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Article

Corporate governance and earnings management struggles: responses to adapt a modern capital mobilisation in the transitional economy

Cogent Business & Management

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Suggested Citation: Pham, Thi Bich Chi; Nguyen, Ha Linh; Vu, Thi Minh Thu; Truong, Van Tu (2022) : Corporate governance and earnings management struggles: responses to adapt a modern capital mobilisation in the transitional economy, Cogent Business & Management, ISSN 2331-1975, Taylor & Francis, Abingdon, Vol. 9, Iss. 1, pp. 1-19, <https://doi.org/10.1080/23311975.2022.2108216>

This Version is available at:

<https://hdl.handle.net/10419/289126>

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To cite this article: Thi Bich Chi Pham, Ha Linh Nguyen, Thi Minh Thu Vu & Van Tu Truong (2022) Corporate governance and earnings management struggles: responses to adapt a modern capital mobilisation in the transitional economy, Cogent Business & Management, 9:1, 2108216, DOI: [10.1080/23311975.2022.2108216](https://doi.org/10.1080/23311975.2022.2108216)

To link to this article: <https://doi.org/10.1080/23311975.2022.2108216>



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Received: 11 September 2021
Accepted: 27 July 2022

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

Code: 218,253,684 (Cogent Business & Management)

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ACCOUNTING, CORPORATE GOVERNANCE & BUSINESS ETHICS | RESEARCH ARTICLE

Corporate governance and earnings management struggles: responses to adapt a modern capital mobilisation in the transitional economy

Thi Bich Chi Pham¹, Ha Linh Nguyen^{1*}, Thi Minh Thu Vu¹ and Van Tu Truong¹

Abstract: As one of the market socialist countries with the dominant power of the government, Vietnam has recognised the importance of the open market with modern corporations regarding capital mobilisation. Up to 2000, Vietnam officially established its stock market showing its openness to a more diverse ownership structure. However, during this transition, the two most prominent issues—the lag of corporate governance practices and earnings management—have created a burden for this young market. In the tendency to join the global economy, this study is conducted to investigate how Vietnamese businesses struggle and overcome those problems. Regression estimators are used to analyse panel data covering the period 2015–2019, and FEM-robust (SE) shows its best fit to the model. The results suggest that to mitigate earnings management, the number of board members should be low, within the optimal span. Foreign ownership with negative



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PUBLIC INTEREST STATEMENT

This study has been done in Vietnam, a socialist country with the dominant power from the government. The country has witnessed many changes since the economy opens toward a “socialist-oriented market economy” such as the establishment of stock market, and the acceptance of various ownership components other than state ownership only. In the transition process and creating a modern channel for capital mobilisation, its newly developed stock exchange has to deal with the lag of corporate governance practices and earnings management. Thus, this study is conducted to investigate how businesses can struggle to overcome those problems by using FEM-robust (SE) model. The results suggest the optimal board members, positive role of foreign ownership and drawbacks of high State ownership and Concentration ownership ratios in struggling with earnings management and corporate governance. This research expects to have contribution during the transformation process of Vietnam, from a centrally planned economy to a market-oriented one.

sign implies that enhancing the foreign shareholders' roles is essential. In contrast, the lowering of state ownership and concentration ownership ratios—the unique features of a transitional economy—might bring a better mechanism of corporate governance and earnings quality. In addition, policymakers, academics, and practitioners should also consider other explanatory variables when concerning corporate governance as well as the phenomenon of earnings management.

Subjects: Corporate Finance; Financial Accounting; Corporate Governance

Keywords: corporate governance; earnings management; modern capital mobilisation; Vietnam

1. Introduction

The concept of corporate governance (CG) has appeared for decades. It is a system of benchmarks by which companies are directed and controlled for best practices. In a competitive business world nowadays, corporate governance has changed dramatically and evolved to meet the corporation's increasingly complex and diverse requirements. However, in developing and transitional countries, corporate governance has faced challenges of falling further behind. Thus, it has grabbed much of international focus, such as China (Jiang & Kim, 2020; Lai & Tam, 2017), the Former Soviet Union (Crotty & Jobome, 2004), and Indonesia (Widagdo et al., 2021). Vietnam is a country that has attributes of a transitional and emerging economy, and it is not out of that challenge.

Vietnam is one of the few remaining Communist countries that steers themselves toward “the socialist-oriented market economy”. The economic reform in 1986 has shifted this poor country to a rapid growth and remarkable successes. Especially, since 2000, Vietnam officially launched its stock market with public limited liability companies, and the State-owned enterprises' equitisation has been progressed well. Unlike before, the current enacted Corporation Law (2014, 2020) now accepts various ownership components instead of state ownership only. Since then, building a well-functioning stock market and improving corporate governance practices are indispensable when there are more and more modernised corporations operating in the economy besides State-owned enterprises (SOEs).

In the corporate governance literature, agency cost and earnings management are also closely related. Keasey et al. (2005) suggest that reforms to corporate governance should create a response to three main issues, in which earnings management is first mentioned. Undoubtedly, the 1997 Asian financial crisis and the recent accounting scandals such as Maxwell in the UK; Enron, and Worldcom in the US ... are well-known examples of earnings management as well as corporate governance fraud. Those high-profile cases have created warnings on how a weak corporate governance can destroy the reputation of the whole system and reduce the reliability of the earnings index.

In Vietnam, the lack of transparency in information disclosure and managers' intentional behaviours bring concerns to investors when the gap between pre- and post-audit reports is widening. For example, in The Vietnam Japan Medical Equipment Joint Stock Company (JVC) in 2015, the profit difference before and after audit is up to 622 billion VND. The reality has raised suspicion about the effectiveness of corporate governance—a mechanism that supports and creates trust among stakeholders (Utami & Pernamasari, 2019).

