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OWNERSHIP STRUCTURE AND THE QUALITY OF FINANCIAL REPORTING IN THAILAND: THE EMPIRICAL EVIDENCE FROM ACCOUNTING RESTATEMENT PERSPECTIVE

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Abstract: *This study investigates the relationship between ownership structure and the quality of financial reporting of listed firms in the Stock Exchange of Thailand. Prior research in this area mainly used quality of earnings or abnormal accruals to proxy for the quality of financial reporting. Unlike prior research, this study employs firms' accounting restatements to reveal the poor quality of financial reporting. The characteristics of ownership structure in this study consist of ownership concentration, institutional ownership, foreign ownership, government ownership, family ownership and political connected firms. The results are consistent with the hypothesis that the characteristics of ownership structure are associated with the quality of financial reporting. The findings show that concentrated ownership firms and political connected firms are positively associated with their accounting restatements. This indicates that concentrated ownership firms and political connected firms have more tendency to restate their financial statement, therefore they have low quality of financial reporting. On the other hand, family ownership firms are negatively associated with their accounting restatements which is consistent with Wang (2006)that founding family ownership is significantly positively associated with the quality of financial reporting. Finally, the study find no significant relation between firm characteristics and the quality of financial reporting.*

Keywords: *Ownership structure / Accounting Restatement / Quality of financial reporting / Thailand.*

1. INTRODUCTION

At present, accounting information disclosed by companies is one of the most important information sources for investors and analysts in evaluating a company (Breton and Taffler, 1995) The financial reporting's user such as suppliers, regulators or investors requires the accurate and reliable data for making their decisions. However, investors frequently focus on the firms' earnings rather than other information. As a result, management have the

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strong incentive to manipulate their earnings in order to fulfill the investors' need.

Association for Investment Management and Research (AIMR) found that a vast majority of portfolio managers and securities analysts' surveys indicated corporate disclosures and the quality of financial reporting are very important. Robinson and Munter (2004) define high quality of financial reporting as overall financial reporting, including disclosures, which results in a fair presentation of a company's operations and financial position. Prior literature frequently employed the earnings quality or earnings management to proxy for the quality of financial reporting because the principle concern of many users has been whether earnings are overstated. However, this study uses financial restatement to signal for the quality of the financial reporting because when firms restated their financial reporting, the creditability of those firms, which is the critical attributes of the financial reporting, has been substantially impaired. Prior research indicates several factors that affect the quality of financial reporting such as management opportunities. analysts forecast, and leverage requirements. One stream of research argues that ownership structure is also the famous factors that affect the quality of accounting data because there are different ownership structures in different firms. Different ownership structures influencesdifferently company performance, the degree and manner of management control and so on Namazi and Kermani, 2008). For example, Garcia-Meca and Ballesta (2009) investigate the relationship between ownership structure and the quality of earnings by using ownership concentration, institutional ownership, and managerial ownership to measure ownership structure. Cornett, Marcus and Tehranian (2008) use institutional and managerial ownership to measure ownership structure.

In order to investigates the relationship between ownership structure and the quality of financial reporting of listed firms in Thailand. This study employs firm's accounting restatements to measure the quality of financial reporting. The ownership structure in this study consist of ownership concentration, institutional ownership, foreign ownership, government ownership, family ownership and political connected firms. The empirical results are consistent with the hypotheses. The results show that concentrated ownership firms and political connected firms are positively associated with their accounting restatements. This indicates that concentrated ownership firms and political connected firms have more tendency to restate their financial statement, therefore they have low quality of financial reporting. On the other hand, family ownership firms are negatively associated with their accounting restatements, which is consistent with the alignment effect that family ownership creates greater monitoring by controlling owners.

2. LITERATURE REVIEW AND HYPOTHESES

Prior literature provides mixed results on the relationship between the ownership structure and the quality of financial reporting. Prabowo and Angkoso (2006) suggest that financial statements are one main device to reduce the agency problem. Although there are other mechanisms such as efficient market for corporate control, governmental regulation, efficient job market for managers and managerial stock ownership program. Thus, the entrenchment effect and the alignment effect of ownership structure are employed to explain those mixed results.

