Does Earnings Management Reduce Firm Value in Malaysia?

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Abstract

There is the conflict between management and owners, called agency problems, which arises because of the separation of ownership and management of a firm. Management must enhance firm value. On the other hand, the management wants to achieve their own objectives with ignoring the owner interests. Accounting information that should be the management report to the owners is often used to perform the management's opportunist action, maximizing their own interests by making earnings management. Therefore, necessary to study whether earnings management is carried out by management affect firm value. Earnings management here can be done in two ways, through the real activities manipulation and accrual manipulation (Roychowdhury, 2006).

This study aims to examine the effect of earnings management, either through the real activities manipulation and accrual activity manipulation, to the firm value in Malaysia. The sampling methods is by purposive sampling, with the criteria are companies that listed in Malaysia Stock Exchange and have complete research variable data 2008. We analyze with multiple regression analysis.

We found that accrual earnings management affects the firm value in Malaysia, but real earnings management doesn't have effect.

Keywords: earnings management, firm value, Investment Opportunity Set (IOS)

INTRODUCTION

There is the conflict between management and owners, called agency problems, which arises because of the separation of ownership and management of a firm. Management must enhance firm value. On the other hand, the management wants to achieve their own objectives with ignoring the owner interests. Accounting information that should be the management report to the owners is often used to perform the management's opportunist action, maximizing their own interests by making earnings management. Therefore, necessary to study whether earnings

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This study aims to examine the effect of earnings management, either through the real activities manipulation and accrual activity manipulation, affect firm value in. The sampling methods is by purposive sampling, with the criteria are companies that listed in Malaysia Stock Exchange and have complete research variable data 2008. We analyze with multiple regression analysis.

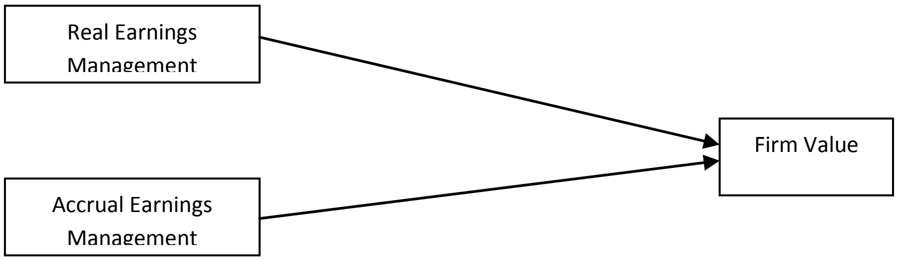
HYPOTHESES DEVELOPMENT

Earnings management is the management's intervention to affect earnings, usually for opportunistic reasons (Subramanyam and Wild, 2009). Earnings management consists of two kinds, accrual earnings management and real earnings management. Accrual earnings management is the earnings management made by management to manipulate accruals without any consequences on the cashflow. Real earnings management is the earnings management that affect on cashflow. This method is different from accrual earnings management in which management does earnings management without impacting cash flow (Subramanyam and Wild, 2009).

Real earnings management practice grow up in the United States since the accounting scandals (Enron and WorldCom) and increased again after the Sarbanes-Oxley Act (SOX) in 2002 (Cohen et.al, 2008). Zang (2007) proved that there is a change in the practice of accrual earnings management and real earnings management. Managers will conduct accrual earnings management at the end of the period when the manager already knew profit before manipulated so they know how much manipulation to achieve the goal. However, this manipulation is very limited because of the audit detection risk. Real earnings management can be done by managers during the current accounting period, either at the beginning of the period or at the end of the period. Real earnings management actually costly than accrual earnings management, but management still do it because this method is more difficult to detect, even by the auditor (Roychowdury, 2006).

Some proponent said that earnings management can reduce firm value. But other proponent said that earnings management can increase firm value. Arya et al (2003) stated that earnings management can be beneficial to share holder. Lin (2011) found that earnings management in Taiwan increases firm value. It is because manager manages earnings to give some information that are not conveyed in unmanaged earnings.

H1: earnings management, either through the real activities manipulation and accrual manipulation, affect the firm value.



