Corporate Disclosures by Family Firms: Malaysian Evidence

Hafiza Aishah Hashim

This study attempts to provide evidence on the effect of corporate governance practices on earnings quality between family and non-family firms. Unlike western economies, many companies in East Asian countries are family owned and family managed or directed with the major shareholders often also directors and managers. The results of regression analyses based on 462 observations (77 family firms matched 77 non-family firms) listed on Bursa Malaysia for the period of 3 years (2007-2009) show that the effect of corporate governance practices on earnings quality varies by ownership category. While lessons can be learnt from the models of corporate governance in developed economies, the study suggests that best corporate governance practices in the East Asian region should be adapted and tailored to the circumstances peculiar to companies in the region. Perhaps, a single standard or 'one size fits all' corporate governance standards is not appropriate to be applied to all Asian countries, where a highly concentrated ownership structure is a common phenomenon.

JEL Codes: G34 and M41

1. Introduction

A study of the role of the family ownership structure is critical to the effectiveness of corporate governance employed by firms in Asia (Claessens and Fan, 2002). Unlike developed countries such as the United Kingdom (UK) and the United States (US), which have a dispersed ownership structure, Asian firms have a more concentrated ownership structure where family control is common in both small and established firms (Mak and Kusnadi, 2004). As reported in Finance Asia 2001, approximately 58 percent of all Asian companies can be classified as being family owned (based on 20 percent cut-off point) where Hong Kong (66.7 percent) and Malaysia (67.2 percent) show the highest degree of family ownership of total market capitalisation controlled by family groups (Cheung and Chan, 2004). La Porta et al. (1999) reviews the corporate ownership structure of 27 countries around the world and reveals that except in economies with very good shareholder protection, such as the US, families or the state typically control firms in countries with poor shareholder protection. The controlling shareholders often control the firms through pyramidal structures and have control rights in excess of their cash flow rights. These controlling shareholders even participate significantly in the management process and have the power to expropriate minority shareholders and raises questions of minority shareholders protection.

In Hong Kong, Jaggi et al. (2009) reports that family ownership represents 60 percent of the total market capitalisation with the ten largest family firms having control of 32.1

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percent of total corporate assets. According to Wiwattanakantang (1999; 2001), 80 percent of non-financial companies traded on the Stock Exchange of Thailand are family owned and 34.81 percent of the firms are totally controlled by a single family. Mak and Li (2001) argue that the role of government and family shareholders in Singapore is very prominent, making it difficult to mount takeover attempts without the support of these two controlling shareholders. Claessens et al. (2000) document that the ten largest families in Indonesia, the Philippines and Thailand control half of the corporate assets, while in Hong Kong and Korea, the ten largest families control about a third of the corporate sector. They argue that wealth concentration might be a formidable obstacle to future policy reform including corporate governance in East Asian corporations.

Like other East Asian countries, concentrated shareholdings by individuals and families distinguish the ownership patterns of Malaysian corporations from their western counterparts (Abdullah, 2006). Claessens et al. (2000) document that Malaysia has the third highest concentration of control after Thailand and Indonesia. According to Thillainanthan (1999), concentration of shareholdings through cross-holdings and a pyramid structure is very common in Malaysian corporations with controlling shareholders being either individuals or families who have more than 50 percent ownership, which may contribute to deficiencies in corporate governance. An analysis of a sample of companies comprising over 50 percent of Bursa Malaysia’s market capitalisation in December 1998 by World Bank (1999), shows that the five largest shareholders in these companies owned 60.4 percent of the outstanding shares and more than half of the voting shares. Additionally, the report provides evidence that 67.2 percent of shares were in family hands, 37.4 percent had only one dominant shareholder and 13.4 percent were state-controlled. Recent study by Ibrahim and Abdul Samad (2010) document that 27 out of the 40 richest Malaysian for year 2008 are family based and account for 67.5 percent of the top 40. Given the significant amount of shares held by family members in Malaysia, it is surprising to find that the relationship between the effect of family ownership and the financial reporting quality, especially on the earnings quality issues has not been extensively explored. The paucity of research in this area provides motivation for the current study as little is known about whether or how corporate governance impacts earnings quality for different class of ownership structure. Hence, this study attempts to provide evidence on the effect of corporate governance practices on earnings quality between family and non-family firms. The results of this study should shed light on the issues of conflicting interests between the controlling owners and minority shareholders in the Malaysian environment, thus explicate the unique institutional context of an Asian country.

