

Vinh Xuan Bui; Chu, Thi Kim Huong

Article

Do foreign shareholders improve corporate earnings quality in emerging markets? Evidence from Vietnam

Cogent Economics & Finance

Provided in Cooperation with:

Taylor & Francis Group

Suggested Citation: Vinh Xuan Bui; Chu, Thi Kim Huong (2019) : Do foreign shareholders improve corporate earnings quality in emerging markets? Evidence from Vietnam, Cogent Economics & Finance, ISSN 2332-2039, Taylor & Francis, Abingdon, Vol. 7, Iss. 1, pp. 1-22, <https://doi.org/10.1080/23322039.2019.1698940>

This Version is available at:

<https://hdl.handle.net/10419/270706>

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To cite this article: Xuan Vinh Vo & Thi Kim Huong Chu | (2019) Do foreign shareholders improve corporate earnings quality in emerging markets? Evidence from Vietnam, Cogent Economics & Finance, 7:1, 1698940, DOI: [10.1080/23322039.2019.1698940](https://doi.org/10.1080/23322039.2019.1698940)

To link to this article: <https://doi.org/10.1080/23322039.2019.1698940>



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Received: 23 September 2019
Accepted: 21 November 2019
First Published: 30 November 2019

*Corresponding author: Xuan Vinh Vo,
Institute of Business Research and
CFVG Ho Chi Minh City, University of
Economics Ho Chi Minh City, 59C
Nguyen Dinh Chieu Street, District 3,
Ho Chi Minh City, Vietnam
E-mail: vxinh@yahoo.com

Reviewing editor:
David McMillan, University of Stirling,
Stirling, UK

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FINANCIAL ECONOMICS | RESEARCH ARTICLE

Do foreign shareholders improve corporate earnings quality in emerging markets? Evidence from Vietnam

Xuan Vinh Vo^{1*} and Thi Kim Huong Chu²

Abstract: Employing a panel dataset of Vietnamese non-financial listed firms, we find that firms with greater foreign shareholdings are aligned with higher quality of financial disclosure. More specially, we find that greater foreign shareholdings are associated with (i) lower earnings management; (ii) more persistent earnings; and (iii) higher informative earnings. On the ground that foreign investors in Vietnam equity market are dominated by institutional investors, the finding from this study supports the spillover hypothesis. This suggests that foreign institutional shareholders with extensive management skills might have ability to assist their invested firms in improving quality of reported earnings.

Subjects: Quantitative Finance; Corporate Finance; Business, Management and Accounting

Keywords: earnings quality; foreign ownership; spillover hypothesis; Vietnam stock market

JEL classifications: G23; G32; M41; M43; M45

1. Introduction

The association between ownership structure and corporate governance has received great attention for years by financial market participants, researchers, and policy makers. A considerable amount of papers in finance literature focuses on analyzing this relation from different perspectives, including agency cost, fraud, and audit quality (Chen, Firth, Gao, & Rui, 2006; McKnight & Weir, 2009; Singh & Davidson III, 2003; Xu & Wang, 1999). In the last two decades, there is an increasing of corporate governance studies which recognize ownership structure as a mechanism for improving the quality of corporate earnings (Aydin, Sayim, & Yalama, 2007; Ben-Nasr, Boubakri, & Cosset, 2009; de Sousa & Galdi, 2016; Jung & Kwon, 2002; Katz, 2009; Klai & Omri, 2011; Mehrani, Moradi, & Eskandar, 2017; Sánchez-Ballesta & García-Meca, 2007).

ABOUT THE AUTHORS

Xuan Vinh Vo is from the *Institute of Business Research, University of Economics Ho Chi Minh City, Vietnam* and *CFVG Ho Chi Minh City, University of Economics Ho Chi Minh City, Vietnam*. His expertise is in the areas of banking and finance.

Thi Kim Huong Chu is a research fellow from the *Institute of Business Research, University of Economics Ho Chi Minh City*. Her research areas are accounting and finance.

PUBLIC INTEREST STATEMENT

In this paper, we employ a panel dataset of Vietnamese non-financial listed firms to explore the link between foreign shareholdings and earnings quality. We report that firms with greater foreign shareholdings are aligned with higher quality of financial disclosure. More specifically, we find that greater foreign shareholdings are associated with (i) lower earnings management; (ii) more persistent earnings; and (iii) higher informative earnings. Our finding supports the spillover hypothesis. This suggests that foreign shareholders with extensive management skills might have ability to assist their invested firms in improving quality of reported earnings.

Recent financial globalization trend opens more space for international capital flow in emerging markets. In response to this trend, the presence of foreign investors is increased in developing countries (Huang & Shiu, 2009). Many authors concur that international investors face several challenges, such as asymmetry information, difficulty in communication, and difference in business culture when conducting investment in newly established markets (Cao, Du, & Hansen, 2017; Karolyi & Stulz, 2003). In addition, emerging markets are featured by weak protection for minority shareholder (La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 2000). These difficulties might equip foreign investors with stronger incentives to protect their investments. As a result, it is important to address a natural question whether foreign shareholders influence the corporate governance of domestic companies.

While there are a few studies investigating the influence of foreign ownership in emerging markets (Baba, 2009; Cao et al., 2017; Desender, Aguilera, Lópezpuertas-Lamy, & Crespi, 2014; Kang, Sul, & Kim, 2010), the role of foreign shareholders in improving earnings quality in Vietnam stock market remains unexplored in the current literature. To fill this gap, this paper examines the relationship between foreign ownership and firm's earnings quality in the context of Vietnam, an important emerging market.

A number of published studies provide evidence that foreign investors have a strong influence on stock market activity in Vietnam stock market. For example, foreign investors play an important role in stabilizing the stock price volatility (Vo, 2015) and containing the risk-taking activities in domestic companies (Vo, 2016). In line with previous studies, we further contribute to the literature on the impact of foreign shareholders on earnings quality. We aim to provide an extensive analysis concerning the role of foreign investors in Vietnam equity market. In particular, we address the question whether foreign shareholders influence the quality of earnings using a sample of non-financial companies listed on the Ho Chi Minh City Stock Exchange over an extended period.

Earnings quality has been an important focus in several studies (Dechow & Dichev, 2002; Dechow, Ge, & Schrand, 2010; Fan & Wong, 2002; He, Ng, Zaiats, & Zhang, 2017; Hribar & Craig Nichols, 2007; Schipper & Vincent, 2003). However, there is no universal and single definition to measure for earnings quality. These previous studies highlight the importance of appropriate proxies for earnings quality. Consequently, previous studies use a wide range of earnings quality concepts and measures, including both accounting measures (earnings persistence, predictability timeliness, earnings management, and earnings smoothness) and market measures (earnings response coefficients and conservatism). Moreover, several studies assert that earnings quality is a multidimensional concept and researchers typically use different proxies of earnings quality in their studies (Fan & Wong, 2002; Francis, LaFond, Olsson, & Schipper, 2004; Myers, Myers, & Omer, 2003; Richardson, Sloan, Soliman, & Tuna, 2001; Sloan, 1996; Wild, 1996).

Investigating earnings quality by using proxies containing one-dimensional angle may induce inadequate conclusions. To address this shortcoming, this paper analyzes earnings quality from two perspectives, including both accounting-based earnings quality and market-based earnings quality. Moreover, as argued by Dechow et al. (2010), the common measures of accounting-based earnings quality are earnings management and earnings persistence, whereas earnings informativeness is the most powerful proxy for market-based earnings quality. In light of above arguments, this research will employ two measurements of earnings quality, namely accounting measure (earnings management and earnings persistence) and market measure (earnings informativeness).

The theoretical literature offers two competing theories to explain the impact of foreign stakeholders on the quality of corporate accounting earnings. The former refers to the knowledge spillover hypothesis. Studies supporting this hypothesis argue that when competent international investors make investment in domestic companies, they have incentives to demand better

accounting standards, do greater monitoring to limit the earnings management of firms and generate the high quality of reported earnings (Abor & Biekpe, 2007; Aydin et al., 2007; Ben-Nasr, Boubakri, & Cosset, 2015; Choi, Lam, Sami, & Zhou, 2013; Firth, Fung, & Rui, 2007; Guo, Huang, Zhang, & Zhou, 2015). The latter relies on the information asymmetry hypothesis (Dvořák, 2005; Klai & Omri, 2011; Xiao, Yang, & Chow, 2004). This hypothesis argues that the constraint of geographic distance and barrier of language limits foreign investors to manage the firm's accounting operation. Consequently, they have less power to oversee the local firms' governance.