2.1 Ownership concentration and the quality of financial reporting

Prior research indicates two alternative effects of ownership concentration on the quality of financial reporting: alignment and entrenchment. According to the alignment impact, the quality of financial reporting in ownership concentrated firms are likely to increase because ownership concentrated firms provides sufficient incentive to larger shareholders to monitor management (Ramsey and Blair, 1993). Ownership concentration may cause positive changes in firm by increasing control, but other mechanism may act reversely. Shipper (1989) shows that ownership concentration cause management behavior improvement in respect to low quality of reporting. In addition, Stiglitz (1985) suggests that concentrated ownership might inversely influence the value of firm, given the capacity of larger shareholders to exploit their dominant position at the cost of minority stockholders. Wang (2006) investigates the association between the presence of concentrated owners and the incidence of fraud. The study finds that high ownership concentration is linked with a higher likelihood of fraud and a tendency to commit fraud. Moreover, Lui and Lu (2007) find a positive and significant association between the level of ownership concentration and earnings management practices. Therefore, the concentrated ownership reduces the quality of financial reporting. Because of the listed firms in The Stock Exchange of Thailand generally have the controlling shareholders. The concentrated ownership can imply the concentration of shares in the hands of a few shareholders, making the entrenchment hypothesis is even more relevant. Thus, the prediction about the relationship between ownership concentration and firms' accounting restatement is as follow:

H1: the ownership concentration is positively associated with the probability of firms' accounting restatement.

2.2 Institutional ownership and the quality of financial reporting

The studies on the institutional ownership effects on the quality of financial reporting reveal the mixed results. Chung, Firth, and Kim (2002) find the inverse relationship between financial reporting quality and institutional ownership. Their result supports the efficient monitoring hypothesis that institutional investors can have abilities and resources to monitor managers effectively in comparison to individual investors. In addition, Velury and Jenkins (2006) examine the quality of reporting proxy by the earnings quality in the conceptual framework of FASB. The result shows the positive relation between the institutional ownership and earnings quality.

On the other hand, some research demonstrates the negative relationship between institutional ownership and financial reporting quality. In this view, the institutional investors are short-term oriented. Balsam, Bartov, and Marquardt (2000) believe that institutional owners are professional investors who have long-term focus. They also state that institutional investors are more able to manage firms' accounting data than non-institutional investors, because they have access to the relevant and timely information. In addition, Roodposhti and Chashmi (2011) find a significant positive relationship between earnings management and institutional ownership for the sample firms in Iran. According to the mixed results, it is ambiguous from prior literature how the institutional ownership affects the quality of financial reporting. However, this study hypothesize that institutional investors can have abilities and resources to monitor managers effectively and can prohibit managers from manipulate the accounting data. Therefore, the prediction about the relationship between institutional ownership and firms' accounting restatement is as follow:

H2: the institutional ownership is negatively associated with the probability of firms' accounting restatement.

2.3 Foreign ownership and the quality of financial reporting

Foreign ownership is found to improve corporate governance. Firms in developed economy countries perform better governance than firms in developing economy countries (LaPorta et. al 1999). Therefore, foreign investors, especially from the developed economies, bring better standard of corporate governance from their countries on average to force their invested

Thai firms to comply with it. Gillan and Starks (2003) argue that foreign investors play a central role in prompting change in many corporate governance systems through either direct monitoring by using their voting right to influence management decisions or indirect monitors by threatening to sell their shares. As mention above, the prediction about the relationship between foreign ownership and firms' accounting restatement is as follow:

H3: the foreign ownership is negatively associated with the probability of firms' accounting restatement.

2.4 Government ownership and the quality of financial reporting

Government enterprises tends to emphasis political objectives rather than economics efficiency and have failed to confront the emerging competition from private enterprises (Naughton, 1995). Moreover, Shleifer (1998) documents that government enterprises is frequently show the corporate inefficiency due to the factors such as bureaucratic interference, conflicting objectives, and weak managerial incentives. The investigation of the effect of government ownership on the quality of financial reporting is controversial topics. Wang and Yung (2011) claim that there is less evidence and it is not clear whether business manager in government ownership firms would behave in the same way as their counterparts in private companies regarding financial reporting. However, several studies on Chinese state-owned enterprises suggest that government ownership is associated with earnings management in the form of related parties transactions (Chen and Yuan, 2004; Liu and Lu, 2003). In addition, Shleifer and Vishny (1989) also suggest that managers in government ownership firms are more likely to mask firm performance and limit information disclosure for the benefit of controlling parties. According to prior research and agency theory mention above, the prediction about the relationship between government ownership and firms' accounting restatement stated is as follow:

H4: the government ownership is positively associated with the probability of firms' accounting restatement.

