

Influence of Firm Characteristics on Firm Value through Corporate Governance and Earnings Management of Listed Companies on the Stock Exchange of Thailand

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Abstract:

The study on causal relationship of firm characteristics that affects firm value through corporate governance and earnings management of companies listed on the Stock Exchange of Thailand. The research aims to study causal relationship of firm characteristics, corporate governance, and earnings management that affect firm value of companies listed on the Stock Exchange of Thailand. Was conducted corporate governance disclosure in accordance with notification of the Stock Exchange of Thailand Re: Principles of corporate governance, 2017. Information in annual registration statement (Form 56-1), annual financial statement, footnotes to financial statement, corporate governance report, and sustainability report in 2018 of 468 companies listed on the Stock Exchange of Thailand were studied with the multiple indicators and multiple causes (MIMIC) model. The findings from the study showed that firm characteristics variable, corporate governance variable, and earnings management variable had influence on firm value both directly and indirectly significantly. It was also found that an increase in firm characteristics resulted in corporate governance and an increase in firm value accordingly. Meanwhile, it was found that an increase in firm characteristics affected a decrease in earnings management.

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I. INTRODUCTION

The financial collapse of giant companies in the United States like the Enron Corporation and WorldCom Company on concealment and creative accounting as well as corporate fraudulent statements caused huge damage to financial markets (Berthelot, Morris & Morrill, 2010, pp. 635-646). Bankruptcy caused by creative accounting, financial reports that do not accurately and completely represent company's operating performance and company's financial position, in transparent practices of executives, inefficient internal control and internal audit have an impact on related persons regarding investors, creditors, employees including reliability of financial reports and confidence in corporate governance. Thailand 1997 financial crisis was partly triggered by weak corporate governance (Maher & Anderson, 1999, pp. 1-51). From that crisis, corporate governance has become an important framework condition considerably (Krenn, 2015, pp. 369-382), contributing to the drive of corporate governance by related agencies (Carcello, Hermanson & Raghunandan, 2005, pp. 69-84) including Thailand whose corporate governance system has been developed to ensure that financial reports will be reliable. Financial statement is an important tool of information for decision making of investors, analysts, shareholders, and board of directors as decision making depends on an increase in corporate governance (Stiglbauer & Velte, 2014, pp. 395-406). Financial statement shall meet good quality, represent fairness and engage in the decision making process (Abdillah, Mardijuwono & Habiburrochman, 2019, pp. 129-144). Therefore, consideration of qualifications of company's board of directors whether or not they plays an important role in the quality of accounting information is interesting because qualifications of company's board of directors will help reduce uncertainty and inequality of the information as well as support the monitoring mechanism of other matters in

companies (Boonlert-U-Thai & Pakdee, 2018, pp. 27-47).

Companies listed on the Stock Exchange of Thailand give importance to corporate governance in a clear manner because people as shareholders cannot access management; therefore, a group of reliable people is appointed to be board of directors to supervise and oversee company executives. Board of directors shall take responsibility for operating performance to shareholders and is independent from management and performs duties to retain benefits of the company and shareholders immensely to ensure that shareholders will receive earnings worth their investment (Securities and Exchange Commission, 2016). Besides, Michelin & Parbonetti (2012, pp. 477-509) found that corporate governance in terms of the size of board of directors and the proportion of independent board of directors to corporate governance resulted in an increase in firm value. Hodgson, Lhaopadchan & Buakes (2011, pp. 53-79) said that corporate governance had an effect on good operating performance and would generate high earnings in the future.

Companies listed on the Stock Exchange of Thailand give substantial importance to corporate governance as it reveals that their management is full of efficiency, transparency, and accountability, building trust and confidence in investors, shareholders, and stakeholders including related persons and leading to stable and sustainable growth (The Stock Exchange of Thailand, 2017). Corporate governance majorly aims to generate maximum benefits to shareholders and create added value to companies since their shareholders or business owners require earnings that are worth their investment. Some companies carry out their business to create earnings as much as possible without consideration of any impact that other people probably receive. Namely, companies can operate their business to achieve their set goals but the earnings they have in return from the operation without consideration of ongoing impact are short-term earnings that cannot create added value to

companies in a long-term period. Therefore, corporate governance plays a part in helping create added value to companies and generate maximum benefits to shareholders and all stakeholders (Srijanpetch, n.d., pp. 19-23).