Drawing upon two strands of literature on the relationship between ownership of foreign investors and earnings quality, this study attempts to explore the nature of foreign stakeholder's role in enhancing the quality of financial reported earnings using a sample of Vietnamese listed firms. More specially, we analyze the association between foreign ownership and earnings quality in Vietnam stock market. We employ three main attributes of earnings quality, namely earnings persistence, earnings management, and earnings informativeness.

Our investigation of the association between foreign shareholdings and quality of reported earnings is important in the context of Vietnam because of various angles. Firstly, in the last few years, with continuous efforts to liberalize and internationalize domestic capital markets, Vietnam promotes economic integration and embarks on several economic policy reforms. Generally, many of these reforms involve elimination of investment barriers on foreign investors. Easing restrictions on foreign ownership in domestic companies is the most important subset for economic reforms. Particularly, a significant reform is that Vietnamese government relaxed the foreign ownership caps in non-banking companies in 2015. This law allows foreigners to own up to 100% of the local firm, which is a significant increase from the previous cap of 49%. This reform naturally provides us a unique opportunity to initiate a comprehensive research of these issues within an emerging market setting.

Secondly, our study is important because the inflow of foreign portfolio investment in Vietnam increases significantly in the last decades. Particularly, data from the World Bank show that foreign portfolio investment inflows into Vietnam significantly increase during the period from 2007 to 2015.¹ This outcome is an important achievement resulting from the political stability and high economic growth in Vietnam over the past decades.

Thirdly, the current study is important in the process of privatization in emerging economies. The shift in government policies which encourage the transformation of corporate ownership structure from state-owned companies into privatized firms brings foreign investors more pace to raise their stake. This is evidenced by the numbers of privatized companies are 289 in 2015 from 95 firms in 2012.²

The analysis for the case of a specific country enables us to adopt a more direct test of the impact of foreign investors on financial reporting quality. The difference in institutional setting and legal framework between well-established markets and newly established markets is documented in many previous studies (Fan & Wong, 2002; Khalil & Ozkan, 2016; La Porta & Lopez-de-Silanes, 1998). In contrary to developed countries, developing countries are characterized by substantial ownership concentration and insufficient disciplines of corporate governance (World Bank, 2013). Moreover, in a unique institutional setting, the shareholders and managers might justify their behavior and discretion according to the nature of this particular economy (Cuomo, Mallin, & Zattoni, 2016; Haxhi & Aguilera, 2017).

This research uses a dataset covering 245 non-financial firms listing on the Ho Chi Minh City Stock Exchange over the period from 2007 to 2015. The current study demonstrates significant evidence that foreign shareholders serve as an active monitor in enhancing earnings quality of domestic companies. In other words, this study offers evidence of a positive correlation between foreign stakeholders and quality of reported earnings. More specifically, our results show that

higher foreign shareholdings are associated with (i) lower earnings management, (ii) more earnings persistence, and (iii) higher informative earnings.

Our analysis offers several implications for investment practice and policy development. Primarily, the paper is important in the sense that emerging markets become more important for foreign investors and policy makers (Cao et al., 2017; Li & Giles, 2015). The finding of a positive effect of foreign shareholdings on local firm's corporate governance might provide valuable information to investors in formulating their investment strategy. Furthermore, although the legal act easing the limit on foreign ownership is promulgated, it does not provide detailed instructions for firms. Clearly, further guidelines are required because both listed companies and investors are still unclear about which specific industries and firms will be fully opened for foreign investors. Hence, the empirical findings in this paper are relevant for policy makers in improving transparency and developing policies. More importantly, removing restrictions on foreign portfolio investment is a priority subset in Vietnam's economic reforms.

The current research contributes to the finance literature in different dimensions. Clearly, the current study uses a dataset and the context of an important emerging market which has dissimilar features in comparison with the developed markets. This allows us to proclaim the critical role of the institutional setting in analyzing the relationship between foreign ownership and earnings quality. Additionally, the paper offers further insights to the current literature by providing evidence of a positive linkage between foreign holdings and corporate quality of earnings.

The structure of the paper is designed as follows. Section 2 presents salient features of foreign ownership in Vietnam stock market. Section 3 reviews related literature and finds there are divergent predictions on the relationship between foreign ownership and earnings quality. Section 4 introduces the sampling procedure and research methodology. Section 5 presents the empirical results and discussion of results. Finally, Section 7 offers some conclusions, insight implications, and suggestions for future research.

2. Stylized facts about foreign ownership in Vietnam stock market

The increased interest from foreign investors is in line with the equity market development in Vietnam. Figure 1 illustrates the foreign securities trading accounts in relative with the market capitalization over the period of 2010–2016. Apparently, the enlarged trading accounts of foreign investors are aligned with the improvement of market capitalization.

Figure 2 reports the proportion of foreign individuals and foreign institutions in total foreign trading value. Apparently, the foreign institutional investors account for over 90% in total value of foreign trading. This suggests that in Vietnam stock market, international institutions play a dominant role in foreign trading activities.

Table 1 shows the descriptive summary of foreign ownership in different industries following the Global Industry Classification Standard (GICS) in Vietnam stock market as of 31 December 2016. Total market capitalization of firms in the sample is presented in the second column of this table. We observe that Consumer Staples is the largest industry which accounts for 37.3% of the total market capitalization while Energy is the smallest industry with only 0.9% of the total market capitalization.

The fourth column presents market capitalization of firms with foreign ownership by industry. Although Consumer Staples is the largest industry in Vietnam stock market, foreign investors appear to prefer financial industry where foreign investors invest a large proportion of their holdings in financial stocks (29.3%). Consumer Staples and Real Estate also attract foreign attention with 27.7% and 12%, respectively. Notably, despite the actual proportion of foreign holdings in pharmaceutical firms is quite high (29.82%) in comparison with the total firms' average value

Figure 1. Foreign securities trading accounts on Vietnamese stock market.

Notes: This figure presents the number of foreign trading accounts over the period of 2010–2016. The bars represent the market capitalization of the Ho Chi Minh City Stock Exchange, expressed in million Vietnam Dong. This measure is reflected on the left scale. The line shows the number of international account holders, reflected on the right scale. Data are collected from Bloomberg and Vietnam Securities Depository.

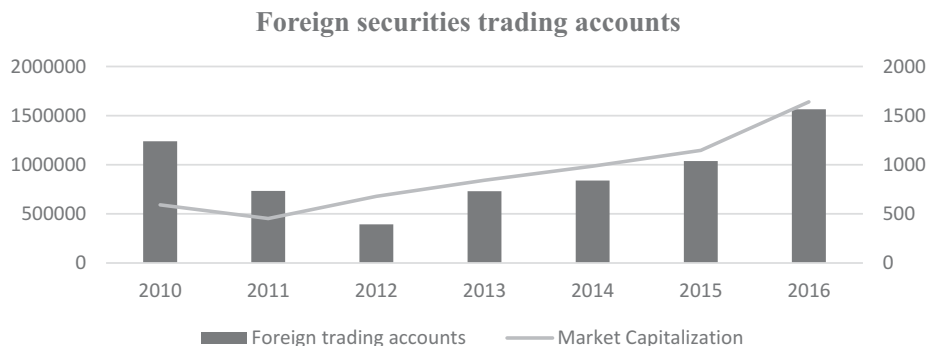
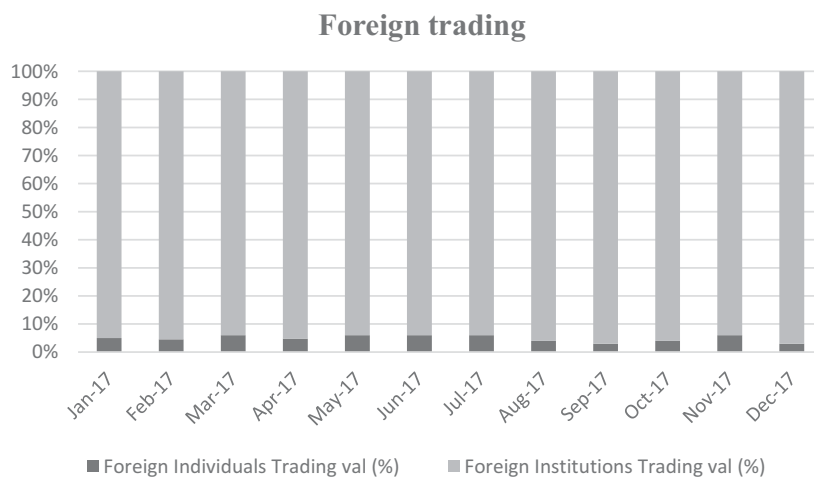


Figure 2. Foreign trading on Vietnam equity market.