3. RESEARCH METHOD

3.1. Population and Samples

The population is company listed in Malaysia Stock Exchange. The observation period was taken in 2008. However, the data used is the financial years 2006 to 2008 because of the formula used a long-range observation. We used purposive sampling method, in which the selection of the sample was based on the following criteria:

Table 1

Sampling Procedure

No	CriteriaQuantity	Malaysia
1	Public Firm	1.256
2	Manufactur Industry	454
3	Uncomplete data	(420)
4	Final sample firms	34

3.2. Variable Measurement

3.2.1. Real earnings management measurement

Real earnings management measurement model Roychowdhury (2006) is used to detect real earnings management in this study. Proxy for real earnings management is abnormal CFO (CFO Abn), kos production of abnormal (Abn PROD), and the cost diskrisionari abnormal (Abn Disc Exp). To capture real earnings management through a third variable in the measurement of comprehensive it will be a variable calculated by combining these three variables.

1. Abnormal Cash flow (CFO)

   a. Normal Cash Flow:

$$\frac{CFO_{it}}{Assets_{i,t-1}} = k_{1t}\frac{1}{Assets_{i,t-1}} + k_2\frac{Sales_{it}}{Assets_{i,t-1}} + k_3\frac{\Delta Sales_{it}}{Assets_{i,t-1}} + e_{it}.$$

b. Abnormal CFO

Abn CFO = Act CFO – Normal CFO

2. Abnormal Production Cost

a. Normal Production Cost

$$\frac{Prod_{it}}{Assets_{i,t-1}} = k_{1t}\frac{1}{Assets_{i,t-1}} + k_2\frac{Sales_{it}}{Assets_{i,t-1}} + k_3\frac{\Delta Sales_{it}}{Assets_{i,t-1}} + k_4\frac{\Delta Sales_{it-1}}{Assets_{i,t-1}} + \varepsilon_{it}$$

b. Abnormal Production Cost

Abn Prod Cost = Act Prod Cost – Normal Prod Cost

3. Abnormal Discretioner

a. Normal Discretioner

$$\frac{DiscExp_{it}}{Assets_{i,t-1}} = k_{1t}\frac{1}{Assets_{i,t-1}} + k_2\frac{Sales_{i,t-1}}{Assets_{i,t-1}} + \varepsilon_{it}$$

b. Abnormal Discretioner

Abn Disc Exp = Act Disc Exp – Normal Disc Exp

Where,

$CFO_t/Assets_{t-1}$ = Operational cash flow divided by total assets *firm i, year t-1*

$1/Assets_{t-1}$ = Intercept divided by total assets *firm i, year t-1*

$Sales_{t-1}/ Assets_{t-1}$ = Net sales divided by total assets *firm i, year t-1*

$\Delta Sales_{t-1}/ Assets_{t-1}$= Delta sales years t-1 divided by total assets *firm i, year t-1*.

$COGS_{it}/ Assets_{t-1}$ = Cost of Good Sold year t divided by total assets *firm i, year t-1*

$\Delta INVit_1/ Assets_{t-1}$= Delta receivable *divided by* total asset *firm i, year t*

$Prod_t$ = Production cost, *firm i, year t*

$DiscExp_t$ = *discretionary expenditure , firm i, year t, that is sum of advertising expense*, *R&D expense, SG&A expenses*

e = *error*

3.2.2. Accrual Earnings Management

We used *Modified Jones Model* to measure *discretionary accruals* (Dechow et al., 1995).

1. *Total Accrual*

$$TACC_{it} = EBXT_{it} - CFO_{it} \dots\dots\dots\dots (1)$$

2. Estimated Total *accrual* yang diestimasi

$$\frac{TACC_{it}}{TA_{i,t-1}} = \alpha_1 \left(\frac{1}{TA_{i,t-1}}\right) + \alpha_2 \left(\frac{\Delta REV_{it}}{TA_{i,t-1}}\right) + \alpha_3 \left(\frac{PPE_{it}}{TA_{i,t-1}}\right) + \ e \dots\dots\dots\dots (2)$$

3. *Non discretionary accrual*

$$NDACC_{it} = \alpha_1 \left(\frac{1}{TA_{i,t-1}}\right) + \alpha_2 \left(\frac{\Delta REV_{it} - \Delta REC_{it}}{TA_{i,t-1}}\right) + \alpha_3 \left(\frac{PPE_{it}}{TA_{i,t-1}}\right) \dots\dots\dots\dots (3)$$

4. *Discretionery accrual*

$$DACC_{it} = \left(\frac{TACC_{it}}{TA_{i,t-1}}\right) - NDACC_{it} \dots\dots\dots\dots (4))$$

