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Mediating Impact of Financial Statements Window Dressings in Public Listed Companies Based on Corporate Governance Mechanism and Firm Financial Performance

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Abstract *This research examined the effects of corporate governance variables (foreign ownership, managerial ownership) on earnings multiples (FFP), and also the ability to earn management to mediate the relationship between corporate governance variables and earnings multiples. In this study, foreign ownership and managerial ownership are independent variables, earnings multiples (developed through PCA method from ROA, ROE and share price) is dependent variable and earnings management is mediating variable. All the relationship between dependent, independent and mediating variables are postulate on renowned agency theory. We estimate the dependent variable, i.e. earnings multiples (developed through PCA method from ROA, ROE and share price) while earning management is measured through modified Jones model, while rest of the data for CG variables are collected from the annual reports of the companies included in the sample. While financial data of earnings multiples and earning, management extracted from DataStream for the corresponding periods.*

Key Words: Foreign Ownership, Managerial Ownership, Earnings Multiples

JEL Classification:

Introduction

Corporate governance attributes have been argued to impact the country economic health by improving the gross domestic product (GDP) (Chuanrommanee & Swierczek, 2007). The Malaysian government also introduce the Malaysian codes on corporate governance MCCG (2000, 2007 and 2012) respectively for improving the confidence of shareholders in public listed companies. The goal of most of these codes and regulation is to improve companies corporate governance environments and thus to boost the confidence of the shareholders(Ahmad & Saha, 2013; Bhagat & Bolton, 2009). Financial performance is an indicator that can be used in meaningful the financial form of a company. The financial performance is made for measuring the healthiness of a company (Mayliza, Dewi& Sari, 2019). Financial performance is a result of many individual decisions made continuously by the management. To decide the investment for financial performance, it permanently needs customers and investors. This financial

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performance has an important role in the decision. The company of the financial performance are measure with Return on Asset (ROA), and they show the capability of a profit for the use of company asset. A financial report is a set of information issued by a company that is not detached from earnings management actions done by the company's manager in improving the company's position (Mayliza et al., 2019). According to Fahmi (2014) The financial performances of business pass on their numerous subjective procedures and utilize its particular resources form their key mode of role to produce its revenues. Profit margin, ROA and Return, on ROE are told by many researches works as three main determinants for the firm financial performance measurement. In this regard, we examined the steps taken by Malaysian Government by examining the impact of corporate governance mechanism (foreign ownership, managerial ownership) on earnings multiple with a mediating variable (earnings management) between the relationship of corporate governance mechanism and earnings multiple.

Earning Management

Earnings management is the manager's attempt to contrivance the accounting information through the selection of accounting methods without conflict with generally accepted accounting principles. Shareholders' efforts to prevent and control the possibility of conflicts of interest as an effect of agency theory can lead to agency costs (Jensen &Meckling, 1976 cited by Rizani et al., 2018). Agency cost is the encumbrance incurred by the principal to overcome or prevent the problem of the practice of manipulation (earnings management) carried out by the manager. According to Lutfi et al., 2016, the problem of earnings management can be avoided or at least suppressed by a self-control mechanism to harmonize differences in interests between owners and management, among others, i.e. ownership of company shares by management; and share ownership by the institution. Moreover, due to their separation of corporate ownership, then the manager would have significant freedom and power and to pursue their own objectives. Sometimes management has their own preference and requirement for the business, while owners are interested in a high return on their investment. These opposite priorities give birth to mistrust between management and ownership. Agency theory stipulates that ownership and the control of a firm are vested in the different individual, and the exists conflict of interest between principal and agent (Aguilera et al., 2008). Similarly, in the owners, some groups have majority shares and have a holding position in business decision making than those who have small numbers of shares, i.e. minority shareholder. These rivalries create agency problems and affect the smooth running of business organizations. These problems get attention to the incidence of world-famous scandals such as Tyco, Enron, WorldCom, and others, seriously felt the need aimed to stop similar problems in the future. The objective of all these regulations to improve their firms CG environments. Board members independence is one of those elements used for prevention of such incidences. The Sarbanes-Oxley Act of 2002 (SOX) also demands that members of an audit committee of listed company firms must be independent.