Notes: The stacked bar chart shows the proportion of trading value by foreign individuals and foreign institutions (in percentage) in 2016. The portion of foreign trading is reflected on the left scale. The gray bars represent the portion of foreign institutional trading value, the black bars illustrate the percentage of foreign individual trading value on the Ho Chi Minh City Stock Exchange (expressed in percentage). Data are provided by Fiinpro, a commercial data supplier in Vietnam.



(14.06%), foreigners invest only 1.1% of market capitalization in Health Care industry. The possible explanation for this phenomenon is because there is a small number of Vietnamese pharmaceutical firms listing their shares on the exchange so that the weight of medicines companies in the foreign portfolio is relatively low.

Regarding the legal framework, the first legal provision controlling foreign ownership restriction in listed companies is introduced in 2009. This early law holds significant constraints for foreign market participants. Especially, this law stipulates that foreign investors are not permitted to own more than 49% of total outstanding shares of a public company. This legal framework, with the purpose of protecting local investors, however, becomes an obstacle for the development of domestic listed companies. This is also contrary to the trend of increased international economic integration. Some listed companies attempt to avoid this restriction by registering to delist in order to raise more foreign capital. Furthermore, restrictions on foreign ownership in public enterprises also create difficulties for foreign fund managers in rebalancing their portfolio. This restriction also prevents foreign investors from excessive trading which in turn reduces stock market liquidity.

Table 1. Foreign ownership by industry on Vietnam stock market

| Industry | Listed firms in industry | | Listed firms with foreign shareholdings | | Average foreign ownership (%) |
|------------------------|--------------------------|---------------|---|---------------|-------------------------------|
| | Number of firms | Mkt. Cap. (%) | Number of firms (%) | Mkt. Cap. (%) | |
| Consumer Discretionary | 36 | 2,115 (2.9) | 34 (94.4) | 787 (4.7) | 12.79 |
| Consumer Staples | 36 | 20,027 (37.3) | 35 (97.2) | 6,269 (27.7) | 19.85 |
| Energy | 9 | 539 (0.9) | 9 (100) | 146 (0.7) | 20.09 |
| Financials | 21 | 21,175 (27.7) | 20 (95.2) | 4,659 (29.3) | 18.23 |
| Health Care | 9 | 813 (2.1) | 9 (100) | 354 (1.1) | 29.82 |
| Industrials | 91 | 7,312 (9.3) | 89 (97.8) | 1,567 (10.1) | 14.12 |
| Information Technology | 7 | 1,167 (3.2) | 7 (100) | 534 (1.6) | 17.78 |
| Materials | 52 | 3,805 (6) | 52 (100) | 1,002 (5.3) | 9.02 |
| Real Estate | 37 | 8,703 (6.8) | 36 (97.2) | 1,139 (12) | 13.86 |
| Utilities | 19 | 6,549 (2) | 19 (100) | 332 (9.1) | 10.37 |
| Not Classified | 4 | 44 (0.06) | 4 (100) | 0.58 (0.003) | 0.85 |
| All | 321 | 72,250 | 314 | 16,790 | 14.06 |

Notes: This table presents the industry classification and foreign ownership by industry on the Ho Chi Minh City Stock Exchange as of 30 December 2016. Data are collected from Bloomberg. The total number of firms by industry is appeared in the first column and the number of firms with foreign presence is reported in the third column. The second and fourth column illustrate market capitalization (Mkt. Cap) of firms in total sample and firms with foreign ownership, respectively. The last column contains data of average foreign ownership in each industry. The parentheses consist of corresponding proportion of individual industry's value to the whole sample's value (in percentage).

The new regulatory framework relaxing foreign ownership caps is introduced in 2015 to attract more foreign capital inflows but still delay in terms of application. This provision states that if annual general shareholders meeting approves on foreign limit relaxation, foreign investors can increase their holdings to one hundred percent (100%) of a firm's outstanding shares. The new legal framework encourages public firms to enhance their business performance by approaching to foreign investment capital. Nonetheless, the law is not clear on which particular sectors or industries which are qualified to remove the limit on holdings of foreign investors.

With respect to corporate governance, Vietnam Corporate Governance Code is promulgated in 2007, marking a positive step in enhancing domestic firm's governance. This Code regulates the internal governance structures of a listed company, investor protection, and information transparency. Since the compulsory corporate governance regulations are applied, the privatization progress of state-ownership enterprises is strongly promoted (World Bank, 2013). In addition, this framework is given certain rights to shareholders, for example, approval of dividends, voting rights to elect the board of directors. Moreover, this legal work enables firm's shareholders to access both financial reports and non-financial information.

3. Related studies on the association between foreign ownership and earnings quality

In the existing earnings quality literature, investigation of the relation between foreign shareholdings and quality of accounting earnings generally leads to divergent and inconclusive results. More specially, some researchers report a positive relationship while others document a negative relationship between these two important variables. The former is commonly explained by the spillover hypothesis and the latter is supported by the information asymmetry hypothesis.

The spillover hypothesis predicts that foreign investors with strong management skills can enhance the quality of reporting earnings. For example, Firth et al. (2007) employ two proxies for earnings

quality, including the earnings response coefficients and discretionary accruals to report that the presence of foreign shareholders positively impacts the earnings quality. A possibility is that the foreign owners force local firm's managers to enhance the quality of financial reporting. Similarly, Abor and Biekpe (2007) find that foreign investors have a significantly positive influence on the quality of earnings in Ghanaian small and medium enterprises. In the same vein, utilizing dataset of firms listed on the Istanbul Stock Exchange, Aydin et al. (2007) conclude that foreign investors play important role in improving the financial performance of local firms. This study also provides evidence that foreign stakeholders improve company's performance better than domestic owners do.

More recently, Ben-Nasr et al. (2015) comprise the sample of firms from 45 countries to examine the influence of foreign shareholders on the quality of earnings. The authors conclude that greater level of international shareholdings is correlated with better earnings disclosure. Likewise, Guo et al. (2015) use a unique set of foreign ownership dataset of listed Japanese firms to explore whether foreign investors influence real earnings management. This study offers evidence that foreign ownership is negatively related to earnings management. In other words, foreign investors play the monitoring role in alleviating the earnings management activities of local firms.

On the contrary, a large volume of papers find a negative association between the level of foreign ownership and the degree of earnings quality. This finding could be explained by the informational asymmetry hypothesis. For example, Xiao et al. (2004) report that larger foreign holdings ratio is aligned with lower quality of reported earnings. This is because foreign investors have the constraint of higher information asymmetry in comparison with local owners. Equally, Klai and Omri (2011) utilize the data set of listed companies on the Tunis Stock Exchange throughout the period from 1997 to 2007 and document that the increased power of foreigners negatively affects financial reporting quality. Those authors suggest the possible explanation for the negative relationship between these two variables relying on the information asymmetry hypothesis. Especially, they state that foreign investors hardly control a firm's accounting operation because they face information disadvantages due to geographic distance, language barriers, and cultural differences.

4. Data and research methodology

4.1. Data

There are currently two main stock exchanges in Vietnam which are the Ho Chi Minh City Stock Exchange (HOSE) and the Hanoi Stock Exchange (HSX). However, the listing requirements and standards are different. The former is the largest bourse in Vietnam which is established in 2000 with 322 listed firms as of 31 December 2015. This bourse is also an attractive destination for foreign investors who invest in Vietnam. The latter is a smaller one which is established in 2005. We use the data for the largest exchange.

Our study utilizes the unbalanced sample of firms listed on the Ho Chi Minh City Stock Exchange. We include firms that have available data for the period from 2007 to 2015. At the end of 2015, there are 322 listed companies, including 57 financial institutions and 265 non-financial firms. The sample excludes 57 financial institutions because of their difference in financial statement presentation and business nature. Furthermore, the research eliminates 20 non-financial companies which we do not have data available in three years. Our final sample include 245 listed firms.

Both accounting and stock market trading data are obtained from Bloomberg database. Distribution of sample observation is presented in Table 2. Panel A shows the distribution of observation by year distribution of observation by industry is classified by GICS sectors.

