Volume: 3, Issue: 1
Page: 84-96
2019

ISSN 2520-4750 (Online) & ISSN 2521-3040 (Print)

International Journal of Science and Business

The Impact of Corporate Governance on Firms' Performance and Earnings Management: The Case of China's Listed Firms

Ismaila Sow & Kokou Wotodjo Tozo

Abstract:

This paper examines the effect of corporate governance on firms' performance and on earnings management in China. Previous works, including on India for example, showed that having board independence did not guarantee to improve firm performance due to poor monitoring roles of independent directors. Findings on the United States, the United Kingdom, New Zealand or Korea were not consensual. As China has become a realm for thriving businesses, one question is what are the core values that drive such successes if they are any different from other countries? To study this question, we use available updated data from 2008 to 2014, on 2,098 Chinese's listed companies for empirical evidence. Firms' performance was measured using the return on equity, the return on assets and Tobin's Q ratios whilst "discretionary accruals" was used as a proxy for earnings management. Two different regression models including pooled OLS and fixed effects were used to test our hypotheses. Main findings indicate that CEO duality and larger boards are detrimental to the firm performance. By contrast, firms perform better when a board includes more independent directors. Furthermore, firms with smaller boards have better earnings quality. These results suggest that board size is a key factor for firms' performance in China. In general, boards do not exceed 22 members in China and the highest share of independent directors is nearly 37% of boards' seats. These findings may be an important hint for new local ventures as well as for foreign partners willing to cooperate with Chinese firms.

IJSB
Accepted 25 January 2019
Published 27 January 2019
DOI: 10.5281/zenodo.2550622

Keywords: Corporate Governance, Earnings Management, firm Performance, China's Listed Firms, CSMAR database.

About Author

Ismaila Sow, PhD candidate, School of Management, University of International Business and Economics, Beijing, China

Kokou Wotodjo Tozo(Corresponding Author), Researcher, Institute of New Structural Economics at Peking University & PhD candidate, School of Management, University of International Business and Economics, Beijing, China

Introduction

Corporate governance has been gaining momentum over the past years, notably from the 1990s. The corporate governance issue has increasingly been discursive since some major corporate scandals emerged in the corporate world decades ago and is ever since considered a mean to resolve conflicts between managers and shareholders (Pi and Timme 1993, Shome and Singh 1995, Okpara 2011). Most recent literature suggest that corporate governance has an effect on firms' performance and earnings quality, so is worth comprehensive analyses (Berthelot et al. 2010; Xie at al., 2003). Firms Performance itself is considered an important variable that affects the various stakeholders of a firm including the shareholders, managers and employees, creditors and lenders as their dividends, their compensations, and bonuses and so on, are dependent on it. The Earnings figure of a firm is also an important issue in a firm's financial reports as it reflects the firm's profitability, which again affects various stakeholders. Thus, the earnings quality is an important factor of proper financial reporting. Some literature (Abdul Rahman and Ali, 2006; Abed et al., 2012) again viewed that corporate governance is an important mechanism that helps to improve firms' earnings quality by reducing earnings management.

Research Significance and objectives

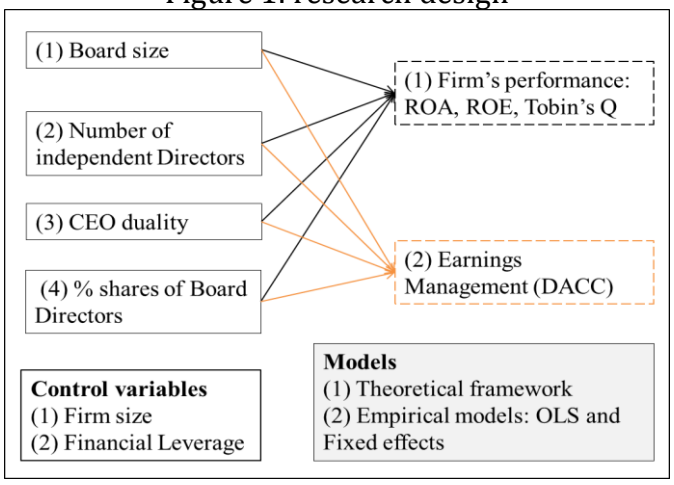
The huge amounts of foreign investment and the growing number of domestic businesses in China are no secret. Today, it's more likely that building a business in China or with Chinese onboard can guarantee success as well as it's believed that Indians make best CEOs in the world. While people are interested in questions like what is the reason for Indian CEOs heading the world's best known companies like Google, Microsoft, Adobe and so on? Our focus is what makes Chinese firms so successfully, considering their internal organizational framework. As we think these companies in their daily activities may have values governing managerial schedule or driving their performance, we are also interested in how this increasing success could become a learning ground for other countries or for new domestic business owners.

