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The Impact of Market Risk and Fair Value Measurement on the Financial Performance of Public Corporates in Malaysia

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Abstract: ***This research is conducted to evaluate the impact of market risk and fair value on the financial performance of public corporations in Malaysia. This is because market price conditions in the market have resulted in many significant write-offs by applying the fair value. Despite the growth seen in Malaysian companies, Market risk is still a difficult challenge that many companies fail to estimate. The study is covered during the period of 2007 and 2016. Market risk was measured by the interest rate and inflation while financial performance was measured by return on equity (ROE). The data collection method used in this research is mainly through primary and secondary data. Primary data was used to collect data on fair value, whereas secondary data was used in collection of market risk. Furthermore, researcher has also used regression analysis to study the relationships between dependent variables and independent variables. The results gathered from the findings showed that there is no relationship between market risk and financial performance of public corporations in Malaysia. Additionally, another hypothesis showed strong relationship between fair value measurement and financial performance. Moreover, researcher also suggested to include other variables such as exchange rate and financial leverage due to which the relationship with market risk could be further analyzed.***

Keywords: Market risk, Fair Value, Financial Performance

I. INTRODUCTION

If a company is reporting under the IFRS, it is anchored on the concept of Fair value which comes under IFRS 13 as opposed to the Historical Cost Accounting (HCA) which is a part of the old GAAP and has been in practice even before Fair value accounting was introduced as said by(Karen, 2011), HCA is also the traditional technique for recording assets and liabilities at their original cost. The basis of this valuation is the stable measuring unit assumption which means that the assets and liabilities are shown at their original cost as if no there has been no change in value since the acquisition as said by(Bessong, 2012). Hence, there will be differences in the values presented in the balance sheet from the actual value. This accounting method associates the revenue with the historical cost of the asset to finalize profits. This is not in the case of fair value. Fair value accounting has been given a lot of recognition by boards such as the International Accounting Standards Board and Financial Accounting Standards Board both have stated the fair value accounting being superior in comparison to historical value accounting. Although, some authors still prefer the use of historical cost while others prefer fair value. The debate on which model is superior is a controversial one. Fair value measurement has introduced componentization and categorization of assets such as Plant, property and Equipment where the component has different expectancy. Assets with several components are not depreciated as a single item. Plants, Property and Equipment are a crucial component on the financial position of an entity. The researcher is interested in the componentization of assets while keeping the focus of the paper is to evaluate the effect of fair value measurement in depreciating plant, property and equipment as well as their going concern(Bessong, 2012).

For many-many years, companies have firmly established the practice of "closing" company ledgers each year and producing annual balance sheets and income statements according to accounting periodicity. In conventional accounting, accountants learn the concept of historical cost accounting, the traditional system that based on double-entry book-keeping and reporting transactions at the amount paid or liable. Accountants only recognized gains and losses when actually realized. The matching principle underlies the historical cost method, where expenses are offset against the revenues they support. This strong accounting principle held the faith of accountants for decades. Today, investors, financial analysts, shareholders, creditors, employees, and communities, nevertheless, believe that historical cost financial statements have lost their value relevance and a good way out may be Fair Vale Accounting(Khan, 2014).Market risk is the possibility for an investor to experience losses due to factors that affect the overall performance of the financial markets in which he is involved. Therefore, this paper analyse the impact of market risk and fair value measurement on the financial performance of the companies in Malaysia.

A. Problem statement

Recent market price conditions have resulted in large write-downs through the application of fair value measurements. Most of the charges have occurred within the companies and other industries. Companies providing credit protection through credit default swaps on the underlying asset, as opposed to insurance contracts, have been impacted by fair value measurements. Even though the default that would trigger protection may not have occurred, companies are required to recognize unrealized losses on the contract when the fair value of the underlying assets has significantly decreased.

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Also affected have been some corporations with investments in auction rate securities which suffered declines (Procházka, 2011).

