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FIRM SIZE, SHARE OWNERSHIP, FIRM VALUE AND CONDITIONAL CONSERVATISM

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ABSTRACT

Firms consider that the effect of conditional conservatism on earnings flow can be less persistent (consistent in the long run), and investors will encounter more difficulties to detect this type of conservatism. Conditional conservatism will impose costs and recognize losses in the period in which it occurs, on the contrary, it will recognize revenues and profits if it is actually realized, so that the resulting profits are lower in the period concerned. If it does not occur in the next period, or if there is a decrease in costs, or revenue has been realized, then the profit of the next period will be reported higher. Consequently, the profits reported by firms tend to be more volatile than firms that adhere to more optimistic accounting principles.

KEY WORDS

Conditional conservatism, firm size, share ownership.

The effect of accounting conservatism cannot be ascertained precisely without accurate measurement or representation, experts consider that models for measuring and operating accounting conservatism has evolved. There are several theories that support the concept of conservatism to increase the value of firms so that it has an impact on the implementation of good corporate governance in organizations and other stakeholders. First, agency theory, as explained by Jensen and Meckling (1976) who stated that there is an agency contract between the shareholders (principals) of an organization and management (agents). Jensen and Meckling stated that shareholders want to maximize income and wealth by receiving dividends and getting an increase in the value of their ownership while managers do not have an interest in shareholder goals but are related to receiving remuneration and all other benefits at the expense of shareholders. Therefore, in financial reporting, both parties are interested in ensuring that the financial statements are prepared according to their independent needs. Managers always want good news, not bad news. By adopting manager's accounting conservatism, managers are forced to report negative economic news as quickly as possible so as to reduce incentives and mitigate asymmetric information (Wei Shi and Haifen, 2016). Managers clearly dislike to provide conservative reporting because it minimizes the volume of returns and incentives received for managers. Therefore, accounting conservatism conflicts with the interests of principals and their agents.

Second, stakeholder theory as proposed by Freeman (1983) who stated that, depends on the organization being responsible not only to shareholders but also to other agents who are interested in the firm's operations and activities. Organizations must ensure both management and stakeholders through accurate financial reporting and timely reaction to sensitive issues for the benefit of the organization. In most cases, managers often show a good impression of financial users by giving a positive statement on financial statements. As a result, they tend to overestimate profits or delay reporting of negative economic news.

LITERATURE REVIEW

Agency theory explains that the interests of managers and the interests of shareholders are often conflicting; as a result, conflicts can occur between the two parties.

The main principle of this theory arises because of the working relationship between the shareholders (principal) and the management of the firm (agent) in the form of agreed cooperation in the form of a contract. Agency relations often lead to conflicts between the two parties. This relationship arises when the principal asks the agent to carry out several activities or jobs for the principal's interests which include delegation as the authority to make a decision. The authority and responsibility of the agent and principal are regulated in a work contract for mutual agreement.

According to Brigham and Houston, signal is an action taken by the firm to provide guidance to investors about how management views the firm's prospects. This signal is in the form of information about what has been done by management to realize the wishes of the owner. Information released by the firm is important because of its effect on investment decisions of parties outside the firm. This information is important for investors and business people because information essentially provides information, notes or descriptions, both for the past, present and future conditions for the survival of the firm and how it affects the firm.

Signalling theory is based on the assumption that the information received by each party is different. In other words, signalling theory is related to information asymmetry. Signalling theory shows the information asymmetry between the management of the firm and those with an interest in information. For this reason, managers need to provide information to interested parties through the issuance of financial statements. Signalling theory explains why firms have the urge to provide financial report information to external parties. The firm's drive to provide information is encouraged by information asymmetry between the firm and outsiders because the firm knows more about the profile of the firm and the prospects that will come than outside parties (investors and creditors).