Corporate governance originated from conflict between shareholders and management executives which seemed to be an obstacle for creating company value (Jensen & Meckling, 1976, pp. 305-360). One of the reasons is management executives can adopt accounting standards that rely on managerial discretion and are able to manage earnings shown in financial statement report. In this regard, the shown earnings cannot represent the actual status and financial reports do not accurately and completely represent company's operating performance and financial position (Burgstahler & Dichev, 1997, pp. 99-126). The earning management technique that executives most likely use is accrual management (Ferris et al., 1998, pp. 235-264). This is consistent with a study conducted by Juan & Emma (2007, pp. 677-691) that found that a company with a high proportion of shares held by board of directors will have a high level of accrual-based earnings management. According to the agency theory, executives who manipulate a high level of earnings require to have higher expected rate of returns to attract investors.

Corporate governance practices have become a point that many countries experiencing problems after the 1997 financial crisis adopted good governance codes into corporate governance practices of companies listed on the Stock Exchange (Zabri, Ahmad & Wah, 2016, pp. 287-296). After the 1997 financial crisis, Thailand viewed the importance of building trust and confidence in capital markets since capital markets are important to the country economic and social systems and sources of crowd funding to agencies in the public and private sectors that would help strengthen balance of the financial system and a driving mechanism for the country's economic development (Securities and Exchange Commission, 2017). Considerable study results of corporate

governance indicated clear connection among corporate governance, operating profit, and an indicator of return on investment. For example, the study of Institutional Shareholder Services (ISS) and Georgia State of University found that companies with corporate governance would have average rate of return from investment and return on equity ratio higher than those of companies with poor corporate governance (The Stock Exchange of Thailand, 2017) and this is consistent with the research conducted by Black, Jang & Kim (2005, pp. 1-67) that revealed that corporate governance resulted in good operating performance of companies and chances to reduce corruption.

Since 2002, the Stock Exchange of Thailand has encouraged listed companies to be aware of the importance and benefits of corporate governance by proposing 15 principles of corporate governance for listed companies to implement as (1) policy on corporate governance, (2) shareholders: rights and equitable treatment, (3) stakeholders' rights, (4) shareholders meeting, (5) leadership and vision of board of directors, (6) conflict of interest, (7) business ethics, (8) balance of power for non-executive directors, (9) aggregation or segregation of duties, (10) directors' and shareholders' remuneration, (11) meeting of board of directors, (12) sub-committees, (13) control system and internal audit, (14) directors' report and (15) investor relations. Later in 2006, the principles of corporate governance for listed companies were revised by comparing to the principles of corporate governance of the Organization for Economic Co-Operation and Development (2004 OECD Principles of Corporate Governance) and recommendation made by World Bank in its Corporate Governance-Reports on the Observance of Standards and Codes (CG-ROSC) for company benefits and benefits of others towards competitive advantage and the growth of Thai capital market.

In 2012, the Stock Exchange of Thailand revised the principles of corporate governance for listed companies by adding best practices of 5 categories

to be compatible with ASEAN Corporate Governance Scorecard (ASEAN CG Scorecard) and the 2012 principles of corporate governance were presented in 5 categories as (1) rights of shareholders, (2) equitable treatment of shareholders, (3) role of stakeholders, (4) disclosure and transparency and (5) responsibilities of board of directors (The Stock Exchange of Thailand, 2017). Consequently, the researcher viewed the importance of analyzing influence of firm characteristics, corporate governance, and earnings management on firm value of companies listed on the Stock Exchange of Thailand for benefits of building trust and confidence in shareholders, investors,

stakeholders and related persons, benefits of companies in giving importance to corporate governance practices that will support companies to have a management system full of efficiency, transparency, and reliability, contributing to firm value with sustainable growth.

II. LITERATURE REVIEW

In the past, there were considerable research papers associated with firm characteristics, corporate governance, earnings management, and firm value and in those studies different variables were determined depending on objectives and points researchers paid attention to which can be summarized in the Table 1.

TABLE I
Summary of research results in the past

Title	Results	Researcher
Relationship analysis of corporate governance, earnings management and practice results.	The study result showed that corporate governance practices were important to earnings management, especially the independence of board of directors.	Hutchinson, Percy & Erkurtoğlu (2008, pp. 239-262)
Corporate governance and earnings management in China.	The study result revealed that board of directors played a part in earnings management after companies experienced loss.	Zhang, Mahenthiran & Huang (2012, pp. 108-127)
Corporate governance and earnings management: companies in Malaysia.	The study result showed that corporate governance could control earnings management in family-owned companies and non-family owned companies and the study also found that the number of board of directors meeting, independence of board of directors, audit committees, the size of audit committees, internal audit, and quality auditors were an effective corporate governance mechanism that help reduce earnings management.	Mansor, Ahmad, Zaluki & Osman (2013, pp. 221-229)

