

BOARD OF DIRECTORS, OWNERSHIP STRUCTURE,
ETHNICITY AND EARNINGS QUALITY :
MALAYSIAN EVIDENCE

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Board of directors, ownership structure, ethnicity and earnings quality : malaysian evidence / Hafiza Aishah Hashim.

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**HAK MILIK
PERPUSTAKAAN SULTANAH NUR ZAHIRAH UMT**

**BOARD OF DIRECTORS, OWNERSHIP STRUCTURE,
ETHNICITY AND EARNINGS QUALITY:
MALAYSIAN EVIDENCE**

HAFIZA AISHAH HASHIM

**THESIS SUBMITTED IN FULFILMENT
OF THE REQUIREMENTS
FOR THE DEGREE OF DOCTOR OF PHILOSOPHY**

**FACULTY OF BUSINESS AND ACCOUNTANCY
UNIVERSITY OF MALAYA
KUALA LUMPUR**

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UNIVERSITI MALAYA
ORIGINAL LITERARY WORK DECLARATION

Name of Candidate: Hafiza Aishah Binti Hashim (I.C/Passport No: 810511115518)

Registration/Matric No: CHA040038

Name of Degree: Doctor of Philosophy

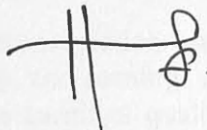
Title of Thesis ("this Work"): Board of Directors, Ownership Structure, Ethnicity and Earnings Quality: Malaysian Evidence

Field of Study: Accounting

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ABSTRACT

The Asian financial crisis in the late 1990s as well as the highly publicised scandals in the United States (US) revealed the critical need for firms in both developed and developing countries to improve corporate governance practices and to regain investors' confidence in the integrity of accounting numbers. The financial crisis, together with US corporate failures and breakdowns in truthful accounting, has resulted in a massive loss of investor confidence in financial reporting, corporate governance and the integrity of the markets the world over and has driven most of the affected countries, including Malaysia, to make improved corporate governance a priority.

To address this issue, this study investigates the relationship between the board of directors' characteristics, ownership structure, ethnicity and earnings quality of 831 non-financial companies listed on Bursa Malaysia's Main Board over the period 2003-2005. Existing literature has documented that financial reporting quality is of higher quality when firms adopt stronger corporate governance mechanisms. To measure earnings quality, this study employs the accrual quality model developed in Dechow and Dichev (2002) and modified in McNichols (2002) and Francis *et al.* (2005).

Generally, the results of this study indicate that corporate governance does matter in Malaysia. Nonetheless, not all elements of measured governance are important. Despite the general belief that greater independence of the board is associated with greater financial reporting quality, this study finds a contrary but significant relationship between board independence and earnings quality. Contradictory to the agency theory, a higher proportion of independent directors is associated with a lower quality of reported earnings. In order to focus beyond the independent directors' monitoring role, this study includes board expertise variables as complementary characteristics that might reasonably enhance the effectiveness of boards. This study finds a positive significant association between governance and firm-specific expertise and earnings quality. Additional directorships held by board members and longer average tenure held by independent directors are found to be two important determinants of an effective board. Neither CEO duality nor board financial expertise are found to be significant in this study.

Interestingly, a positive significant association between outside board ownership as well as family and institutional ownership, and earnings quality is noted, suggesting the dominant impact of ownership structure on earnings quality in Malaysia. The study reveals that family ownership and institutional ownership play a significant role in explaining the quality of reported earnings. The presence of a higher proportion of family members on the corporate board is likely to enhance the earnings quality reported by the firms. Additionally, it is found that an increase in the institutional investors' shareholdings has a positive role in determining earnings quality in Malaysia. Further, this study reports higher earnings quality associated with firms dominated by Malay directors suggesting that quality of financial reporting cannot be culturally free and is impacted largely by government policy.

Overall, this study makes a contribution to extant literature by evidencing that financial reporting quality depends on the efficiency of a bundle of governance mechanisms that needs to be explored from different theoretical perspectives taking account of the institutional context.