Table 2. Distribution of observations

| Panel A: Distribution of observations by year | |
|---|---------------------------|
| Year | No. of observation |
| 2007 | 1,144 |
| 2008 | 1,469 |
| 2009 | 1,929 |
| 2010 | 2,388 |
| 2011 | 2,543 |
| 2012 | 2,572 |
| 2013 | 2,584 |
| 2014 | 2,569 |
| 2015 | 2,520 |
| Total firm-year observations | 19,718 |
| Panel B: Distribution of observation by industry | |
| GICs classification | No. of observation |
| Consumer Discretionary | 2,558 |
| Consumer Staples | 2,568 |
| Energy | 713 |
| Health Care | 718 |
| Industrials | 5,708 |
| Information Technology | 478 |
| Materials | 3,396 |
| Real Estate | 491 |
| Utilities | 1,281 |
| Not classified | 1,807 |
| Total firm-year observations | 19,718 |

4.2. Methodology

Our proxies of earnings quality consist of accounting-based (earnings management, earnings persistence) and market-based (earnings informativeness). The benefits of approaching both perspectives are enhancing the robustness of the test and providing comprehensive results.

4.2.1. Earnings management

Previous studies suggest that the presence of earnings management results in poor quality of earnings (Deng, Li, & Liao, 2017; Hribar & Craig Nichols, 2007; Lo, 2008; Schipper & Vincent, 2003). Discretionary accruals are widely used as the common measure of earnings management (Ben-Nasr et al., 2009, 2015; Degeorge, Ding, Jeanjean, & Stolowy, 2013; Firth et al., 2007; Francis & Wang, 2008; Park & Park, 2004; Wang, 2006). Higher (smaller) discretionary accruals translate into greater (less) earnings management.

We perform two-step procedure to estimate the influence of foreign shareholdings on earnings management. We first conduct the total accruals regression to estimate discretionary accruals. We then estimate a regression between foreign ownership and discretionary accruals.

Specially, in the first step, we employ the measurement of discretionary accruals using the approach of Dechow and Dichev (2002) and Degeorge et al. (2013):

$$\frac{CAC_{it}}{TA_{it}} = \theta_0 + \theta_1 \frac{CFO_{it-1}}{TA_{it}} + \theta_2 \frac{CFO_{it}}{TA_{it}} + \theta_3 \frac{CFO_{it+1}}{TA_{it}} + \theta_4 DCFO_{it} + \theta_5 DCFO_{it} \frac{CFO_{it}}{TA_{it}} + \varepsilon_{1it} \quad (1)$$

where subscripts i and t denote the firm i and year t . CAC_{it} represents current accruals and is measured by liabilities and non-cash based asset ($CAC_{it} = \Delta CA_{it} - \Delta CL_{it} - \Delta CASH_{it} + \Delta STDEBT_{it}$, where ΔCA_{it} is the variation of current assets; ΔCL_{it} is the variation of current liabilities; $\Delta CASH_{it}$ is the variation of cash and equivalents; $\Delta STDEBT_{it}$ is the variation of short and current long-term debt); TA_{it} is the average total assets at year t and $t-1$ of firm i ; CFO_{it} denotes the cash flows from operations and is calculated by the difference of net income and current accruals ($CFO_{it} = NI_{it} - CAC_{it}$, where NI_{it} is the net income). CFO_{it-1} is the operation cash flows at year $t-1$ and CFO_{it+1} is the operation cash flows at year $t+1$; $DCFO_{it}$ is a binary variable which takes the value of one if $(CFO_{it}/TA_{it} - CFO_{it-1}/TA_{it}) < 0$, and zero otherwise.

Dechow and Dichev (2002) argue that the residuals in Equation (1), ε_{1it} , are recognized as the discretionary accruals. The absolute value of residuals ε_{1it} or $(|A_RES_{it}|)$ is acknowledged as the proxy for earnings management. Accordingly, the higher absolute value of the residuals $(|A_RES_{it}|)$ or the greater earnings management corresponds to a lower earnings quality.

In the second step, we use the below regression model to investigate whether foreign shareholders play an active role in firm's earnings management:

$$|A_RES_{it}| = \delta_0 + \delta_1 FOR_{it} + \delta_2 SIZE_{it} + \delta_3 LEV_{it} + \delta_4 ROA_{it} + \delta_5 AG_{it} + \delta_6 LOSS_{it} + \varepsilon_{2it} \quad (2)$$

where $|A_RES_{it}|$ is the discretionary accruals, measured by the absolute value of the residuals in Equation (1); FOR_{it} is the percentage of total equity owned by foreigners to total outstanding shares; $SIZE_{it}$ is the natural logarithm of market capitalization; LEV_{it} is total debt to total assets ratio; ROA_{it} is net income to total assets ratio; AG_{it} is the growth of total asset; $LOSS_{it}$ is the binary variable which get value of one if the net income is negative, and zero otherwise.

The coefficient δ_1 captures the statistical significance of the association between international shareholdings and earnings management. The negative (positive) value of coefficient δ_1 suggests that higher ownership of foreigner will lead to the better (lower) quality of earnings.

Furthermore, we employ several firm characteristics as control variables since accruals are likely affected by some factors other than the ownership. Considering to firm size ($SIZE$), Watts and Zimmerman (1986) and Moses (1987) anticipate that large firms are more likely to engage earnings manipulation. However, Ashari, Koh, Tan, and Wong (1994) and Atik (2009) argue that large firms are generally examined by the equity researchers and outside investors, therefore they might have less space to manipulate or manage income. Because the relation between firm size and earnings management is not consistent, we simply expect that there is association between firm size and discretionary accruals.

The leverage degree may have effect on the firm's earnings management activities. DeFond and Jiambalvo (1994) report that high firms are likely to engage more earnings management activities. Nevertheless, high debt companies may be closely overseen by the lenders, hence, they are less likely to adopt aggressive earnings management practices (Chung, Firth, & Kim, 2002; Park & Shin, 2004). We include leverage (LEV) to control for the impact of debt effect.

Furthermore, we incorporate return on asset as the proxy of profitability (ROA). As argued by Orlitzky, Schmidt, and Rynes (2003) and Chen and Yuan (2004), firms with lower rate of return on asset have lesser earnings quality. Similarly, Ferreira and Matos (2008) document that greater ownership by foreigners is associated with higher operating performance. In light of the above discussion, we expect a positive signal for the association between earnings quality and firm's profitability.

Growth opportunity (AG) is included as the control variable and is measured by the annual total asset growth. Chan, Ferguson, Simunic, and Stokes (2001) and Lui (2003) argue that market participants might provide a higher valuation to firms with good growth opportunities because

these firms tend to have more internal information about the growth prospects. Thus, internal management is likely to reveal positive information through financial reports in which earnings have been manipulated to indicate the firm's profitable prospects (Healy & Palepu, 2003). Consistent with the extant studies, we predict that manager in higher growth firms may engage more discretionary accruals management.

Finally, following Ben-Nasr et al. (2015) and Francis and Wang (2008), we include *LOSS* to control for the economic losses. Previous research addresses that if firms post negative earnings, they have the incentive to manipulate the financial earnings (Callen, Robb, & Segal, 2008; Lang & Lundholm, 1993).

4.2.2. Earnings persistence

Drawing on prior literature, this study adopts earnings persistence as a measurement for quality of reported earnings (Ali, Chen, & Radhakrishnan, 2007; Ben-Nasr et al., 2015; Deng et al., 2017; Francis et al., 2004). Accordingly, we employ earnings persistence as the second proxy for earnings quality to examine the correlation between foreign shareholdings and the quality of reported earnings.

The current study adopts the earnings persistence model from Sloan (1996) to assess the influence of the foreign holdings on earnings persistence:

$$NI_{it} = \beta_0 + \beta_1 NI_{it-1} + \beta_2 NI_{it-1} * FOR_{it} + \beta_3 SIZE_{it} + \varepsilon_{3it} \quad (3)$$

where NI_{it} is the net earnings at year t divided by averaged total assets at year t ; NI_{it-1} is the net earnings at year $t-1$ divided by averaged total assets at year $t-1$. The other variables are defined earlier.

In Equation (3), the coefficient β_1 measures the earnings persistence. The higher value of β_1 indicates the better quality of earnings. The coefficient β_2 captures the influence of foreign shareholders on the persistence of earnings.