According to Zhang, (2015) & Yulius Kurnia Susanto, (2016), the influence of a CGM and EM. The viewpoint of their corporate governance the empirical finding line are quiet. The earning management has dependent variable and audit committee has an independent variable, so the relationship between the audit committee and earning management has negative, and earning management, and CEO-chair duality is the correlation between positively. The board size and managerial ownership is the variable of corporate governance, and they are insignificant relationship with the earning management and negative association between the CGM and EM. Earning management is the process of a and taking the step of accepted Accounting Principal (AAP) and order to reported the earning from expected profit. Akram et al. (2015). In the short term to implement their earning management and this working of all such company that they are highly investigating the all markets that the other stakeholder and investor don't know such investigation and not penalize such practice. Family business mostly focuses long term and are mostly motivate for adjusting and monitoring the managerial decision and avoiding information asymmetries and therefore earning management. Earning Management is one the major issue under discussion in the research studies done in the area of financial reporting. Good Corporate governance is one where management or controlling shareholders has no or little expropriation of business resources result in better performance. Corporate Governance mechanisms are not the same for developed and emerging economies. There are wide differences between the two economies based on their legal environments, institutions, and regulatory (Prowse 1999). Pakistan is laying in the category of emerging market economy. The development of Corporate Governance in Pakistan has a history of two decades back. In 2002, SECP issued CG code for all its three Stock Exchanges, i.e. Karachi, Lahore and Islamabad. These codes were drawn upon the experiences of those countries having similarity in common law and tradition to Pakistan. The motives of these codes were to safeguard the interest of stockholders and to sponsor marketplace confidence. The Law and regulations the perform not stationary according to contextual need and obligation of resident business companies. The demand for building the confidence of stockholders and the existing principles of CGM also change according to with move of time. This result is an ever-changing body of laws, rules and the performs. These rules will ensure photograph, accountability for the safeguard of business the common interests of all stakeholders. Furthermore, strict audit compliance needs to ensure high standards of CGM.

Firm Financial Performance

Financial performance is an indicator that can be used in meaningful the financial form of a company. The company is the ability to proper management of control and manage the firm financial performance. According to IAI (2007). By measuring the financial performance of the company by analyzing the financial statements through financial ratios. The company financial performance is measure through financial ratio According to Harahap (2008) there is the following ratio are Liquidity ratio, Profitability ratio, Solvency ratio, Activity ratio, liquidity ratios, profitability ratios, solvency ratios, activity ratios, The company financial performance are examine with the help of manager OR management to improve the company performance in future and also reduce the risk losses. Pattanayak (2017). provided empirical evidence concerned to financial policies which could deliberately be influenced by earnings management and ultimately influence the firm's performance (Kamran, Zhao, Ali, & Sabir, 2018). The financial performance is made for measuring the healthiness of a company (Mayliza, Dewi& Sari, 2019). Financial performance is a result of many individual decisions made continuously by the management. To decide the investment for financial performance, it permanently needs customers and investors. This financial performance has an important role in the decision. The company of the financial performance are measure with Return on Asset (ROA) and, they show the capability of a profit for the use of company asset. A financial report is a set of information issued by a company that is not detached from earnings management actions done by the company's manager in improving the company's position (Mayliza et al., 2019). According to Fahmi (2014) The financial performances of business pass on their numerous subjective procedures and utilize its particular resources form their key mode of role to produce its revenues. Profit margin, ROA and Return, on ROE are told by many types of research works as three main determinants for the firm financial performance measurement. Research by Mahrani and Soewarno (2018) stated that a high professionalism independent administrator will take more effective decisions and which realize the efficiency of supervising managers. The decisions taken by the administrator is not only in favour of certain parties, but it not only for the advantage of the company and they will do for the advantage of investors and instruction to expand the FP of a Corporation. According to Ahmed & Hamdan (2015). The decision of an independent administration they are more profitable for company financial performance. Simarly, Coleman (2007) studied how CG affects the FFP for African countries (Ghana, South Africa, Nigeria and Kenya). They used size of Panel, panel Freedom, Chief executive officer duality, Frequency Meeting of a board as an independent variable and dependent variable is ROA for 103 listed companies on Ghana, Nigeria, Kenya and Johannesburg stock exchanges.

Yasser, Entebang, & Mansor (2011) show in studies and indicate that the influence of CGM and FP of the listed company of Pakistan stock exchange. This study used Board size Chief executive officer duality, the composition of the board, committee of audit as a proxy for CG while the firm fanatical performance is measure or show in a shape of ROA, ROE and PM. They are indicating the positive connection of Return on Asset the profit Margin CG variables of the size of the panel, composition panel and committee of audit. The study, however, could not give any evidence of a significant relationship between performance variables (ROE and PM) and CEO duality.

