

**THE EFFECT OF BOARD STRUCTURE AND INSTITUTIONAL OWNERSHIP
ON EARNINGS MANAGEMENT**

By

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**Thesis Submitted to the Graduate School of Management,
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The study examines the role of outside directors and institutional shareholders in constraining the earnings management activities. A sample of 613 firms from construction, industrial products and consumer products sectors were selected from the Main Board in Bursa Malaysia. The time period covered for this study was from 2001 to 2003. The Modified Jones Model with cross sectional approach was employed in this study. The finding shows that the magnitude of earnings management in Malaysian listed firms was approximately 16% of the previous year total assets. Most firms manage the earnings upward rather than downwards. No relationship was observed between the degree of earnings manipulation and the proportion of outside directors and institutional shareholders. This is inconsistent with most studies which provide evidence that outside directors and institutional shareholders are effective corporate governance mechanisms in constraining the earnings management. However, there is weak evidence to show that

outside directors have some effect in curbing the earnings management in the construction sector.

The findings suggest that outside directors have the ability to constrain the earnings management as indicated in the construction sector. Adding more outside directors in the board and having institutional shareholders may not reduce earnings management practices if the ownership of a firm is highly concentrated and the process of selecting outside directors is not clearly stated and transparent.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi sebahagian keperluan untuk ijazah Master Sains

KESAN STRUKTUR LEMBAGA PENGARAH DAN INSTITUSI PEMEGANG SAHAM KE ATAS PENGURUSAN HASIL

Oleh

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Kajian ini menyelidik keberkesanan peranan pengarah luaran dan institusi pemegang saham dalam menyekat pengurusan hasil. Jumlah sampel sebanyak 613 buah syarikat dari sektor pembinaan, barang industri, dan barang pengguna dipilih dari Papan Utama Bursa Saham Malaysia. Kajian ini merangkumi tahun 2001 ke 2003. Modified Jones Model dengan pendekatan “cross sectional” digunakan dalam kajian ini. Hasil kajian menunjukkan purata pengurusan hasil di Malaysia ialah sebanyak 16% atas jumlah aset pada tahun lepas. Didapati bahawa syarikat lebih cenderung meningkatkan hasil daripada menurunkan hasil. Daripada keputusan yang diperolehi, tiada hubungan yang wujud di antara pengarah luaran dan institusi pemegang saham dengan pengurusan hasil. Keputusan ini tidak seiringan dengan kebanyakan kajian yang membuktikan bahawa pengarah luaran dan institusi pemegang saham merupakan mekanisme kawalan korporat yang efektif dalam menyekat pengurusan hasil. Walaubagaimanapun wujud hubungan

yang negatif antara pengarah luaran dengan pengurusan hasil di sektor pembinaan tetapi buktinya amat lemah.

Adalah dicadangkan bahawa pengarah luaran berupaya menyekat pengurusan hasil dalam sektor pembinaan. Penambahan bilangan pengarah luaran dan institusi pemegang saham berkemungkinan tidak dapat mengurangkan praktik pengurusan hasil jika hakmilik syer terlalu memusat kepada sesetengah pihak dan proses memilih pengarah luaran tidak dinyatakan dengan jelas dan lutsinar.

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I certify that an Examination Committee met on **26 April 2006** to conduct the final examination of **Wong Shi Yang** on her **Master of Science** thesis entitled “**The Effect of Board Structure and Institutional Ownership on Earnings Management**” in accordance with Universiti Pertanian Malaysia (Higher Degree) Act 1980 and Universiti Pertanian Malaysia (Higher Degree) Regulations 1981. The Committee recommends that the candidate be awarded the relevant degree. Members of the Examination Committee are as follows:

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DECLARATION

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.

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TABLE OF CONTENTS

	Page
ABSTRACT	ii
ABSTRAK	iv
ACKNOWLEDGEMENTS	vi
APPROVAL	vii
DECLARATION	ix
LIST OF TABLES	xii
LIST OF FIGURE	xiii
LIST OF ABBREVIATIONS	xiv
CHAPTER	
1 INTRODUCTION	
1.1 Background of the Study	1
1.2 Motivations of Earnings Management	5
1.3 Corporate Governance in Malaysia	7
1.4 Corporate Governance Mechanisms to Deal with Earnings Management	10
1.4.1 Board Structure and Earnings Management	10
1.4.2 Ownership Structure and Earnings Management	12
1.4.3 Advisor Structure and Earnings Management	12
1.4.4 Capital Structure and Earnings Management	14
1.5 Problem Statement	15
1.6 Objectives of the Study	17
1.7 Significance of the Study	18
1.8 Organization of the Thesis	19
2 THEORETICAL FRAMEWORK AND LITERATURE REVIEW	
2.1 Theoretical Framework	20
2.1.1 Agency Theory	20
2.1.2 Signaling Theory	21
2.1.3 Corporate Governance Theory	22
2.1.4 Models for Detecting Earnings Management	24
2.1.4.1 The Healey Model	24
2.1.4.2 The DeAngelo Model	24
2.1.4.3 The Industry Model	25
2.1.4.4 The Jones Model	25
2.1.4.5 The Cross-sectional Model	26
2.1.4.6 The Modified Jones Model	27
2.1.5 Comments on Earnings Management Models	29

2.2	Review of Literature	31
	2.2.1 Earnings Management Relative to Thresholds	31
	2.2.2 Monitoring Role of Board of Director	32
	2.2.3 Evidence on Board Monitoring and Earnings Management	34
	2.2.4 The Role of Institutional Ownership in Monitoring Manager	35
3	METHODOLOGY	
3.1	Data Collection	37
3.2	Scope and Method of Analysis	39
	3.2.1 Measurement of Earnings Management	39
	3.2.1.1 Modified Jones Model	39
	3.2.2 Measurement of Outside directors and Institutional Ownership	46
	3.2.3 Control Variables	47
3.3	Hypotheses	52
	3.3.1 Hypothesis for Board Monitoring	52
	3.3.2 Hypothesis for Institutional Ownership	53
	3.3.3 Hypothesis for Board and Institutional Monitoring	55
4	FINDINGS AND ANALYSIS	
4.1	Descriptive Statistics	57
4.2	Correlation Analysis	63
4.3	Board Structure on Earnings Management	65
	4.3.1 Univariate Tests	65
	4.3.2 Multivariate Tests	67
4.4	Institutional Ownership on Earnings Management	69
	4.4.1 Univariate Tests	69
	4.4.2 Multivariate Tests	70
4.5	Board Structure and Institutional Ownership on Earnings Management	72
	4.5.1 Multivariate Tests	72
4.6	Summary of Hypotheses Result	76
5	SUMMARY AND CONCLUSION	
5.1	Summary of Findings	78
5.2	Limitations	83
5.3	Recommendations for Future Research	84
5.4	Implications of the Findings	85
	REFERENCES	86
	BIODATA	