Firm Size is a scale which can be classified as the size of the firm according to various ways, namely by total assets, log size, stock market value, and others. The size of the firm will affect the ability to bear the risks that may arise from various situations faced by the firm. The size of the firm is considered capable of influencing the firm value. Because the larger the size or scale of the firm, the easier it will be for firms to obtain both internal and external funding sources.

The firm value is very important because high firm value will be followed by the high prosperity of shareholders. The higher the stock price, the higher the firm value. The high value of the firm is the desire of the firm owners, because high value shows that the prosperity of shareholders is also high. The wealth of shareholders and firm is presented by the market price of shares which is a reflection of investment, financing and asset management decisions.

Share ownership structure is the proportion of institutional ownership and management ownership in a firm (Sujoko and Soebiantoro, 2007). Two types of ownership in the ownership structures are:

Institutional ownership is the number of shares owned by the institutional investors of the total number of shares outstanding. Beiner et al. (2003) stated that institutional ownership is the sum percentage of voting rights held by an institution. In this study, institutional ownership is measured using an indicator of the percentage of the total number of shares owned by an institution from all outstanding share capital, as has been used by several researchers such as; Clay (2002): Beiner et al. (2003); Shen et al. (2006); Cornertt et al. (2006); Bhattacharya and Graham (2007); Li and Zhao (2007); Lee (2008).

Managerial ownership shows the percentage of firm share ownership by the owner of the firm. Managerial ownership is proxied by the percentage of share ownership by directors and commissioners (Lafond and Watts, 2007). The bigger the percentage of shares ownership on the managerial side, they will work more proactively in order to be able to realize the interests of shareholders which ultimately will increase trusts, and then resulting in the rising value of the firm. Management ownership is expressed through the number of shares owned by management and the board of commissioners divided by the total number of shares of the firm.

Conservatism chooses financial principles that lead to the minimization of reported cumulative earnings, namely recognizing slower income, recognizing costs faster, valuing assets at lower values, and valuing liabilities at higher values. The level of financial conservatism is calculated through integrating the asymmetric timeliness of earnings measurement model (Basu, 2007), the asymmetric cash flow model for accruals measurement (Ball & Shivakumar, 2005), and the market to book ratio (Beaver & Ryan, 2000). Conditional conservatism is measured using the Basu (1997) regression model, the extent to which earnings reflect bad news faster than good news. Good news and bad news are based on firm stock returns.

METHODS OF RESEARCH

The population used in the study are companies listed on the Indonesia Stock Exchange in 2010-2017. The sample in this study are all companies listed on the Indonesia Stock Exchange from 2010-2017.

This study uses panel data which is a combination of time-series data and cross-section data. The research data used are quantitative in the form of ratio or interval data which is secondary data obtained and collected from various related sources. When viewed from the time of collection, the type of data in this study uses panel data (a combination of two time series data and cross section data) taken in the 2010-2017 period with research aids using Eviews. The data source used in this study is secondary data in the form of Annual Report from the Indonesia Capital Market Directory (ICMD) website www.ojk.go.id.

The population used in the study are companies listed on the Indonesia Stock Exchange from 2010 to 2017. While the sampling technique used is purposive sampling, which is the method of sampling using established criteria in accordance with the research objectives. The sample is part of the population that is considered to represent its characteristics. The criteria for sampling are as follows:

a. Companies listed on the Indonesia Stock Exchange from 2010 - 2017.
b. Active companies continuously distribute dividends from 2010-2017.

