

Corporate Governance on Earnings Quality in Malaysia

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Abstract

This research aimed to investigate the effects of corporate governance, the rights of shareholders, equitable treatment on shareholders, role of stakeholders, disclosure and transparency, and responsibilities of the board, on earnings quality of the listed firms in Malaysia. Using quantitative research method, the researcher collect the data from annual reports of the public firms in 2018 and from the websites of the listed firms in Malaysia. The sample group was used in the data analysis consisting of 251 companies and the statistics used in the data analysis were the descriptive statistic namely, frequency, percentage, standard deviation, and inference statistics with multiple regression analysis.

The research results showed that corporate governance which had the positive significant effects on earnings quality were the rights of shareholders, disclosure and transparency, and responsibilities of the board. In contrast, equitable treatment on shareholders and role of stakeholders had the negative significant effects on earnings quality.

Keywords: Corporate Governance; Earnings Quality; Organization for Economic Co-operation and Development.

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การกำกับดูแลกิจการที่มีต่อคุณภาพกำไรในประเทศมาเลเซีย

สุธาทิพย์ พาโพธิ์¹ นุชจรี พิเชษฐกุล² สักรว จัตุระโทก³

บทคัดย่อ

บทความวิจัยนี้มีวัตถุประสงค์เพื่อตรวจสอบผลกระทบของการกำกับดูแลกิจการ สิทธิของผู้ถือหุ้น การปฏิบัติต่อผู้ถือหุ้นอย่างเท่าเทียมกัน บทบาทของผู้มีส่วนได้เสีย การเปิดเผยข้อมูลและความโปร่งใส และความรับผิดชอบต่อคณะกรรมการ ต่อคุณภาพการกำกับกำไรของบริษัทจดทะเบียนในมาเลเซีย โดยใช้วิธีวิจัยเชิงปริมาณ โดยทำการศึกษาข้อมูลจากรายงานประจำปีของบริษัทมหาชนในปี 2018 และจากเว็บไซต์ของบริษัทที่จดทะเบียนในมาเลเซีย กลุ่มตัวอย่างที่ใช้ในการวิเคราะห์ข้อมูล จำนวน 251 บริษัท และสถิติที่ใช้ในการวิเคราะห์ข้อมูล สถิติเชิงพรรณนา คือ ค่าความถี่ ค่าร้อยละ ส่วนเบี่ยงเบนมาตรฐาน และสถิติอนุมาน ด้วยการวิเคราะห์ความถดถอยเชิงพหุคูณ

ผลการวิจัย พบว่า หลักการกำกับดูแลกิจการด้านสิทธิของผู้ถือหุ้น การเปิดเผยข้อมูลและความโปร่งใส และความรับผิดชอบต่อคณะกรรมการมีอิทธิพลเชิงบวกกับคุณภาพกำไร ส่วนหลักการกำกับดูแลกิจการด้านการปฏิบัติต่อผู้ถือหุ้นอย่างเท่าเทียมกันและบทบาทของผู้มีส่วนได้เสียมีอิทธิพลเชิงลบกับคุณภาพกำไร

คำสำคัญ: การกำกับดูแลกิจการ; คุณภาพกำไร; องค์การเพื่อความร่วมมือและการพัฒนาทางเศรษฐกิจ

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Background and Significance of the Problems

Malaysia is one of the first five countries that established Association of Southeast Asian Nations or so-called ASEAN in 1967. The 1997-1998 Asian financial crisis is considered as one of the most significant economic events in recent world history. The crisis began in Thailand and then spread rapidly to South Korea, Indonesia, the Philippines, and Malaysia. Poor corporate governance is widely viewed as one of the structural weaknesses responsible for the outbreak of this situation (Nam & Nam, 2004) Corporate governance had become a key policy issue confronting many Southeast Asian countries, including Malaysia (Singam, 2003).

Malaysia's corporate governance framework is contained in several pieces of legislation and guidelines including the Companies Act 2016 (CA 2016), the Capital Markets and Services Act 2007 (CMSA), the Malaysian Code on Corporate Governance 2017 (MCCG), Bank Negara Malaysia's (BNM) Guidelines on Corporate Governance, Bursa Malaysia's Main Market, Ace Market and Leap Market Listing Requirements, and the Code of Ethics for Company Directors issued by the Companies Commission of Malaysia (CCM) (Sankar & Yen, 2019). In 2015 the law called the Capital Market Services Act and Listing Requirements were introduced in Malaysia for enhancing the integrity of the Malaysian capital market and creating the better corporate governance culture among the publicly listed firms. (Asian Development Bank,

2017) The structure of ownership, composition and operation of firms and conglomerates are the most essential factors for determining a good corporate governance. From the study of Saad (2010), it was found that the majority of the listed firms in Malaysia are complied with the code in corporate governance practices very well.

