IFRS related party transactions disclosure and firm valuation in the United Arab Emirates emerging market

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Abstract

Purpose – The purpose of this paper is to investigate the relationship between related party transactions disclosure (*RPTD*) and firm valuation in the United Arab Emirates (UAE), an emerging market.

Design/methodology/approach – Data on study variables were obtained manually from the published financial statements of all listed companies in the stock market during the period 2008-2012. Panel regression analysis models with fixed and random effects were used to ensure reliability of results. Several robustness checks were undertaken on the study outcomes.

Findings – The empirical results show that there is a significant negative relationship between *RPTD* and firm valuation in the UAE. *RPTD*s for subsidiaries and associates have the most damaging impact on firm valuation. Other control variables such as corporate governance disclosure (*CGD*), debt to equity, asset tangibility and sales growth show significant impact on firm valuation.

Research limitations/implications – The potential difference in the understanding of what constitutes "related party" across companies may affect the extent of related party disclosure across companies. Furthermore, some variables are not controlled for such as ownership structure and cultural values.

Practical implications – This paper provides useful practical guidelines for regulatory agencies, corporate managers and other stakeholders for improving the financial reporting system.

Originality/value – *RPTD* was measured according to the International Financial Reporting Standards (IAS 24) standards. Furthermore, the impact of new control variables such as *CGD* and product market competition was tested for financial and non-financial sectors.

Keywords Disclosure, UAE, Firm valuation, Related party transactions

Paper type Research paper

1. Introduction

The issue of related party transactions has attracted more attention in recent years due to their controversial impact on shareholders' wealth. Some scholars have argued that related party transactions may produce benefits to a company through, for example, optimizing the allocation of company resources, reducing information asymmetry with other parties (Kohlbeck and Mayhew, 2010), better coordination among different activities and efficient enforcement of contracts (Yeh *et al.*, 2012). In contrast, other scholars have provided empirical evidence that these transactions may increase the potential risk of expropriation of shareholders' wealth and hence reduce firm valuation (Berkman *et al.*, 2009; Cheung *et al.*, 2006; Gordon *et al.*, 2006; Jian and Wong, 2010; Lin *et al.*, 2010; Nekhili and Cherif, 2011). This can be done through tunneling and/or "propping" of company resources. Tunneling is the transfer of resources out of a firm and toward the main shareholders, away from the minority shareholders (Johnson *et al.*, 2000), and "propping" is the process through which the main shareholders transfer their resources to firms within the same group (Friedman *et al.*, 2003). Both result in expropriation of company wealth away from minority shareholders. The main purpose of this paper is to investigate the impact of related party transactions disclosure (*RPTD*) on firm valuation using the International Financial Reporting Standards (IFRS) scheme.

JEL Classification — M40, M41

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This paper adds to the existing literature on financial disclosure practices in three ways. First, unlike previous studies, which used the frequency of occurrence and/or amount of related party transactions, this paper measures *RPTD* using a composite disclosure index based on IFRS (IAS 24) in a new Asian emerging market, the United Arab Emirates (UAE). The use of IFRS disclosure index can be a useful tool to improve comparisons between companies, resolve conflicting empirical results, streamline common understanding of related party transactions and promote convergence with IFRS especially in countries with flexible accounting regulations. The IFRS *RPTD* index was obtained from the accounting firm Klynveld, Peat, Marwick and Goerdeler International (KPMG, 2011). Second, it sheds some light on whether the relationship between related party transactions and firm valuation was affected by the extent of other types of financial disclosures among companies. Thus, corporate governance disclosure (*CGD*) was incorporated in comprehensive panel regression analysis models with fixed (random) effects for financial and non-financial sectors during a five-year time period. This paper also provides evidence according to the type of IFRS *RPTD*, and it uses several robustness checks to include the impact of changing business environment, unlike previous cross-sectional studies. Finally, new independent control variables such as product market competition were tested.

The UAE is an interesting business environment to study for several reasons. First, the local authorities have since 2007 been undergoing a new process to upgrade and enforce new corporate governance regulations; however, the code still provides some exemptions on certain *RPTD*. Thus, the enactment of a new corporate governance code provides an interesting opportunity to check the effectiveness of regulations in ensuring investors' confidence in the stock market and more specifically in related party transactions. Second, convergence toward IFRS practices is still in progress in the UAE due to, among other things, the regulatory environment. The local regulatory framework provides flexible commitment to a single set of high-quality international accounting standards such as the IFRS during the study period (Commercial Companies Law, 1984). Consequently, both regulators and auditors are able to ensure compliance with IFRS within the boundaries of relevant laws and regulations. Thus, this paper provides support to the recent regulatory amendments (Commercial Companies Law, 2015), which mandate all companies to implement the IFRS in preparing their financial reports. Third, there are two stock markets in the UAE: Dubai stock market (DFM) and Abu Dhabi Securities Exchange (ADX). Both markets follow quite similar regulations and are supervised by the UAE Securities and Commodities Authority. More recently, the Dubai stock market has managed to integrate with the Morgan Stanley Capital International index for emerging markets. Such integration requires more corporate financial disclosure initiatives to maintain investor confidence in the stock market and ensure a continuous flow of foreign direct investments in the future. The empirical results in this paper show that *RPTD* is significantly negatively related to firm valuation in the UAE stock market. *RPTD*s for subsidiaries and associates have the most damaging impact on firm valuation. Other control variables such as *CGD*, debt to equity, asset tangibility and sales growth showed significant impact on firm valuation. The remainder of the paper is structured as follows. Section 2 presents the theoretical and empirical literature review and sets out the hypothesis to be tested. Section 3 discusses the data collection and the statistical methodology used. The discussion of the empirical results is presented in Section 4. The robustness checks are provided in Section 5. Finally, Section 6 provides conclusions and recommendations for respective stakeholders and relevant future research.