Although corporate governance in Vietnam continues to evolve, the lag has raised concerns for information users. Measuring by The ASEAN Capital Market Forum (ASEAN Capital Market Forum (ACMF), 2017), Vietnam has the lowest corporate governance index compared to other countries in the region, and listed companies in Vietnam are generally small in size and less standardised in practices. In addition, legal protection for investors is one essential element of corporate governance and earnings management (Leuz et al., 2003; Shleifer & Vishny, 1997). However, according to

Worldbank's (2020) about the investors' protection index, Vietnamese legal environment is now at a low position, ranking 97 among 190 countries globally. Among the users of accounting information, investors are subjected to the highest pressure on information needs because they invest capital in companies but do not directly use it. Therefore, for decades, the topic between CG and EM attracts interest from worldwide researchers and pioneers, especially in Western countries with the highly developed capital market (Fathi, 2013; Healy & Wahlen, 1999; Xie et al. (2003)).

In the Vietnamese context, Tran et al. (2020) investigate CG and EM, but in the banking industry. Another research examines CG and EM but with restriction in sample size and mainly focuses on the financial performance aspect (Dao & Ngo, 2020). Recognising that prior studies in Vietnam have little analysis of CG regarding ownership structure with the salient attributes of a socialism mechanism, this research goes deeper into testing CG and EM with the breakdown of ownership structure under high control power of the government.

Based on the school of positive accounting theory (PAT), agency theory (AT), and information asymmetry (IA), the study evaluates how businesses struggle with the CG and EM in the Vietnamese stock exchange. The study expects businesses to have meaningful responses in dealing with investors' protection, improving CG and reducing EM in a new transitional market in this country.

2. Theoretical background and literature review

2.1. Theoretical background

2.1.1. Positive accounting theory (PAT)

PAT is a branch of academic accounting research for explaining and predicting accounting practices. Watts and Zimmerman (1986) are pioneers in the Positive Accounting Theory (PAT). For decades, corporate governance and earnings management have been central topics of PAT, and three hypotheses in PAT could be used to explain this line of research. These are hypotheses in PAT: (1) bonus plan hypothesis: managers prefer to shift profits from the future into the present to meet the bonus plan (2) equity hypothesis (debt covenant hypothesis): managers tend to loosen the limit of allowed debt ratio for obtaining additional funds by managing earnings, and (3) political cost hypothesis (size hypothesis): managers may choose to suspend the current period earnings or minimize earnings for receiving government grants.

2.1.2. Agency theory

Agency theory is a key theory in economics and has become the basis for positive accounting research (Healy, 1985; Jones, 1991). Agency theory provides a basic understanding of corporate governance and earnings management interaction. According to Berle and Means (1932), the separation between shareholder ownership and the control function of managers is risky because this separation can lead to opportunistic actions that cause losses to owners' capital. Following Berle and Means (1932), Jensen and Meckling (1976) and evolving from the idea of the separation of ownership from control, agency theory assumes that managers are self-interest, and the manager, in spite of being an agent of the principal (investor), could still act on their personal interest, and earnings management may fall in the case of ignoring investors' interest, indicating weak corporate governance.

2.1.3. Information asymmetry

In addition to resolving conflicts in the agency relationship, asymmetric information is a factor that significantly impacts the interests of market participants. Asymmetric information is a common phenomenon when trading in markets, in which participants intentionally conceal information, leading to one party having complete information. In contrast, the other party lacks necessary information when making investment decisions or signing contracts. When managers have more information and understanding of a company's business opportunities than investors, they can

inflate the firm's value, and conceal information (Akerlof, 1970). Asymmetric information in the stock market is a loophole for the arising of opportunistic earnings manipulation by managers.

2.2. Overview of prior related works

In the research about corporate governance and earnings management, Fan et al. (2021) show that improvements in CG can reduce EM and suggest that the improvements in CG would improve financial reporting. According to Healy and Wahlen (1999), if CG mechanisms are effective, the interest of both the owners and managers of firms should converge. Good CG can reduce agency problems and thus lower EM. Prior studies have investigated CG and shown mixed results regarding the relations between CG attributes and EM.

Board size is one of the most popular variables in testing CG. Jensen (1993) argues that increasing membership means increasing marginal costs and reducing operational efficiency. In New Zealand, Seng and Findlay (2013) investigate the association between CG mechanisms and EM. They conclude that the board size of directors significantly positively interacts with EM, which means that larger boards seem to be ineffective than smaller ones. In Portugal, Alves (2012) provides empirical evidence about the positive relationship between CG and EM. However, according to Fathi (2013) in France, and Xie et al. (2003) in the US; the bigger the board size is, the lower the EM is. In the study of a number of top 250 ranking international oil and gas corporations globally, the authors find that board size does not impact EM (Al-Azeez et al., 2019). In China, Lai and Tam (2017) stated the same result of an insignificant relation.

The role of independent members on the board of directors does not significantly associate with EM (Seng & Findlay, 2013). In Norway, Kjærland et al. (2020) expect to provide valuable insights about CG and EM under the Nordic approach, and they find that board independence positively affects EM. The positive result is also found in the study of Al-Azeez et al. (2019). Meanwhile, Johari et al. (2008) in Malaysia, Chen et al. (2006), and Lai and Tam (2017) in China show a negative relation between EM and independent directors on the board.

The duality between chief executives and chairman has been primarily concerned due to the agency theory. The separation between shareholder ownership and the control function of managers could lead to risky decisions in managing resources. Rahman et al. (2006), Fathi (2013), and Lai and Tam (2017) conclude no evidence of relationship between the duality of CEO and EM. The others show a positive relationship between duality and EM (Al-Azeez et al., 2019). Contradicting many others, Charfeddine et al. (2013) provide a negative result.

Besides some most discussed key factors such as the board size, independent directors, and duality, the ownership structure is another essential component of CG. Most CG and EM studies focus on the diversity of ownerships (Alves, 2012; Kjærland et al., 2020; Lai & Tam, 2017).

Alves (2012) provides empirical evidence for other variables such as ownership structure (managerial ownership and ownership concentration ratios); the higher ratios could reduce the level of EM. Piosik and Genge (2019) give the U-shaped evidence between concentration ownership and EM and the negative relation with managerial ownership. Kjærland et al. (2020) show that sharing ownership by directors positively affects EM. Testing the institutional ownership, Bamahros et al. (2015) find evidence to encourage a long-term strategy for share ownership. Lai and Tam (2017) examine the ownership, CG, and EM and provide the negative sign between EM and the largest shareholders, a positive sign for percentage state ownership; Chen et al. (2008) provide the same conclusion. Lai and Tam (2017) also find no relation with foreign ownership. Vo et al. (2019), Guo and Ma (2015), and An (2015) displayed a positive role of foreign ownership in reducing EM. Warfield et al. (1995) confirm the negative relation, as discussed in Jensen and Meckling (1976), regarding managerial ownership.

