression summaries. In this model the specification of five variables (board size, board independence, ownership structure, firm size and firm leverage) revealed the ability to predict the net assets value. The respective R2 value of 0.272 denotes that 27.2 % of the observed variability in net assets value can be explained by the differences in variables namely board size, board independence, ownership structure, firm size and firm leverage. The remaining 72.8 % is not explained which means that the remaining 72.8 % of the variance in the net assets value is related to other variables not depicted in this model.

Table 3: Coefficients for Predictors of Net Assets Value

Model	Beta	Standard Error	t value	Significant
Constant	-249.219	604.599	-.412	.681
Board size	-14.365	11.147	-1.289	.201
Board independence	-1000.505	275.760	-3.628	.000
Ownership structure	554.133	135.477	4.090	.000
Firm size	98.664	61.421	1.606	.112
Leverage	-479.281	151.089	-3.172	.002

$R^2 = 0.272$

Further, this model reveals that the coefficient for all three variables such as board independence, ownership structure and firm leverage are significant at the 0.05 level which indicates that these variables have a significant impact on net assets value. For the other two variables such as board size and firm size, t values are insignificant at the 0.05 level and it means that these variables do not contribute to the value-relevance of the accounting information measure of net assets value.

CONCLUSION

This study examined the impact of corporate governance on value relevance of accounting information of the listed Sri Lankan hotels and travels sector. The study covered 20 listed firms over the period 2012 to 2016 and the major findings of the study are summarized. Based on the multiple regression analysis hypothesis one is not supported. Therefore, there is no significant impact of board size on value relevance of accounting information in Sri Lanka. Further, hypotheses two and three are supported as board independence and ownership structure have a significant impact on value relevance of accounting information of the listed hotels and travels sector in Sri Lanka.

Regression results show that firms with strong corporate governance exhibit higher value-relevance of accounting information. Results further show that firm leverage is also an important determinant of value-relevance of accounting information. The implications of the study may help prevent corporate scandals which have become quite prominent and to gain investors' confidence in an organization. Bringing more independent directors on the board seems to be a good initiative in bringing impartial and objective opinions and decision making.

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