2. Background and hypothesis development

2.1 Theoretical framework

This paper utilized the multi-theoretical framework of the agency theory, information asymmetry theory and signaling theory, which provide economic explanations for the extent of corporate disclosure practices (Healy and Palepu, 2001; Watts and Zimmerman, 1986).

The agency theory (Jensen and Meckling, 1976) predicted that there is a conflict of interest between corporate management (agent) and shareholders (principle) due to the separation of ownership and control. This conflict creates agency problems and gives rise to agency costs as corporate management may expropriate company resources to achieve private benefits away from the interests of equity holders (Jensen and Meckling, 1976), using several tools such as related party transactions. Corporate governance mechanisms and formal contracts, as suggested by Jensen and Meckling (1976), can be used to overcome the agency problem, align the interests of both parties and achieve corporate goals and objectives. However, certain scholars argue that the diversity of agency problems and high cost of enforcement may undermine the use of formal contracts in practice (Klein, 1983). In the same vein, the information asymmetry theory suggested that the agency conflict may give rise to an unequal distribution of information among corporate management and other stakeholders, which can create problems such as adverse selection and moral hazard (Akerlof, 1970; Wilson, 1987). Akerlof (1970) argued that the existence of asymmetric information among transacting parties tend to decrease the average prices of products and services. Information asymmetry can encourage dishonest sellers to deceive certain business transactions, and consequently risk-averse buyers may avoid these transactions or discount their market value (Akerlof, 1970). To overcome this asymmetry, the signaling theory (Akerlof, 1970; Spence, 1973) suggested that corporate management can disclose information to signal their managerial and financial strength, alignment of interests with shareholders, reduce agency costs and leverage firm valuation (Healy and Palepu, 2001; Lundholm and Winkle, 2006). Based on this theoretical framework, it can be argued that misuse of related party transactions and/or the existence of flexible disclosure requirements may increase the agency problem and create more information asymmetry between management and shareholders. This problem can contribute to the imbalance of power in business transactions, biased business transactions and may encourage risk-averse investors to discount stock prices.

2.2 Empirical evidence

Previous empirical studies showed controversial results pertaining to the economic consequences of related party transactions. The overall outcome seems to show that effective articulation and enforcement of relevant regulations, nature of related party transactions and market conditions play a key role on firm valuation across countries. Certain scholars support the notion that related party transactions represent efficient market exchanges away from any expropriation of company resources (Gordon *et al.*, 2007). It is argued that these transactions can reduce transactions costs (Fan and Goyal, 2006) and improve allocation of financial resources (Khanna and Palepu, 1997) and economies of scale (Fisman and Khanna, 2004), especially in developing countries which may suffer from market imperfections (Pizzo, 2013). For example, Moscariello (2012) showed a very weak relationship between related party transactions and management opportunistic behavior, suggesting that the existence of strong regulations in Italy prevents such behavior, compared with France and Germany regulations. More recently, Kim *et al.* (2015) showed insignificant relationship between abnormal related party transactions and tax avoidance in Korea. Furthermore, Downs *et al.* (2016) found no evidence that real estate investment trusts managers and sponsors use related party transactions to gain private benefits away from minority shareholders in Hong Kong, Malaysia and Singapore.

In contrast, other scholars provide evidence that related party transactions involve conflict of interest between management and shareholders. Consistent with the agency problem, these transactions are considered as harmful exchanges involving expropriation of company resources away from shareholders interest. Several empirical results support this notion by showing evidence on the relationship between related party transactions, earnings management (Jian and Wong, 2010), low firm performance (Wan and Wong, 2015), high

audit fees (Habib *et al.*, 2015), abnormal stock returns (Cheung *et al.*, 2006), lower firm valuation (Gordon *et al.*, 2006; Kohlbeck and Mayhew, 2010; Nekhili and Cherif, 2011) and loans management (Cullinan *et al.*, 2006). For example, Kohlbeck and Mayhew (2010) found that companies with related party transactions have significantly lower valuations and marginally lower subsequent returns than companies without these transactions prior to the Sarbanes-Oxley Act (2002) in the USA. Cheung *et al.* (2006) found that companies disclosing related party transactions earn on average significant negative market adjusted abnormal returns due to differences in the legal systems between Hong Kong and China. Similarly, Nekhili and Cherif (2011) found that the frequency of related party transactions has a damaging impact on companies' market value in a weak minority shareholders protection environment like France.

More recent stream of studies focused on factors moderating the relationship between related party transactions on firm valuation such as government ownership, tax avoidance incentives and percentage of parent directors (Kim *et al.*, 2015), and ownership concentration (Minjung *et al.*, 2014). For example, Du *et al.* (2013) found that controlling shareholders perform related party transactions that lead to losses in firm valuation and depressed stock prices in Hong Kong. The overall empirical evidence on the negative role played by related party transactions in expropriation of shareholders wealth coupled with the recent corporate financial scandals such as Enron creates fertile ground for public misperception of these transactions and leads to regulatory sanctions to protect shareholders wealth (Pizzo, 2013). However, certain scholars argue that these regulations may be insufficient to guard company resources and call for additional advanced enforcement measures such as specialized courts, anti-tunneling social norms (Enriques, 2015) and effective corporate governance mechanisms to reduce information asymmetry and agency costs (Goldberg *et al.*, 2016).

