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OWNERSHIP STRUCTURE AND DISCRETIONARY ACCRUALS IN MALAYSIAN PUBLIC LISTED COMPANIES

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Abstract

Ownership structure exercised differently for each company in accordance with the type of operation thus lead to different exercise of discretionary accruals. In an attempt to investigate any possible relation between the ownership structure and discretionary accruals, this study examined the annual reports of 199 Malaysian companies listed on the Main Board of Bursa Malaysia. The study used managerial ownership, institutional ownership and block-holder ownership as the proxy in indicating different ownership structure while discretionary accruals are calculated using formula of modified model adopted from past study. The findings revealed that ownership structure have significant effect towards discretionary accruals. Managerial ownership have a positive effect with discretionary accruals thus indicated that a higher managerial ownership leads to a higher value of discretionary accruals. In addition, institutional ownership and block-holder ownership have a negative effect with discretionary accruals. Therefore, having higher number of institutional and block-holder ownership reduced the value of discretionary accruals.

Keywords: Earnings management, discretionary accruals, ownership structure.

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1. Introduction

Earnings management occurs when financial statement is being manipulated and altered hence the performance of the company can mislead the stakeholders (Healy & Wahlen, 1999). The action that has been decided by managers might be due to lack of observable action even though there were a monitoring by shareholders (Alves, 2012). The practices of earnings management is considered as unethical even though there is no violation of accounting standard (Elias, 2002).

Healy (1985) introduced discretionary accruals as one of detection in earnings management. An over aggressive manipulation can leads to a higher discretionary accruals (Marciukaityte & Szewczyk, 2011). Moreover, companies that have big negative accruals are likely due to financial distress (Chen et al., 2008) thus drive the management into manipulating earnings to achieve optimum financing level (Marciukaityte & Szewczyk, 2011).

The accounting policy adopted by the companies can trace the sign of the discretionary accruals (Ines, 2017). These signs showed companies adopted aggressive accounting strategy and conservative accounting strategy (Gietzmann & Ireland, 2005). As for aggressive accounting, managers tried to inflate the results and ultimately drive shareholders to claim for higher dividends that cause to a reduction of resources. As for creditors, the operation of the business continuity can be assure if opted for this strategy (Ines, 2017). However, such situation will bring the users to the financial statements with errors that do not reveal the actual situation of the companies (Kamarudin et al., 2012). Meanwhile, conservative accounting tends to undervalue a profit thus avoids overvaluation of assets, protects assets against exhaustion risk and reduces the expropriation risk of resources (Ines, 2017).

Corporate governance mechanisms have influenced the accounting behaviour including earnings management (Alves, 2012). Significant quota owned by managers will reduce the enticement to manipulate accounting information (Warfield et al., 1995). Nevertheless, as investors have access to sensible and significant information, it can prevented managers in managing accruals (Chung et al., 2002). However, different ownership might have major impact on the degree of earnings quality (Alves, 2012). Therefore, this study investigates the effect of ownership structure on earnings management (discretionary accruals) in Malaysian public listed companies.

2. Problem Statement

Nowadays, academicians, researchers, financial markets regulators and investors are focusing more towards the earnings management issue (Kazemian & Sanusi, 2015) due to there has been growing scandal in corporate governance. Additionally, Toshiba scandals that occurred in September 2015 has be nominated as top five biggest scandals. Toshiba has admitted of overstated earnings by nearly $2 billion over seven years (Matthews & Gandel, 2015). Toshiba's shareholders have less information and organizational skill, as they do not really understand what is going on inside hence it leads to Toshiba's managers to determine their own working conditions as well as the opportunity to enrich themselves at the expense of stockowners. Based on 2015 annual report, there are more than 70% of overseas shareholders in Toshiba thus (causing) hard for these shareholders to monitor the discretion made by the managers. The scandal has proven that

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the management are easily manipulated the earnings due to lack of observable action taken especially by the overseas shareholders.

Agency problem is a conflict that is created from different interest that comes from management and ownership. Management and ownership have a different interest that creates conflict known as agency problem (Jensen & Meckling, 1976). Shareholders must monitor decisions made by managers to ensure the shareholders' interest met and disclosed accurate as well as transparent financial statements. In the past, shareholders were not directly involved in making decision and just followed the exit policy by selling the shares that is held by them if they were not satisfied with management actions. However, nowadays, shareholders have become more engaged in monitoring the management and actively participating in the companies' process as well as try to influence the companies' top management to take care of their long-term interest. Shareholders can play a very effective monitoring role thus improving companies' performance from any earnings management (Tahir, 2015). Ownership structure and discretionary accruals become a continuing debate in the literature in corporate governance (Kazemian & Sanusi, 2015).