The inclusion of control variables in this model allows us to provide more comprehensive analysis. Lev (1983) reports that firm size is positively relative with earnings persistence. Similarly, Ali et al. (2007) and Ben-Nasr et al. (2015) document that firm size also impact on earnings persistence. However, Li, Abeysekera, and Ma (2014) document that small firms are associated with higher profit persistence. Therefore, we have no directional prediction on the correlation between firm size and earnings persistence.

4.2.3. Earnings informativeness

The market value of listed companies captures the information on reported earnings. Accordingly, firm's net income can be employed to explore the relation between financial reporting quality and equity returns. Particularly, the changes in stock price are implied to be reflected changes in reporting earnings, suggesting that investors embed informativeness of earnings into the stock price. Following the prior studies (Ben-Nasr et al., 2015; Deng et al., 2017; Fan & Wong, 2002; Wang, Wong, & Xia, 2008), we utilize the below regression to understand the impact of foreign ownership on informativeness of earnings:

$$CR_{it} = \alpha_0 + \alpha_1 EPS_{it} + \alpha_2 EPS_{it} * FOR_{it} + \alpha_3 SIZE_{it} + \alpha_4 MTB_{it} + \varepsilon_{4it} \quad (4)$$

where CR_{it} is measured as the cumulative 12-month stock returns; EPS_{it} is the earnings per share; MTB_{it} denotes the ratio of market value to book value; the other variables are defined earlier.

The coefficient α_1 measures the magnitude of earnings in stock returns. The coefficient α_2 measures differential earnings informativeness in relative to the level of foreign ownership. If the coefficient α_2 is positive, it implies that higher informative of earnings is associated with the larger proportion of foreign stake holdings.

The current study employs firm size (*SIZE*) to control for size effect. As argued by Atiase (1985) and Freeman (1987), larger firms have higher earning-stock return sensitivity than smaller firms. In contrast, Fombrun and Shanley (1990) and Verschoor (2005) document that smaller companies tend to excessively expose their performance to attract the attention of market participants. Therefore, the earnings–equity return relation in small firms might be more sensitive than in large firms.

In addition, we incorporate the market to book ratio to proxy for firm’s growth opportunities (*MTB*). Collins and Kothari (1989) document that firm’s growth is associated with future earnings. The higher market to book ratio leads to the higher earnings growth, and the stronger earnings–equity returns relation.

4.3. Endogeneity concern

There is a primary concern that ownership variable is recognized as an endogenous variable (Batten & Vo, 2015; Chung & Zhang, 2011; Giannetti & Simonov, 2006; Leuz, Lins, & Warnock, 2010). The endogeneity concern might arise because foreign investors prefer to invest in firms with high earnings quality. Specifically, Leuz et al. (2010) report that international investors will not invest in firms which have potential problems of corporate governance. Likewise, Chung and Zhang (2011) and Giannetti and Simonov (2006) offer evidence that foreign capital is flowed more to well-governed companies. Recently, Batten and Vo (2015) document that foreign investors tend to avoid investing into weak financial management firms where local investors have informational advantages.

Wooldridge (2006) argues that the least squares regression method might be biased and inconsistent estimators if the endogeneity is present in testing model. The author suggests the use of two-stage least squares (2SLS) estimation to overcome this problem. Specifically, in the first stage, the endogenous variable is regressed with the instrumental variables. In the second stage, the main models are estimated for the left-hand variables based on coefficient values of the explanatory variables.

In this paper, we adopt listing period as the instrument variable to enhance the robustness of the analyses. We employ listing period as the instrument variable because in our sample, foreign ownership is associated with listing period whereas three dimensions of earnings quality seem have no correlation with listing period.^{(3),(4)}

5. Analysis of the relation between foreign ownership and earnings quality

In this subsection, we use different estimation models to explore the effect of foreign ownership on the quality of earnings. More specifically, the study analyzes the correlation between foreign shareholdings and earnings management, earnings persistence and earnings informativeness in the context of Vietnam equity market.

We briefly discuss our ordinary least squares (OLS) results and then we present our results from the 2SLS estimation method.

5.1. Descriptive statistics

Table 3 contains summary statistics for the dependent, independent variables and firm-level variables used in the regressions. It appears that, on the average, foreign ownership ratio is 12%. This is comparable to data from Ben-Nasr et al. (2015) who report 12.5% average foreign shareholdings of 45 countries. This statistic is higher than 8.1% of average foreign ownership in China (Firth et al., 2007) and 7.5% in Ghana (Abor & Biekpe, 2007). We denote that the foreign ownership restriction in Vietnam stock market has recently removed since 2015. As the result, the foreign holdings are widely dispersed from the mean value of 5.6% versus the highest owning 49%. Regarding firm characteristics variables, we find that the ratio of return on total assets and leverage ratio has wide dispersion as the average value is around of 8% and 11% while the highest value reaches to more than 80%. We also observe that the average debt rate is at the level of 25%, interpreting that debt does not heavily weigh on Vietnam-listed firms. As shown in Table 3, the average value of market-to-book is 1.27 which is greater than 1, implying the stock prices exceed the book value of listed firms in Vietnam stock market. This statistic also suggests that Vietnamese institutions have strong growth prospect.

Table 3. Summary descriptive statistics

| Variables | Mean | Median | Maximum | Minimum | SD |
|-----------|----------|----------|-----------|------------|----------|
| FOR | 0.12 | 0.052 | 0.49 | 0.00 | 0.1435 |
| A_RES | 0.06 | 0.03 | 1.17 | 0.00 | 0.18 |
| NI | 0.08 | 0.06 | 0.95 | -0.59 | 0.10 |
| CR | 0.05 | 0.00 | 2.71 | -1.23 | 0.47 |
| LEV | 0.25 | 0.24 | 0.88 | 0.00 | 0.20 |
| LOSS | 0.07 | 0.00 | 1.00 | 0.00 | 0.25 |
| MTB | 1.27 | 0.95 | 25.45 | -14.71 | 1.36 |
| ROA | 0.08 | 0.06 | 0.78 | -1.58 | 0.09 |
| SIZE | 13.07 | 13.30 | 41.72 | 00.00 | 2.88 |
| AG | 0.22 | 0.10 | 8.14 | -0.68 | 0.54 |
| EPS | 2,133.88 | 1,758.83 | 95,542.00 | -21,602.05 | 3,332.53 |

Notes: This table reports the summary descriptive statistics of 245 Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange from 2007 to 2015. Source: Bloomberg. *FOR* is the percentage of total equity owned by foreigners to total outstanding shares; *|A_RES|* is the absolute value of discretionary accruals; *NI* is the net earnings; *CR* denotes the stock return and measured as cumulative 12-month stock returns; *LEV* is total debt to total assets ratio; *ROA* is net income to total assets ratio; *AG* is the growth of total asset; *SIZE* is the natural logarithm of market capitalization; *LOSS* is the binary variable which get value of one if the net income is negative, and zero otherwise; *MTB* denotes the ratio of market value to book value; *EPS* is the earnings per share.

High correlation between independent variables might lead to multicollinearity problem. Therefore, we use the Spearman correlation coefficients in Table 4 to identify the multicollinearity problem among the independent variables in this research. As reported in this table, all the correlation coefficients are under 0.8. Following Kennedy (2003), we can conclude that there is no problem of multicollinearity.

5.2. Analysis of the relation between foreign ownership and earnings management

In this section, we investigate the association between the foreign ownership in listed firms and the level of earnings management. Firstly, Table 5 presents the baseline result of the direct relationship between foreign shareholdings and discretionary accruals. The ordinary least square estimation suggests that there is no clear evidence of the association between the two variables in the whole sample, but it shows that higher foreign ownership leads to lower level of earnings management in large firms.

Secondly, Table 6 provides the results from the 2SLS estimation for the analysis of the relation between foreign ownership and discretionary accruals. The negative and significant coefficient on the association between international shareholders and firm's discretionary accruals (-0.1162) indicates that greater foreign shareholdings are aligned with less earnings management in their invested firms. This finding is consistent with previous studies (Ayadi, 2014; Ben-Nasr et al., 2015; Francis & Wang, 2008; Park & Park, 2004; Velury & Jenkins, 2006).

A potential explanation for the negative relationship between the two variables in Vietnam setting is that the greater presence of foreign institutional investors over foreign individual investors. Foreign shareholders with strong knowledge of finance and management might be actively in supervising their portfolio firm's managerial behavior (Almazan, Hartzell, & Starks, 2005). Consequently, higher stock proportion held by foreign shareholders results in an improvement in the earnings quality of Vietnamese listed firms.