Therefore, based on previous literature presented, the following is hypothesized:

H1. There is a significant negative relationship between *RPTD* and firm valuation in the UAE stock markets.

3. Data and methodology

An unbalanced panel data set was used which includes all active listed companies in the Dubai stock Market (DFM) and ADX (108 companies) during the period 2008-2012. Data on all study variables were collected manually from the annual published financial statements. The data set contains a total of 540 observations, with $n = 445$ being valid due to missing data. Foreign companies listed on the stock market were excluded to ensure consistency of results. Previous studies measured *RPTD* by number, value (Gordon *et al.*, 2006) or using dummy variables (Cheung *et al.*, 2006; Kohlbeck and Mayhew, 2010). In contrast, *RPTD* (independent variable) in this paper was measured using the IFRS (IAS 24) standards, obtained from KPMG (2011), to improve comparisons across companies, avoid conflicting empirical results and encourage convergence with international accounting standards. The IFRS (IAS 24) disclosure index consists of 78 items divided into ten different categories: general information, transactions with parent, entities with joint control, subsidiaries, associates, joint ventures, key management personnel, post-employment benefit plans, other related parties and government-related entities (Appendix). Each item takes a value of 0, 1, 2 or 3 points based on the disclosure details provided. The IFRS (IAS 24) disclosure index Cronbach's α coefficient showed a value of 0.79, above the acceptable benchmark of 0.70 (Barako *et al.*, 2006), which supports the internal consistency of the index as a measure for related party transactions in the UAE stock markets. Furthermore, three independent academics were asked to construct the index using a random sample of listed companies' financial statements, and their results were qualitatively similar to the study indices. The dependent variable firm value (*lnMVBV*) was represented by Tobin's *Q* ratio (Nekhili and

Cherif, 2011). This measure reflects the market perception of company performance, rather than accounting-based measures, which may suffer from management discretion. It therefore provides a more accurate picture of future operational status (Chen *et al.*, 2009). Tobin's *Q* was measured as the market value of the firm divided by the book value of total assets at the end of December of each year, as all listed companies are required to follow a calendar accounting period. However, this measure should be dealt with some caution as the UAE stock market is characterized by a weak-form market efficiency (Marashdeh and Shrestha, 2008). This implies that stock prices may not reflect all the relevant information in the market which may place some doubts on the validity of market prices as a measure of value.

Other control variables include the following: *CGD*, leverage (*DE*), assets tangibility (*TANG*), natural logarithm of sales growth (*lnSG*), firm profitability (*PL*), dividend payments (*DIV*), product market competition (*PMC*) and industry type (*IND*). *CGD* was measured using a composite index of 42 items, based on previous empirical studies, obtained from ElKelish and Hassan (2015). Similar to the *RPTD* index, the *CGD* index was articulated and validated manually from the financial statements of all listed companies in the UAE. Previous empirical studies showed that *DE* can be used to expropriate funds from minority shareholders by diverting favorable loans to members of the same group (Faccio *et al.*, 2003), and may be used to increase the level of earnings management to maintain a steady level of company performance (DeFond and Jiambalvo, 1994; Hwang *et al.*, 2013). In contrast, other scholars have argued that debt financing can be used to discipline the opportunistic behavior of managers (Gordon *et al.*, 2006) as loan agreements usually include terms which oblige the management to maintain a certain level of operational performance (Chen *et al.*, 2009) and to comply with debt covenants (DeFond and Jiambalvo, 1994). Assets tangibility (*TANG*) was used to represent the fixed component of total assets in the financial statement. Previous studies have found that disclosure is related to growth opportunities and external financial needs (Durnev and Kim, 2005). *TANG*, *lnSG*, *PL* and *DIV* were therefore implemented to control for firms' ability to offset share mispricing and uninformed investor speculations. Some previous studies stressed that *PMC* influences costs and benefits of monitoring company performance (Karuna, 2010) and hence can increase financial disclosure and reduce agency and transaction costs (Williamson, 1975). In contrast, other scholars have argued that *PMC* can result in high proprietary cost which may constrain financial disclosure (Hail *et al.*, 2010). Industry type (*IND*) is a dummy variable used to control for expected variations in IFRS disclosure implementation and to avoid creating confounding effects due to the nature of related party transactions in different industries (Ge *et al.*, 2010). The ownership structure control variable was not included in the model due to unavailability of a complete time series data set, a limitation that needs to be addressed in future research. A list of study variables' labels and definitions is provided in Table I.