Board of director's structure and earnings management in Malaysia.	The study result showed that board of directors was associated with earnings management.	Jamaludin, Sanusi & Kamaluddin (2015, pp. 235-242)
Efficiency of board of directors and audit committees variety of nationalities that affect earnings management: a case study of manufacturing sector in Malaysia.	The study result revealed that board of directors and audit committees had positive relationship with earnings management before and after improvement principles of corporate governance in Malaysia.	Mohammad, Wasiuzzaman & Salleh (2016, pp. 726-746)
Corporate governance, Islamic corporate governance and earnings management in Oman.	The study result indicated that companies with poor corporate governance resulted in earnings management. There was no relationship between the size of board of directors and corporate governance board of directors but the gender of board of directors significantly related to earnings management.	Elghuweel, Ntim, Opong & Avison (2017, pp. 190-224)
The impact of corporate governance code on earnings management in listed non-financial firms: Evidence from Kenya.	The finding from the study showed that there was no significance between accruals and corporate governance and corporate governance did not have any effect on earnings management of non-financial firms in Kenya.	Outa, Eisenberg & Ozili (2017, pp. 428-444)
Corporate governance, international corporate governance ranking, and earnings management: an international case study.	The study result indicated that corporate governance had significance to a low level of earnings management in each country.	Helaly, Shehata & Sherif (2018, pp. 373-390)

Does corporate governance influence earnings management in listed companies in Bahrain?	The study result revealed that ownership and independence of board of directors had positive relationship with earnings management, the size of board of directors had negative relationship with earnings management, and aggregation of Chairman of the Board's position did not correlate with earnings management.	Alareeni (2018, pp. 551-570)
Corporate governance board of director survey: Forgetful greatness.	The finding from the study showed that companies having corporate governance board of directors resulted in enthusiastic practices and better financial efficiency.	Henri & Heroux (2019, 339-352)
Corporate governance and capital structure: Evidence from Pakistan.	The study result revealed that corporate governance measures played an important role in determining firm characteristics and companies had clear duties to perform corporate governance practices.	Sheikh (2019, pp. 341-353)

Research hypotheses

- H1: Firm characteristics have a direct influence on corporate governance.
- H2: Firm characteristics have a direct influence on earnings management.
- H3: Firm characteristics have a direct influence on firm value.
- H4: Corporate governance has a direct influence on earnings management.
- H5: Corporate governance has a direct influence on firm value.
- H6: Earnings management has a direct influence on firm value.

III. METHODOLOGY

Population and sample

Population in this research consists of the listed companies in the Stock Exchange of Thailand

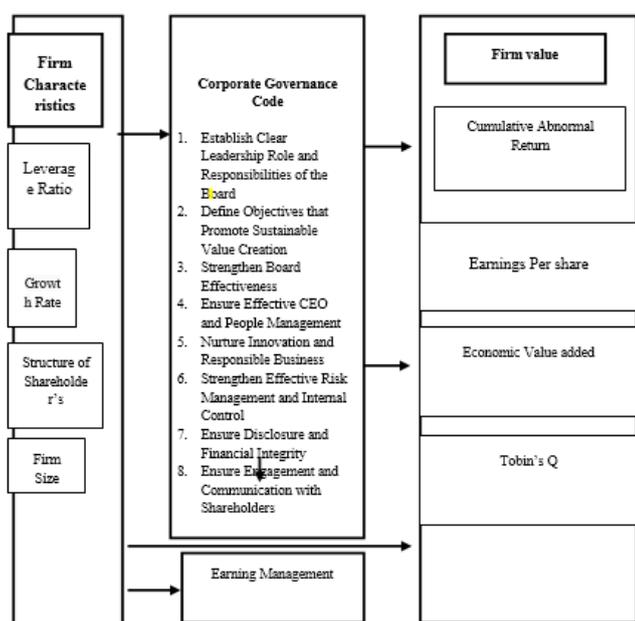


Fig 1. Conceptual Framework

as of the year 2018 from 7 categories of industry and 468 companies (Data as of January 9, 2019, the Stock Exchange of Thailand, 2019) as shown in Table 2.