Overall, the results of family firms are much weaker compared to the non-family firms. The effect of CEO duality and board size is insignificant while the effect of board independence and board meeting is contrary to the agency prediction. In contrast, the study documents a significant relationship between board independence and board size and earnings quality for non-family firms thus suggesting that the same corporate governance systems for widely-held firms did not work for family-owned firms.
The remainder of this paper is organized as follows. Section 2 discusses the relevant literature to develop research hypotheses. Section 3 outlines and explains the sample selection, research method and variable measurement. Section 4 analyses and discusses the research results. Finally, the conclusions and suggestions for future research are considered in Section 5.

2. Literature Review

The agency theory proposes ownership structure as one of the main corporate governance mechanisms to solve agency problems and suggests that concentrated ownership will result in more effective monitoring (Jensen and Meckling, 1976). While researchers in developed countries focus on the conflict of interest between outside shareholders and managers in a diffused ownership, in Asia where ownership concentration structures are more prevalent, the agency problem shifts to conflicts between the controlling owners and the minority shareholders (Claessens and Fan, 2002). The concentrated ownership creates agency conflicts between controlling owners and minority shareholders, which are difficult to mitigate through the traditional functions of a board of directors (Fan and Wong, 2003). The tightness of ownership allows self-interested behaviour of managers to go unchallenged, internally by the board of directors and externally by takeover markets, as the controlling owners, who are often also the managers, gain effective control of a corporation and have the power to determine how the company is run and may expropriate the minority shareholders’ wealth.

However, questions of whether family ownership provides an incentive to reduce agency costs or create it, still remains an open empirical issue. There are two contradictory views regarding the relationship between family ownership and agency costs. On the one hand, several researchers agree that concentrated shareholdings in the hands of family have an incentive to reduce agency costs through a better alignment of shareholder and managerial interests. Bartholomeusz and Tanewski (2006) highlight several reasons as noted by prior researchers that favour family firms as agents to reduce agency costs. First, as the benefits and costs of the company are borne by the same person, family firms have more incentive to protect their wealth as it is tied directly to the welfare of the company. Second, family firms have greater expertise concerning the firm’s operation that places them in a better position to effectively monitor the firm’s activities. Study by Hashim and Devi (2008a) find support that the presence of family members reduces agency costs. They suggest that family members have greater expertise concerning the firm’s operations to effectively monitor the firm’s activities. Third, in order to protect the family’s name and reputation, family firms strive to maximize the long-term wealth of their firms. Fourth, given that the family member’s are tied together creates a special and unique relationship that develops loyalty, efficient and effective communication and decision making, which in turn reduces the agency costs. Wang (2006) argues that a founding family firm is less likely to engage in opportunistc behaviour in reporting earnings in order to protect their family’s reputation, wealth and long-term firm performance. He reports evidence that higher founding family
Ownership is associated with lower abnormal accruals, greater earnings informativeness and less persistence of transitory loss components in earnings.

However, according to Bartholomeusz and Tanewski (2006), other literature also draws attention to the possibility that concentrated ownership by family firms creates agency costs. First, family firms might use their concentrated blockholding to expropriate the wealth of outside shareholders through excessive compensation, related-party transactions and special dividends. Barontini and Bozzi (2011) highlight the issue of rent extraction in the form of excessive compensation for Italian firms. They find that family firms’ board compensation is significantly higher than non-family firms and board compensation is higher when the founder of the firm or his descendents are members of the board. Second, given that their wealth is undiversified, family firms tend to be risk avoidant where they might use their control to invest in less risky projects that are not aligned with other shareholders' interests. Ibrahim and Abdul Samad (2011) document that firm value is lower in family firms than non-family firms and suggest that family firms are more risk averse and concerned with family interest and the survival of the firm. Third, under the pyramidal control structure (which is common in a family business group) family firms may create agency costs if the family members pursue the interests of other members at the expense of outsiders. Focusing on financial disclosure, Fan and Wong (2002) find that earnings figures are less informative when controlling owners possess high voting rights and when voting rights substantially exceed cash flow rights. The earnings figure loses its credibility because investors perceive that the figure is being manipulated by controlling owners.