The general multiple linear regression analysis model (OLS) specification is as follows:

$$lnMVBV_{it} = \alpha + \beta_1(RPTD)_{it} + \beta_2(CGD)_{it} + \beta_3(DE)_{it} + \beta_4(TANG)_{it} + \beta_5(lnSG)_{it} + \beta_6(PL)_{it} + \beta_7(DIV)_{it} + \beta_8(PMC)_{it} + \beta_9(IND)_{it} + \varepsilon_{it} \quad (1)$$

where *lnMVBV* is the natural logarithm of firm value, *RPTD* the related party transactions disclosure, *CGD* the corporate governance disclosure, *DE* the company leverage (debt to equity ratio), *TANG* the assets tangibility, *lnSG* the natural logarithm of sales growth, *PL* the firm profitability (dummy variable 1 for profitable firms or 0 otherwise), *DIV* the dividend payments (dummy variable 1 for dividend payment or 0 otherwise), *PMC* the product market competition, *IND* the industry type (dummy variable 1 for financial services or 0 otherwise), *it* represents firm (*i*) at time period (*t*) and ε the error term.

Variables[a]	Definitions
lnMVBV	Natural logarithm of firm value represented by Tobin's *Q* (firm market value divided by total book assets as on December 31)
RPTD	Related party transactions disclosure based on IFRS (IAS 24)
CGD	Corporate governance disclosure
DE	Company leverage (total liabilities divided by total equity)
TANG	Asset tangibility (total fixed assets divided by total assets)
lnSG	Natural logarithm of sales growth $(sales_t - sales_{t-1})/sales_{t-1}$
PL	Firm profitability (dummy variable of 1 for profitable firms or 0 otherwise)
DIV	Dividends payment (dummy variable of 1 for dividend payment or 0 otherwise)
PMC	Product market competition (firm sales divided by industry sales)
IND	Industry type (dummy variable of 1 for financial services or 0 otherwise)

Note: [a]All variables are firm-level data

Table I.
Summary of variables

The panel regression analysis model was applied with fixed and random effects to increase the robustness of the results. The natural logarithm transformation was used in some variables to improve the regression's fit and to reduce any simultaneity bias.

4. Empirical results and discussion

4.1 Descriptive statistics and correlations

The study variables' descriptive statistics in Table II show a large range of mean and standard deviation values, which reduces the possibility of sample selection bias. For example, the mean values range from 18.20 for *CGD* to −0.96 for *lnMVBV*, while the standard deviation values range from 6.17 for *RPTD* to 0.22 for *PMC*. More specifically, the high mean and standard deviation values for *RPTD* justify the use of the industry dummy variable to highlight disclosure differences between industries.

The correlation matrix for the study variables is shown in Table III. The *lnMVBV* (the dependent variable) showed significant correlation with several explanatory and control variables, including *RPTD*, *CGD*, *DE*, *TANG*, *PMC* and *IND* at different levels of significance. The results showed a significant positive relationship between *RPTD* and *CGD* at the 1 percent level which indicates that companies which disclose more information on *RPTD* usually do the same for *CGD*. There was no significant sign of multicollinearity between the explanatory variables, as all variables were below the correlation coefficient benchmark of 0.80 (Kennedy, 2008).

Variables	*n*	Minimum	Maximum	Mean	SD
lnMVBV	464	−3.47	1.42	−0.966	0.90
RPTD	524	1.00	35.00	12.23	6.17
GCD	519	6.00	33.00	18.20	5.85
DE	522	0.00	14.77	2.08	2.44
TANG	520	0.00	1.32	0.38	0.30
lnSG	496	−1.69	1.94	0.04	0.38
PL	525	0.00	1.00	0.83	0.37
DIV	526	0.00	1.00	0.59	0.49
PMC	506	0.00	1.00	0.11	0.22
IND	540	0.00	1.00	0.24	0.42

Notes: *lnMVBV*, natural logarithm of firm value; *RPTD*, related party transactions disclosure; *DE*, natural logarithm of company leverage; *TANG*, assets tangibility; *lnSG*, natural logarithm of sales growth; *PL*, company profitability; *DIV*, dividends payment; *PMC*, product market competition; *IND*, industry type

Table II.
Descriptive statistics

	lnMVBV	*RPTD*	*CGD*	*DE*	*TANG*	*lnSG*	*PL*	*DIV*	*PMC*	*IND*
lnMVBV	1									
RPTD	−0.40***	1								
CGD	−0.23***	0.32***	1							
DE	−0.63***	0.42***	0.06	1						
TANG	0.22***	−0.11***	0.04	−0.48***	1					
lnSG	0.04	0.03	−0.00	0.08**	−0.03	1				
PL	−0.07	0.06	0.01	0.14***	−0.08	0.08	1			
DIV	−0.00	0.07	0.15***	0.08**	−0.04	0.11**	0.37***	1		
PMC	0.10**	0.08	0.11**	−0.16***	0.24***	0.12***	0.08**	0.00	1	
IND	−0.47**	0.30***	0.01	0.68***	−0.56***	0.03	0.10**	0.12	−0.20***	1

Notes: *lnMVBV*, natural logarithm of firm value; *RPTD*, related party transactions disclosure; *DE*, natural logarithm of company leverage; *TANG*, assets tangibility; *lnSG*, natural logarithm of sales growth; *PL*, company profitability; *DIV*, dividends payment; *PMC*, product market competition; *IND*, industry type. Correlation coefficients are provided. **,***Correlation is significant at the 5 and 1 percent levels, respectively, in a two-tailed test