Related Literature and Research Methodology

How does board size affect performance? To this question, the first school of thought argues that a smaller board size will contribute more to the success of a firm (Lipton and Lorsch, 1992; Jensen, 1993; Yermack, 1996). However, others consider that a large board size will improve a firm's performance (Pfeffer, 1972; Klein, 1998; Coles 2008). Previous works, including on India for example, showed that having board independence did not guarantee to improve firm performance due to poor monitoring roles of independent directors (Garg, 2007). Other empirical evidence has documented that, board independence is associated with superior performance in the United States (Pearce & Zahra, 1991) as well as in the United Kingdom (Ezzamel & Watson, 1993), New Zealand (Hossain, Prevost & Roa, 2001) and Korea (Choi, Park & Yoo, 2007; Joh & Jung, 2012). Elsewhere, some other studies have been interested on the CEO power scope and its influence over earnings quality. Using CEO duality as a proxy measure, the literature has demonstrated that the combination may affect the board effectiveness in monitoring management. For instance, Chtourou et al. (2001) showed that there was existence of a negative relationship between the earnings management and the separation between both functions. Another consideration is that the presence of independent director on the board can have a positive impact on reducing earning management by the use of discretionary accrual. For (Beasley (1996), Dechow et al. (1996) the relationship is negative between the percentage of the independent boards and the

earnings management .On Thai listed companies however, Supawadee et al. (2013) found that there is a significant positive relation between the earnings management and board independence, which indicates that a large number of independent boards is more likely to increase the level of the earnings management. From our own perspective, there may be evidence of earning manipulation in Chinese listed companies, or certainly clear signs of good performance, but with reasons and organizational perspectives different from those of other countries, say Western firms. The current study does not intend to delve in a comparative analysis between Chinese, other Asian or Western culture in corporate governance, it's rather a focused discussion to inform on the existence of a certain relationship and the scope of the impact of different internal factors to Chinese firms' performance. Clearly stated, the aim is to see which component of corporate governance including the transparency of financial statements, the ownership structures, and the board of directors has strongest impact on earnings management and firm performance in China. This may help to detect the core values driving the success of Chinese firms. In practice, this section still reviews previous literature, then discusses our methodology adopted (see figure 1). We provide details on the theoretical foundation, variables specification and data used to underline and understand the relationship between firms' financial performance and corporate governance as well as earning management practices from the perspective of China.

Figure 1: research design



Source: Authors' conception based on literature

Corporate governance on firm's performance: variables measurement and models specification

Performance, under its various measures including ROA, ROE and Tobin's Q, is the endogenous variable on which the other variables act in our estimates. Our goal is to study the effects of explanatory variables on performance. In total, two types of performance measurement will be taken into account in our study, namely: the market performance measured by the Market-to-Book and the financial performance measured by the Return On Assets and Return On Equity. Studying these two types of performance (stock market and financial) is very important, insofar as this differentiation makes it possible to take into account the different characteristics of the company. Indeed, while the Market-to-Book is a measure of value in the enterprise market, the ROA and the ROE are financial ratios measuring the competitiveness of the company and the efficiency of management.

Financial performance (ROA and ROE)

ROA and ROE measures have been used by several authors to describe financial performance of businesses. For specification: ROA (Return on Assets) represents the return on invested capital and expresses the ability of these assets to create a certain level of operating profit. This measure has been used by a very large number of authors such as Daines (2001), Adams and Santos (2005), Eisenberg et al (1998). The measure that we will retain, in our study, for the calculation of the ROA is:

$$ROA = \frac{Total\ profits}{Total\ Assets}$$

ROE (Return on Equity) stands for the return on equity and expresses the ability of capital invested by shareholders to generate a certain level of net profits. Several authors have also used this measure of performance including Bouri and Bouaziz (2007), Brown and Caylor (2004), Lehman and Weigrand (2000). The measure used to measure ROE is as follows:

$$ROE = \frac{Net\ profits}{Shareholders'funds}$$

Market-to-Book ratio: The Tobin's Q

The stock market performance of companies is apprehended through a ratio called Market-to-Book (MTB) expressing the increase in the price of the company's stock following its strong valuation by investors in the stock market (Zhegal and Maaloul 2010). Based on that definition and following Shome and Singh (1995), we believe such a ratio makes a reasonable proxy for the company's investment opportunities, so expressing the other performance variable as:

$$Tobin's\ Q = \frac{Market\ value\ estimation}{Total\ Assets}$$

Based on the descriptions that preceded, our econometric model for empirical test between firm performance and the exogenous variables is expressed as in the following:

$$\begin{aligned} PERF_{it} = {} & \beta_0 + \beta_1(Board\ size)_{it} + \beta_2(Number\ of\ independent\ Directors)_{it} \\ & + \beta_3(CEO\ duality)_{it} + \beta_4(\%\ shares\ of\ Board\ Directors)_{it} \\ & + \beta_5\ log(Firm's\ size)_{it} + \beta_6(Financial\ Leverage)_{it} + \varepsilon_{it} \end{aligned}$$

Corporate governance on earnings management: variables measurement and models specification

The majority of recent earnings management literature relies primarily on discretionary accruals and so this study will use the discretionary accruals as a proxy for earnings management. Most researchers prefer to use the cash flow statement approach as it is more useful than the balance sheet approach (Shah et al., 2009, Soliman and Ragab 2014). In this study too, we use the cash flow statement approach to compute the total accruals. Based on that approach the total accruals can be calculated as follows:

$$TA_t = NI_t + CFO_t$$

Where: TA_t are total accruals, NI_t net income and CFO_t represents cash flows from operating activities in year t. Total accruals on their own are not yet the proxy for earnings management; on the contrary, earnings management is the part of the accruals that managers can have control and are able to practice manipulations on. According to this, the total accruals are divided into two parts including discretionary and non-discretionary accruals. Therefore, in order to get the discretionary accruals, non-discretionary accruals are subtracted from total accruals (Shah and Butt 2009).

$$TA_t = DACC_t + NDA_t$$

Where, in year t: TA stands for total accruals, $DACC$ for discretionary accruals and NDA for non-discretionary accruals. There actually exist various models and methods exist in the computation of the discretionary accruals such as the Healy model, the De Angelo model, the Jones model and finally the modified cross sectional Jones model. Following the latter, the equation used to calculate NDA as in the Uwuigbe et al (2015) and Shah et al (2009) is as follows:

$$NDA_{t,j} = \beta_{1j}\left[\frac{1}{A_{t-1}}\right] + \beta_{2j}\left[\Delta REV_t - \frac{\Delta AR_t}{A_{t-1}}\right] + \beta_{3j}\left[\frac{PPE_t}{A_{t-1}}\right]$$

Where: NDA_t is the non-discretionary accruals for firm j in year t, A_{t-1} are total assets for firm j in year $t-1$, ΔREV_t the changes in the revenues (sales) for firm j in year t less revenue in year $t-1$, ΔAR_t is the change in accounts receivables for firm j in year t less receivable in year $t-1$, PPE_t are gross properties, plants and equipment for firm j in year t, β_{ij} are firm specific parameters. In order to find the firm specific parameters to be used in the NDA equation, a regression equation as in the following is used:

$$\frac{TAC_t}{A_{t-1}} = \beta_{1j}\left[\frac{1}{A_{t-1}}\right] + \frac{\beta_2[(\Delta REV_t - \Delta AR_t)]}{A_{t-1}} + \beta_{3j}\left[\frac{PPE_t}{A_{t-1}}\right] + \mathcal{E}_t$$

After calculating the total accruals using the cash flow statement approach and calculating the non-discretionary accruals through the equation of the modified Jones model, the discretionary accruals can then be calculated using the following equation:

$$DACC_{jt} = \frac{TAC_{jt}}{A_{jt-1}} - NDA_{jt}$$

After having presented all the variables of our model as well as their measures, we can deduce our model of analysis which expresses the link between earnings management and the dependent variables as above specified.

$$DACC_{it} = \beta_0 + \beta_1(Board\ size)_{it} + \beta_2(Number\ of\ independent\ Directors)_{it} + \beta_3(CEO\ duality)_{it} + \beta_4(\%\ shares\ of\ Board\ Directors)_{it} + \beta_5\ log(Firm's\ size)_{it} + \beta_6(Financial\ Leverage)_{it} + \varepsilon_{it}$$

Where:$DACC_{it}$ is the discretionary accrual, the proxy variable for earning management, $\beta_i, i = 1,2,\ldots,6$ are the constants to estimate and ε_{it} the error term.