Vietnam is on the way to the transformation from a centrally planned economy to a market-oriented economy. It has a unique ownership structure, the dominant role of the state and

concentration ownership. In transitional markets, Vietnam experienced the agency conflict that could be found between controlling and minority shareholders in the case of a concentrated ownership structure. It is different from the principal-agent model rooted in Anglo-Saxon countries where the stock markets formed early. Berglöf and Von Thadden (1999) recommend that in a transitional economy, we should extend our focus on a three-way conflict between large blockholders, managers, and minority shareholders instead of the only relation between managers and shareholders in the original agency theory model. Megginson and Netter (2001) did a cross-nation study in a range of transition countries between 1997 and 2000, and they found that ownership structure is one of the most discussed topics. Some main results are consistent with the significant positive roles of private ownership other than state ownership, concentrated private ownership other than diffused ownership, foreign ownership other than domestic ownership, and majority ownership by outsiders other than insiders in terms of financial performance improvements. Therefore, in this research, as a suggestion, we gather state ownership and concentration ownership as two prominent uniqueness of a market socialist, a transitional economy of Vietnam.

3. Research framework and research hypothesis

3.1. Research framework

The research framework about the main key factors of corporate governance and earnings management is presented in Figure 1:

3.2. Research hypothesis

3.2.1. Corporate governance variables

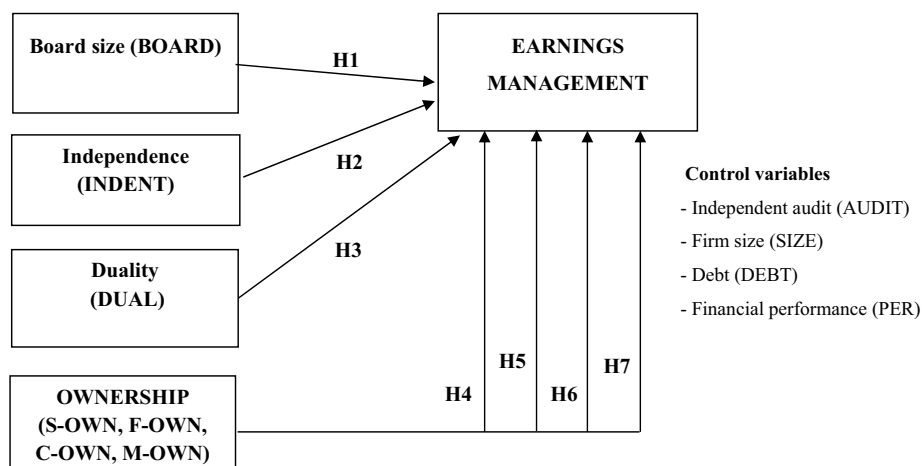
3.2.1.1. *Board size (BOARD)*. The effectiveness of the board of directors depends on its size. Beasley (1996) & Yermack (1996) show that the decision-making process of small-sized boards is more efficient than large-scale boards, but with large boards, the ability to control the actions of the senior managers is better (Zahra & Pearce, 1989). In the line of Fathi (2013), and Xie et al. (2003), the larger the board size, the lower the EM is. Thus, hypothesis H1 is proposed as follows:

H1: Board size in companies listed on the Vietnamese stock exchange is negatively related to earnings management

3.2.1.2. *Independence directors (INDENT)*. Corporation Law No. 59/2020/QH14 (2020), Vietnam, clearly states that ensuring a balance between members holding executive titles with independent members is essential for the Board of Directors to operate effectively. The existence of

Figure 1. Research framework for testing corporate governance and earnings management.

(Source: Proposed by authors)



independent members will help monitor the managers' behaviour, thereby controlling the EM activities. As for Chen et al. (2006), Lai and Tam (2017), and Johari et al. (2008), the higher the percentage of independent directors, the better the control of governance behaviour and will reduce the EM. Together with these authors, the research hypothesis H2 is as follows:

H2: The number of independent directors in companies listed on the Vietnamese stock exchange is negatively related to earnings management

3.2.1.3. *Duality between CEO and Chairman (DUAL)*. The roles of the manager and the board of directors need to be separate, which will be good for the board's operation because to operate effectively and minimize the behaviours of EM, the separation is necessary (Cadbury Report, 1992). Research results of Al-Azeez et al. (2019) show that if the CEO is also the chairman of the Board of Directors, it is likely that the EM will be high. Thus, hypothesis H3 is as follows:

H3: The duality of CEO and Chairman in companies listed on the Vietnamese stock exchange has a positive relationship with EM

3.2.2. *Ownership (state, foreign, concentration, and managerial ownership: S-OWN, F-OWN, C-OWN, M-OWN)*

Investors tend to consider that the transparency and appropriateness of a company's ownership structure and financial reporting are their key criteria in the investment-making decision process. One unique feature in Vietnam is the existence of SOEs, especially in many important sectors such as banking, education, and electricity sectors. Even though many SOEs have been equitised and converted into a corporation, the State still holds a majority interest in ownership

Similarities could be found in the context of China, where state ownership is the typical attribute in its stock market (Chen et al., 2008; Lai & Tam, 2017). China and Vietnam share common similarities in terms of law and market, which means that the higher the state ownership ratio, the more the company will be involved in EM. Nguyen (2017) emphasises the common in terms of law and market between Vietnam and China; when the state ownership is getting higher, the EM level will increase. The H4 hypothesis is as follows:

H4: State ownership of companies listed on Vietnamese stock exchange has a positive relationship with earnings management

Foreign investment is considered a factor for increasing capital as well as showing the attractiveness of the company. It also has the power in restraining EM behaviours. Based on the positive influence of foreign ownership on EM, as indicated in the studies of Guo and Ma (2015) and An (2015), the authors also expect a positive role of ownership structure in terms of foreign ownership in reducing EM in Vietnam. Therefore, the hypothesis H5 is presented below:

H5: Foreign ownership of companies listed on Vietnamese stock exchange is inversely related to earnings management

In opposite to developed countries with characteristics of distributed ownership structure, Asian countries have shown their centrally owned structure. Many Vietnamese companies start as small companies with a single controlling shareholder. Even with the expanding process and significant changes in equitisation, the controlling shareholders or this concentrated ownership

structure are still entailed. Concentrated ownership may create insider dominance and weaken the protection of external outsiders such as shareholders/investors (IFC-SSC, 2010). The power of controlling shareholders in making a decision can limit corporate governance in operating effectively. In the study of Piosik and Genge (2019), authors synthesise prior related research and find that the majority displays the positive association between ownership concentration and accrual EM. We proposed hypothesis H6 as follows:

H6: The ownership concentration of companies listed on the Vietnamese stock exchange has a positive relationship with earnings management

Another angle of owner structure is managerial ownership. The interaction between managerial ownership and earnings management has been tested in the research of Warfield et al. (1995), Alves (2012), and Piosik and Genge (2019) with the results of negative signs arising when managerial ownership interacts with earnings management. It is consistent with the agency theory (Jensen & Meckling, 1976); the convergence of benefits of managers and shareholders will be achieved when managers are also shareholders. Therefore, the proposed hypothesis H7 is as the following:

H7: The managerial ownership ratio of a listed company on the Vietnamese stock exchange is inversely related to earnings management

3.2.2.1. *Control variables.* in addition to corporate governance variables, control variables are added. These are tested in this paper and are expected to have some contribution insights.

3.2.2.2. *Independence audit (AUDIT).* auditing will help to ensure the reliability and the faithful of the financial statements. Using the independent audit variable, Fathi (2013) evidences that when audited by the Big 4, the level of EM will be lower because large auditing firms like the Big 4 have high reputation for independence and expertise. The reputation of audit firms is often seen as a barrier to EM, and information disclosure is more transparent (Xie et al., 2003).

3.2.2.3. *Debt ratio (DEBT).* the debt covenant hypothesis is one of the three commonly used hypotheses in PAT (Watts & Zimmerman, 1986). Many studies show a positive relationship between debt leverage and EM (Charfeddine et al., 2013; Defond & Jiambalvo, 1994; Dichev & Skinner, 2002). This research follows the school of Watts and Zimmerman (1986), supporting that firms with higher debt ratios tend to use accounting procedures for income increase and loosen debt ratios in terms of debt constraint.

3.2.2.4. *Financial performance (PERF).* the Bonus plan hypothesis (Watts & Zimmerman, 1986) could explain financial performance and EM. In order to preserve the image of the business, many managers seek to prevent a decrease by EM techniques (Chen et al., 2006; Hirshleifer, 1993; Kjærland et al., 2020). This research stands on the view of the tendency to manage earnings to keep prestige for companies.

3.2.2.5 *Firm size (SIZE).* deriving from the hypothesis of political costs in PAT (Watts & Zimmerman, 1986), firm size significantly impacts EM. Numerous studies used firm size to represent political costs incurred in EM studies and demonstrate that firm size and political costs are positively related (Alves, 2012; Charfeddine et al., 2013). This research follows the political hypothesis and expects that the larger the firm size, the higher the political costs, and thus, the more EM are usually made.

4. Research methodology

4.1. Sampling and collecting data

According to the State Security Commission of Vietnam, there are 745 listed companies up to July 2021 (SSC, 2021). Among them, we only focus on non-financial listed companies with a sample of 658 companies. Due to the limitation in collecting data and the effect of Covid-19, we select the time frame from 2015 to 2019. At first, we cleaned up and eliminated missing data for the collected data from financial statements of non-financial listed companies on the Vietnamese stock exchange and have a sample of 3,120 observations. Processing data had gone through two steps, discretionary accruals (DA) calculation according to Jones (1991) model and then running the regressions for this research.

Step 1: Non-discretionary accruals (NDA) and discretionary accruals (DA) calculations

Using a sample of 3,120 observations, we estimate NDA and DA by using the original Jones (1991) model. The original Jones (1991) model is considered a reliable model in the Vietnamese stock market (Nguyen & Nguyen, 2016). Then, the DA results are inputs of the second step. The positive DA means there is income-increasing EM, and the negative DA means there is income-decreasing EM (Abbott et al., 2006).

Step 2: Regressions for Model (1) and Model (2)

DA plays the role of dependent variables in Model (1) and Model (2) in Section 4.2 below. While calculating the research variables, 495 observations were eliminated because of insufficient data. A number of 215 observations with DA = 0 (a proxy for non-EM companies) were also put aside. The authors expect strong-balanced panel data. Thus, companies that do not have full data from 2015 to 2019 were wiped out with 422 observations. The ultimate sample consists of 1,990 strong-balanced panel data. Stata ver.12 was employed for data processing analysis.

4.2. Regression models

In this study, we collected data from non-financial listed companies on the Vietnam stock exchange for the period 2015–2019. Model 1 is for OLS estimation. Model 2 is for the regression technique of FEM and REM.

Model (1):

$$DA = \alpha_0 + \alpha_1 \text{BOARD} it + \alpha_2 \text{INDENT} it + \alpha_3 \text{DUAL} it + \alpha_4 \text{S} - \text{OWN} it + \alpha_5 \text{F} - \text{OWN} it + \alpha_6 \text{C} - \text{OWN} it + \alpha_7 \text{M} - \text{OWN} it + \alpha_8 \text{AUDIT} it + \alpha_9 \text{DEBT} it + \alpha_{10} \text{PERF} it + \alpha_{11} \text{SIZE} it + \epsilon it$$

Model (2):

$$DA = \alpha_0 + \alpha_1 \text{BOARD} it + \alpha_2 \text{INDENT} it + \alpha_3 \text{DUAL} it + \alpha_4 \text{S} - \text{OWN} it + \alpha_5 \text{F} - \text{OWN} it + \alpha_6 \text{C} - \text{OWN} it + \alpha_7 \text{M} - \text{OWN} it + \alpha_8 \text{AUDIT} it + \alpha_9 \text{DEBT} it + \alpha_{10} \text{PERF} it + \alpha_{11} \text{SIZE} it + \omega it$$

In which:

$$\text{Where: } \omega it = \epsilon it + u_i$$

ϵit : error term, varies across individuals i and time t

u_i : representing the effects of all the time-invariant variables that have not been included in the model of every individual i .