2.5 Family ownership and the quality of financial reporting

Family ownership could affect the quality of financial reporting in one of two competing ways; the entrenchment effect and the alignment effect. The entrenchment effect is consistent with the traditional view that family firms are less efficient because ownership concentration creates incentives for managers to expropriate wealth from outside shareholders (Shleifer and Vishny, 1997). Fan and Wong (2002) argue that family ownership limits accounting information flows to outside investors. As a results, family members have the incentive and opportunity to manipulate accounting data for private rents. Contrary, the alignment effect argues that family ownership creates greater monitoring by controlling owners. Demsetz and Lehn (1985) suggest that family ownership might monitor firms more effectively because of their long-term and sustainable presence in the firm, and the intention to preserve the family name. Accordingly, the alignment effect predicts that family firms are less likely to engage in opportunistic behavior in reporting financial statement. There is many research which consistent with the alignment effect. For example, Ali, Chen, and Radhakrishnan (2007) suggest that family firms have higher earnings quality than non-family firms, although family firms disclosed the less information compared to non-family ones. In addition, Wang (2006) suggests that founding family ownership is significantly associated with lower abnormal accruals, greater earnings informativeness, and less persistence of transitory loss component in earnings, after controlling for potential bias from time-series correlation, executive compensation, and nonfamily blockholder ownership. According to the alignment effect, the prediction about the relationship between family ownership and firms' accounting restatement is as follow:

H5: the family ownership is negatively associated with the probability of firms' accounting restatement.

2.6 Political connected firms and the quality of financial reporting

Facio (2006) examine how the quality of the accounting information reported by publicly traded firms is affected by the existence of political connections. They use the definition and measure of the political connected company and use the standard deviation of firm's discretionary accruals as a proxy of earnings quality. They find that the political connected firms provide lower quality of accounting earnings than do their non-connected peers. As mention above, the prediction about the relationship between the political connected firms and firms' accounting restatement is as follow:

H6: the political connected firms are positively associated with the probability of firms' accounting restatement.

3. RESEARCH DESIGN

3.1 Sample

The sample used in this study consists of all non-financial Thai listed firms in SET index in year 2011. From the samples, incomplete or missing data firms and rehabilitation firms were removed. The data regarding accounting restatement are hand collected from SET Market Analysis and Reporting Tool (SETSMART) database and SET Information Center. Financial-firms are excluded due to the difference and more restricted regulations. The data for the ownership structure and firms characteristics are obtained from the company's annual report submitted annually to the Stock Exchange of Thailand. The company's annual report provides ownership data that includes the top 10 shareholders in the firm. It also provides a list of a firm's affiliated companies and the shareholdings. Finally, this study collects accounting data from consolidated financial statements instead of separated financial statements because the consolidated financial statements represent the results of overall activities of firms, which include firm and their subsidiaries, not only the activities of one single firm as shown in separated financial statements.

3.2 Model for Testing Hypotheses

To test whether ownership structures are associated with the accounting restatement, the dummy variable of restatement is regressed on the ownership structure variables and control variables. The following model are used for hypothesis testing.

$$\begin{aligned} RESTATE_i = {} & \beta_0 + \beta_1 CONCENT_i + \beta_2 INSTITUTE_i + \beta_3 FOREIGN_i \\ & + \beta_4 GOVERN_i + \beta_5 FAMILY_i + \beta_6 POLITIC + \beta_7 SIZE_i \\ & + \beta_8 LEV_i + +\varepsilon_i \end{aligned}$$

4. EMPIRICAL RESULT

Table 1, presents the descriptive statistics of dependent and independent variables used in this study. The variables consist of CONCENT (the percentage of share held by shareholder who owning 5% or more of firm's shares), INSTITUTE (the percentage of firm's share held by institute investors), FOREIGN (the percentage of firm's share held by foreign investors), GOVERN (the percentage of firm's share held by government or state owner), FAMILY (the percentage of firm's share held by a singer shareholder or member of his or her family by either blood or, marriage), SIZE (the natural logarithm of firm's total assets), LEV (total debts to total assets of firm), RESTATE (an indicator variable with the value of "1" if firm has financial reporting restatement in year 2011, "0" if firm does not have financial reporting restatement), and POLITIC (an indicator variable with the value of "1" if one of firm's family member is a member of parliament or a minister).

Table 1, Panel A reports the descriptive statistics of independent variables which are continuous variables. The average of ownership concentration is 55.57% with the maximum of 97.81% which indicates that listed firms in The Stock Exchange of Thailand generally have the controlling shareholders. The average percentage of shares held by the institute investors, foreign investors, and government are 12.91%, 11.96%, and 1.91%, respectively. The percentage of family shareholders in Thai listed firms is 33.00% on average with the maximum percentage of 99.64%. The high percentage of family shareholders is consistent with Wiwattanakantang (2001) that firms more than 80 percent of Thai listed firms have the controlling shareholders and most of them are controlled by family.

Table 1, Panel B reports the descriptive statistics of RESTATE and POLITIC variables which are nominal variables. The results show 113 firms (26.2%) have restate their financial statements while 274 firms (70.8%) have not. In addition, the result also shows 166 firms (42.9%) have political connections in year 2011.