Variables specification and Research hypotheses

Table 1: Measurement of the independent and control variables

Variables	Measuring tool
Board Independent (BDIND)	Number of independent directors divided by total number of director on the board
CEO Duality (CEODUO)	if the chairman/CEO is the same person=1 and 0 otherwise
Board size (BDSIZE)	Total number of directors in the board
Control variables	
Firm Financial leverage (FLEV)	Total debt ratio (Total debt/Total Assets)
Firm Size (FSIZE)	Natural log of total assets

Based on theoretical arguments and review of literature, the following hypothesis has been formulated:

Table 2: Research hypotheses

	ROA	ROE	Tobin's Q	DACC
Board size	-	-	-	+
Number of independent Directors	+	+	+	-
CEO duality	-	-	-	+
% shares of Board Directors	+	+	+	+
Firm's size in log	+	+	+	+
Financial Leverage	+	+	+	-

Note: (+) indicates a positive whilst (-) indicates a negative relationship between the dependent (first row) and the independent variables (first column)

Data Analysis and results discussion

For empirical analysis, the panel set –2,098 Chinese listed firms, between 2008 and 2014– for our variables of interest could only be found on CSMAR database which provides data back to 1999 on profiles, annual compensation and number of shareholdings of managerial staff of China listed companies, changes of equity structure, changes of board chairman and general manager of listed companies, shareholders meetings and executive equity incentives of listed companies. Data can be retrieved from http://us.gtadata.com/SingleTable/Index. We were limited to 2008-2014 due to missing values. In our regressions we checked for results robustness by introducing "firm size" and "financial leverage" as controlling variables. As previously outlined in our methodology, ROA, ROE and Tobin's Q are used to proxy firms' financial performance whilst DACC is considered an indicator to capture the practice of firm's earnings management. The regressions are preceded by the summary statistics and the correlation matrix to give an overview of the data features and the relationship that exists between each pair of variables (see table 3 and table 4).

Table 3: Summary statistics

Variable	Observation	Mean	Std. Dev.	Minimum	Maximum
ROA	14,678	-.1212668	20.44876	-2474.175	108.3518
ROE	14,686	.1238473	6.541005	-167.1067	713.2036
Tobin's Q	14,687	5.86105	420.8711	.027231	50939.53
DACC	14,663	-.0244314	1.815016	-153.6852	44.56904
Board size	14,687	8.959828	1.854585	4	22
Number of independent Directors	14,687	3.269558	.6785471	1	8
Number of shares of Board Directors	13,929	2.98e+07	8.61e+07	0	2.09e+09
CEO duality	14,480	1.774793	.4177331	1	2
Firm's size in log	14,686	21.82792	1.4088	11.34833	30.6568
Financial Leverage	14,687	1.557086	20.09137	-253.741	2210.362

Table 4: Correlation matrix

	ROA	ROE	Tobin's Q	DACC	Board size	Number of independent Directors	Number of shares of Board Directors	CEO duality	Firm's size in log	Financial Leverage
ROA	1.0000									
ROE	0.0131	1.0000								
Tobin's Q	-0.0219	0.0014	1.0000							
DACC	0.0460	0.1622	0.0002	1.0000						
Board size	0.0184	-0.0079	-0.0207	-0.0772	1.0000					
Number of independent Directors	0.0163	-0.0019	-0.0180	-0.0711	0.7857	1.0000				
Number of shares of Board Directors	0.0031	-0.0027	-0.0030	0.0068	-0.0725	-0.0496	1.0000			
CEO duality	-0.0056	-0.0151	0.0044	-0.0136	0.1659	0.1181	-0.1249	1.0000		
Firm's size in log	0.0278	-0.0326	-0.0709	-0.0652	0.3538	0.3745	0.0203	0.1832	1.0000	
Financial Leverage	0.0002	-0.0004	-0.0003	0.0001	0.0125	0.0290	-0.0059	0.0084	0.0086	1.0000

Given the panel nature of the data, we performed statistical tests that support the choice of methods used in the regressions. These include (i) **The F-test:** used to decide between the pooled OLS and the fixed effect models**.** H0: OLS should be suitable**;** H1: fixed effect is rather the appropriate choice. (ii) **The Lagrangian multiplier (LM) test:** we perform LM test to decide between the pooled OLS and the random effect models. H0: in favor of pooled OLS; H1: Random effect. (iii) **The Hausman test:** Hausman test indicates which of the fixed or random effect is the appropriate model. H0: Random effect is appropriate; H1: fixed effect is rather the appropriate method.