In addition, Table 1 shows the definitions and variable measurements in the research model.

Table 1. Definitions and variable measurement in the research model

Variables	Names of variables	Measurements
DA	<i>Discretionary accruals</i>	(*) the Jones (1991)
BOARD	<i>Board size</i>	The number of members
INDENT	<i>Independent board members</i>	The percentage of independent board members
DUAL	<i>CEO and chairman duality</i>	1 if CEO is chairman of the board and 0 otherwise
S-OWN	<i>State ownership ratio</i>	The percentage of State ownership
F-OWN	<i>Foreign ownership ratio</i>	The percentage of Foreign ownership
C-OWN	<i>Ownership concentration</i>	The percentage of Ownership concentration
M-OWN	<i>Managerial ownership</i>	The percentage of Managerial Ownership
DEBT	<i>Debt ratio</i>	Debt/ Equity
PERF	<i>Financial performance</i>	ROE = Profit/Average of Equity
SIZE	<i>Company size</i>	Log of total assets
AUDIT	<i>Independent audit</i>	1 if company is audited by a Big 4 auditor, 0 otherwise

(Source: Authors' synthesis)

Measurement of discretionary accruals (*).

Earnings management can be implemented by real activities or via using accruals (Cohen & Zarowin, 2008; Nguyen, 2021). In real EM, reported earnings could be altered via regular business practices such as increasing reported earnings by cutting discretionary expenses (Roychowdhury, 2006). Meanwhile, accrual-based EM is a way to manipulate earnings through the accrual process. Within the scope of the paper, the authors only focus on accrual-based EM, and discretionary accrual is the proxy for EM.

In EM literature, prior studies use a variety of tools to measure the discretionary accrual. In this research, we select the original Jones (1991) because it is the basis for establishing many other modified models from the first introduction in the 90s until now.

4.2.1. Original Jones model (1991)

The term accruals refer to the difference between net income (non-cash profit) in the income statement and the net cash from statement of cash flows. Accruals have two components: non-discretionary accruals (NDA) and discretionary accruals (DA). Jones (1991) expected variance of revenue and depreciation on fixed assets would cause changes in accruals and built the model for estimation of DA. According to the original Jones (1991), total accruals in the event year t as follows:

$$\frac{TA_{it}}{A_{it-1}} = \alpha_1 \times \frac{1}{A_{it-1}} + \alpha_2 \times \frac{\Delta REV_{it}}{A_{it-1}} + \alpha_3 \times \frac{PPE_{it}}{A_{it-1}} + \varepsilon_{it}$$

Where:

TAit: total accruals in year t, company i

ΔREVit: Sales in year t—Sales in year t-1, company i

PPEit: Cost of PPE at the end of year t, company i

A_{it-1} : Total assets at the end of year $t - 1$ in company i

$\alpha_1, \alpha_2, \alpha_3$: estimate parameters

ϵ_{it} : errors in year t of company i

Then, NDA and DA are calculated:

$$NDA_{it} = \alpha_1 \times \frac{1}{A_{it-1}} + \alpha_2 \times \frac{\Delta REV_{it}}{A_{it-1}} + \alpha_3 \times \frac{PPE_{it}}{A_{it-1}}$$

$$DA_{it} = TA_{it}/A_{it-1} - NDA_{it}$$

In which:

NDA_{it} : Non-discretionary in company i , year t

$\alpha_1, \alpha_2, \alpha_3$ estimate parameters (Based on $\alpha_1, \alpha_2, \alpha_3$)

Parameters $\alpha_1, \alpha_2, \alpha_3$ are estimated by OLS method

5. Data analysis and results

5.1. Descriptive statistics

Table 2 represents the descriptive statistics of corporate governance variables BOARD, INDENT, DUAL and S-OWN, F-OWN, C-OWN, and M-OWN.

Board size (BOARD): on average, the number of board members is at least 3 and at most 11. The average number is 5.52, with an SD (Standard deviation) of 1.09. The board of directors' optimal size ranges between 5 and 9 members (Campos et al., 2002), and the size of the board in the sample is satisfactory. The board size is in line with the "Corporation Law" (2020) of Vietnam, which stipulates that the minimum number of members on the board of directors is 3, and the maximum is 11.

Independent board members (INDENT): Among the 1,990 observations, the average independent member is 0.62, spans from 2 to 9 members (min 20%–max 100%). According to Corporate Law (2014), in Vietnam, at least 1/3 (one-third) of the board should be independent members. However, the new "Corporation Law" (2020), Article 137 stipulates that at least 20% of the total number of board members should be independent members. Our sample meets the requirement of Corporation Law in Vietnam.

CEO and chairman duality (DUAL) is a dummy variable. Descriptive statistics show that the duality rate is 37%, high ratio of duality may appear to have self-interest behaviours in the Vietnamese stock exchange. Since the issuance of the "Corporation Law" (2020), the chairman of the Board of Directors is no longer allowed to act as a director or general director.

State ownership (S-OWN)

The unique of Vietnam, being transformed from a centrally planned economy to a market economy, the ratio is very popular with the highest holding rate of 96.72% (the lowest is 0%). The mean was 28.28%, SD was 24.72%, and the median is 29.8%. As the dominance of State is the characteristic of Vietnamese enterprises, approximately 28.28% of the companies are held by the State. Even with the progress of state-owned enterprises privatization, the power control of the government is still high.