Yasser et al., (2011) Studies the Pakistan stock exchange and Karachi stock exchange 100-index with their own structure and firm financial performance for the period of 2009 to 2013. They used Hirschman–Herfindahl index (HHI) index (eight categories of ownership structure) and the related variable such as earning per share return on asset and economic value-added.

Arora (2016) carried out a similar research study for Indian manufacturing industries where corporate governance is measured with the size of board committee of auditing and size of board director and institution ownership while for FP NPV ROA, ROE used as an accounting performance measure and SR and Tobin's Q as market performance measure. Contrary to the previous studies, the result showed that CG variables have no significant association with accounting performance of these firms, however, board independence, board size have a positive relationship, and board meeting is negatively associated Tobin's Q.

Family Ownership

Family ownership can be defined as the percentage of total shares held by family member divided by the total number of shares (Hutchinson & Gul, 2004). Foreign owner with proportion of shares in the firm tends to help in minimizing the agency costs between agent and principal. Following the above, EM practices can be reduced with managerial ownership as managers being an owner take effective decisions, which, in turn, minimizes EM practices and improve FFP. Thus, offering some portion of shares to the management of the firm motivates managers who, in turn, will act in the best interest of shareholders. Therefore, management of the firm will produce good results when they are among shareholders and are entitled to dividend returns based on the shares owned. The relationship between managerial ownership and EM is developed based on agency theory. Agency theory proposes that, if there is a separation of management and ownership in corporations, this separation will lead to agency problems. Up to date, surprisingly rare research on foreign investor and EM has surfaced in literature. This highlights the importance of further examination of the role that foreign investors play in either constraining or motivating the practice of EM. Due to the lack of empirical evidence about the relationship of foreign ownership and EM practices concerning the subject matter, none of these views is conclusively supported because the findings of above-mentioned studies provide limited knowledge about the relationship of foreign ownership and EM practices. Therefore, the relationship between family ownership and EM is unclear and inconclusive, which needs to be further explored. Thus, it is necessary to examine whether family ownership mitigates agency conflicts, reduces EM practices, and enhances firm value remains an empirical question.

Managerial Ownership

Managerial ownership can be defined as the percentage of total shares held by employees divided by the total number of shares (Hutchinson & Gul, 2004). Managers with some proportion of shares in the firm tend to help in minimizing the agency costs between agent and principal. Following the above, EM practices can be reduced with managerial ownership as managers being an owner take effective decisions, which, in turn, minimizes EM practices and improves FFP. Thus, offering some portion of shares to the management of the firm motivates managers who, in turn, will act in the best interest of shareholders. Therefore, management of the firm will produce good results when they are among shareholders and are entitled to dividend returns based on the shares owned. The relationship between managerial ownership and EM is developed based on agency theory. Agency theory proposes that, if there is a separation of management and ownership in corporations, this separation will lead to agency problems (Claessens et al., 2000; Jensen & Meckling, 1976). Moreover, agency theory also postulates that higher managerial ownership can reduce agency problems and hence increase firm performance (Ibrahim & Samad, 2011; Fama & Jensen, 1983a; Fama, 1980; Jensen & Meckling, 1976). Although the study has found that the interests of the employee can be increased if a specific percentage of shares are offered to them (Hutchinson & Gul, 2004). However, on the other hand, offering shares to managers of the firm can become a reason for EM practices (Bova et al., 2015). Prior studies have found that managerial ownership is one of the most important incentives to motivate managers (Njuguna & Moronge, 2013; Velury & Jenkins, 2006; Jensen & Meckling, 1979), and thus in controlling EM practices of the firm (Firth et al., 2007; Alexander, Cindy R & Cohen, 1999). However, the majority of empirical studies found mixed and inconsistent results on the relationship between managerial ownership and EM practices (Agrawal & Knoeber, 1996). Similarly, a positive association between employee ownership and EM was reported, using a sample of 107 firms of Australian stock exchange for the year 1993 to 1997 (Koh, Ping-Sheng, 2003). However, unlike the above findings, some studies also have revealed a negative impact of managerial ownership on EM practices (Bova et al., 2015; Teshima & Shuto, 2008; Saleh et al., 2005; Rajgopal et al., 1999; Warfield et al., 1995). The negative impact of managerial ownership on EM practices means that managers (with a proportion of shares as an owner) are helpful in controlling EM practices. Thus, past research on the relationship between employee ownership with EM has found mixed, inconclusive, or contradictory results (Bova et al., 2015). In this scenario, Warfield et al. (1995) presented credible explanations that these results may be due to the use of different measurements (proxies), sample size, and number of years.