The study by Bartholomeusz and Tanewski (2006) identifies the relationship between family control and a corporate governance structure of 100 listed companies (i.e. 50 family firms and 50 matched non-family controlled firms) trading on the Australian Stock Exchange and found that family firms have lower outside directors’ shareholdings; fewer large blockholders; a lower proportion of independent directors; a higher proportion of ‘grey’ directors and a greater combination of roles between CEO and Chairman compared to the non-family controlled firms. This suggests that corporate governance structures adopted by family firms create agency costs as the structures are inconsistent with maximizing the value of the company. A study by Choi et al. (2007) reports a significant difference on the effect of governance mechanisms between Chaebol vs. non-Chaebol firms in Korea. In general, they find that the results of the Chaebol sample are much weaker overall compared to the non-Chaebol sample, which suggests that Chaebols are so powerful in Korea as to possibly dominate and nullify the oversight and market discipline function of internal and external governance mechanisms.

Another interesting study by Klein et al. (2005) reports a surprisingly negative significant relationship between board independence and performance for family firms’ sample in Canada. The results are contradictory with the prediction of agency theory. As many large firms in Canada are controlled by individual, family or private holdings companies, they suggest that family firms may be better view from the vantage point of stewardship theory. Study by Jaggi et al. (2009) note that outside directors monitoring effectiveness
is reduced in family controlled firms, which results in a lower quality of reported earnings in Hong Kong. Overall, the findings of their study suggest that the requirement for higher proportion of independent directors is unlikely to be effective in family controlled firms. Other study by Barontini and Bozzi (2011) find support for rent extraction through excess compensation payment in Italian family firms. Particularly, they report that high board compensation are associated with smaller board size, higher proportion of family members on the board and lower future performance for founder family firms listed on Milan Stock Exchange.

To date, there are relatively limited studies from Malaysian context that examine the effect of corporate governance mechanisms on financial reporting quality focusing on family firms. Among few studies, Ibrahim and Abdul Samad (2009) document that firm value is lower in family firms than non-family firms. They further reported that family firms mitigate agency problems by retaining a small number of directors on board, minimizing outside directors and adopting the role duality as compared to non-family firms. Other studies such as Haniffa and Cooke (2002), Mohd Ghazali and Weetman (2006) and Wan-Hussin (2009) focus on the direct relationship between family ownership and accounting disclosure and do not provide evidence on the significant difference on the effect of governance mechanisms between family and non-family firms. Thus, this study proposes the following testable hypothesis:

H1: The board characteristics (i.e. board independence, CEO duality, board meeting and board size) are associated with earnings management for family and non-family firms.

3. Methodology and Research Design

3.1 Sample selection

The adopted criteria of family firms in this study corresponds with that used by Ibrahim and Abdul Samad (2009) that compare corporate governance and performance between family and non-family firm of public listed companies in Malaysia – the presence of family on board and family share ownership of at least 20 percent of outstanding equity stakes. Inclusion of sample into family firms is based upon these two criteria. These two criteria are adopted for two reasons; firstly, it has been used by previous studies, and secondly, information on lists of family ownership is whether unavailable or unrecorded for Malaysian corporation (Ibrahim and Abdul Samad, 2011). Based on 636 total number of companies listed on the Main Board of Bursa Malaysia as at 31st December 2007, 77 family firms matched 77 non-family firms for a period of 3 years (2007-2009) are selected for the sample of the study.
Table 1
Sample selection for family firms

<table>
<thead>
<tr>
<th>Total number of companies listed on the Main Board of Bursa Malaysia as at 31st December 2007</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less:</td>
<td></td>
</tr>
<tr>
<td>Banks, insurance and unit trusts</td>
<td>52</td>
</tr>
<tr>
<td>Companies that do not comply with family firms criteria</td>
<td>245</td>
</tr>
<tr>
<td>Companies with incomplete data (unavailable annual report, companies with less than 8 observations, de-listed companies within years 2007-2009 and unavailable financial and corporate governance data)</td>
<td>262</td>
</tr>
<tr>
<td><strong>Final sample</strong></td>
<td><strong>77</strong></td>
</tr>
</tbody>
</table>