Using the mean value of firm size as the benchmark, we partition our sample into two groups, including a group of large companies and a group of small companies. Large companies are the ones which have the value of firm size exceeding the mean value and otherwise. We observe that in the Vietnamese large companies, managers tend to manipulate the earnings with the presence of foreign owners while in the small firms, the earnings management through discretionary accruals is likely to

Table 4. Correlation matrix

| | FOR | A_RES | NI | CR | LEV | LOSS | MTB | ROA | SIZE | AG | EPS |
|------------------|----------|---------|----------|---------|----------|----------|---------|---------|---------|---------|-----|
| FOR | 1 | | | | | | | | | | |
| A_RES | 0.01 | 1 | | | | | | | | | |
| NI | 0.25*** | 0.19*** | 1 | | | | | | | | |
| CR | 0.09*** | 0.09*** | 0.20*** | 1 | | | | | | | |
| LEV | -0.16*** | 0.11*** | -0.1*** | -0.06** | 1 | | | | | | |
| LOSS | -0.07*** | -0.19** | -0.48*** | -0.14* | 0.10*** | 1 | | | | | |
| MTB | 0.21*** | 0.10*** | 0.39*** | 0.17*** | -0.13*** | -0.16*** | 1 | | | | |
| ROA | 0.24*** | 0.19*** | 1.00*** | 0.20*** | -0.20*** | -0.48*** | 0.39*** | 1 | | | |
| SIZE | 0.06*** | 0.06*** | 0.08*** | 0.08*** | 0.14*** | -0.03 | 0.13*** | 0.08*** | 1 | | |
| AG _{it} | 0.00*** | 0.46*** | 0.34*** | 0.07*** | 0.03*** | -0.16*** | 0.18*** | 0.34*** | 0.05*** | 1 | |
| EPS | 0.30*** | 0.15*** | 0.29*** | 0.36*** | -0.19*** | -0.49*** | 0.56*** | 0.80*** | 0.12*** | 0.22*** | 1 |

Notes: This table shows the Spearman correlation matrix of the sample of Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange from 2007 to 2015. Data are collected from Bloomberg. FOR is the percentage of total equity owned by foreigners to total outstanding shares; |A_RES| is the absolute value of discretionary accruals; NI is the net earnings at year t divided by averaged total assets; CR denotes the stock return and measured as cumulative 12-month stock returns; LEV is total debt to total assets ratio; ROA is net income to total assets ratio; AG is the growth of total asset; SIZE is the natural logarithm of market capitalization; LOSS is the binary variable which get value of one if the net income is negative, and zero otherwise; MTB denotes the ratio of market value to book value; EPS is the earnings per share.

*, **, and *** represent the statistical significance at the 10%, 5%, and 1% level, respectively.

Table 5. Ordinary least squares estimation of the relation between foreign ownership and discretionary accruals

| Variable | Total sample A_RES | | Large companies (LARGESIZE) A_RES | | Small companies (SMALLSIZE) A_RES | |
|----------------|--------------------|---------|-----------------------------------|---------|-----------------------------------|---------|
| | Coeff. | t-stat. | Coeff. | t-stat. | Coeff. | t-stat. |
| FOR | -0.0084 | -0.8380 | -0.0732*** | -2.8265 | -0.0138 | -0.3428 |
| SIZE | 0.0006 | 1.0998 | -0.0009 | -0.3384 | 0.0012 | 1.2963 |
| LEV | -0.0233*** | -2.6743 | -0.0464 | -1.9945 | -0.0905*** | -3.3672 |
| ROA | 0.1344*** | 6.2335 | 0.2816*** | 6.1143 | -0.2399*** | -5.9655 |
| AG | 0.0084 | 1.5299 | -0.0051 | -0.7350 | 0.0089 | 0.8046 |
| LOSS | 0.1032*** | 15.9465 | 0.0686*** | 8.7252 | 0.0673*** | 6.4145 |
| Intercept | 0.0366*** | 5.2496 | 0.0684 | 1.9124 | 0.0701*** | 5.4705 |
| R ² | 0.1945 | | 0.5995 | | 0.6571 | |
| No. of Obs | 1119 | | 630 | | 489 | |

Notes: This table shows the results of OLS estimator for sample of Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange over the period from 2007 to 2015. *FOR* is the percentage of total equity owned by foreigners to total outstanding shares; *|A_RES|* is the absolute value of discretionary accruals; *LEV* is total debt to total assets ratio; *ROA* is net income to total assets ratio; *AG* is the growth of total asset; *SIZE* is the natural logarithm of market capitalization; *LOSS* is the binary variable which get value of one if the net income is negative, and zero otherwise. Model (2): $|A_RES_{it}| = \delta_0 + \delta_1 FOR_{it} + \delta_2 SIZE_{it} + \delta_3 LEV_{it} + \delta_4 ROA_{it} + \delta_5 AG_{it} + \delta_6 LOSS_{it} + \varepsilon_{2it}$.

*, **, and *** represent the statistical significance at the 10%, 5%, and 1% level, respectively.

be unrelated to the presence of international investors. This finding supports the size hypothesis that large firms are liable to manipulate reporting earnings (Moses, 1987; Watts & Zimmerman, 1986).

Regarding the effect of profitability on the relation of foreign shareholdings and earnings management, we find that firm's profitability (*ROA*) is positively associated with discretionary accruals. This result suggests that firms with high profitability are resulted to lower earnings quality. In this sense, the findings pronounce the characteristic of Vietnamese capital market that lower profitable firms are more likely to control the earnings number to attract the foreign investors. This finding is inconsistent with Orlitzky et al. (2003) and Chen and Yuan (2004) who report a positive association between *ROA* and firms' earnings quality.

5.3. Analysis of the relation between foreign ownership and earnings persistence

We firstly present the result of ordinary least squares estimator in Table 7 which shows the association between foreign ownership and the persistence of earnings. We find that there is no clear evidence of the relationship between the level of foreign shareholdings and the degree of earnings persistence.

In the next step, the results from 2SLS estimation for the analysis of the impact of the foreign investors' holdings on earnings persistence are reported in Table 8. The value of the coefficient on the influence of foreign shareholdings and earnings persistence is 0.2896, suggesting that the presence of foreigners significantly and positively influences the corporate earnings persistence. This evidence is in line with the findings from existing studies (Ali et al., 2007; Ben-Nasr et al., 2015; Francis et al., 2004).

In addition, we observe that foreign shareholders play positive role in enhancing the persistence of accounting earnings in large firms group. This result is consistent with finding of prior studies (Ali et al., 2007; Ben-Nasr et al., 2015; Lev, 1983).

5.4. Analysis of the relation between foreign ownership and earnings informativeness

Table 9 provides the ordinary least squares estimates of the association between the level of foreign holdings and the informativeness of earnings. The baseline results reveal that in both large firms and small firms, foreign investors have no clear effect on the earnings informativeness.

Table 6. Two-stage least squares estimation of the relation between foreign ownership and discretionary accruals