Hypothesis of the Study

H1: Foreign ownership will have a positive relationship with earnings multiples.
H2: There is a positive relationship between managerial ownership and earnings multiples.
H3: Foreign ownership will have a negative relationship with earnings management.
H4: Managerial ownership and earnings management have a negative relationship.
H5: The higher the earnings multiples, the lower will be the earnings management.
H6: Earnings management will perform a mediating role between foreign ownership and earnings multiples.
H6: Earnings management will perform a mediation role between managerial ownership and earnings multiples.

Model Specification and Tests

FFP= α0 + a1 (FO) + a2 (MO) + a3 (Control Variables) + e
EM = α0+ b1 (FO) + b2 (MO) + b3 (Control Variables) + e
FFP= α0+ c1 (EM) + c2 (Control Variables) + e
FFP= α0 + d1 (FO) + d2 (MO) + d3 (EM) + d4 (Control Variables) + e
Where:
FFP: earnings multiples
α0-: Constant
FO: Foreign Ownership
MO: Managerial Ownership.
EM: Earnings Management.
e = allowed error.
Research Design and Data Analysis

Data and Sample

The sample for this study is based upon 320 Malaysian Public Listed Companies for five years i.e.2014–2018. The data for the variables extracted from DataStream, Companies annual reports and BURSA Malaysia website(Dalnial, Kamaluddin, Sanusi, & Khairuddin, 2014). After extracting the data, we analyzed through SPSS and STATA. For making the result more robust, constant and stable, we run some initial steps for cleaning and screening the data, which implied that the samples ready for data run(Sekaran & Bougie, 2003).

Descriptive Statistics

Table 1. Descriptive Statistics

	N	Min	Max	Mean
FO	1600	0	1.00	.7768
MO	1600	0	100.00	85.3295
EM	1600	0	17708845.43	197863.2519
FFP	1600	.01	47.30	1.8245
MKTC	1600	0.00	54550116.00	1169282.1425
ROA	1600	-109.18	633.78	5.4980
MKTBV	1600	-193.26	1077065.59	1862.4047
N	1600			

Correlation Analysis

Table 2. Correlations Statistics

Correlations							
	FO	**MO**	**EM**	**FFP**	**MktCapzn**	**ROA**	**MartTBokV**
FO	1						
MO	-.050*	1					
EM	.066**	-.043	1				
FFP	.090**	-.021	.263**	1			
MKTC	.088**	-.065*	.231**	.491**	1		
ROA	.020	.013	.015	.145**	.073**	1	
MKTBV	.002	-.041	.018	.022	.294**	.055*	1

Multiple Liner Regression Analysis

The results shown in Table 3 (Model 1) under random model (Foreign Ownership) explain 26% of the variance of earnings multiples (FFP), with the $R^2 = 0.26$, ($p = 0.047$). The results also show that foreign ownership has a significant positive effect on earnings multiples ($p< 0.01$). Similarly, by looking into table 3 (Model.1), foreign ownership also found to influence earnings multiples (FFP), (with the ß= 0.3925, and the p> 0.1i.e.0.047).

However, on the other hand, the empirical result in table3 (model 1) for managerial ownership reveal the result without significance and impact by showing (with the ß= 0.00155, and the p> 0.1 i. e0.725). Moreover, talking about control variables, market capitalization and ROA has a significant positive impact on earnings multiples (FFP), while market to book value has a significant negative impact on earnings multiples (FFP).