TABLE II

Number of samples by industry groups

Industrial groups' names	No. of firms
1. Agro-Industrial and Food Industrial groups	52
2. Consumer product industrial groups	39
3. Industrial product industrial groups	89
4. Real estate and construction industrial groups	96
5. Resource industrial groups	47
6. Service industrial groups	110
7. Technology Industrial groups	35
Total	468

Source :Name of the Listed Companies in the Stock Exchange, the Stock Exchange of Thailand, 2019.

Research Format

The researchers collected data of the mechanisms of corporate governance, earnings management, and firm value by filtering and filed data from annual reports (Form 56-1), corporate governance report, sustainable report and annual financial statements of the listed companies in the Stock Exchange of Thailand in 2018. Also, data of corporate governance disclosure was derived from statistics of corporate governance disclosure according a guideline of GRI (Global Reporting Initiative, 2011) and cross-checked data from annual reports (Form 56-1), financial statements, corporate governance report, sustainable report and notes to financial statements of the listed companies in the Stock Exchange of Thailand in 2018. The checking criteria are as follows:

Companies which disclosing corporate governance on one dimension earns 1 point

Companies which not disclosing corporate governance on any dimensions earns 0 point

Note: if the companies disclose corporate governance but the dimensions are not relevant to corporate activities, the symbol will be N/A (Not Applicable) and the researchers will not include that data to be analyzed.

The statistics used to analyze data

This study adopted Structural Equation Model and Multiple Indicators and Multiple Causes (MIMIC) Model to analyze data.

IV. RESULTS

With regard to data analysis result presentation, the researcher specified symbols representing variables for the presentation so as to have the same understanding of symbols used in this research study. The symbols are shown in the Table 3 as follow:

TABLE III

Thai names and English names of variables and indicators.

Variables	Abbreviation
Firm Characteristics	COM
Leverage Ratio	LEV
Growth Rate	GRO
Structure of Shareholder's	SHD
Firm Size	SIZ
Corporate Governance Code	CGC
Establish Clear Leadership Role and Responsibilities of the Board	CG1
Define Objectives that Promote Sustainable Value Creation	CG2
Strengthen Board Effectiveness	CG3
Ensure Effective CEO and People Management	CG4
Nurture Innovation and Responsible	CG5

Business	Economic Value added	EVA
Strengthen Effective Risk Management and Internal Control	CG6	Tobin's Q
Ensure Disclosure and Financial Integrity	CG7	The result of conceptual framework analysis following hypothesized model showed that the model was modified to allow error correlation which was true to actual situation. The researcher modified the model to enable the conceptual framework to be consistent with empirical data as seen in the Table 4.
Ensure Engagement and Communication with Shareholders	CG8	
Earning Management	EAR	
Firm value	FMV	
Cumulative Abnormal Return	CAR	
Earnings Per share	EPS	

TABLE IV

The path coefficient, standard error, and t-value of the structural equation model after modification for causal model analysis of influence of firm characteristics, corporate governance, and earnings management on firm value of companies listed on the Stock Exchange of Thailand in 2018 (n = 468).

Path Diagram	Path Coefficients	Standard Errors	t-values
GAMMA			
COM	0.12*	0.06	1.96
CGC			
COM	-0.16*	0.07	2.40
EAR			
COM	0.59**	0.22	2.72
FMV			
BETA			
CGC	0.21*	0.10	2.01
FMV			
CGC	-0.16**	0.05	3.33
EAR			
EAR	-0.46**	0.12	3.92
FMV			
Remark :Path Diagram is the layout of path, Path Coefficients mean the value assigned to the path * refers to a statistical significant level of 0.05 (1.960 ≤ t-value < 2.576) ** means a statistical significant level of 0.01(t-value ≥ 2.576).			

Based on the Table 4, the path analysis results according to the equation model of the influence of firm characteristics, corporate governance, and earnings management on firm value of companies

listed on the Stock Exchange of Thailand are presented in 2 parts as (1) measurement model comprising influence path between observed variables and endogenous latent variables

(LAMDA-Y) and (2) structural parts consisting of (2.1) GAMMA and (2.2) BETA. Measurement model analysis results in the structural equation model after modification showed that firm characteristics, corporate governance, and earnings management had an effect on firm value of companies listed on the Stock Exchange of Thailand.

Consideration of factor loading of the observed variables and the endogenous latent variables of firm characteristics (COM) revealed the component variable that best described firm characteristics (COM) was the size of companies (SIZ) with the highest factor loading equal to 0.98, followed by leverage Ratio (LEV) with factor loading equal to 0.23, company's growth rate (GRO) with factor loading equal to 0.13 and structure of Shareholder's (SHD) with factor loading equal to 0.12.