| Panel A First-Stage Least Squares | | | | | | | |
|---|-----------------|--------------------|--------------------------------|-----------------------------------|--------------------------------|-----------------------------------|---------|
| Variable | Total sampleFOR | | Large companies (LARGESIZE)FOR | | Small companies (SMALLSIZE)FOR | | |
| | Coeff. | t-stat. | Coeff. | t-stat. | Coeff. | t-stat. | |
| SIZE | 0.0064*** | 2.9637 | 0.0341*** | 3.9849 | 0.0042 | 1.8181 | |
| LEV | -0.0788*** | -3.3263 | -0.0795** | -2.1843 | -0.0977*** | -2.7545 | |
| ROA | 0.0249 | 0.7549 | 0.0475 | 1.1212 | -0.0696 | -1.2465 | |
| AG | -0.0080 | -1.2974 | -0.0186** | -2.2746 | -0.0035 | -0.2606 | |
| LOSS | 0.0105 | 1.0519 | 0.0167 | 1.1852 | -0.0009 | -0.0637 | |
| LIST_PER | 0.0224*** | 6.1787 | 0.0257*** | 4.7337 | 0.0095 | 1.6995 | |
| Intercept | 0.0416 | 1.5535 | -0.3340*** | -2.8681 | 0.0641** | 2.3525 | |
| R ² | 0.8180 | | 0.8350 | | 0.8281 | | |
| No. of Obs | 1316 | | 764 | | 552 | | |
| Panel B Second-Stage Least Squares (2SLS) | | | | | | | |
| Variable | Expected | Total sample A_RES | | Large companies (LARGESIZE) A_RES | | Small companies (SMALLSIZE) A_RES | |
| | | Coeff. | t-stat. | Coeff. | t-stat. | Coeff. | t-stat. |
| FOR | - | -0.1162*** | -3.0021 | -0.2352*** | -2.8029 | -0.0770 | -1.1264 |
| SIZE | -/+ | 0.0017 | 1.6614 | 0.0146** | 2.3656 | -0.0009 | -0.6633 |
| LEV | -/+ | -0.0265* | -1.9474 | -0.0292 | -1.0132 | -0.0248 | -0.9454 |
| ROA | -/+ | 0.2396*** | 8.7889 | 0.4136*** | 6.8231 | 0.1202 | 0.9412 |
| AG | + | 0.0013 | 0.1908 | -0.0001 | -0.0072 | 0.0004 | 0.0232 |
| LOSS | + | 0.1007*** | 13.8266 | 0.0938*** | 5.4357 | 0.1098*** | 5.2498 |
| Year dummy | | Yes | | Yes | | Yes | |
| Industry dummy | | Yes | | Yes | | Yes | |
| R ² | | 0.1458 | | 0.0969 | | 0.2072 | |
| No. of Obs | | 852 | | 464 | | 388 | |

Notes: This table shows the results of 2SLS estimator for sample of Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange over the period from 2007 to 2015. FOR is the percentage of total equity owned by foreigners to total outstanding shares; |A_RES| is the absolute value of discretionary accruals; LEV is total debt to total assets ratio; ROA is net income to total assets ratio; AG is the growth of total asset; SIZE is the natural logarithm of market capitalization; LOSS is the binary variable which get value of one if the net income is negative, and zero otherwise. Instrument variable is listing period (LIST_PER). Model (2): $|A_RES_{it}| = \delta_0 + \delta_1 FOR_{it} + \delta_2 SIZE_{it} + \delta_3 LEV_{it} + \delta_4 ROA_{it} + \delta_5 AG_{it} + \delta_6 LOSS_{it} + \epsilon_{2it}$.

*, **, and *** represent the statistical significance at the 10%, 5%, and 1% level, respectively.

To deal with endogeneity problem as mentioned in previous section, we use 2SLS in this analysis. Table 10 summarizes the results from 2SLS estimation for the analysis of the relation between foreign ownership and earnings informativeness on Vietnam stock market. The coefficient on the correlation between foreign shareholders and earnings informativeness is 0.0012 which suggests that foreign holders have a positive impact on earnings informativeness. The presence of foreign shareholders is beneficial for the company on the grounds that their high requirements on accounting practices lead to the improvement of earnings information. The findings suggest that Vietnamese institutions with a higher percentage of foreign holdings have higher informative accounting earnings. The results also support the evidence from prior studies (Ayadi, 2014; Ben-Nasr et al., 2015; Fan & Wong, 2002; Wang, 2006).

Table 7. Ordinary least squares estimation of the relation between foreign ownership and earnings persistence

| Variable | Total sampleNI | | Large companies (LARGESIZE)NI | | Small companies (SMALLSIZE)NI | |
|----------------|----------------|---------|-------------------------------|---------|-------------------------------|---------|
| | Coeff. | t-stat. | Coeff. | t-stat. | Coeff. | t-stat. |
| NI(-1) | 0.2024*** | 5.7709 | 0.05910 | 1.22018 | 0.1558*** | 2.7492 |
| NI(-1)*FOR | 0.0683 | 0.4177 | 0.31730 | 1.56857 | -0.1363 | -0.4101 |
| SIZE | 0.0005 | 0.5363 | 0.00259 | 0.62442 | 0.0013 | 1.0012 |
| Intercept | 0.0497*** | 4.2361 | 0.02940 | 0.50065 | 0.0422*** | 2.7419 |
| R ² | 0.6519 | | 0.6916 | | 0.6892 | |
| No. of Obs | 1530 | | 898 | | 632 | |

Notes: This table provides the results of OLS estimation for panel sample of Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange over the period from 2007 to 2015. FOR is the percentage of total equity owned by foreigners to total outstanding shares; NI_t is the net earnings at year t divided by averaged total assets at year t; NI_{t-1} is the net earnings at year t-1 divided by averaged total assets at year t-1; SIZE is the natural logarithm of market capitalization. Model (3): $NI_t = \theta_0 + \theta_1 NI_{t-1} + \theta_2 NI_{t-1} * FOR_t + \theta_3 SIZE_t + \epsilon_{3it}$.

*, **, and *** represent the statistical significance at the 10%, 5%, and 1% level, respectively.

Table 8. Two-stage least squares estimation of the relation between foreign ownership and earnings persistence

| Panel A First-Stage Least Squares | | | | | | | |
|---|-----------------|----------------|--------------------------------|-------------------------------|--------------------------------|-------------------------------|---------|
| Variable | Total sampleFOR | | Large companies (LARGESIZE)FOR | | Small companies (SMALLSIZE)FOR | | |
| | Coeff. | t-stat. | Coeff. | t-stat. | Coeff. | t-stat. | |
| NI(-1) | 0.1867*** | 5.9894 | 0.2119*** | 4.2750 | 0.1531*** | 3.0120 | |
| SIZE | 0.0065*** | 3.4056 | 0.0467*** | 5.9899 | 0.0039* | 1.7892 | |
| LIST_PER | 0.0584*** | 7.1111 | 0.0716*** | 6.0308 | 0.0460*** | 3.5437 | |
| Intercept | -0.0447 | -1.6185 | -0.6206*** | -5.4589 | -0.0168 | -0.5364 | |
| R ² | 0.8726 | | 0.8933 | | 0.8611 | | |
| No. of Obs | 1303 | | 751 | | 552 | | |
| Panel B Second-Stage Least Squares (2SLS) | | | | | | | |
| Variable | Expected | Total sampleNI | | Large companies (LARGESIZE)NI | | Small companies (SMALLSIZE)NI | |
| | | Coeff. | t-stat. | Coeff. | t-stat. | Coeff. | t-stat. |
| NI(-1) | + | 0.6546*** | 19.3340 | 0.6105*** | 11.7851 | 0.7151*** | 15.4761 |
| NI(-1)*FOR | + | 0.2896*** | 2.6009 | 0.3064* | 1.8939 | 0.1865 | 0.9995 |
| SIZE | +/- | 0.0004 | 0.4386 | 0.0097*** | 2.8686 | 0.0003 | 0.2304 |
| Year dummy | | Yes | | Yes | | Yes | |
| Industry dummy | | Yes | | Yes | | Yes | |
| R ² | | 0.5603 | | 0.5749 | | 0.5604 | |
| No. of Obs | | 865 | | 470 | | 395 | |

Notes: This table provides the results of 2SLS estimation for panel sample of Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange over the period from 2007 to 2015. FOR is the percentage of total equity owned by foreigners to total outstanding shares; NI_t is the net earnings at year t divided by averaged total assets at year t; NI_{t-1} is the net earnings at year t-1 divided by averaged total assets at year t-1; SIZE is the natural logarithm of market capitalization. Instrument variable is listing period (LIST_PER). Model (3): $NI_t = \theta_0 + \theta_1 NI_{t-1} + \theta_2 NI_{t-1} * FOR_t + \theta_3 SIZE_t + \epsilon_{3it}$.

*, **, and *** represent the statistical significance at the 10%, 5%, and 1% level, respectively.