The requirements to use fair value measurements have been criticized for producing inaccurate results in the unusual market conditions recently experienced. Such results, it is argued, hurt the company in the long run. If a company must record losses in such an environment, critics claim, it signals bad news to investors that may ultimately be misleading (Palea, 2014).Subsequently, researcher are desirable to record only realized gains and losses. In considering this contention it is important for the company to identify accounting principle such as fair value is produced with the target of giving data that will serve the interest of investor, organizations and arrangement makers over the long term. This research tries to research whether fair value is a suitable apparatus utilized as a part of measuring market value for organizations in Malaysia.

Risks will always be evident in all establishments in business that have the sole purpose of generating revenue and profits. There is a lot of exposure given to financial institutions to several types of risks such as interest are risk, credit risk, market risk, liquidity risk, currency risk, exchange risk, operational risk these are the risks that have a high probability of affecting the firm (Barus, 2017).Markets risk affects the value of a portfolio, whether a trading portfolio or investment portfolio, this will decrease because of the changes in the market factors. The typical market risk factors include interest rates, stock price, commodity prices, inflation rate risk and foreign exchange rate. Equity risk is the risk that stock prices in general or the obscure volatility may change. Equity risk affects the stock prices in general or the implied vitality may change. Currency risk affects the foreign exchange rates which for instance affects the value of an asset held in that specific currency. Inflation risk also known as power risk is the probability that the cash flows from investments will not be worth much because of the changes in the purchasing power due to inflation (Barus, 2017).

The subject of market risk has received a lot of attention in the banking literature and the ongoing crisis has increased the research done on the subject. Whereas, prior studies show that an increase in loans would also increase market risk, the structure of loan portfolios also play a critical role. Managing the lending structure since it has been proved by (Hanson, 2008)that there may be further diversification of risk if the bank lending goes to different sectors, even in the case of a large portfolio. Additionally (Marcucci, 2009) have discovered that different portfolio risk has different effects on different phases of economic cycles. This shows that banks that take more risks are highly affected during times of recessions and are prone to the impact of economic conditions in comparison to less risky banks. .Thus, it can be concluded that the lending structure is vital as it has numerous impacts on the bank risk exposure in different stages of the economic cycle. Apart from risk exposure, (Rossi, 2009). It is also discovered that different lending structure can impact the capitalization and bank efficiency. Previous researches have focused on the impact of the market risk on the financial performance of the banks. Therefore, this research will be focused on the impact of market risk on the financial performance of the public limited companies. By conducting this research, the researcher will fill the gap of the study on the market risk.

It is necessary to for the public limited companies of Malaysia to monitor the market risk because market risk is an external risk which is uncontrollable and the impact of it can affect the financial performance of the companies. Therefore, the companies are required to implement tools and measurements which will be used to analyse the market risk of the firm. In this study the researcher needed to check whether the impact of market risk have any effect on the financial performance of the company. Therefore, this paper analyse the impact of market risk and fair value measurement on the financial performance of the companies in Malaysia.

B. Objectives

- To determinant market risk and fair value measurement on the financial performance of companies in Malaysia
- To examine whether fair value measurement increase financial performance of companies in Malaysia.
- To examine the effects of market risk on the financial performance of the companies in Malaysia.
- To determine whether fair value accounting is an appropriate tool used to measure value for companies in Malaysia.