3. Research Questions

The research question for this study is as follows:

What is the effect of ownership structure-managerial ownership, block-holders ownership and institutional ownership on discretionary accruals in Malaysian Public Listed Companies?

4. Purpose of the Study

Based on previous researchers, practitioners and regulators stated that there is a need of control action in earnings management problem as accounting earnings is one of the main important items in financial performance (Dechow & Skinner, 2000). Earnings management practices considered as unethical if there is an intention to divert users' perception even though no violation of accounting standards (Elias, 2002). Therefore, this study perhaps can provide information related with the effect of ownership structures on earnings management. It also provides further evidence for the companies to identify which type of ownership should be use in order for them to reduce the possibility of earnings management practice in the companies.

5. Research Methods

5.1. Population and Sample

The target population of this study are 799 companies in Bursa Malaysia Main Board in year 2018. The sample taken are 200 companies as the type of sampling used is simple random sampling. All banks and other financial institution industry in the sample chosen are excluded because the financial institutions annual report are based on Bank Negara Malaysia that adopt different format and financial report (Rauf et al., 2012). Thus, the final sample used are 199 companies.

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5.2. Measurement Variaables

This study used modified Jones (1991) model formula as suggested by Dechow et al. (1995) and adopted from Xie et al. (2003) study for discretionary accruals. The model was used due to Kothari et al. (2005) performed a simulation to evaluate between Jones and the modified Jones model and found that discretionary accruals in modified Jones model improves the conclusions reliability. Based on the formula, total accruals (TAC) are the combination of non-discretionary accruals (NDA) and discretionary accruals (DAC) as per below;

$$TAC = NDA + DAC$$

Regression analysis conducted in obtaining the parameters to differentiate the value for different industry. This is to obtain a more accurate result on the accruals measured rather than generalising the parameter with the same value for different type of industry (Rauf et al., 2012). The equation is as follows:-

Equation (1)

$$\frac{TAC_{i,j,t}}{TA_{i,j,t}} = \alpha_j\left(\frac{1}{TA_{i,j,t-1}}\right) + \beta_j\left(\frac{\Delta Sales_{i,j,t}}{TA_{i,t-1}}\right) + \varepsilon_{i,j,t}$$

Where:

$TACc_{ijt}$ = Total accruals, the changes in non-cash current assets less changes in operating current liabilities for firm I, industry j and year t

$TA_{i,j,t-1}$ = Firms i's total assets at year t-1

$\Delta Sales_{ijt}$ = Changes in revenue from year t-1 to year t

α_j β_j = Specific parameters for industry j

ε_{ijt} = Errors for firm i, industry j and year t

NDA expressed as the companies underlying performance (Rahman and Bakar, 2002). NDA calculated with the value of parameter obtained by the regression using equation (1) with this formula:-

$$DA = \alpha_j\left(\frac{1}{TA_{i,j,t-1}}\right) + \beta_j\left(\frac{\Delta Sales_{i,j,t} - \Delta Rec}{TA_{i,t-1}}\right)$$

In obtaining, the value of discretionary accruals (DAC), the total accruals (TAC) deducted with non-discretionary accruals (NDA), as follows:-

$$DAC = \frac{TAC_{i,j,t}}{TA_{i,j,t}} - \left[\alpha_j\left(\frac{1}{TA_{i,j,t-1}}\right) + \beta_j\left(\frac{\Delta Sales_{i,j,t} - \Delta Rec}{TA_{i,t-1}}\right)\right]$$

For the independent variables, this measurement adopted by past study in determining the related variables. Managerial ownership measured by the percentage of shares owned by the directors from total shares issued (Yeo et al., 2002). The measurement of institutional ownership represented by number of outstanding shares held by institutional investors in a firm at the end of financial year (Tahir, 2015). Meanwhile, the blockholders ownership measured as the percent of shares individual block-holders (excluding managers) owning 5% or more of firm's equity share capital (Al-Fayoumi et al., 2010).

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6. Findings

6.1. Descriptive Analysis

Table 01. Descriptive Statistic for The Dependent and Independent Variables

	N	Min	Max	Mean
Managerial	199	.00	58.94	10.3732
Block-holders	199	.00	87.62	51.3283
Institutional	199	.00	73.28	6.6288
DAC	199	-8.24	5.09	-5.9562

As shown in Table 01, the proportion of managerial ownership ranged from 0% to 58.94%. It described that the minimum percentage of managerial ownership is 0%, which indicated that the companies do not have any managerial ownership meanwhile the maximum percentage is 58.94%. The mean of the managerial ownership in the sample companies is 10.37%.