3.2 Regression model

The following multiple regression model was utilised to determine the extent of the influence of each of the variables in the study on the earnings quality between family and non-family firms:

\[
PACDA = \alpha_0 + \beta_1 BIND + \beta_2 CEODUAL + \beta_3 BDSIZE + \beta_4 BDMEET + \beta_5 LNSALES + \beta_6 LEV + \beta_7 ROA + \beta_8 DUM_YR08 + \beta_9 DUM_YR09 + \varepsilon
\]

The dependent variable is earnings management measured by the absolute value of discretionary current accruals, scaled by lagged total assets \((PACDA)\). The independent variable consists of board independence \((BIND)\), CEO duality \((CEODUAL)\), board size \((BDSIZE)\) and board meetings \((BDMEET)\). \(BIND\) is measured by the proportion of independent non-executive directors on the board, expressed as a percentage. In Malaysia, the Malaysian Code on Corporate Governance 2000 (MCCG 2000) requires one third of the board to consist of independent non-executive directors. If the independent non-executive directors fulfill their monitoring role in mitigating earnings management activity, it is predicted that higher proportions of independent non-executive directors will be negatively associated with earnings management. Study by Peasnell et al. (2000), Klein (2002), Davidson et al. (2005) and Jaggi et al. (2009) find a significant negative relationship between earnings management and a higher proportion of outside directors, supporting agency theory claims that outside directors provide an effective monitoring tool for the board to mitigate earnings management activity.

\(CEODUAL\) occurs when the chairman of the board is also the CEO of the firm. In Malaysia, the MCCG 2000 recommends a separation of roles between the CEO and the chairman of the board. The separation of the position of CEO and Chairman provides an essential check and balance of the management’s performance. In this study, the variable takes a value of one if the roles of the chairman and CEO are combined; otherwise it takes a value of 0. It is predicted that firms with a separation role between chairman and CEO are less likely to engage in earnings management activity. A study by Davidson III et al. (2004) reports evidence consistent with the agency theory
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prediction of increased agency problems with a dual governance structure. They found
greater earnings management associated with companies whose succession
announcement created a dual leadership structure compared to those with successions
creating a non-dual structure.

BDSIZE is measured by the total number of board members (Abdul Rahman and
Mohamed Ali, 2006) while BDMEET is measured by the number of board meetings held
per annum (Xie et al. 2003). Xie et al. (2003) argue that larger boards may be better in
preventing earnings management compared to smaller boards as larger boards may be
more likely to have independent directors with corporate and financial expertise.
Therefore, a negative relationship between board size and earnings management is
predicted. With respect to board meetings, Xie et al. (2003) argue that boards that meet
more often could reduce earnings management activity as they are able to allocate
more time on issues such as earnings management while boards that seldom meet are
unlikely to focus on these issues. They found evidence of a negative association
between a lower level of earnings management and the meeting frequency of the board.
They suggest that board activity provides effective monitoring mechanisms of corporate
financial reporting.

Consistent with prior studies (Peasnell et al., 2000; 2005; Bedard et al., 2004; Davidson
et al., 2005; Hashim and Devi, 2008a,b; Jaggi et al., 2009), this study include firm size
(LNSALES), leverage (LEV), return on assets (ROA) and dummy years (DUM_YR) as
control variables in the regression model. LNSALES denotes the size of the company
in terms of total sales. A larger firm size is expected to have better earnings quality as
they are closely monitored by the external capital markets (Park and Shin, 2004) and
are less likely to engage in earnings management (Klein, 2002; Peasnell et al., 2005;
Abdul Rahman and Mohamed Ali, 2006). A positive relationship between firm size and
earnings quality is predicted. With respect to LEV, firms with higher leverage are
expected to have higher earnings management as firms that are currently facing
financial constraints have greater incentives to manage earnings upward to avoid
potential loss by disclosing financial problems that will result in a lower quality of
financial reports (Park and Shin, 2004). A study by Klein (2002) and Davidson et al.
(2005) reports a positive significant association between leverage and earnings
management activity. ROA is used to control for the growth rate and firm performance.
ROA is measured as the ratio of net income, before extraordinary items, to the total
assets (Abdul Rahman and Mohamed Ali, 2006; Jaggi et al., 2009). Firms with low firm
performance have more incentive to engage in earnings management (Abdul Rahman
and Mohamed Ali, 2006). A negative relationship between firm performance and
earnings management is predicted. Finally, this study also includes the dummy
variables for years to control for the effect of the time period.