Table III. Correlation matrix

4.2 The regression analysis model

The multiple regression analysis (OLS) was used to estimate the firm valuation model, as given in Table IV (Model 1). The results revealed significant negative relationships between *lnMVBV* and *RPTD, DE, TANG* and *IND* at the 1 percent level, and a significant positive relationship with *lnSG* at the 5 percent level. The overall model has an adjusted R^2 of 0.43, with significant *F*-statistic at the 1 percent level. Therefore, *H1* is not rejected. This implies that local market participants discount firms with related party transactions, which is consistent with previous empirical studies prior to regulatory intervention in the USA (Kohlbeck and Mayhew, 2010) and in a country with low minority shareholders protection such as France (Nekhili and Cherif, 2011). This implies that related party transactions may be

	lnMVBV			
	Model 1	Model 2	Model 3	Model 4
Constant	−0.106 (−0.811)	0.343−(2.16)**	−0.417 (−1.22)	0.386 (2.18)**
RPTD	−0.152 (−3.78)***	−0.082 (−1.96)*	0.042 (0.472)	−0.113 (−2.17)**
			−0.07 −0.097	
CGD		−0.183 (−4.86)***	−0.097 (−1.21)	−0.231 (−4.60)***
DE	−0.549 (−10.38)***	−0.566 (−10.91)***	−0.618 (−6.89)***	−0.386 (−7.65)***
TANG	−0.135 (−2.92)***	−0.413 (−3.13)***	−0.023 (−0.284)	−0.143 (−2.98)***
lnSG	0.077 (2.12)**	0.067 (1.87)*	−0.049 (−0.673)	0.127 (2.63)***
PL	−0.008 (−0.209)	−0.019 (−0.499)	0.052 (0.602)	−0.017 (−0.339)
				0.139 (2.75)***
DIV	0.063 (1.64)	0.080 (2.09)**	−0.080 (−0.974)	0.139 (2.75)***
PMC	0.016 (0.424)	0.026 (0.694)	−0.204 (−2.40)**	0.042 (0.845)
IND	−0.139 (−2.61)***	−0.151 (−2.86)***		
R^2	0.44	0.47	0.49	0.30
Adjusted R^2	0.43	0.46	0.45	0.29
Durbin-Watson	1.98	2.0	2.0	2.12
F-statistic (*p*-value)	0.00***	0.00***	0.00***	0.00***
Max./Min. VIF	2.22/1.03	2.25/1.03	1.68/1.31	1.22/1.04
Valid *n*	445	439	116	323

Notes: VIF, value inflation factor. *n*, number of observations; *lnMVBV*, natural logarithm of firm value; *RPTD*, related party transactions disclosure; *CGD*, corporate governance disclosure; *DE*, company leverage; *TANG*, assets tangibility; *lnSG*, natural logarithm of sales growth; *PL*, company profitability; *DIV*, dividends payment; *PMC*, product market competition; *IND*, industry type. Standardized β coefficients are provided. *t*-Values are given in parentheses. *,**,***Significant at 10, 5 and 1 percent levels, respectively, in a two-tailed test

Table IV. Multiple linear regression analysis model (OLS) and dependent variable: firm value (*lnMVBV*)

used for expropriation of company resources (Yeh *et al.*, 2012), and/or flexible compliance with IFRS may initiate more concerns on the misuse of these transactions. Model 2 incorporated the impact of *CGD* on firm valuation. Results showed that *CGD* has a significant negative impact on *LnMVBV* at the 1 percent level, while *RPTD* maintained its significant negative sign at the 10 percent. The overall model showed an increase in the adjusted R^2 to 0.46 with significant *F*-statistic at the 1 percent level. The industry type (*IND*) showed significant negative impact on *lnMVBV* at 1 percent level in both Models 1 and 2 which highlighted the need to run the regression models separately for both financial and non-financial sectors. Results revealed that a significant negative impact of *RPTD* on firm valuation in the non-financial sector (Model 4) at 5 percent level, while the financial sector (Model 3) showed no significant relationship between *RPTD* and firm valuation. This may reflect the high level of regulation and supervision imposed by the regulatory authorities (e.g. UAE Central Bank) on the financial sector compared to the non-financial sector and provides support for more enforcement of IFRS (IAS 24) on listed companies in the UAE stock markets.

Furthermore, the multiple regression analysis was repeated for each type of IFRS (IAS 24) *RPTD* (Appendix). Results in Table V (Model 1) showed that *RPTD* with subsidiaries (*T4*) and *RPTD* with associates (*T5*) have the most significant negative impact

	lnMVBV		
	Model 1	Model 2	Model 3
Constant	−0.01 (−0.05)	−0.47 (−1.24)	−0.03 (−0.15)
T1	−0.05 (−1.29)	−0.06 (−0.77)	−0.04 (−0.86)
T2	−0.02 (−0.70)	0.05 (0.58)	−0.05 (−1.02)
T3	−0.05 (−1.50)	−0.05 (−0.70)	−0.07 (−1.57)
T4	−0.06 (−1.75)*	−0.01 (−0.18)	−0.08 (−1.41)
T5	−0.10 (−2.84)***	−0.05 (−0.62)	−0.12 (−2.28)**
T6	−0.06 (−1.64)	0.14 (1.32)	−0.08 (−1.57)
T7	0.06 (1.58)	0.03 (0.37)	0.07 (1.60)
T9	0.05 (1.51)	0.11 (1.45)	0.04 (0.94)
T10	−0.05 (−1.34)	−0.00 (−0.02)	−0.09 (−1.78)*
CGD	−0.16 (−4.48)***	−0.09 (−1.04)	−0.21 (−4.22)***
DE	−0.52 (−9.55)***	−0.61 (−6.15)***	−0.34 (−5.70)***
TANG	−0.06 (−1.39)	−0.03 (−0.45)	−0.07 (−1.38)
lnSG	0.06 (1.74)*	−0.06 (−0.84)	0.11 (2.34)**
PL	−0.00 (−0.09)	0.05 (0.55)	.00 (0.04)
DIV	0.07 (2.00)**	−0.05 (−0.68)	0.14 (2.69)***
PMC	0.06 (1.69)*	−0.26 (−2.15)**	0.08 (1.71)*
IND	−0.13 (−2.53)***		
R^2	0.51	0.52	0.35
Adjusted R^2	0.49	0.44	0.32
Durbin-Watson	2.01	1.95	2.15
F-statistic (*p*-value)	0.00***	0.00***	0.00***
Max./Min. VIF	2.62/1.04	3.05/1.09	1.69/1.08
Valid *n*	439	116	323