Consideration of factor loading of the observed variables and the endogenous latent variables of corporate governance (CGC) showed that the component variable that best described corporate governance was chief executives recruitment and development and personnel administration (CG4) with the highest factor loading equal to 0.86, followed by promoting innovation and conducting business with responsibility (CG5) had factor loading equal to 0.83 while maintaining financial reliability and information disclosure (CG7) had factor loading equal to 0.73, awareness

of roles and responsibilities of board of directors as leaders of the organization who create value to business in a sustainable manner (CG1) with factor loading equal to 0.72, overseeing the company's proper system of risk management and internal control (CG6) had factor loading equal to 0.66, enhancing the effectiveness of board of directors (CG3) with factor loading equal to 0.63, supporting participation and communicating with shareholders (CG8) had factor loading equal to 0.62, The component variable that least described corporate governance was determining objectives and major goals of business for sustainability (CG2) that had factor loading equal to 0.42.

Factor loading of the observed variables and the endogenous latent variables of firm value (FMV) found that abnormal rate of return (CAR) had the highest factor loading equal to 0.30, followed by earnings per share ratio (EPS) with factor loading equal to 0.28, economic value added (EVA) with factor loading equal to 0.26 and performance measurement ratio (TBQ) had factor loading equal to 0.19.

The study results of influence of firm characteristics, corporate governance, and earnings management on firm value of companies listed on the Stock Exchange of Thailand can be concluded as seen in the Table 5 and Figure 2

TABLE V

Analysis results of the structural equation model path based on the hypotheses.

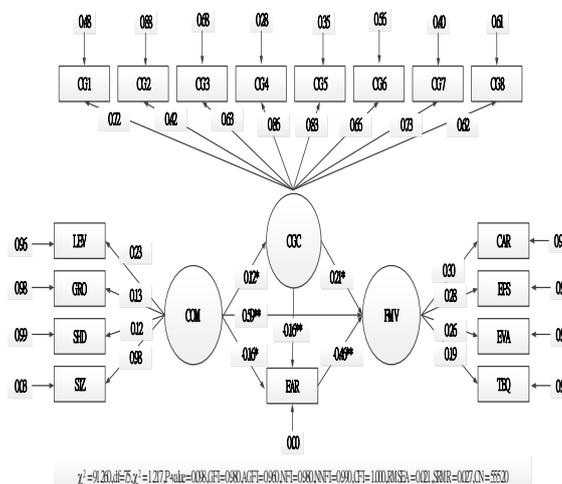
Var	CGC			EAR			FMV		
	T	D	I	TE	DE	I	TE	DE	IE
iabl	E	E	E			E			
e									
CO	0.	0.		-	-	-	0.7	0.5	0.1
M	1	1	-	0.1	0.1	0.	0*	9*	1**
	2	2		8*	6*	0	*	*	(0.0

	*	*		*	(0. 2 (0. (0. 4)
	(0 (0 (0. 07) (0 24) 22)				
	.0 .0 6)	.0 6)	07)	.0 1)	
			-	-	
			0.1 0.1	0.2 0.2	0.0
CG			6* 6*	8* 1*	7*
C			* *	(0. (0. (0.0	
			(0. (0. 11) 10) 3)		
			05) 05)		
				-	-
				0.4 0.4	
EA				6* 6*	
R				* *	-
				(0. (0.	
				12) 12)	
Observable Variable	C	E	F		
	G	A	M		
	C	R	V		
R ²	0. 0 1	0. 0 6	0.7 8		

$\chi^2 = 91.26$, $df = 75$, $\chi^2/2 = 1.22$, P-value = 0.098,
GFI = 0.98, AGFI = 0.96, NFI = 0.98, NNFI =
0.99, CFI = 1.00, RMSEA = 0.021, SRMR =
0.027, CN = 555.20

Note p* < .05; p** < .01; p*** < .001

Total Effect (TE), Direct Effect (DE) and Indirect Effect (IE)



Note $p^* < .05$; $p^{**} < .01$; $p^{***} < .001$

Fig.2 Influence model of firm characteristics that affects firm value through corporate governance and earnings management of listed companies on the Stock Exchange of Thailand in 2018

Analysis results of the influence path between the causal variables and the endogenous latent variables

The structural analysis between the causal variables and the endogenous latent variables indicated that the causal variables having an influence on the endogenous latent variables with a statistical significance level of 0.01 consisted of firm characteristics variables (COM) and firm value variables (FMV) with the highest path coefficient equal to 0.59. The causal variables having an influence on the endogenous latent variables with a statistical significance level of 0.05 consisted of firm characteristics variables (COM) and earnings management variables (EAR) with the path coefficient equal to 0.16, followed by firm characteristics variables (COM) and corporate governance variables (CGC) with the path coefficient equal to 0.12.