Next, the range for block-holders ownership is from 0% to 87.62%. It indicated that sample companies that do not have any block-holders ownership while the maximum percentage of having block-holders ownership is 87.62%. From the table above, the mean for the block-holders ownership is 51.33%.

The range for the institutional ownership is 0% to 73.28%, which described that there is the company that does not have any institutional ownership while the maximum percentage is 73.28%. The average company to have institutional ownership is 6.63%.

Meanwhile, the range for discretionary accruals showed the minimum value is -8.24 and the maximum is 5.09. The negative value of discretionary accruals showed that the company are exercising conservative accounting policy. For positive value of discretionary accruals, it indicated the company are exercising aggressive accounting policy (Ines, 2017). The mean for discretionary accruals is -5.96.

6.2. Normality Test

Table 02. Normality Test

	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	df	Sig	Statistic	df	Sig
Managerial	.251	199	.000	.709	199	.000
Block-holders	.081	199	.003	.967	199	.000
Institutional	.285	199	.000	.608	199	.000
DAC	.149	199	.000	.661	199	.000

This study used Kolmogrov-Smirnov because the sample size is more than 50 companies. The normality table 2 showed that the p-value of all variables is less than 0.05 that indicated that the data is significant and not normally distributed. Therefore, this study used Spearman (non-parametric) for correlation test.

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6.3. Correlation Test

Table 03. Correlation Test

	DAC		
	Correlation Coefficient	Sig. (2-tailed)	N
Managerial	.391**	.000	199
Block-holders	-.257**	.000	199
Institutional	-.654**	.000	199

As shown in Table 03, there is an effect of managerial ownership on discretionary accruals in Malaysian Public Listed Companies. The result showed that there is a significant relationship between managerial ownership and discretionary accruals in a positive direction where the correlation coefficient is valued at -0.391 at the 0.01 level. Therefore, this indicated that the higher the manager shareholders in a company, the higher discretionary accruals in the company. The result is consistent with Ballesta and Meca (2007) where they found that higher managerial ownership might increase the practice of manipulation of earnings. This is due to less pressure from outside parties towards the manager thus may lead them to make decisions based on their own interest. Study by Kim and Yi (2005) as well as Cheng and Warfield (2005) also concluded that earnings management do have relation with managerial ownership.

In addition, result from the table showed there is a significant effect between block-holders ownership and discretionary accruals. The correlation is significant at 0.01. There is negative significant relationship with value of -0.257. This showed that with higher percentage of block-holders ownership, the discretionary accruals will decreased. Thus, this is consistent with the previous study done by Ilmas et al. (2018) and Al-Fayoumi et al. (2010) that found the significant negative relationship as outside blockholders have enthusiasm and power to monitor the managers' action than shareholders, hence lessen earnings management.

Moreover, there is an effect of institutional ownership on discretionary accruals in Malaysian Public Listed Companies The result showed a significant negative relationship between institutional ownership and discretionary accruals with value -0.654 at 0.00. This is consistent with the previous studies by Aygun et al. (2014) revealed that discretionary accruals will increased whenever the institutional ownership is decreased. Institutional investors have high ability to access the relevant available information, lead them to several advantages which allowing them to exercise control at the lowest cost (Kouaib & Jarboui, 2014). Institutional ownership involved directly with the companies therefore engaged in conflict resolution that occur (Al-Zoubi, 2016). Hence, managers discouraged to involve in earnings management due to high involvement by institutional investors as they concentrated on the investors' long-term benefits (Al-Zoubi, 2016).

7. Conclusion

Based on the findings obtained in this study, it can be concluded that the ownership structure do have significant effect towards discretionary accrual. Khan et al. (2007) mentioned that high level of managerial ownership in companies will increase their voting power, do actions that will beneficial to them and decrease the internal and external stakeholders' monitoring power (Lasfer, 2006).

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Meanwhile, outside block-holders can act as effective monitors so they can oversee the management activity and have great influence to them (Zhong et al., 2007). Then it gives the chances for them to practice lower earnings management is lower. Managers that being monitor closely are less likely to engage in the pulling out of private benefits and therefore they have less to hide from shareholders by managing the earnings (Dou et al., 2016).

The higher proportion of institutional ownership will limit the managers to accruals discretion due to the institutional investors have a high monitoring power (Aygun et al., 2014). As proactive shareholders, they conducted regular engagements with management of companies and voted on key issues at general meetings so they have the upper hand towards the managers (Kazemian & Sanusi 2015). Furthermore, these investors also have competency to understand the financial statement and ability to discover any earnings management (Velury & Jenkins, 2006) hence it will lessen the capability of management to commit fraud (Kazemian & Sanusi 2015).

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