Where,

$DACC_{it}$	= *Discretionary Accruals, firm i, year t*
$NDACC_{it}$	= *Non Discretionary Accruals, firm i, year t*
$TACC_{it}$	= Total accrual, *firm i, year t*
TA_{it-1}	= Total asset, *firm i, year t*
$EBXT_{it}$	= Net income before *extraordinary item, firm i, year t*
CFO_{it}	= Cash flow from operational, *firm i, year t*
ΔRev_t	= Delta Revenue, *firm i, year t*
PPE_t	= Net Fixed Asset , *firm i, year t*
ΔRec_t	= Delta Receivable, *firm i, year t*
e	= *error*

3.2.3. Firm Values

Price to book value or PBV illustrate how much the market value of shares of a company's book value. the higher this ratio means that the market believes the prospects for the company.

$$PBV = \frac{\text{Stock Price}}{BV}$$

Book Value (Book Value / BV) is the ratio of the price computed by dividing the total net assets (assets - debt) to total shares outstanding.

$$BV = \frac{\text{Total Equity}}{\text{The amount of share}}$$

3.2.4. Control Variable : Firm Size

This study used firm size as a control variable. The bigger the company, the greater the earnings management undertaken by management because of the demands of the investors and creditors larger than smaller firm, greater management's expectations would be a bonus gained and greater opportunities for earnings management. Firm size is proxied by the natural logarithm of assets (Asset Ln).

3.3. REGRESSION MODEL

This research examines the effect of earnings management, either through the real activities manipulation and accrual activity manipulation, to the firm value in Malaysian Stock Exchange. The research included firm size as a control variable. These regression models of this study:

$FV = a_0 + a_1$ REM + a2 AEM + a3 Size + e

Where,

FV : firm value

REM : real earnings management

AEM : accrual earnings management

Size : firm size

e : error term

4. ANALYSIS

Before drawing conclusions on the results of the above regression, first we tested the classical assumptions. Classical assumption test showed that the residuals were normally distributed. Testing multicollinearity assumptions are met by looking multicollinearity VIF and tolerance value. Data used in this analysis do not indicate multicollinearity. Testing autocorrelation assumptions are met. The data did not show any symptoms of autocorrelation as indicated by the test results Durbin-Watson statistic (DW test). Here are the results of the study sample descriptive statistics. Testing heterocedasticity assumptions are met. The data did not show any symptoms of heteroscedasticity. This is exemplified by the relationship between all the independent variables on the absolute error term is not significant.

Table 1

Descriptif Statistic

Region		Mean	Minimum	Maximum	N	Std. Deviation
Malaysia	*AEM*	0.2016	-5.30	4.09	34	1.81944
	REM	-0.0166	-0.23	0.24	34	0.099818
	Size	12.3503	9.82	15.96	34	1.31047
	FV	2.0459	0.36	12.55	34	2.58738

These regression results for hypotheses 1 Earnings Management will affects firm value:

Tabel 2
Result Hypothesis 1

Variable	Coeficient	Std Error	t	Sig	Conclusion
Constant	-9.959	3.666	-2.716	0.011	
AEM	0.990	0.296	3.339	0.002	Significant
REM	-0.660	0.248	-2.659	0.012	Not significant
Ln Asset	5.077	4.546	1.117	0.273	Significant

From the table above, we can know that, in Malaysia, accrual earnings management can increase firm value significantly. In other way, real earnings management cannot affect firm value significantly.

These results are in line with the results of Lin (2011) and the argument of Arya et al. (2003) which states that earnings management can increase firm value. Earnings management can be beneficial to share holder so earnings management increases firm value. It is because manager manages earnings to give some information that are not conveyed in unmanaged earnings.

5. CONCLUSION

Earnings management is the intervention by the management for some reason to affect earnings, usually for personal or opportunistic reasons (Subramanyam and Wild, 2009). Earnings management consists of two kinds, namely accrual earnings management and real earnings management. (Subramanyam and Wild, 2009).

According to the proponent that argues that earnings management can increase firm value. Arya et al (2003) stated that earnings management can be beneficial to share holder. Lin (2011) found that earnings management in Taiwan increases firm value. It is because manager manages earnings to give some information that are not conveyed in unmanaged earnings.

This study aims to investigate The Effect Of Earnings Management to Firm Value. Sampling method with purposive sampling method, the criteria listed companies in Malaysia Stock Exchange and has a complete research variable data in 2008. The analysis tools are multiple regression analysis.

The results stated that in Malaysia, accrual earnings management can increase firm value significantly. In other way, real earnings management cannot affect firm value significantly. These results are in line with the results of Lin (2011) and the argument of Arya et al. (2003) which states that earnings management can increase firm value. Earnings management can be beneficial to share holder so earnings management increases firm value. It is because manager manages earnings to give some information that are not conveyed in unmanaged earnings.

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