Notes: *n*, number of observations; *lnMVBV*, natural logarithm of firm value; *T1*, General information; *T2*, transactions with parent; *T3*, transactions with entities with joint control; *T4*, transactions with subsidiaries; *T5*, transactions with associates; *T6*, transactions with joint ventures; *T7*, transactions with key management personnel; *T8*, transactions with post-employment benefit plans; *T9*, transactions with other related parties; *T10*, transactions with government-related entities; *CGD*, corporate governance disclosure; *DE*, company leverage; *TANG*, assets tangibility; *lnSG*, natural logarithm of sales growth; *PL*, company profitability; *DIV*, dividends payment; *PMC*, product market competition; *IND*, industry type. Standardized β coefficients are provided. *t*-Values are given in parentheses *T8* is excluded from the model due to missing values. *,**,***Significant at 10, 5 and 1 percent levels, respectively, in a two-tailed test

Table V.
Multiple linear regression analysis model (OLS) for each *RPTD* type and dependent variable: firm value (*lnMVBV*)

on *lnMVBV* at 10 and 1 percent level, respectively. The overall model has an adjusted R^2 of 0.49 with significant *F*-statistic at the 1 percent level. Such damaging impact on *lnMVBV* was more pronounced in the non-financial sector rather than the financial sector. The non-financial sector (Model 3) showed significant negative relationship between *RPTD* with associates (*T5*), government-related entities (*T10*) and *lnMVBV* at 5 and 10 percent level, respectively, which is consistent with the results in Table IV.

Overall, it seems that the existence of flexible IFRS enforcement and low protection of minority shareholders (Johnson *et al.*, 2000; La Porta *et al.*, 1998) may encourage listed companies to engage in related party transactions regardless of their potential side effects on firm valuation in the UAE. At the same time, investors continue to reduce firm value as related party transactions may be used to expropriate company resources and/or their inability to assess these transactions due to lack of disclosure. Therefore, it is suggested that regulators should require more compliance with IFRS requirements to ensure adequate disclosure, give more power to external auditors to ensure compliance with IFRS standards and place sanctions on corporate management and/or auditors' professional misconduct. These measures may alleviate investors' negative perception of related party transactions, provide better tools to evaluate the impact of these transactions on corporate resources and ensure fairness through arm's length transactions. In the same vein, corporate managers need to use good corporate governance and internal control mechanisms on related party transactions to increase investors' confidence in the financial reporting system (Chen *et al.*, 2009; Nekhili and Cherif, 2011).

Other control variables showed significant impact on firm valuation on different confidence levels (Table IV, Model 4). *DE* has the highest significant negative impact on firm valuation at the 1 percent level, since debt financing can be used in earnings management (Hwang *et al.*, 2013) and to expropriate funds from minority shareholders (Faccio *et al.*, 2003). The results also reflected the significant impact of *TANG* and *lnSG* on *lnMVBV* at the 1 and 5 percent levels, respectively. *IND* showed a significant negative impact on *lnMVBV* at the 1 percent level, which highlighted the sensitivity of the financial sector to *RPTD* during the period of study. *PMC* has a significant negative relationship with firm valuation only in the financial sector in Table IV (Model 3). The model diagnostic tests for all models showed no sign of multicollinearity among the control variables, with Variance Inflation Factors within the acceptable limits of five degrees (Studenmund, 2006). The Durban-Watson statistic showed no sign of autocorrelation with values around the acceptable benchmark of 2.00 (Studenmund, 2006). The Goldfeld Quandt test indicated no significant sign of heteroscedasticity of residuals.

5. Robustness checks

A number of tests were conducted to check on the reliability of the regression models estimated. First, a panel regression analysis model was conducted using fixed firm and year effects (EFM). The results in Models 1, 2 and 3 in Table VI were qualitatively similar to those given in Table IV, with *RPTD* showing a significant negative relationship with *lnMVBV* at the 5 and 10 percent levels. Furthermore, the panel regression analysis with random effects (RAN) was implemented, and results were qualitatively similar to those given in Table IV (results are not shown for reasons of brevity).