Conceptual framework

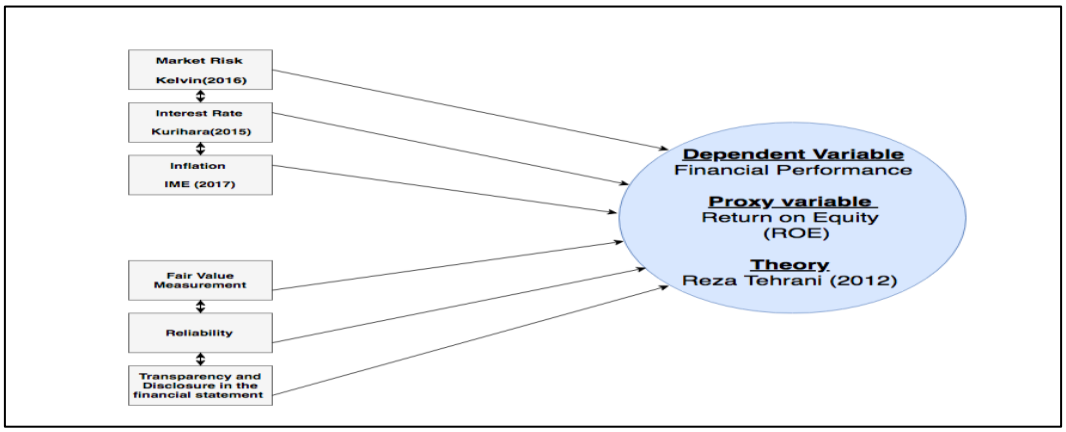

Exhibit 1: Conceptual Framework

Source: primary

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II. METHOD & MATERIALS

In order to solve the problems and answer the research problem, both primary and secondary data will be used to answer the research problem. Therefore, the research selects quantitative research methods to gather the information because this method includes both primary and secondary data. The data in this method is collected by various measurement and statistical tools which are questionnaires and surveys. In this study, the researcher will pick up 70 respondents to get the result of the data from the sampling. The secondary data refers to data taken from secondary sources which are, websites, various reports on financial performance of Public corporate from the period of 2007-2016. In this study, the researcher used statistical package for social sciences (SPSS) software as data analysis tool because this software will give relevant result from the data which is collected by questionnaire. However, the researcher also wants to utilize different types of statistical methods in his study which are explanatory methods, reliability-data method, descriptive methods, and Regression model to test the hypothesis at 5% significant level and Independent sample T-Test.The functional Methods of this models is mention below;

Model of market risk and financial performance

$$YFP = \alpha+\beta1X_1(IR) +\beta2X_2(IF)+e$$

Where,
YFP = Financial performance as measured ROE
X_1 = Interest Rate
X_2 = Inflation
ε = Error term
β1= coefficient

In order to explain this regression function, financial performance is a dependent variable and Market risk is independent variables. The market risk is divided into two sub independent variables which are Interest Rate and Inflation.

III. RESULTS

Table 1: Model Summary towards the Relationship between Market Risk Affect and Financial Performance of Firms

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.424[a]	.180	-.054	2.31659

a. Predictors: (Constant), INTEREST, INFLATION
Source: Secondary Data

The variable that was tested in this research has the margin of 18.0% as seen in the model summary table as the R square value which is 0.180. This indicates that independent variable tested in this research managed to make discussions on this paper by approximately 18% margin while the remaining 82% represents other variables of this research such as commodity risk, currency risk and financial risk.

Table2: ANOVA Test between the Market Risk and Financial Performance of Firm

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.371	2	4.185	.780	.495[b]
	Residual	37.561	7	5.366		
	Total	45.932	9			

a. Dependent Variable: Financial
b. Predictors: (Constant), Inflation, Interest

The Market Risk is sub divide in two factors in this paper by the researcher. The research measure the market risk on the bases on interest rate and inflation. In the above table, F statistic is .780, indicating that the explanatory power of independent variable is low. The table above also indicates that the overall model's significance level is 0.495 (p>0.05). Commonly, *p*-value should be less than 0.05 to be considered statically significant (Hair Jr, et al., 2016).As a result, the overall model is significant as evidence with the F statistic of .780 at **significance level of 0.495 (p>0.05).** This reflects that the null hypothesis (H0) of the hypothesis H1 and hypothesis H3 are acceptable that there is no relationship between all independent variables (IV) and dependent variable (DV). Therefore, Hypothesis H1 & H3 is rejected

Table 3: Regression Model Summary of the Relationship between Fair Value Measurement and Financial Performance of Firms

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.799[a]	.638	.633	.59465

a. Predictors: (Constant), FV
Source: Primary data

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The variables that is tested in this research is expressed by a margin of 63.8% as indicated in the model summary table as the R square value of .638. This indicates that the independent variable which is tested in this research has made a discussion in this research by an estimated margin of 64% in which the remaining 36% represents the other variables.