Analysis results of the influence path between the causal variables and the endogenous latent variables based on consideration of the structure between the causal variables and the

endogenous latent variables showed that the causal variables having an influence on the endogenous latent variables with a statistical significance level of 0.01 consisted of earnings management variables (EAR) and firm value variables (FMV) with the highest path coefficient equal to -0.46, followed by corporate governance variables (CGC) and earnings management variables (EAR) with the path coefficient equal to 0.16. The causal variables having an influence on the endogenous latent variables with a statistical significance level of 0.05 consisted of corporate governance variables (CGC) and firm value variables (FMV) with the path coefficient equal to 0.21.

Based on the results of studying causal relationship of firm characteristics, corporate governance, and earnings management that have an effect on firm value of companies listed on the Stock Exchange of Thailand, hypothesis test results are shown in the Table 6

TABLE VI
Results of hypothetical testing

Research Hypothesis	Hypothetical Testing	Direction/Effect
H1: Firm characteristics have a direct influence on corporate governance.	Accepted	+*
H2: Firm characteristics	Accepted	-*

have a direct influence on earnings management.		
H3: Firm characteristics have a direct influence on firm value.	Accepted	+**
H4: Corporate governance has a direct influence on earnings management.	Accepted	-**
H5: Corporate governance has a direct influence on firm value.	Accepted	+*
H6: Earnings management has a direct influence on firm value.	Accepted	-**

Note: + defines as a significantly positive effect
- defines as a significantly negative effect

V. CONCLUSION AND RESEARCH DISCUSSION

Firm characteristics have a direct positive influence on corporate governance information disclosure and firm value and it is also found that firm characteristics have an indirect positive influence on firm value through disclosure of corporate governance information with statistical significance. The study results showed that an increase in firm characteristics, firm size, shareholder concentration, company growth, and leverage ratio shall result in disclosure of corporate governance information accordingly. This is consistent with the study of Sheikh (2019) that found corporate governance measures played

an important role in determining firm characteristics and companies had clear duties to perform corporate governance practices. The study on firm size of companies listed on the Stock Exchange of Thailand in 2017 revealed that differences in firm size had an influence on disclosure of economic, social, and environment information differently. The findings from the study showed that large firms disclosed more information than medium-sized and small-sized firms (Phoprachak, 2018). With regard to shareholder concentration, results from previous studies gave consistent results with this study as the findings showed that companies with high shareholders concentration would have a high disclosure level of corporate governance information as well and it was also found that company's operating performance increased by a disclosure level of corporate governance report (Klinphanich et al., 2019) and Henri & Heroux (2019) found that companies having corporate

governance board of directors resulted in enthusiastic practices and better financial efficiency. Results of the study on firm characteristics found that firm characteristics had a direct and indirect influence through disclosure of corporate governance information on earnings management in a negative manner with statistical significance or it can be said that an increase in firm characteristics enabled higher earnings management accordingly. Those study results were consistent with the past research of Alareeni (2018) that found that the size of board of directors had negative relationship with earnings management and aggregation of Chairman of the Board's position did not correlate with earnings management and the study of Mansor et al., (2013) that found that corporate governance could control earnings management in family-owned companies and non-family owned companies and the study also found that the number of board of directors meeting, independence of board of directors, audit committees, the size of audit committees, internal audit, and quality auditors were an effective corporate governance mechanism that help reduce earnings management which is consistent with the results of this study in terms of disclosure of corporate governance information that found that it had a direct negative influence on earnings management and earnings management had a direct negative influence on firm value as well.

VI. RECOMMENDATION

1. Future research should be additionally conducted using this conceptual framework and adding causal variables such as liquidity or profitability. To magnify study results, the study should be categorized by industry groups so as to penetrate study results.

2. Future research should be additionally conducted on qualitative study and study results should be profoundly magnified in terms of costs of disclosure of corporate governance information.

3. Additional studies should be conducted using this conceptual framework with MAI group of companies listed on the Stock Exchange of Thailand.

4. Future research can be additionally conducted using this conceptual framework and the study should be classified by industry groups so as to penetrate and confirm study results.

5. Future research shall magnify study results using this conceptual framework and the study should be conducted on company sustainability when their practices follow the study results of this research so as to increasingly magnify study results.

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