Value Relevance of Accounting Data and the Impact of Accounting and Corporate Governance Reforms: Evidence from an Emerging Market

by

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Abstract

Accounting and financial economics researchers have been trying to link accounting information to firm value since the seminal Ball and Brown (1968) study that found a significant market reaction to earnings announcements. The value relevance of the bottom lines of financial statements (net income and owners' equity) was later formalized and modeled by Ohlson (1995), and Feltham and Ohlson (1995). Their study gave rise to a proliferation of papers that empirically test their linear model which associates a firm's reported accounting numbers with its stock price. A more recent strand of research on corporate governance (CG) has found that capital flows to countries with better investor protection rights and to more transparent firms whose stock prices are set more efficiently (La Porta et al.,1997 and 2000). In this study, we propose to combine and contribute to these two strands of literature The idea that higher quality accounting numbers through the use of higher quality accounting standards, more extensive disclosure practices, and use of CG best practices reduce information asymmetry among investors and thus strengthen the association between security prices and accounting numbers forms the basis of our argument.

The first objective of our study is to investigate the association between the accounting bottom lines in the financial statements of ISE listed firms and their market value during the 1993–2005 period. Second, we explore how this association is affected by a series of voluntary and mandatory accounting and corporate governance reforms. We will specifically investigate the value relevance of general price level accounting and voluntary IFRS adoptions during the period 2003-2004. We will also explore the impact of the mandatory adoption of IFRS by all listed firms in 2005 and the CG Principles Compliance Reports required in the annual reports for the first time in 2004, and the Turkish Commercial Code which covers a broader range of CG mechanisms (if promulgated before we complete this study). We believe that these accounting and financial reporting reforms will help mitigate the most important agency problem in the ISE, the expropriation of minority shareholders by concentrated family owners, and thus are expected to enhance the value relevance of accounting information.

The study contributes to extant literature on value relevance and the recent global improvements in accounting, financial reporting and corporate governance. The results can be used to assess the usefulness of transparency, CG reforms and accounting harmonization in enhancing the informativeness of accounting numbers in an emerging market where expropriation by concentrated family ownership is the biggest agency problem. As such, they will be of interest to preparers of financial statements, international and local policy makers and regulators, including accounting standard setters, and investors at a time when debate on convergence to IFRS and other corporate governance reforms have become intense.

Keywords: Value relevance, net Income, book value of equity, accounting valuation models, disclosure, corporate governance