Second, two alternative measures were used as a proxy for firm valuation. These were return on equity (*ROE*) and return on assets (*ROA*). The empirical results using regression models (OLS) were qualitatively similar to those given in Table IV. *RPTD* has a significant negative relationship with *ROE* and *ROA* at the 10 and 5 percent level, respectively. In addition, the Hausman test statistic for potential endogeneity between *RPTD* and firm valuation was conducted. Two separate simultaneous equations were identified to measure both *lnMVBV* and *RPTD*. The results showed that *lnMVBV* fitted value term is

	lnMVBV		
	Model 1	Model 2	Model 3
Constant	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
RPTD	−0.01 (−2.05)**	−0.01 (−1.93)*	−0.01 (−2.01)**
CGD	−0.02 (−1.89)*	−0.02 (−4.88)***	−0.02 (−1.96)**
DE	−0.24 (−9.89)***	−0.20 (−10.87)***	−0.24 (−9.91)***
TANG	−0.49 (−3.17)***	−0.42 (−3.11)***	−0.49 (−3.15)***
lnSG	0.14 (1.30)	0.16 (1.81)*	0.13 (1.24)
PL	−0.14 (−1.23)	−0.05 (−0.50)	−0.15 (−1.29)
DIV	0.17 (1.99)**	0.15 (2.10)**	0.17 (2.01)**
PMC	−0.03 (−0.22)	0.10 (0.70)	−0.03 (−0.22)
IND	−0.23 (−1.77)*	−0.31 (−2.89)***	−0.23 (−1.76)*
Fixed effects	Firm	Year	Firm/year
R^2	0.59	0.47	0.59
Adjusted R^2	0.44	0.46	0.44
Log likelihood	−383.20	−436.17	−380.95
F-statistic (*p*-value)	0.00***	0.00***	0.00***
Valid *n*	439	439	439

Table VI.
Panel regression analysis with fixed effects model (FEM) and dependent variable: firm value (*lnMVBV*)

Notes: *n*, number of observations; *lnMVBV*, natural logarithm of firm value; *RPTD*, related party transactions disclosure; *CGD*, corporate governance disclosure; *DE*, company leverage; *TANG*, assets tangibility; *lnSG*, natural logarithm of sales growth; *PL*, company profitability; *DIV*, dividends payment; *PMC*, product market competition; *IND*, industry type. Standardized coefficients are provided. *t*-Values are given in parentheses. *,**,***Significant at 10, 5 and 1 percent levels, respectively, in a two-tailed test

insignificant in the *RPTD* equation. The Wu/Hausman specification test has insignificant *F*-value of 4.42, and thus, *lnMVBV* can be considered as exogenous to *RPTD* (Brooks, 2009). In contrast, *RPTD* fitted value term is significant in the *lnMVBV* equation at the 1 percent level. The Wu/Hausman specification test has significant *F*-value of 94.56 at 1 percent level. This implies that *lnMVBV* is a function of *RPTD* but not the contrary (Brooks, 2009). Also, the regression analysis model (OLS) was repeated using the *RPTD* variable but with a lag of one period. An independent variable with a lag period can improve any potential endogeneity with the dependent variable (Yeh *et al.*, 2012). Results showed that *RPTD* has a significant β coefficient of −0.017 at the 1 percent level.

Other robustness checks

Some additional robustness checks were conducted to increase reliability of outcomes (results are not shown for reasons of brevity). The regression analysis model (OLS) was repeated after inclusion of a seasonal dummy variable to take into consideration the impact of the financial crises in 2008. The seasonal dummy variable takes value of 1 for year 2008 or 0 otherwise. Results showed that the seasonal dummy variable is insignificant, while other results were qualitatively similar to those given in Table IV. Two additional control variables were implemented in the regression analysis model (OLS): turnover value and turnover volume. Results showed that turnover value was insignificant while turnover volume was significant at 5 percent level, and other results were qualitatively similar to those given in Table IV. The top and bottom 2 percent of the sample size were dropped to avoid the impact of any outliers (Hwang *et al.*, 2013). Then, the regression analysis model (OLS) was repeated, and the results were qualitatively similar to those given in Table IV. Firms were divided into two groups according to the extent of their *RPTD* level. The arithmetic mean of 12.23 in Table II was used as a cut-off point to separate companies into high and low *RPTD* levels. Firm valuation was then compared between the two groups (Hwang *et al.*, 2013). The regression analysis (OLS) for the high disclosure group of firms showed a significant negative relationship

with firm valuation, with a β coefficient of −0.154 at the 1 percent level, while the low disclosure group showed no significant relationship with firm valuation. This implies that the negative impact on firm valuation is driven more by firms with high *RPTD* than those with lower levels. Finally, the regression analysis (OLS) was repeated after deleting firms which were generating losses, to avoid the impact of negative earnings (Ge *et al.*, 2010), and the results showed a significant negative *RPTD* with a β coefficient of −0.118 at the 1 percent level.