Earnings should represent current performance. In addition, current earnings should also be an indicator for future earnings and free from (misleading) earnings management (Ahrens, 2009). The researchers were then interested in studying the relationship between corporate governance and the earnings. As seen from the results of research published in recent days, they mostly revealed a positive effect of corporate governance on its earnings. For example, the better quality of corporate governance leads to the better quality of earnings (Antonio, Laela, & Darmawan, 2019). The better compliance with corporate governance reduces discretionary accruals implying lower managerial opportunistic behavior (Bhuiyan, Roudaki, & Clark, 2013). Earnings accuracy is higher for the firms with effective corporate governance (Shin & Kim, 2019). There is a negative relationship between the quality of corporate governance and the level of accruals (Bistrova & Lace, 2012) implying manipulate earnings. Therefore, it is expected the results of this research to show that all variables should have positive effects on earnings quality.

Research Objectives

This research aimed to investigate the effects of corporate governance: the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders, disclosure, and transparency, and responsibilities of the board, on earnings quality of the listed firms in Malaysia.

Scope of the Research

In this research, the data were collected from annual reports of the public firms in 2018 and from the websites of the listed firms in Malaysia. The samples were selected using the purposive sampling method, which was determined by several criteria based on the firms' financial statements reported in 2018 and the financial period ending on December 31. The firms in the financial sector and those showing losses were excluded from the sampling method of this research. The final samples consisted of 251 firms. The data were analyzed by using Multiple Linear Regression.

Research Benefits

The previous literature in the area of corporate governance mostly focused on some of its principles, especially the principle of the rights of shareholders and the responsibilities of the board. This study extensively completely examines all the principles of corporate governance of OECD in the 2004 version, on earnings quality. It is easier for stakeholders to use accounting information

in decision-making processes in the Stock Exchange of Malaysia, one of the ASEAN financial markets. This research provides some evidence for governments, regulators, and leaders of organizations for further decision-making. Secondly, this research confirms whether the five principles of corporate governance have an influence on earnings quality.

Concepts, Theories, and Related Literatures

In this research, the researcher reviewed the theory and concepts and research related to corporate governance. And Agency theory is a principle that is used to explain and resolve issues regarding the relationship between business principles and their agents. Besides, agency theory is based on the concept of Jensen and Meckling (Jensen & Meckling, 1976) and it is a fundamental theory in corporate governance (Abdullah & Valentine, 2009).

The Organization for Economic Cooperation and Development (OECD) set the 2004 version of Principles of Corporate Governance, which are composed of five aspects of corporate governance comprising (1) rights of shareholders, (2) equitable treatment of shareholders, (3) role of stakeholders, (4) disclosure and transparency, and (5) responsibilities of the board. The last one is the G20/OECD Principles of Corporate Governance, which is provided for the adoption of the organizations, especially the listed firms

in the stock market (Organization for Economic Co-operation and Development, 2004).

Conceptual Framework

The research aimed to find out the effects

of corporate governance measures on earnings quality of the listed firms on the Stock Exchange of Malaysia: Bursa Malaysia, MYX. The research framework was shown in figure 1 in the following:

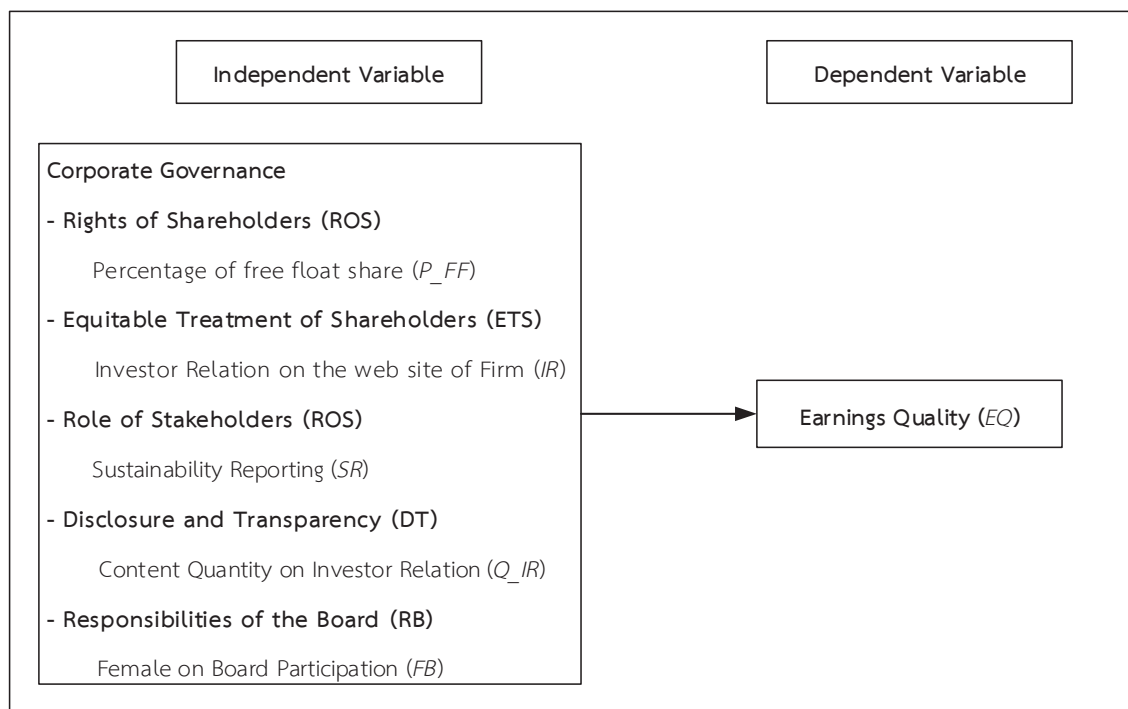


Figure 1 Conceptual Framework

The limitations of this research were in two aspects: the level of sustainability reporting and the representation of corporate governance. This research identified the level of sustainability reporting which depends on the step of development disclosure from original focusing on the environment to expand into topic-specific standards: economic, environmental, or social. However, how the firm chooses its reporting depends on the

characteristics of its business. Manufacturing firms and service firms may report in different forms. The representation of corporate governance could be done by using many proxies relying on the dimensions of corporate governance. This research concentrated on the minority shareholder, the conception of the asymmetry information, and gender on board.

Hypotheses of the Research

There is a significant effect of corporate governance on earnings quality of the listed firms in Malaysia.

Research Methodology

The population in this research were the registered firms that operated and submitted the annual report on Bursa Malaysia in 2018, which had a total of 794 firms. Nevertheless, this research excluded the financials sector

(31 firms), firms with incomplete information (52 firms), loss firms (127 firms), and the firms which did not have the accounting period from 1 January to 31 December (333 firms). Therefore, 251 firms were the sample of this research. Data were collected from secondary sources through the listed firms' websites and Bursa Malaysia's website. Then, the data were analyzed by using the multiple regression, and variables measurement of corporate governance was shown in table 1 as follows:

Table 1

Variable's measurement of corporate governance

Corporate Governance	Variables Measurement
Rights of Shareholders	The percentage of free float (P_FF)
Equitable Treatment of Shareholders	Investor Relation on the Firm Website Apparent: (IR) 1 = Dedicated investor relations area on firm website 0 = Otherwise
Role of Stakeholders in Corporate	Sustainability Reporting (SR) 1 = Firm that set Sustainability report or Corporate Social Responsibility report 0 = Otherwise
Disclosure and Transparency	Quantity Content on Investor Relation (Q_IR)
Responsibilities of the Board	Female on Board Participation (FB) 4 = Female on board = 75% or higher 3 = Female on board between 50% to 74.99 % 2 = Female on board between 25% to 49.99% 1 = Female on board = 24.99% or lower

The earning quality variable was measured by using the model of Ball and Shivakumar (Ball & Shivakumar, 2006) as shown in equation (1) and (2).

$$TA_{it}/A_{i,t-1} = \beta_0 + \beta_{1i}(1/A_{i,t-1}) + \beta_{2i}(\Delta Rev_{it}/A_{i,t-1} - \Delta Rec_{it}/A_{i,t-1}) + \beta_{3i}(PPE_{it}/A_{i,t-1}) + \beta_{4i}(CFO_{it}/A_{i,t-1}) + \beta_{5i}[(NEG_CFO_{it})/A_{i,t-1}] + \beta_{6i}[(NEG_CFO * CFO_{it})/A_{i,t-1}] + \epsilon_{it} \quad (1)$$

Where:

TA_{it} = total accruals in year t for firm i

$A_{i,t-1}$ = total assets in year $t-1$ for firm i

ΔRev_{it} = revenues in year t less revenues in year $t-1$ firm i

Rec_{it} = receivables in year t less receivables in year $t-1$ firm i

PPE_{it} = gross property, plant, and equipment in year t for firm i

CFO_{it} = Cash Flow from Operation year t firm i

NEG_CFO_{it} = An indicator variable set equal to one if CFO is less than zero, and zero otherwise

ϵ_{it} = error term in year t for firm i

The absolute values of discretionary accruals as a proxy for accounting conservatism was multiplied by -1 of the absolute values of discretionary accruals (DA) so that higher values of it represents higher earning quality

(EQ) (Hope, Thomas, & Vyas, 2013).