3.3 Dependent variable

Recent study argued that current discretionary accruals are more subject to earnings
manipulation and firm performance should also be considered in calculating
discretionary accruals (Jaggi et al., 2009). Taking these two factors into consideration,
this study applies a cross sectional version of the performance-adjusted current discretionary accruals (PACDA) model to detect earnings management (Kothari et al. 2005).

\[
\begin{align*}
TCA_{it}/AT_{i,t-1} &= \alpha_0 \left(1/AT_{i,t-1}\right) + \beta_1 \left(\Delta REV_{it}/AT_{i,t-1}\right) + \beta_2 \left(ROA_{i,t-1}\right) + \varepsilon_{it} \ldots \ldots (1) \\
ECA_{it}/AT_{i,t-1} &= \alpha_0 \left(1/AT_{i,t-1}\right) + \beta_1 \left(\Delta REV_{i,t-1} \Delta AR_{i,t}/AT_{i,t-1}\right) + \beta_2 \left(ROA_{i,t-1}\right) \ldots \ldots (2) \\
PACDA &= TCA_{it}/AT_{i,t-1} - ECA_{it}/AT_{i,t-1} \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots (3)
\end{align*}
\]

Where:

- \(TCA_{it}\) = total current accruals is net income (earnings before extraordinary items and discontinued operations) plus depreciation and amortization minus operating cash flows for firm \(i\) in the year \(t\)
- \(\Delta REV\) = change in revenue for firm \(i\) in the year \(t\)
- \(\Delta AR\) = change in accounts receivable for firm \(i\) in the year \(t\)
- \(ROA\) = ratio of net income before extraordinary items to total assets for firm \(i\) in the year \(t-1\)
- \(AT\) = total assets for firm \(i\) in the year \(t\)
- \(\varepsilon_{it}\) = error term for firm \(i\) in the year \(t\)

Consistent with Jaggi et al. (2009), the ordinary least squares (OLS) regression model was used to estimate industry specific parameters \(\alpha\) and \(\beta\). To estimate the industry specific parameter, Equation 2 was used comprising of data from all companies matched on the year of observation and categorized in the same industry grouping. Having estimated equation 2, the amount of discretionary accruals (PACDA) is calculated as the difference between the firm’s total current accruals (TCA) and its expected current accruals (ECA). All variables in the accrual expectation model are deflated by total opening assets to reduce heteroscedasticity (Jones, 1991).
4. Discussion of Findings

4.1 Descriptive statistics

As reported in Table 2, the mean of earnings management for the full sample is 0.049. Earnings management value as indicated by the absolute value of PACDA shows that non-family firms have higher earnings management value than family firms, 0.046 and 0.052, respectively. However, these mean differences for earnings management proxy are not statistically significant.

In terms of board composition, 86 percent of companies meet the recommendation of the MCCG 2000 to have at least one third of the board comprising independent non-executive directors. The average, 42.2 percent, of the proportion of independent non-executive directors indicates the domination of insiders in the board composition of companies in Malaysia. However, it can be seen that the mean percentages of independent non-executive directors on the board is higher for non-family firms than family firms as indicated by the mean value 44.2 percent and 40.1 percent, respectively. These mean differences are statistically significant at 0.01 percent level.

As depicted in Table 2, the number of companies with role duality in non-family firms is relatively small compared to family firms, with the mean being 1.7 percent. This suggests that the recommendation contained in the MCCG 2000 for the separation of the CEO and the Chairman role were complied with by most non-family firms in Malaysia. However, the number of companies with role duality is higher in family firms (16.9 percent), indicating that role duality is more common in family firms. Role duality shows a highly significant difference in mean between family and non-family firms.