RESULTS AND DISCUSSION

Table 1 – Test Variable X to Conditional Conservatism

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.617069	0.064422	9.578587	0.0000
LN_TA	-0.114579	0.025086	-4.567439	0.0000
IO	-0.004755	0.002709	-1.755226	0.0816
MO	-0.045973	0.030075	-1.528594	0.1288

Table 2 – Test Variables X to Y (Tobins Q)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	11.78718	1.563160	7.540611	0.0000
LN_TA	-4.291083	0.565395	-7.589533	0.0000
IO	-0.037740	0.036234	-1.041565	0.2996
MO	-0.140790	0.523612	-0.268882	0.7885

The results of regression equations as follows:

Table 3 – Test Variables M to Y (Tobins Q)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	11.78718	1.563160	7.540611	0.0000
CONSERV_COND	29.52090	4.829555	6.112550	0.0000
CONSERV_UNCOND	-30.34247	3.766173	-8.056580	0.0000

Based on the above results:

- IO and MO variables have no effect on firm value;
- Ln TA and Conditional conservatism influences to firm value;
- Conditional Conservatism is mediate the effect of the Ln TA on Firm value.

The Effect of Conditional Conservatism as Mediation Between Firm Size and Firm Value

These findings indicate that both large firms and small firms will view financial statements as something that is conservative. Firms generally have high flexibility and accessibility in funding issues through the capital market. This convenience can be captured as good information. The size of a large and growing firm can reflect the level of future profits.

Conditions in Indonesia suggest that large firms may have higher tax rates, but large firms are also likely to obtain greater political benefits (favorable agreements with the government and import restrictions) as compensation for high tax rates. As for small-sized firms, it shows investors' perceptions that the firm is in trouble so that investors reduce the value of their shares.

In addition, the regulations issued by the government are in accordance with what is desired by the firm, so that government regulations can be used as a benchmark for firms to apply accounting conservatism.

The results of this study are in accordance with the size hypothesis. The size hypothesis is based on the assumption that large firms are more politically sensitive and have greater welfare transfer costs (political costs) than smaller firms. Large firms may have higher tax rates, but large firms may also get greater political benefits (favorable government agreements and import restrictions) as compensation for high tax rates. This means that the greater the political costs of a firm, the more likely a firm manager is to choose accounting procedures that defer reporting of current period earnings to future periods. In other words, large firms tend to reduce reported profits compared to small firms.

The Effect of Conditional Conservatism as a Mediation Between Share Ownership and Firm Value

Institutional ownership of shares does not necessarily make the institution able to carry out the function of monitoring the performance of the firm's management in carrying out the principles of conservatism for the preparation of financial statements. This condition explains that managers have given clear signals to users of financial statements to reduce information asymmetry. Managers do not provide information through financial statements. Managers should provide clear information about the condition of the firm including implementing conservative accounting policies that produce higher quality earnings because this principle prevents firms from exaggerating profits and helps users of financial statements by presenting earnings and assets that are not overstated. Conservatism has not been considered as a way that can prevent any attempt to transfer shareholder wealth to managers through excessive compensation.

The Effect of Firm size on Firm Value

These results prove the effect of firm size on the firm value, where the greater the size of the firm, then there is a tendency for more investors to pay attention to the firm. Large firms tend to have more stable conditions. This stability attracts investors to own the firm's shares. This condition is the cause of the rising price of the firm's shares in the capital market. Investors have great expectations for large firms.

The results of this study indicate that it is assumed that large firms experience a tendency to attract attention and become the public spotlight, so that it will encourage these firms to implement better corporate governance structures and mechanisms, thus firm size has a positive effect on firm value. The size of the firm will certainly have a positive effect on the level of profitability achieved by the firm, like the results of research conducted by Hall and Weiss (1967).

If the firm has a large total assets, it shows that the firm has reached the stage of maturity where the firm's cash flow is positive and is considered to have good prospects in a relatively long period of time in this stage, while also reflecting that the firm is relatively more stable and more able to generate profits compared to firms with small total assets.

The results of this study are also in line with agency theory which reveals that managers and shareholders have different goals. On the one hand, the welfare of shareholders depends solely on the market value of the firm, on the other hand, the welfare of managers is highly dependent on the size and risk of the firm's bankruptcy. As a result, managers are interested in investing in order to increase growth and reduce firm risk through diversification, although this may not always improve the welfare of shareholders (Bethel and Julia, 1993).