Table 9. Ordinary least squares estimation of the relation between foreign ownership and earnings informativeness

| Variable | Total sampleCR | | Large companies (LARGESIZE)CR | | Small companies (SMALLSIZE)CR | |
|----------------|----------------|---------|-------------------------------|---------|-------------------------------|---------|
| | Coeff. | t-stat. | Coeff. | t-stat. | Est. Coeff. | t-stat. |
| EPS | 0.0001 *** | 4.4812 | 0.0000 | 0.3016 | 0.0001*** | 8.9944 |
| EPS*FOR | 0.0000 | -0.8233 | 0.0000 | 0.6291 | -0.0001 | -1.1376 |
| SIZE | -0.0053 | -0.5448 | -0.0816 | -1.5539 | -0.0012 | -0.1282 |
| MTB | 0.5314*** | 25.4070 | 0.6439*** | 21.7168 | 0.1447*** | 4.7156 |
| Intercept | -0.5802*** | -4.4407 | 0.3520 | 0.4783 | -0.2760*** | -2.5389 |
| R ² | 0.4483 | | 0.5420 | | 0.4045 | |
| No. of Obs | 1680 | | 1003 | | 667 | |

Notes: This table shows the results using OLS estimation for panel sample of Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange over the period from 2007 to 2015. *FOR* is the ratio of total equity owned by foreigners to total outstanding shares (in percentage); *CR* denotes the stock return and measured as cumulative 12-month stock returns; *SIZE* is the natural logarithm of market capitalization; *MTB* denotes the ratio of market value to book value; *EPS* is the earnings per share. Model (4) : $CR_{it} = \alpha_0 + \alpha_1 EPS_{it} + \alpha_2 EPS_{it} * FOR_{it} + \alpha_3 SIZE_{it} + \alpha_4 MTB_{it} + \epsilon_{4it}$.

*, **, and *** represent the statistical significance at the 10%, 5%, and 1% level, respectively.

Furthermore, we find that foreign shareholders positively influence the relationship between earnings and return in large firms and this impact is not clear in small firms. This finding is consistent with Atiase (1985) and Freeman (1987) who report that the earning-return relation is more sensitive in large companies than in small companies.

6. Conclusion

The central objective throughout this paper is to determine the nature role of foreign shareholders in monitoring the discretion in local firm’s financial disclosures. To achieve our goal, we analyze the impact of foreign ownership on the different attributes of the earnings quality. Specifically, this research investigates the correlation between foreign ownership and three proxies of earnings quality, namely earnings management, earnings persistence, and earnings informativeness.

The results of multivariate estimations show that foreign shareholders serve as a positive role in enhancing corporate’s earnings quality. Particularly, our analysis provides evidence of the negative relationship between foreign ownership and earnings management, suggesting that an increase in foreign holdings percentage results in a decrease in discretionary accruals. Furthermore, our findings show significant evidence of the correlation between foreign owners and earnings persistence. Finally, we find the existence of a significant positive association between the international investors and the earnings informativeness, translating an increase of the percentage of capital held by the foreign investors results in a higher informativeness of earnings. All in all, these findings allow us to report the vital role of foreign shareholders in enhancing the quality of earnings in Vietnamese listed firms.

Our research provides insightful implications for both market participants and policy makers. Initially, the results from the multivariate analysis show that foreign investors positively influence domestic companies’ governance and promote the quality of firm’s reported earnings. Therefore, equity researchers might consider ownership structure as an important determinant of Vietnamese companies’ corporate governance. Furthermore, developing policies to attract foreign capital flow is among priority subset in Vietnam’s economic reforms. The findings in this analysis assist policy makers to increase the awareness and comprehensive understanding of the role of foreign ownership in Vietnam capital market.

In this paper, we pronounce the importance of sole foreign ownership role while the other ownership structure types have not been included, for example, state ownership, managerial

Table 10. The analysis of the relation between foreign ownership and earnings informativeness

| Panel A First-Stage Least Squares | | | | | | |
|-----------------------------------|-----------------|---------|--------------------------------|---------|--------------------------------|---------|
| Variable | Total sampleFOR | | Large companies (LARGESIZE)FOR | | Small companies (SMALLSIZE)FOR | |
| | Coeff. | t-stat. | Coeff. | t-stat. | Est. Coeff. | t-stat. |
| EPS | 0.0000*** | 4.3677 | 0.0000*** | 4.3446 | 0.0000*** | 2.1446 |
| SIZE | 0.0083 | 1.2838 | 0.0484*** | 4.3030 | -0.0091 | -1.3013 |
| MTB | 0.0202*** | 2.2424 | 0.0111 | 1.6153 | 0.0115 | 1.2105 |
| LIST_PER | 0.0502*** | 5.7578 | 0.0472*** | 4.6540 | 0.0406*** | 3.0378 |
| Intercept | -0.0907 | -1.0773 | -0.6403*** | -4.1998 | 0.1294 | 1.4811 |
| R ² | 0.1520 | | 0.2487 | | 0.0799 | |
| No. of Obs | 1365 | | 795 | | 570 | |

| Panel B Second-Stage Least Squares (2SLS) | | | | | | | |
|---|----------|----------------|---------|-------------------------------|---------|-------------------------------|---------|
| Variable | Expected | Total sampleCR | | Large companies (LARGESIZE)CR | | Small companies (SMALLSIZE)CR | |
| | | Coeff. | t-stat. | Coeff. | t-stat. | Est. Coeff. | t-stat. |
| EPS | | -0.0002*** | -2.2668 | -0.0004*** | -2.5017 | 0.0001* | 1.9267 |
| EPS*FOR | + | 0.0012*** | 2.7465 | 0.0017*** | 2.6837 | 0.0003 | 0.7665 |
| SIZE | +/- | -0.0948*** | -2.0407 | -0.5231*** | -2.6642 | 0.0071 | 0.6208 |
| MTB | + | 0.6279*** | 2.6159 | 0.7673*** | 3.3265 | 0.1213 | 1.2536 |
| Year dummy | | Yes | | Yes | | Yes | |
| Industry dummy | | Yes | | Yes | | Yes | |
| R ² | | 0.2040 | | 0.2257 | | 0.4095 | |
| No. of Obs | | 925 | | 513 | | 412 | |

Notes: This table shows the results using 2SLS estimation for panel sample of Vietnamese non-financial companies listed on the Ho Chi Minh City Stock Exchange over the period from 2007 to 2015. FOR is the ratio of total equity owned by foreigners to total outstanding shares (in percentage); CR denotes the stock return and measured as cumulative 12-month stock returns; SIZE is the natural logarithm of market capitalization; MTB denotes the ratio of market value to book value; EPS is the earnings per share. Instrument variable is listing period. Model (4) : $CR_{it} = \alpha_0 + \alpha_1 EPS_{it} + \alpha_2 EPS_{it} * FOR_{it} + \alpha_3 SIZE_{it} + \alpha_4 MTB_{it} + \epsilon_{4it}$.

*, **, and *** represent the statistical significance at the 10%, 5%, and 1% level, respectively.

ownership which may have a possible impact on the earnings quality of Vietnamese listed companies. In terms of directions for future research, we suggest a further study could assess the effects of these ownership types on earnings quality.

Acknowledgements

This paper was presented at the INFINITI Conference on International Finance Asia-Pacific, at the University of Economics Ho Chi Minh City, Vietnam on 7–8 December 2016. We are especially grateful for many insightful comments and helpful suggestions on earlier version of the present paper from Hong Bo, SOAS University of London, UK. The helpful comments of other conference participants are also gratefully acknowledged.

(1) Retrieved 11 January 2017 from <http://data.worldbank.org/indicator/BN.KLT.PTXL.CD>

(2) Retrieved 11 January 2017 from <http://doimoi.doanhnghiep.chinhphu.vn/so-lieu/>

(3) In the untabulated results, foreign ownership is highly correlated to listing period whereas the three

attributes of earnings quality (earnings management, earnings persistence, earnings informativeness) are not associated with listing period.

(4) Validity of the instrument variable: F-statistic values in the first stage of earnings management, earnings persistence, and earnings informativeness models are 33.15, 38.17, and 50.56, respectively. These F-statistic values are well above ten, that says my instrument pass the rule of thumb (Stock, Wright, & Yogo, 2002).

Funding

The authors received no direct funding for this research.

Author details

Xuan Vinh Vo¹

E-mail: vxvinh@yahoo.com
E-mail: vxvinh@yahoo.com
ORCID ID: <http://orcid.org/0000-0002-4725-6914>
Thi Kim Huong Chu²
E-mail: huong.chu@maybank-kimeng.com.vn

¹ Institute of Business Research and CFVG Ho Chi Minh City, University of Economics Ho Chi Minh City, 59C Nguyen Dinh Chieu Street, District 3, Ho Chi Minh City, Vietnam.

² Institute of Business Research, University of Economics Ho Chi Minh City, 59C Nguyen Dinh Chieu Street, District 3, Ho Chi Minh City, Vietnam.

Citation information

Cite this article as: Do foreign shareholders improve corporate earnings quality in emerging markets? Evidence from Vietnam, Xuan Vinh Vo & Thi Kim Huong Chu, *Cogent Economics & Finance* (2019), 7: 1698940.

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