Table 2. Descriptive statistics for corporate governance variables

Variables	Observation	Mean	Median	Min	Max	SD
Board size (BOARD)	1990	5.52	5	3	11	1.09
Independence (INDENT)	1990	0.62	0.6	0.2	1	1.15
Duality (DUAL)	1990	0.37	0	0	1	0.48
State ownership (S-OWN) (%)	1990	28.28	29.8	0	96.72	24.72
Foreign ownership (F-OWN) (%)	1990	5.62	0.38	0	88.69	10.80
Concentration ownership (C-OWN) (%)	1990	32.25	34.79	0	98.11	27.45
Managerial ownership (M-OWN) (%)	1990	10.67	3.93	0	86.75	14.79

(Source: Analysed by authors)

Foreign ownership (F-OWN): as observed in Table 1, the variable ranges from 0% to 88.69%. However, the mean is only 5.62%, the DA is 10.80%, and the median is 0.38%. Foreign ownership is often a positive sign to assess the reputation and quality of business information. The rate of foreign ownership in Vietnam is also a notable factor because from being controlled at a low rate, it has now been expanded to create favourable conditions for enterprises to attract capital from abroad. However, it remains low.

Ownership concentration (C-OWN), like S-OWN, shows a mean of 0 and a max of 98.11%, SD equals 27.45%, and a median of 34.79%. The average ratio of 32.25% for ownership concentration of major shareholders, a high percentage of this variable may affect the managers' actions in doing business.

Managerial ownership (M-OWN) indicates min 0, max 86.75%, median 3.93%, SD 14.79%, and the average value of 10.67%. In Western countries, this type of ratio is higher. In our case, due to the concentration ownership, state ownership has played a more powerful role. Table 3 describes the mean, median, maximum, minimum, and standard deviation of variables belonging to the control variable group, including Debt (DEBT), Financial performance (PERF), Company size (SIZE), and Independent Audit (AUDIT).

Debt (DEBT) is also known as a company's financial leverage. It has a minimum value of 0.40, while the maximum is 17.26. Thus, the financial leverage is very different; there are companies with leverage of only about 0.4, while there is a company with a debt ratio of about 17 times equity.

Financial performance (PER) spans from min of -1.33 to a max of 1.01, average ROE of 12%, indicating a rapid growth. A negative ROE means that these companies are not operating effectively and get a loss. The higher the ROE is, the more effective of using the shareholders' capital is, proving an attractive stock for investors.

Company size (SIZE), the minimum value is 10.19, the maximum value is 13.96 with a variability of 0.62, and a median of 11.77. In any size, companies have reasons to manage earnings. Small-scale companies can adjust earnings to increase business value, and large-scale units may also implement EM to keep their reputation.

Table 3. Descriptive statistics for control variables

Variables	Observation	Mean	Median	Min	Max	SD
Debt (DEBT)	1990	2.10	1.60	0.40	17.26	1.79
Financial performance (PERF)	1990	0.12	0.12	- 1.33	1.01	0.16
Company size (SIZE)	1990	11.77	11.77	10.19	13.96	0.62
Independent audit (AUDIT)	1990	0.22	0	0	1	0.42

(Source: Analysed by authors)

Independent audit (AUDIT), listed companies on the Vietnamese stock exchange are audited by both Big 4 and non-Big4. Descriptive statistics have two values, 1 and 0, for max and min. On average, the number of companies audited by the Big 4 accounts for only 22%, a tiny number compared to 78% of the remaining companies.

After estimating through the Jones (1991) model, the DA value can be observed in Table 4. The mean is 0.09, with a SD of 0.74. The minimum value is negative 5.53, the maximum is 2.76, and the median is 0.22. If we divide 1990 observations into two groups: NEG (a group with negative DA) and POS (a group with positive DA), then we can know that NEG is the group that uses DA for income-decreasing behaviour, and the POS means income-increasing behaviours (Abbott et al., 2006)

5.2. Correlation coefficients

Table 5 describes the correlation coefficient between the variables in the research model. From the correlation matrix, we can see the dependence between variables.

5.3. Regression

As presented in the section on methodology, first, we run the OLS technique. The fixed-effects model (FEM) and the random-effects model (REM) are estimated for panel data, allowing us to explore the cross-section and time-series data simultaneously. After affirming the fit for the whole model (F-test, Wald Chi2), the summarized results presented in Table 6 are retrieved from OLS, FEM, REM, and FEM (robust SE) methods:

In detail, first, we use the ordinary least squares OLS model. However, the OLS was not suitable for panel data, then the FEM model (fixed effects model) and the REM (random effect model) are performed in our regressions. As for Hausman's test and F-test, the FEM model is selected. Next, the Lagrangian Multiplier Test is an additional test; it shows that heteroskedasticity matters. Thus, the REM regression model with robust SE is performed. After running the REM (robust SE) regression, we build the regression model as follows:

$$DA = -5.1023 - 0.0301 * BOARD_{it} + 0.0018 * S - OWN_{it} - 0.0031 * F - OWN_{it} + 0.0006 * C - OWN_{it} - 0.0951 * AUDIT_{it} + 0.0702 * DEBT_{it} + 1.04 * PERF_{it} + 0.4321 * SIZE_{it} + wit$$

6. Discussions

This discussion section is about the results under FEM (robust SE). In relation to EM, four out of seven CG variables are significant. All of the four control variables are significant at a level of 0.05 and 0.001.

6.1. Board size (BOARD) and earnings management (DA)

The variable "Board size" (BOARD) and DA are correlated with the coefficient = -0.0301 and p-value <0.1, and there exists the opposite link between BOARD and DA. Thus, hypothesis H1 is accepted "Board size has a negative relationship with EM". This result is consistent with the

Table 4. Descriptive statistics for DA

Variable	Observation	Mean	Median	Min	Max	SD
DA	1990	0.09	0.22	- 5.53	2.76	0.74

(Source: Analysed by authors)

previous studies concluding that the higher the number of directors, the lower the internal quality control (Fathi, 2013; Xie et al., 2003). It should reach the harmonisation based on the suggested optimal size (5–9 members; Campos et al., 2002) and "Corporation Law" (2020) of Vietnam, which stipulates that the minimum number of members on the board of directors is 3 and the maximum is 11. In addition, according to ASEAN Capital Markets Forum (ASEAN Capital Market Forum (ACMF), 2017), based on the indicators to evaluate corporate governance, Vietnam only achieved 35.14/100 points, of which the index related to "responsibility of the board of directors" is the lowest among the 5 assessed indicators (at 20 points). Thus, to better promote the board of directors' role, businesses need to consider the optimal number of members and improve the CG mechanism to enhance the quality of CG in general, other than simply paying attention to the number of members.