Next, this research investigated the effect of corporate governance on earnings quality by using equation (2) as follows:

$$EQ = \alpha_0 + \alpha_1 P_FF + \alpha_2 IR + \alpha_3 SR + \alpha_4 Q_IR + \alpha_5 FB + \epsilon_{it} \quad (2)$$

Result

Descriptive statistics of discrete variables were summarized in table 2 and those of continuous variables were shown in table 4. The discrete variables including IR , SR , Q_IR ,

and FB which represent OECD Corporate

Governance in the aspects of equitable treatment of shareholders, role of stakeholders, disclosure and transparency, and responsibilities of the board, respectively.

Table 2

Descriptive statistics of discrete variables

	Variables	Frequency	Percent	Valid Percent	Cumulative Percent
IR	1	46	18.30	18.30	18.30
	0	205	81.70	81.70	100.00
	Total	251	100.00	100.00	
SR	1	197	78.50	78.50	78.50
	0	54	21.50	21.50	100.00
	Total	251	100.0	100.00	111
Q_IR	0-5 items	123	49.00	49.00	49.00
	6-10 items	105	41.83	41.83	90.83
	11-15 items	17	6.77	6.77	97.60
	16-21 items	6	2.40	2.40	100.00
	Total	251	100.00	100.00	
FB	1 = 24.99% or lower	25	9.96	9.96	9.96
	2 = 25% to 49.99%	204	81.27	81.27	91.23
	3 = 50% to 74.99%	21	8.37	8.37	99.60
	4 = 75% or higher	1	0.40	0.40	100.00
	Total	251	100.00	100.00	100.00

Table 3 showed descriptive statistics of continuous variables: P_FF which represents OECD Corporate Governance in the aspect of rights of shareholders, Meanwhile, P_FF_S which is the square root of P_FF was

transformed to reduce skewness and Kurtosis value. Z Value of them are not over 3.29, which corresponds with an alpha level 0.05, and conclude the distribution of them are normal (Kim, 2013).

Table 3

Descriptive statistics of continuous variables

Variable	N	Min	Max	Mean	SD	Skewness	Std. Error of Skewness	Z Value of Skewness	Kurtosis	Std. Error of Kurtosis	Z Value of Kurtosis
P_FF	251	2.10	86.90	29.56	14.35	0.756	0.154	4.920	0.540	0.306	1.763
P_FF_S	251	1.45	9.32	5.27	1.32	0.103	0.154	0.670	0.184	0.306	-0.599

ผ่านการรับรองคุณภาพจากศูนย์ดัชนีการอ้างอิงวารสารไทย (TCI) อยู่ในกลุ่มที่ 2 สาขามนุษยศาสตร์และสังคมศาสตร์

Table 4 showed the multiple regressions model. This model was significant at reliability level of 99% ($\alpha = 0.01$)*, indicating that this model is statistically valid. R^2 and adjusted R^2 were 0.266 and 0.261, respectively, meaning that the explanatory variables are able to explain the dependent variable by 26.60%.

The coefficients of P_FF_S , IR , SR , Q_IR , and FB are +0.428, -0.607, -0.620, +0.040, and +0.331, respectively, and all variables are significant at a significance level of 0.01. The coefficients of almost all independent variables showed the results as expected, except IR and SR .

Table 4

Multiple regression results of corporate governance on earnings quality in Malaysia

Independent Variables	Exp. Sign	Unstandardized Coefficients		Standardized Coefficients Beta	t-test	p-value	Collinearity Statistics	
		B	Std. Error				Tolerance	VIF
(Constant)	None	-2.230	0.213		-10.455	0.000		
P_FF_S	(+)	0.428	0.030	0.483	14.329	0.000*	0.801	1.248
IR	(+)	-0.607	0.137	-0.198	-4.436	0.000*	0.456	2.195
SR	(+)	-0.620	0.085	-0.272	-7.252	0.000*	0.649	1.540
Q_IR	(+)	0.040	0.015	0.121	2.757	0.006*	0.473	2.116
FB	(+)	0.331	0.040	0.325	8.255	0.000*	0.586	1.705
F				58.357				
p-value				0.000*				
R^2				0.266				
Adj R^2				0.261				