ABSTRAK (BAHASA MELAYU)

Krisis kewangan Asia pada akhir 1990an dan skandal yang melanda US yang banyak didedahkan menyebabkan banyak firma di negara membangun mahupun sedang membangun terpaksa memperkukuhkan lagi amalan pentadbiran korporat bagi meraih semula keyakinan para pelabur dalam pengurusan amanah. Krisis kewangan dan kegagalan syarikat korporat US serta kelemahan sistem perakaunan menjejaskan keyakinan pelabur terhadap laporan kewangan, pentadbiran korporat dan pasaran amanah dunia yang turut mempengaruhi kebanyakan negara yang terjejas termasuk Malaysia agar memantapkan lagi pentadbiran korporat sebagai agenda utama.

Bagi menangani isu tersebut, kajian ini meneliti hubungan antara ciri-ciri lembaga pengarah, struktur pemilikan, etnik dan kualiti pendapatan bagi 831 syarikat bukan kewangan yang tersenarai dalam Papan Utama Bursa Malaysia bagi tahun 2003-2005. Sorotan pembacaan yang dibuat menunjukkan bahawa kualiti laporan kewangan adalah lebih baik jika firma memiliki mekanisma pentadbiran korporat yang baik. Bagi mengukur kualiti pendapatan, kajian ini menggunakan model kualiti berakru yang dikemukakan oleh Dechow dan Dichev (2002) yang kemudiannya diubahsuai oleh McNichols (2002) dan Francis *et al.* (2005).

Umumnya, dapatan kajian menunjukkan bahawa pentadbiran korporat adalah isu penting di Malaysia. Bagaimanapun, bukan semua perkara yang berkaitan dengan topik berkenaan adalah penting. Sungguhpun umum percaya bahawa kewujudan ahli lembaga pengarah bebas meningkatkan kualiti kewangan, kajian mendapati sebaliknya walaupun wujud pengaruh yang jelas antara ahli lembaga pengarah bebas dengan kualiti pendapatan. Bercanggahan dengan teori agensi, peningkatan nisbah ahli lembaga pengarah bebas didapati berkait langsung boleh menjejaskan kualiti pendapatan. Bagi melihat fungsi pengurusan lembaga pengarah, kajian turut mengambilkira pembolehubah kepakaran lembaga pengarah sebagai ciri-ciri tambahan yang mungkin meningkatkan kecekapan syarikat. Kajian ini mendapati perkaitan langsung yang positif antara pentadbiran dan kepakaran khusus firma serta kualiti pendapatan. Kuasa pengarah berbilang bagi ahli lembaga pengarah dan pemilikan yang lebih lama oleh ahli lembaga pengarah bebas juga didapati merupakan dua penentu utama kecekapan syarikat. Kajian turut menunjukkan bahawa kewujudan CEO-Pengerusi berdwiperanan dan atau pengarah dengan kepakaran kewangan syarikat adalah tidak berkaitan.

Menariknya, hubungan yang positif dan jelas antara pemilikan saham oleh ahli lembaga pengarah bebas dengan pemilikan keluarga serta institusi dan kualiti pendapatan dapat dilihat. Hal ini menunjukkan pengaruh yang kuat antara struktur pemilikan dengan kualiti pendapatan di Malaysia. Kajian juga memperlihatkan bahawa pemilikan keluarga dan institusi turut menyumbang kepada kualiti pendapatan firma. Kewujudan lebih ramai ahli lembaga pengarah daripada pemilikan keluarga adalah berkesan untuk meningkatkan kualiti pendapatan. Begitu juga dengan pemilikan saham oleh pelabur institusi yang turut memberi kesan yang positif terhadap kualiti pendapatan di Malaysia. Kajian ini menyatakan bahawa pendapatan yang lebih berkualiti turut dipengaruhi oleh firma-firma yang ditadbir oleh ahli lembaga pengarah majoritinya berbangsa Melayu beerti kualiti laporan kewangan turut dipengaruhi oleh faktor budaya dan polisi kerajaan.

Keseluruhannya, kajian ini pastinya menyumbang kepada literatur yang sedia ada dengan membuktikan bahawa kualiti kewangan yang diperolehi bergantung kepada kecekapan beberapa mekanisme pentadbiran yang perlu diterokai dari pelbagai perspektif teori dengan turut mengambilkira konteks institusi.

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