6.2. Independence board members (INDENT) and earnings management (DA)

The "Independent directors" (INDENT) shows an insignificant result. Although there is no evidence to conclude hypothesis H2, we still try to find out why the "Independent board members" (INDENT) is inappropriate. Even in Corporation Law (2014) in Vietnam or the latest "Corporation Law" (2020) has emphasised the importance of independent directors as board members, the role of INDENT is very weak or even overlooked. The ownership structure is highly concentrated (role of state ownership, large shareholder ownership), thus, electing or approving INDENT is just for completing the procedure and meeting the requirement to be listed on the stock exchange other than substance (Bui Thi Thuy, 2015). It requires more completion from the legal perspective in promoting the role of independent members.

6.3. CEO and chairman duality (DUAL) and earnings management (DA)

The "CEO and Chairman duality" (DUAL) does not have a significant effect on DA. Thus, we reject hypothesis H3; this result is consistent with previous studies (Fathi, 2013; Lai & Tam, 2017; Rahman et al., 2006). In Vietnam, out of 1,990 observations, 37% have the phenomenon of dual function.

Table 5. Correlation matrix between the variables in the research model

Variables	DA	BOARD	INDENT	DUAL	S-OWN	F-OWN	C-OWN	M-OWN	AUDIT	DEBT	PERF	SIZE
DA	1.0000											
BOARD	0.1187	1.0000										
INDENT	-0.0158	0.0172	1.0000									
DUAL	-0.0400	0.0194	-0.3033	1.0000								
S-OWN	0.0244	-0.1739	-0.0417	-0.1832	1.0000							
F-OWN	0.1082	0.2178	0.1100	-0.0374	-0.1592	1.0000						
C-OWN	0.0820	-0.0554	0.0408	-0.1007	0.3337	0.0541	1.0000					
M-OWN	-0.0080	0.1488	-0.0957	0.2016	-0.4606	-0.0046	-0.0652	1.0000				
AUDIT	0.2195	0.1013	0.1436	-0.1553	0.0320	0.2495	0.0664	-0.0583	1.0000			
DEBT	0.1658	-0.0477	-0.0987	-0.0755	0.0982	-0.1684	0.0282	-0.0369	0.0083	1.0000		
PERF	0.2056	0.0221	-0.0146	0.0074	0.0818	0.0691	0.0751	-0.0418	0.0215	-0.2023	1.0000	
SIZE	0,6320	0.2817	0.0772	-0.1300	-0.0302	0.2829	0.0598	0.0195	0.4938	0.2358	0.0418	1.0000

(Source: Analyzed by authors)

Table 6. Comparison: OLS, FEM, REM, FEM (robust SE)

	Pooled OLS	Fixed effect	Random effect	Fixed effect (robust SE)
Variables	(1)	(2)	(3)	(4)
BOARD	- 0.0381*** (0.0122)	- 0.0301** (0.0151)	- 0.0316** (0.0131)	- 0.0301 * (0.0162)
INDENT	- 0.1813** (0.0865)	- 0.0605 (0.0905)	- 0.0852 (0.0825)	-0.0605 (0.1072)
DUAL	0.0467* (0.0279)	0.0186 (0.0332)	0.0317 (0.0291)	0.0186 (0.0378)
S-OWN	-0.0002 (0.0006)	0.0018 (0.0015)	0.0004 (0.0009)	0.0018* (0.0011)
F-OWN	- 0.0042*** (0.0013)	- 0.0031** (0.0014)	- 0.0036*** (0.0013)	- 0.0031* (0.0017)
C-OWN	0.001** (0.0005)	0.0006* (0.0003)	0.0006* (0.0003)	0.0006* (0.0004)
M-OWN	- 0.011 (0.001)	0.0001 (0.0011)	- 0.0001 (0.001)	- 0,0001 (0.0017)
AUDIT	- 0.1926 *** (0.035)	- 0.0951 ** (0.0418)	- 0.1175*** (0.0367)	- 0.0951* (0.0492)
DEBT	0.086 (0.0077)	0.0702*** (0.0107)	0.0419*** (0.0087)	0.0702*** (0.0139)
PERF	0.8468*** (0.0791)	1.04*** (0.0667)	0.9787*** (0.0632)	1.04*** (0.1251)
SIZE	0.8538*** (0.0256)	0.4321*** (0.0930)	0.7546*** (0.0397)	0.4321** (0.1733)
Constant	-9.7229*** (0.2887)	-5.1023*** (1.0802)	-8.7641*** (0.4555)	-5.1023** (2.0226)
Observations	1,990	1,990	1,990	1,990
R-squared	0.4559	0.3775	0.4480	0.3775
Number of ID		398	398	398
VIF	<10			
Hausman test		0.0017**		
Autocorrelation		0.0000***		
Heteroskedasticity		0.0000***		

Standard errors in parentheses.

*** p < 0.01, ** p < 0.05, * p < 0.1.

(Source: Analysed by authors)

However, since the issuance of the "Corporation law" (2020), the chairman of the Board of Directors is no longer allowed to act as a director or general director.

6.4. State ownership (S-OWN) and earnings management (DA)

In Vietnam, the ownership structure is highly concentrated, with state ownership, the coefficient = 0.0018 with a p-value <0.1, showing a significant positive relationship. Thus, we accept hypothesis H4. The result is consistent with previous studies (Chen et al., 2008; Lai & Tam, 2017). Vietnam's starting point is a centrally planned economy; all activities of enterprises are under the direction of the State. To some extent, SOEs operate inefficiently due to their dependence on

finance allocation and sponsorship from the government. In the direction of a market economy, Vietnam has achieved some signs of progress in restructuring and equitizing SOEs. However, these changes do not mean more efficient changes in management. The result explains businesses that have a higher rate of state ownership are more likely to implement EM.