The Effect of Share Ownership on Firm value

Low managerial shareholding in a firm causes managers to not be able to make decisions based on their own desires. Management has no control in determining debt because many are controlled by the majority owner. The results of this study contradict the agency theory (Jensen & Meckling, 1976), which stated that the higher the ownership structure by the insider (management), the less the agency problem due to the more harmonious interests between managers and owners, most of whom are management themselves so that they can increase the firm value. This finding is related to the characteristics of public firms in Indonesia which have a relatively low proportion of managerial share ownership. Based on the data, the average managerial ownership is only 6.65%, as a result, there is no significant effect of managerial function in reducing agency problems because low ownership allows the integration of the interests of shareholders, and management interests can not be realized.

Share ownership indicated by institutional investors and is still believed to have the ability to monitor management actions better than individual investors. Institutions as shareholders are considered better able to detect mistakes that occur. If changes in current profits are not regarded to be beneficial to investors, investors can liquidate their shares.

Institutional investors usually have a large number of shares, so if they liquidate their shares, it will affect the overall value of the shares. To avoid liquidation from investors, managers will conduct earnings management. In addition, there is the view of institutional investors as experienced investors (sophisticated). This means that investors are more focused on future earnings, which is greater than current earnings. This study reinforces the statement of Sudarma (2004) that the institutional ownership of affiliated holding firms in Indonesia is still a family firm where the management of the firm is still part of the family firms.

The results of this study are consistent with Erkens et al (2012), high institutional ownership carries a great risk, where the level of loss of shareholders is higher. At a very high level of ownership, there is a tendency for institutional investors to impose certain non-optimal policies, ignoring the interests of minority shareholders through the power of voting they have. This is because the majority owner of the institution participates in the control of the firm, as a consequence, it tends to prioritize personal interests even at the expense of minority owners. According to Modligiani, there is information asymmetry between shareholders and managers, this is because managerial parties have more complete information than shareholders.

The Effect of Conditional Conservatism on Firm value

The results of this study found that conditional conservatism has an effect on firm value, meaning that the existence of conditional conservatism can have an impact on firm value. Fluctuations in earnings tend to be inconsistent and managers who are more opportunistic tend to not pay attention to the application of conditional conservatism. In addition, the more conservative the firm, the reported earnings tend to be irrelevant and do not present the actual situation. As a result, the earnings quality is biased due to understatement.

Firms consider that the effect of conditional conservatism on earnings flow can be less persistent (consistent in the long run), and investors will encounter more difficulties to detect this type of conservatism. Conditional conservatism will impose costs and recognize losses in the period in which it occurs, on the contrary, it will recognize revenues and profits if it is actually realized, so that the resulting profits are lower in the period concerned. If it does not occur in the next period, or if there is a decrease in costs, or revenue has been realized, then the profit of the next period will be reported higher. Consequently, the profits reported by firms tend to be more volatile than firms that adhere to more optimistic accounting principles. With the use of conditional conservatism in the firm, it will make profits tend to fluctuate or less persistent. This means that the higher the conditional conservatism, the lower the earnings quality reported.

CONCLUSION

In terms of firm size, the greater the size of the firm, the greater the attention given to the firm by the investors because investors assume that large firms tend to have more stable conditions and investors want to own firm shares, so as to increase the firm's stock price. In the eyes of investors, large firms tend to attract attention and become the public spotlight, which will encourage these firms to implement better corporate governance structures and mechanisms. Large firms may have higher tax rates, but they may also get greater political benefits (favorable government agreements and import restrictions) as compensation for high tax rates.

Firms with high share ownership can make the results of this study as a reference in the application of conservatism. Managerial ownership is the percentage of firm stock ownership by firm directors compared to the number of shares of the firm in circulation as a whole. The relationship between managerial ownership and conservatism occurs when the firm will make an investment that will affect the firm's profit. This is due to accounting conservatism that will make the firm to better recognize losses and delay the recognition of profits that can affect the manager's performance evaluation.

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