Similar to studies by Abdul Rahman and Mohamed Ali (2006) and Haniffa and Hudaib (2006), the average board size of both family and non-family firms in Malaysia is eight directors. The size is within the range recommended by Jensen (1993) for board effectiveness. With regards to the number of board meetings, both family and non-

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**Table 2**

Descriptive Statistics of Family and Non-Family Firms in Malaysia

<table>
<thead>
<tr>
<th>Variables</th>
<th>Full sample (N=462)</th>
<th>Family Firms (N=231)</th>
<th>Non-family Firms (N=231)</th>
<th>t-statistics of differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>PACDA</td>
<td>0.049</td>
<td>0.046</td>
<td>0.052</td>
<td>-1.100</td>
</tr>
<tr>
<td>BIND</td>
<td>0.422</td>
<td>0.401</td>
<td>0.442</td>
<td>-4.058***</td>
</tr>
<tr>
<td>CEODUAL (%)</td>
<td>9.31</td>
<td>16.9</td>
<td>1.7</td>
<td>5.793***</td>
</tr>
<tr>
<td>BDSIZE</td>
<td>7.97</td>
<td>8.05</td>
<td>7.87</td>
<td>1.026</td>
</tr>
<tr>
<td>BDMEEET</td>
<td>5.13</td>
<td>5.02</td>
<td>5.24</td>
<td>-1.671*</td>
</tr>
<tr>
<td>SALES (RM'000)</td>
<td>1201245.15</td>
<td>1233248.48</td>
<td>1169241.83</td>
<td>-0.945</td>
</tr>
<tr>
<td>LEV</td>
<td>0.455</td>
<td>0.434</td>
<td>0.476</td>
<td>-2.178**</td>
</tr>
<tr>
<td>ROA</td>
<td>0.069</td>
<td>0.065</td>
<td>0.073</td>
<td>-0.773</td>
</tr>
</tbody>
</table>

***Significant at 0.01 level; **Significant at 0.05 level; *Significant at 0.1 level.
family firms show almost equivalent numbers which is, 5 times. Only board meetings show a significant difference in mean between family and non-family firms.

The mean firm size, as represented by total sales of the firm, is RM 1,201,245,150. Finally, the averages for firm leverage and return on assets is 45.5 percent and 6.9 percent, respectively. The average for return on assets for non-family firms is slightly higher than those of family firms as indicated by the mean value of 7.3 percent and 6.5 percent, respectively. Only leverage shows a significant difference in mean between family and non-family firms.

With respect to correlation among variables, the correlation matrix tested in the study confirms that no multicollinearity exists between the variable since none of the variables correlates above 0.80 or 0.90.

4.2 Regression Results

<table>
<thead>
<tr>
<th>Table 3</th>
<th>Regression Results</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Family</td>
</tr>
<tr>
<td></td>
<td>Coefficient</td>
</tr>
<tr>
<td>(Constant)</td>
<td>-0.132</td>
</tr>
<tr>
<td>BIND</td>
<td>0.148</td>
</tr>
<tr>
<td>CEO-DUAL</td>
<td>0.029</td>
</tr>
<tr>
<td>BDSIZE</td>
<td>0.035</td>
</tr>
<tr>
<td>BD-MEET</td>
<td>0.116</td>
</tr>
<tr>
<td>LNSALES</td>
<td>-0.102</td>
</tr>
<tr>
<td>LEV</td>
<td>0.220</td>
</tr>
<tr>
<td>ROA</td>
<td>0.302</td>
</tr>
<tr>
<td>DUM_YR08</td>
<td>-0.029</td>
</tr>
<tr>
<td>DUM_YR09</td>
<td>0.096</td>
</tr>
<tr>
<td>Adjusted $R^2$</td>
<td>0.103</td>
</tr>
<tr>
<td>$F$-value</td>
<td>3.948</td>
</tr>
<tr>
<td>$N$</td>
<td>231</td>
</tr>
</tbody>
</table>

***Significant at 0.01 level; **Significant at 0.05 level; *Significant at 0.1 level.
The results reported in Table 3 for family and non-family firms are based on pooled data (2007-2009). In general, results of family firms produce different findings from non-family firms that suggest significant differences on corporate governance employed by family and non-family firms.