6.5. Foreign ownership (F-OWN) and earnings management (DA)

Foreign ownership (F-OWN) and DA, coefficient = -0.0031 with p -value <0.1 , presenting a statistically negative association between F-OWN and DA, we accept hypothesis H5. The result is in line with the results of previous works of Guo and Ma (2015), and An (2015). The foreign ownership ratio plays a positive role in reducing the ability of EM behaviours. Many studies have shown that foreign ownership is considered an effective mechanism to improve corporate governance and enhance the quality of management because foreign investors often require high standards when evaluating financial and accounting information (Aggarwal et al., 2005). The current regulations in Vietnam on the rate of foreign ownership are being relaxed to the maximum because attracting capital from foreign investors is not only for financial resources but also affirms the prestige of the business

6.6. Concentration ownership (C-OWN) and earnings management (DA)

Concentration ownership (C-OWN) and DA, coefficient = 0.0006 with p -value <0.1 . We accept hypothesis H6 about the significant positive association between two variables. The result is consistent with previous studies (Piosik & Genge, 2019). Vietnamese companies start as small companies with a single controlling shareholder. Even the expanding process and changes while equitising significantly, the controlling shareholders or this concentrated ownership structure are still be entailed and show their dominance in controlling business activities, even in EM behaviours.

Debt (DEBT) has a positive relationship with DA, the coefficient = 0.0702 with p -value <0.001 . It means that the higher leverage, the more EM involved. The results of the thesis are similar to the results of others (Charfeddine et al., 2013; Defond & Jiambalvo, 1994; Dichev & Skinner, 2002). This result can be explained by the PAT (Watts & Zimmerman, 1986) related to the Debt/Equity ratio hypothesis, which states that a debt contract with restricted terms will help avoid investing in risky projects or diluting debt ... The tendency of using EM to loosen the debt limit is probable, especially in Vietnam, businesses still raise capital mainly from banking channels. Thus, reducing the conflict of the agency relationship between creditors—managers (enterprise) can limit the violation of debt contracts thereby can positively influence the reliability of published financial information.

“Financial performance” (PERF) has a positive relationship with the DA, the coefficient = 1.04 with a p -value <0.001 . As businesses operate more efficiently, businesses will tend to adjust their earnings to keep their image and show sustainability in their corporate values. Thus, this is a statistically significant relationship, but hypothesis H2 is opposite to the obtained results. The relationship between PERF and DA is positive, contrary to many previous studies by Fathi (2013), Charfeddine et al. (2013), Fathi (2013), and Chen et al. (2006). With this result, applying the PAT Theory (Watts & Zimmerman, 1986) related to the bonus plan hypothesis, it is possible to explain why the more efficient firms are, the more competitive they are. With the hypothesis of the bonus plan, the manager can, for personal benefits, for the company’s bonus plan, implement quality control always maintain positive results, both to attract investment and enjoy the benefits.

“Company size” (SIZE) has a positive relationship with DA, the coefficient = 0.4321 with p -value <0.05 . It means the larger the enterprises, the greater the ability to adjust earnings. This result is consistent with the results of studies by many authors (Alves, 2012; Charfeddine et al., 2013). According to the political cost hypothesis, in the PAT (Watts & Zimmerman, 1986), large firms are often the first in the market to be affected by political factors such as when Governments’ grants. Numerous studies demonstrate that firm size and political costs are positively related. Thus, the larger the firm size, the higher the political costs and vice versa (Tehrani et al., 2009). Firm size is a widely used variable representing political costs incurred in earnings management studies (Alves, 2012; Charfeddine et al., 2013).

“Independent Audit” (AUDIT) is correlated with DA by the coefficient = -0.0951 with p -value < 0.1 . With this result, we see a negative relationship between AUDIT and DA. This result is consistent with the results of studies by many authors (Fathi, 2013; Xie et al., 2003). The result showed that companies audited by Big 4 are less involved in EM than firms not audited by Big 4, leading reputable audit firms. However, compared to other countries, the proportion audited by the Big 4 in Vietnam is very low, accounting for only 22% of the total observations, while other countries are higher: 57% in Poland (Piosik & Genge, 2019),

In summary, by testing some key corporate governance variables, only BOARD and the other three ownership variables are significant, while INDENT and DUAL are insignificant. Recognising the important role of corporate governance, the most recent effort of the State is the introduction of the first Vietnam Corporation Codes since Dec 2019. Towards a greater transparency, CG codes should be promoted to be widely accepted, thereby encouraging the development of Vietnam’s stock exchange, and increasing the ability to protect investors and the quality of corporate governance.

7. Conclusions and limitations

This study provides empirical evidence of CG and EM in Vietnam, a transition economy rooted in the socialist mechanism. The FEM (robust) estimator has been employed, and our finding suggests that the lower number of board members within the optimal span can mitigate EM. Regarding ownership structure, the positive role of foreign ownership can reduce managers’ incentives to do self-interest or high-risk activities. In contrast, independent board members and duality both are insignificant. It is recommended to highlight the benefits of modern corporation codes that were successful in the Western context for dealing with CG and EM in transition contexts like Vietnam. In addition, reducing the dominance of state ownership, mitigating the conflict agency, and decreasing the influence of large block holding shareholders for protecting minority shareholders are determinants for a better CG and lead to lower EM. Therefore, investors need to be careful when accessing financial information because only good corporate governance can bring transparency and confidence to investors.

There exist some limitations that can diminish the value of the research findings. When measuring discretionary accrual, there are other methods for testing EM other than only Jones (1991) model. The sample size could be more extended and should capture other corporate governance variables. Besides, testing corporate governance and EM in some countries that share common attributes could provide a valuable comparison. In future research, it is expected to overcome those limitations for better work.

Acknowledgements

The authors thank anonymous referees for their constructive comments and suggestions.

Funding

This research was funded by the National Economics University (NEU), Hanoi, Vietnam; Đại học Kinh tế Quốc dân

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Disclosure statement

No potential conflict of interest was reported by the author(s).

Citation information

Cite this article as: Corporate governance and earnings management struggles: responses to adapt a modern capital mobilisation in the transitional economy, Thi Bich Chi Pham, Ha Linh Nguyen, Thi Minh Thu Vu & Van Tu

Truong, *Cogent Business & Management* (2022), 9: 2108216.

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