Table 5: Tests results

	ROA	ROE	TOBIN'S Q	DACC
F-TEST	F (2620, 11110) = 1.07 Prob > F = 0.0112 p-value < 0.05	F(2620, 11113) = 1.03 Prob > F = 0.1588 p-value > 0.05	F(2620, 11113) = 1.03 Prob > F = 0.2028	F(2620, 11089) = 8.07 Prob > F = 0.0000 p-value < 0.05
LM test		chibar2(01) = 0.00 Prob > chibar2 = 1.0000	chibar2(01) = 0.00 Prob > chibar2 = 1.0000	
HAUSMAN TEST	chi2 (5) = 25.46 Prob>chi2 = 0.0001 p-value < 0.05			chi2(5) = 52.98 Prob>chi2 = 0.0000 p-value < 0.05
DECISION APPROPRIATE MODEL	Fixed effect	Pooled OLS	Pooled OLS	Fixed effect

Note on decision: Reject H0 if the p-value < 0.05

In the following, we discuss our findings based on hypotheses formulated and the results as in table 6 below

Table 6: Result one; corporate governance and firms' performance

VARIABLES	(not controlled) ROA	(controlled) ROA	(not controlled) ROE	(controlled) ROE	(not controlled) Tobin's Q	(controlled) Tobin's Q
Board size	0.260	-0.333***	-0.0554*	-0.0345	-1.981***	0.988
	(0.333)	(0.0333)	(0.0496)	(0.0499)	(0.272)	(3.285)
Number of independent Directors (in log)	6.904**	6.404**	0.391**	0.345**	41.47*	5.530**
	(2.688)	(2.689)	(0.472)	(0.476)	(31.14)	(3.390)
CEO duality	-1.790***	-1.890***	-0.270*	-0.202*	5.529	5.16
	(0.828)	(0.829)	(0.138)	(0.139)	(9.127)	(9.184)
%age of shares of Board Directors	-0.0137	0.0527	-0.0137*	-0.0150**	0.683*	0.864*
	(0.0728)	(0.0733)	(0.00757)	(0.00757)	(0.499)	(0.499)
Firm's size (in log)		1.895***		-0.167***		-23.64***
		(0.442)		(0.0441)		(2.903)
Financial Leverage		-0.000288		-0.000202		-0.000207
		(0.00935)		(0.00271)		(0.179)
Constant	-7.192**	-48.06***	0.787*	3.834***	68.66***	500.6***
	(3.067)	(10.01)	(0.422)	(0.909)	(27.88)	(59.90)
Observations	13,738	13,737	13,741	13,740	13,741	13,740
R-squared	0.401	0.303	0.102	0.101	0.501	0.405
Number of ID	2,621	2,621				
F-Test	Yes	Yes	Yes	Yes	Yes	Yes
Lm Test			Yes	Yes	Yes	Yes
Hausman Test	Yes	Yes				

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Board size on firms' performance

Hypothesis 1: there is a negative association between board size and firm performance in china listed firm.

$$PERF = \beta_{BDSIZE} + \beta_1 BDSIZE + \beta_i X_i + \varepsilon_1, \qquad \beta_1 < 0 \text{ and } X_i \text{ kept constant} \quad (1)$$

Empirical studies on impact of board size on firm performance have always showed mixed results. These results also differ based on the measure used. In our case, only the controlled regression confirms our hypothesis, suggesting that, adding one member to the board size decreases the ROA by 0.333%. This is an indication that, exaggerating the number of board members can slow down the performance of the firm. The effect is negative in both cases for ROA. When controlled for, the results show that an increase in the board size leads to a 0.0345% loss in ROE. In reality it is often difficult for larger groups to reach a smooth consensus as decisions are to be made. In contrast a smaller board in terms of number of directors is likely to reach agreement in less time (Yermack, 1996). Using Tobin's Q for performance shows a positive sign when controlled for. As the share of board of directors increases, one will expect the board size to reduce, therefore, the two factors will have exactly the opposite effect on firms' performance.