6. Conclusion

Recent accounting literature has showed more interest in related party transactions and firm valuation due to the complex effect of these transactions on shareholders' wealth. This paper investigates the relationship between *RPTD* and firm valuation in the UAE, an emerging market. Empirical results revealed that there is a significant negative relationship between IFRS related party transaction disclosure and firm valuation. This is consistent with previous empirical studies which showed investors reduce companies with related party transactions prior to regulatory intervention in the USA (Kohlbeck and Mayhew, 2010) and in a country with low minority shareholders protection like France (Nekhili and Cherif, 2011). *RPTD* for subsidiaries and associates have the most damaging impact on firm valuation. Other control variables such as *CGD*, debt to equity, asset tangibility and sales growth showed a significant impact on firm valuation. Product market competition has a significant negative impact on firm valuation only in the financial sector. This paper provides an evidence on the behavioral deviations from the theoretical stances of the agency theory in terms of investors' reaction to *RPTD* in the UAE stock markets. The negative relationship between *RPTD* and firm valuation may be due to the use of related party transactions to expropriate company resources away from equity interests and/or flexible compliance with IFRS may initiate more concerns on the misuse of these transactions. Furthermore, the existence of a relatively low level of minority shareholders' protection in the UAE stock markets may encourage corporate management and/or major shareholders to increase related party transactions regardless of their negative impact on firm valuation. Thus, this paper has several practical implications for regulatory agencies, corporate management and other stakeholders. Regulators need to enhance the mandatory rules to provide more comprehensive disclosure and monitoring frameworks on related party transactions and their potential influence on minority shareholders based on IFRS (IAS 24) standards and strengthen the power of the audit industry to ensure compliance with IFRS requirements. Corporate management should take into consideration the potential cost and benefits of related party transactions, articulate and disclose formal related party transactions policy and procedures, and improve the disclosure content and format for relevant related party transaction in line with the IFRS (IAS 24) standards to avoid investors' negative expectation. This study has some limitations which need to be considered in future studies. First, although many listed companies follow the definition of "related party transactions" as mentioned in IFRS (IAS 24), there may be some differences in the understanding of what is meant by "related party" across companies which can affect the extent of disclosure in the financial reports. Second, the UAE stock market is characterized by a weak-form market efficiency which may encourage biased deviations in stock prices. Third, the paper did not control for some variables due to limited data sources such as ownership structure and cultural values. Furthermore, future studies should compare the impact of related party transactions before and after the enactment of the new companies Law (2015) to highlight the importance of IFRS enforcement, the potential link between related party transactions and expropriation of company resources and extend to other countries within the IFRS (IAS 24) scheme to increase the generalization of the results.

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UAE legislations

Commercial Companies Law (1984), United Arab Emirates Federal Law No. (8).

Commercial Companies Law (2015), United Arab Emirates Federal Law No. (2).

Appendix. Related party transactions disclosure index checklist (source: KPMG, 2011)

General (T1)

- Disclose related party relationships between parent and subsidiaries irrespective of whether transactions have taken place between those related parties (1 point).
- Disclose the name of the parent and the ultimate controlling party, if different (1 point).
- Disclose the name of the ultimate parent of the group, if not disclosed elsewhere in information published within the financial statements (1 point).
- If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, then disclose the name of the next most senior parent that does so (1 point).
- Disclose items of similar nature in aggregate except when separate disclosure is necessary to understand the effects of related party transactions on the financial statements (1 point).
- Disclose that related party transactions were made on terms equivalent to those that prevail in arm's length transactions only if such terms can be substantiated (1 point).
- If the entity reacquires its own shares from related parties, then provide disclosure in accordance with IAS 24 (1 point).

Transactions with parent (T2)

- The nature of the related party relationship (1 point).
- Information about the transactions and outstanding balances, including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).
- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognized during the period in respect of bad or doubtful debts due from this related party (1 point).

Transactions with entities with joint control or significant influence over the entity (T3)

- The nature of the related party relationships (1 point).
- Information about the transactions and outstanding balances, including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).
- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognized during the period in respect of bad or doubtful debts due from this related party (1 point).

Transactions with subsidiaries (T4)

- The nature of the related party relationship (1 point).
- Information about the transactions and outstanding balances, Including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).
- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognized during the period in respect of bad or doubtful debts due from this related party (1 point).

Transactions with associates (T5)

- The nature of the related party relationship (1 point).
- Information about the transactions and outstanding balances, Including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).
- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognised during the period in respect of bad or doubtful debts due from this related party (1 point).

Transactions with joint ventures in which the entity is a venture (T6)

- The nature of the related party relationship (1 point).
- Information about the transactions and outstanding balances, including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).

- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognized during the period in respect of bad or doubtful debts due from this related party (1 point).

Transactions with key management personnel of the entity or its parent (T7)

- The nature of the related party relationship (1 point).
- Information about the transactions and outstanding balances, including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).
- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognized during the period in respect of bad or doubtful debts due from this related party (1 point).
- Short-term employee benefits (1 point).
- Post-employment benefits, including contributions to defined contribution plans (1 point).
- Other long-term benefits (1 point).
- Termination benefits (1 point).
- Share-based payments (1 point).

Transactions with post-employment benefit plans (T8)

- The nature of the related party relationships (1 point).
- Information about the transactions and outstanding balances, including commitments, necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).
- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognized during the period in respect of bad or doubtful debts due from this related party (1 point).

Transactions with other related parties (T9)

- The nature of the related party relationships (1 point).
- Information about the transactions and outstanding balances including commitments necessary for an understanding of the potential effect of the relationship on the financial statements (2 points).

- The amount of the transactions (1 point).
- The amount of outstanding balances, including commitments (2 points).
- Their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement (3 points).
- Details of any guarantees given or received (1 point).
- Provisions for doubtful debts related to the amount of outstanding balances (1 point).
- The expense recognized during the period in respect of bad or doubtful debts due from this related party (1 point).

Government-related entities (T10)

- The name of the government and the nature of its relationship with the entity (2 point).
- The nature and amount of each individually significant transaction (1 point).
- For other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent (1 point).

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