As depicted in Table 3, the coefficient for board independence (BIND) is negative and significant for non-family firms but positive and significant for family firms. As predicted, higher proportion of independent non-executive directors is associated with lower earnings management for non-family firms. Nonetheless, contradictory to the prediction of the agency theory, this study finds a significant positive association between BIND and earnings management for family firms. It suggests that firms with higher board independence have higher earnings management. Recent studies by Klein et al. (2005) and Ibrahim and Abdul Samad (2009) also reveal a significant but contrary sign between board independence and performance in Canadian and Malaysian samples. They suggest that the agency theory assumptions on the monitoring role of independent directors may not fully apply to countries with a highly concentrated ownership structure, especially for family firms. It appears in the study of Klein et al. (2005), family firms are penalised for having a board that is independent from the management thereby obviating the need for a high level of board independence. Jaggi et al. (2009) report similar findings on the association between board independence and earnings management and suggest that an increase in the proportion of outside directors to strengthen board independence is unlikely to be effective in family controlled firms. Consequently this raises concerns of the effectiveness of some requirements such as calls for a majority of independent directors given the fact that family controlled firms are dominant in Asian corporations.

Regarding the CEO duality (CEODUAL), both coefficients are not significant. The result was consistent with prior findings by Abdullah and Mohd Nasir (2004) and Abdul Rahman and Mohamed Ali (2006) who found an insignificant association between CEO duality and discretionary accruals for the Malaysian sample. As the corporate boards are controlled by management, Petra (2005) argues that an independent chairperson has a discernable impact on management decisions. Perhaps, the insignificant findings may be due to the failure of the chairman to challenge the CEO and to be independent from the management. As suggested by Felton and Wong (2004), the key to the success of the split-leadership structure is to appoint an appropriate person for the chairman and the CEO post. They suggest for the chairman to be independent from operational roles to effectively monitor the CEO.

Consistent with expectations, this study finds a negative significant association between board size (BDSIZE) and earnings management. The negative coefficient is consistent with prior findings (Xie et al., 2003) of the effectiveness of board when they are bigger in size. Conversely, the coefficient of board size is positive but statistically insignificant for family firms’ sample. With respect to board meetings (BDMEET), the coefficient is found to be positive and significant for family firms but negative and insignificant for non-family firms. The positive coefficient is contradictory with the prediction of active monitoring and lower earnings management. The findings cast doubts on the appropriateness of
the MCCG 2000 recommendation for active board meeting to increase the quality of financial reporting especially for family firms.

Overall, the results of family firms are much weaker compared to the non-family firms. The effect of CEODUAL and BDSIZE is insignificant while the effect of BIND and BDMEET is contrary to the agency prediction suggesting that the same corporate governance systems for widely-held firms did not work for family-owned firms.

4.3 Discussion on Control Variables

Out of five control variables included in the model, two were found to be significant. The coefficients on leverage (LEV) are positive and significant for both family and non-family firms. LEV was used to control firms that are currently facing financial difficulties. The positive coefficient suggests firms with higher leverage have greater earnings management. The findings support the argument that firms that are currently facing financial constraints have greater incentives to manage earnings upward to avoid potential loss by disclosing financial problems (Park and Shin, 2004). The effect of return on assets (ROA) to control for the growth rate and firm performance is found to be positive but only significant for family firms. The positive coefficient differs from the prior prediction of a negative relationship between firm performance and earnings management. None other controlled variables were found to be significant in the study.

5. Conclusion

The main objective of this study is to provide evidence on the effect of corporate governance practices on earnings quality between family and non-family firms. Dividing sample into family and non-family firms shows that the results of the two samples are quite different. Though findings for non-family firms confirm to the agency theory prediction, evidence from family samples either not significant or contradictory to the agency theory prediction. While lessons can be learnt from the models of corporate governance in developed economies, there does seem to be a general agreement that new Western corporate governance laws and codes are deficient, to some extent, in meeting the requirements of users in Asian developing countries with particular ownership structures, business practices, enforcement capabilities and cultural values (Barton et al., 2004). The question that surfaces is whether the corporate governance reforms adopted by Asian developing countries are appropriate or effective for those countries (Cheung and Chan, 2004). Given the fact that family controlled firms are dominant in Asian corporations, the findings of this study support the call to address the implementation of corporate governance mechanisms that are most appropriate for the institutional context of a particular country.

References

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