* Significant at a significance level of 0.01

Discussion

This research used percentage of free float as the representation of the rights of shareholders. The regression result showed the positive coefficients of IR (+0.428) as expected, implying that the high level of free float has an effect on high earnings quality. Because free float gives information about the ownership structure of the firm, a low percentage of free

float indicates a concentrated ownership structure (Eva & Claudia, 2018). The firm that has a few shareholders indicate the concentrated ownership, and it can trigger agency problems (Al-Rassas & Kamardin, 2016). Fan and Wong (2002) pointed out the positive association between concentrated ownership and low earnings quality in the firms in East Asian. Due to the study of Nurim, Sunardi,

and Raharti (2017) this situation comes from the reason that the concentrated ownership may bring board loyalty to the majority of shareholders who have a significant power to hire them or not. As a result, the majority is suspected possibility of getting advantages from more information. It causes asymmetric information between free float and majority shareholders. Thus, the increase of free float percentage would decrease ratio of majority shareholders, leading to the increase of earnings quality.

According to the study in Thailand, the decrease of corporate disclosure and transparency led to the increase of the asymmetric information between informed and uninformed investors (Chiyachantana, Nuengwang, Taechapiroontong, & Thanarung, 2013). Furthermore, investor relations websites, sustainability reporting, and content quantity of investor relations used in this research were as the proxies of equitable treatment of shareholders, role of stakeholders, and disclosure and transparency, respectively. Investor relations is the source of more information, and it improves access to information (Rodrigues & Galdi, 2017). Also, internet investor relations had the negative association with information asymmetry (Nel, Smit, & Brummer; Rodrigues & Galdi, 2017). Besides, the view of the non-financial information nowadays becomes much more important for disclosure of sustainability reporting such as sustainability report or

corporate social responsibility report. The degree of disclosure of sustainability reporting are different (Ellili & Nobanee, 2016). Sustainability report is usually published as an annual report (E-CSR). The number of sustainability reporting that is separated from the annual report is growing (Clement & Searcy, 2012). Regarding the results of this research, two variables did not show the expected results: *IR* (coefficient = -0.607) and *SR* (coefficient = -0.620). For the result of *IR* variable, it can be analyzed the setup of investor relations sector, and it could be well known explained that R&D expense and education and training expenses are regarded as discretionary expenses (Kang & Kim, 2011). This is consistent with the study of Wang (2010), stating that R&D expenditure can be capitalized as well as be the way for “Professional Judgment” to create a new space for the firm's earnings management. For the result of *SR* variable, it is supported by the study of Mahjoub (2018) which addressed that the level of reporting of sustainability positively affects the practice of income smoothing. This research was in line with previous study of Lo’pez, Garcia, and Rodriguez (2007) that there is the negative effect of sustainability practices on performance in short-term. They further explained that in sustainability practices can increase expenses including risk prevention, research, and training. In addition, the time effort and investment are needed for sustainability-related activities so that profitability is decreased in the short term.

Thus, based on these reasons, the two variables led to a decrease in the earnings quality. Unlike Q_IR , content quantity on investor relation, it showed coefficient of +0.040 as expected. The disclosure and transparent had a positive effect on earnings quality. It can be explained that the high content of quantity on investor relations reduces the asymmetry of information among all shareholders, so it leads to high earnings quality. Finally, FB variable showed coefficient of +0.331. The aspect of board of directors and the gender board diversity had negative relationships with the level of information asymmetry (Abad, Lucas-Pérez, Minguez-Vera, & Yagüe, 2017). Moreover, the presence of a female director on the audit committee limits earnings management. This is consistent with the theory of gender and previous literature which pointed out that females are more conservative and unbiased than males in making ethical decisions-making (Thiruvadi & Huang, 2011). In addition, Post and Byron (2015) also explained to support this result by stating that female on board representation is positively

related to boards' two primary responsibilities including monitoring and strategy involvement.

Recommendation

Contribution of this research could be useful for stakeholders, especially investors who need not only financial information but also non-financial information for the decision making. It also contributed to regulators as a value in preparing and amending corporate governance codes. This research identified the level of sustainability reporting which depends on the step of development disclosure relying on the characteristics of its business. Manufacturing firms and service firms may report in different forms. The earnings quality was measured by discretionary accruals only. Using of multiple proxies may be helpful to generalize the research results. Therefore, the future research should be to extend the analysis to use more than one proxy of earnings quality. Besides, the type of industry should be considered while sustainability reporting in the other dimension should not be ignored.

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