Table 4: ANOVA Test between the Fair Value Measurement and Financial Performance of Firm

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	51.639	1	51.639	146.036	.000[b]
	Residual	29.349	83	.354		
	Total	80.988	84			

a. Dependent Variable: DV
b. Predictors: (Constant), FV

Source: Primary Data

In the above table, F statistic is 146.03, indicating that the explanatory power of independent variable is very high. The table above also indicates that the overall model's significance level is 0.000 (p<0.05). Commonly, *p*-value should be less than 0.05 to be considered statically significant (Hair Jr, et al., 2016). As a result, the overall model is significant as evidence with the F statistic of 146.036 at **significance level of 0.000 (p<0.05).**This reflects that the alternative hypothesis (HA) of the hypothesis H2 are acceptable that there isrelationship between all independent variables (IV) and dependent variable (DV). Therefore, Hypothesis H2 is accepted.

Table5: Regression Model Summary towards the Relationship between Benefit of Fair Value Measurement and Financial Performance of Firms

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.815[a]	.664	.656	.57589

a. Predictors: (Constant), TRANS, RE

Source: Primary Data

The variable tested in this research is defined by a margin of 66.4% as indicated in the model summary table as the R square value of 0.664. This indicates that the independent variable in this research made a discussion on this paper by an estimated margin of 66% in which the remaining 34% are other variables which consist of accurate valuation of the items, timely information among many others.

Table 6: ANOVA Test between the Benefit of Fair Value Measurement and Financial Performance of Firm

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	53.793	2	26.896	81.098	.000[b]
	Residual	27.195	82	.332		
	Total	80.988	84			

a. Dependent Variable: DV
b. Predictors: (Constant), TRANS, RE

Source: Primary Data

In the above table, F statistic is 81.09, indicating that the explanatory power of independent variable is high. The table above also indicates that the overall model's significance level is 0.000 (p<0.05). Commonly, *p*-value should be less than 0.05 to be considered statically significant (Hair Jr, et al., 2016). As a result, the overall model is significant as evidence with the F statistic of 81.098 at **significance level of 0.000 (p<0.05).**This reflects that the alternative hypothesis (HA) of the hypothesis H4 are acceptable that there isrelationship between all independent variables (IV) and dependent variable (DV). Therefore, Hypothesis H4 is accepted.

IV. RECOMMENDATIONS

Based on the finding and result of this research, fair value measurement is recommended compare to historical cost for every public company because fair value measurement measure the price of the assets and liability which is done by means of a proper transaction. Furthermore, the company can assume the risk of assets and liabilities, however on the basis of fair value is assumptions made regarding the market place. Additionally, fair value takes the same characteristic of the asset or liability. Such conditions must include the location and condition of the asset along with any restrictions on its use or sale. Furthermore, the fair value measurement presents relevant and reliability of information of the financial statement of the company to the internal and external user in order to make to the decision. Fair value measurement also present more transparency of the financial statement of the company compare to historical cost because historical cost accounting record the value of assets and liability based on their historical cost period but fair value accounting measure and record the value of the company assets and liability based on the market period.

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Based on the findings in the research, it shows that there no effect of market risk on the financial performance on firm in Malaysia and R square of the market risk variable cover only 18.0% of research discussion. This indicates that the result in this study should be not only collected from two variables of market risk such as interest rate and inflation, basically the result should be collected on other variable of market risk such as, credit risk, currency risk, commodity risk and financial risk. The study recommended that the firm should adopted different ways of reducing the market risk such as asset securitization and financial derivatives, and the firm are required to have methods and financial concepts for measuring the risk. The risk management of the firm are not only to require to control the market risk based on the inflation and interest rate but also need to focus of balance sheet items and other elements which helps in measuring maximum amount of risks and standard for reducing the overall returns amount of each certain factors of risk.

This research is recommended for Malaysian public listed companies as the research aims to offers better knowledge about the impact of fair value measurements and market risk on the financial performance of the firm. This can enable the companies to improve their performance of the firm through implementing fair value measurement and taking into consideration the market risk which affects the company. Similarly, the research is also recommended for future researchers and academicians as there are many corporate governance variable findings that have been conducted by previous researchers. This can support the future researchers and academicians who wishes to expand the research projection to completely understand several variables of fair value measurement and market risk, as well as their impacts on the financial performance of the Malaysian public listed companies.

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