The regression of the financial reporting restatement on firms' ownership structure and firms' characteristics are performed and shown in Table 2. The pseudo R2 is equal 16.7%. The model shows that ownership concentration (CONCENT) is positively significantly related to financial reporting restatement (RESTATE). This result supports hypothesis 1 that the ownership concentration is positively associated with the probability of firms' accounting restatement. The finding is consistent with the entrenchment hypothesis that the concentrated ownership reduces the quality of financial reporting. Therefore, concentrated ownership firms have a tendency to manipulate accounting data and to commit fraud (Wang, 2006). Moreover, this result is consistent with Fan and Wong (2002) which indicates that concentrated ownership and associated pyramidal and cross-holding structures are negatively associated with the quality of accounting information in seven East Asian countries, including Thailand.

In addition, the results in Table 2 also show that political connection (POLITIC) is significantly related to financial reporting restatement (RESTATE). The coefficient of POLITIC is significantly positive at 1%, thus hypothesis 6 is supported. This result indicates that the political connected firms have low quality of financial reporting since they have more probability to restate their financial reporting. These association is consistent with Chaney, Faccio, and Parsley (2007) that the political connected firms provide lower quality of accounting earnings than do their non-connected peers.

Contrary, family ownership (FAMILY) is negatively significantly related to financial reporting restatement (RESTATE). The regression result is also shown in Table 2. The negative association between family ownership and financial reporting restatement is consistent with predicted sign in hypothesis 5. According to the prior research, family ownership could affect the quality of financial reporting in one of two competing ways; the entrenchment effect and the alignment effect. The result of this study supports the alignment effect that family ownership creates greater monitoring by controlling owners and less likely to engage in opportunistic behavior in reporting accounting data (Demsetz and Lehn, 1985). The intuition behind this relation is the intention of family owner to preserve their family name and to maintain their sustainable benefits.

Furthermore, the regression results are not support hypothesis 2, 3, and 4. The institute ownership (INSTITUTE), foreign ownership (FOREIGN), and government ownership (GOVERN)are not significantly associated with the financial reporting restatement. Moreover, the INSTITUTE and FOREIGN have positive relations with financial reporting restatement, which contrary with predicted sign. The positive relation means that when institute owner and foreign owners are increased, the quality of financial reporting of such firms are decreased. However, the coefficient of GOVERN is consistent with predicted sign that means firms with government ownership have a tendency to restate their financial reporting.

Table1.
Descriptive Statistics

Panel A: Continuous Variables				
Variable	*Minimum*	*Maximum*	*Mean*	*S.D.*
CONCENT	0.00	97.81	55.57	19.69
INSTITUTE	0.00	85.00	12.91	14.73
FOREIGN	0.00	94.02	11.96	17.73
GOVERN	0.00	77.28	1.91	9.42
FAMILY	0.00	99.64	33.00	24.38
SIZE	16.54	27.97	22.11	1.58
LEV	.000	2.07	0.48	0.28

Panel B: Nominal Variables				
Variable	1	%	0	%
RESTATE	113	29.2	274	70.8
POLITIC	166	42.9	221	57.1

Table 2
Regression of the financial restatement and ownership structure

	Expected sign	*Parameter estimates*	*Sig.*	
Intercept		-0.571	0.767	
Ownership structure variables:				
CONCENT	+	0.031	0.000	***
INSTITUTE	-	0.002	0.823	
FOREIGN	-	0.001	0.876	
GOVERN	+	0.001	0.920	
FAMILY	-	-0.011	0.047	***
POLITIC	+	0.966	0.000	***
Control variables:				
SIZE	+/-	-0.111	0.204	
LEV	+/-	0.369	0.407	
Pseudo R-square		0.167		
N=387				

Note: ***, **, and * represent significance at the 1%, 5% and 10%, respectively.

The regression being estimated is

$$RESTATE_i = \beta_0 + \beta_1 CONCENT_i + \beta_2 INSTITUTE_i + \beta_3 FOREIGN_i + \beta_4 GOVERN_i + \beta_5 FAMILY_i + \beta_6 POLITIC + \beta_7 SIZE_i + \beta_8 LEV_i + +\varepsilon_i$$

Where;

RESTATE = an indicator variable with the value of "1" if firm has financial restatement in year 2011, "0" if firm does not have financial restatement in year 2011.

CONCENT = the percentage of share held by shareholder who owning 5% or more of firm's share in year 2011.

INSTITUTE = the percentage of firm's share held by institute investors in 2011.

FOREIGN = the percentage of firm's share held by foreign investors in 2011.

GOVERN = the percentage of firm's share held by government or state owner in year 2011.

FAMILY = the percentage of firm's share held by a singer shareholder or member of his or her family by either blood or, marriage in year 2011.

POLITIC = an indicator variable with the value of "1" if one of firm's family member is a member of parliament or a minister during the year 2011, "0" if not.

SIZE = natural logarithm of firm's total assets in year 2011.

LEV = total debts to total assets of firm in year 2011.

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