Table 3. Ordinary Least Squares (OLS) Results

DV: Shareholders value (Share Price)	Model No.1	Model No.2	Model No.3
Foreign Ownership	0.392** (0.1975)	-0.8494 (0.488**)	-6.97*** (9.97)
Managerial Ownership	0.00155 (0.0044)	-0.122 (0.1088)	3.97*** (1.85)

Market Capitalization	4.23*** (1.89)	0.0440*** (0.00466)	
ROA	0.0181*** (0.00343)	-1.2 (0.849)	0.0183*** (0.0033)
Market to Book Value	-1.6*** (2.67)	-1.45** (0.660)	0.000015*** (2.62)
Constant	0.0823** (0.0421)	.1893** (.10411)	1.15*** (0.085)
R-Square	0.26	0.59	0.29
Prob.	0.000	0.000	0.000
Sample	320	320	320
Observations	1600	1600	1600

**** p<0.01, ** p<0.05, * p<0.10*

Table 3 (Model 2). results under random model showing the relationship between the foreign ownership and earnings management (modified Jones Model) is negative and significant (p = -.0849). While the other independent variable managerial ownership has an insignificant negative relationship to earnings management.

The value of R2is 0.59, which shows that 59% of the variance in earnings management is explained by independent variables (foreign ownership & managerial ownership).

Table 3 (Model 3), shows the results of regression analysis of the influence of earnings management on FFP (earnings multiples). The results, of earnings management negatively significant (p< 0.01 and ß= -6.97) with the FFP (earnings multiples). Moreover, R2= 0.29, explains that 29 % of the variation in FFP is explained by the earnings management.

Mediation / Multiple Hirerical Linear Regression Results

We performed regression test to estimate the impact of mediating variable (earning management) on the relation between corporate governance variable and earnings multiples (FFP) (table 4&5) (Baron, Kenny, & psychology, 1986).

In order to reach a conclusion following condition defined by Baron and Kenny (1986), which indicates that foreign ownership does not significantly affect earnings multiples (FFP), because (ß= 0.002, p > 0.01). In the second conditional test of Baron and Kenny (1986), we run the regression and found a significant result (ß= 1.30, p < 0.01). Hence, the result showed that foreign ownership has a significant impact on reporting quality, which shows the effects of shareholder value (ß= 1.18 & 0.665, p< 0.01).

Similarly, the results of regression analysis for the other independent variable (managerial ownership) in table.4 also showing the impact of managerial ownership on FFP with (ß= -0.002, p > 0.10), but with no significant impact. Therefore, the first condition of mediation was not met, however for the second condition with the results of (ß= -1.9, p < 0.05), thus the second condition for mediation also met. Moreover, for the third condition of mediation of mediation we got (ß= 1.28, 1.20, p> 0.01, p< 0.01). Therefore, earnings management does not act as mediating between managerial ownership and FFP.

Table 4. Barren and Keney Test for Mediation

	MV	DV	Step 1 A-B (a)		Step 2 A-C (c)		Step 3 Path (c') A-B-C		Type of Mediation
			Beta	RSq	Beta	RSq	Beta	RSq	
FO	EM	FFP	1.30**	0.074	.002	0.819	1.18** 0.665***	0.074 0.074	Partial
MO	EM		-1.9**	0.0019	-.0042	0.0004	1.28 1.20***	0.0693 0.0693	Full

In table.5 we run the Sobel-Goodman Mediation Tests by STATA-15 for drawing the impact of mediating variable between dependent and independent variables. Here, earnings management is a mediating variable, while foreign ownership and managerial ownership is independent variable and FFP is dependent variable. According to Sobel-Goodman Mediation Tests, the main decision about mediating impact will be based on the indirect effect.

The condition for the Sobel test is that" Z "will be greater than 1.64, and "p" will be significant.

Hence, looking into the indirect effect results in table.5 we can generalize that earnings multiples mediates the relationship between foreign ownership and FFP (Z= 2.54 >1.9 and p< .05), and met the Sobel condition for mediating, while on the other hand, the same earnings management has no mediating impact on the relationship between managerial ownership and FFP by indicating (Z= -1.707 <1.9 and p< .05).

Table 5. Sobel Test for Mediation

IV	MV	DV	Indirect Effect (Sobel)		Type of Mediation
			Beta		
SL	RQ	SP	1.30**	Z= 2.54 P=0.011	Partial
NCI	RQ		-1.9**	Z= -1.707 P=.087	No mediation

Indirect effect: Z>1.9 and P <0.005, <0.010

Contribution of the Study

To summarize from an empirical, academic, theoretical and practical perspective this study has a number of contributions to knowledge on corporate governance mechanism; earnings multiples developed on PCA method from different performance indicators like (ROA, ROE, EPS, SMP) and earnings management which will benefit the listed firms in Malaysia.

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