Board independence on firms' performance

Hypothesis 2: there is a positive relationship between board independence and firm performance in china listed firm.

$$PERF = \beta_{BDIND} + \beta_2 BDIND + \beta_i X_i + \varepsilon_2, \qquad \beta_2 > 0 \text{ and } X_i \text{ kept constant}$$

In general the relationship between board independence and firm performance has not been straightforward agreed on. Some authors have found negative relationship (Fauzi and Locke, 2012). For Wallison (2006), having independent directors on the board is not for better performance but for better governance. Our results however show that firms perform better when the number of independent directors increases. This is also confirmed in the literature (Gani and Jermias, 2006). Using data from the manufacturing firm which listed in the Compustat S & P 500, they found that board independence has a significant positive association of performance of firms. In our case, ROA for instance goes up by 6.904% with an additional director onboard. The control has not had much impact on the coefficient and the significant level. Effects on ROE are similar whereby the original coefficient is 0.391 against 0.345 in the control with both statistically significant at 5% level. Only in the case of Tobin's have the coefficients been different.

CEO duality on firms' performance

Hypothesis 3: there is a negative association between CEO duality and firm performance in china listed firm.

$$PERF = \beta_{CEODUO} + \beta_3 CEODUO + \beta_i X_i + \varepsilon_3, \qquad \beta_3 < 0 \; and \; X_i \; kept \; constant$$

Results are also ambiguous as of the choice of the dependent variables. Remark that duality is negatively linked to ROA and ROE while having exactly the opposite sign to Tobin's Q. These results are stable in that they are statistically significant on ROA and not on the other variables. In the literature too, opinions aren't consensual. Pi and Timme (1993) find that there is negative relationship between CEO duality and accounting performance measures in banking industry. For Baliga, Moyer, and Rao (1996) there is no evidence of performance changes on the changes in the duality framework and their results are also close to that of Daily and Dalton (1997) who argue that there is no significant difference in performance between dual CEO and non-dual CEO firms. Dahya and Travlos (2000) find that firms perform better with dual CEO and Dahya and McConnell (2005) share a completely different view that splitting the titles of CEO and chair of the board is not associated with performance improvement. For China, Li and Nai (2004) find that CEO duality is associated with lower economic value added, a measure for valuing firm productivity and that, as in our case, it reduces firm performance.

Table 7: Results two; corporate governance and earnings management

VARIABLES	(not controlled) DACC	(controlled) DACC
Board size	-0.0157*	0.0268**
	(0.0103)	(0.0104)
Number of independent	-0.206**	-0.214**
Directors (in log)	(0.156)	(0.156)
CEO duality	0.0155	0.0168
	(0.0480)	(0.0810)
%age of shares of Board	0.0124***	0.0130***
Directors	(0.00422)	(0.00425)
Firm's size (in log)		-0.0282
		(0.0257)
Financial Leverage		-1.07e-05
		(0.000542)
Constant	-0.267	0.342

	(0.178)	(0.582)
Observations	13,717	13,716
R-squared	0.600	0.580
Number of ID	2,621	2,621
F-Test	Yes	Yes
Lm Test		
Hausman Test	Yes	Yes

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Earnings management has a negative effect on earnings quality, and may weaken the credibility of financial reporting, why? For example, a manager seeking to reduce expenses in the current period might defer scheduled routine equipment maintenance until the next accounting period. The result is higher reported earnings in the current period, but the maintenance delay, of course, may be detrimental to the company's future operations. In that direction, our hypotheses suggest that quality of firm governance should be a constraining factor to the earning management. Except in the case of board size and the number of independent directors, every factor in the basic model has positive effect on earnings management. This implies that, for the first, as a larger board size is bad for firm performance, it should by the same mean have a direct impact on earnings management, which is not the case here. By contrast, the second negative sign of independent board fits in our predictions. Furthermore, the positive impact displayed by other variables is in line with our hypotheses. Some authors predicted that a large number of directors have more opportunities to have independent directors with sufficient experience, which helps to mitigate the earnings management. But this not the case in China, and this verifies the positive correlation in our controlled model fitting our assumption. The summary statistics show that boards tend to have less independent director aboard (see table 3). The isolated variable of independent directors on the other hand verifies our hypothesis with the negative coefficient. Estimates on CEO duality and shares of board directors are robust in this case, so far, their positive signs and significant levels did not change. This suggests that an increase in these factors will intensify earnings manipulation which undermines the firm report integrity. Such manipulations can have their own negative effects on the firm performance, but indirectly through the same variables that affect earnings management.

Conclusion

This paper examined the effect of corporate governance on firm performance on the one hand and on earning management on the other hand in China. By first reviewing fundamental models on firm governance, we employed two different regression methods including pooled OLS and fixed effects for empirical evidence. Data on 2,098 Chinese listed firms running from 2008 to 2014 has been used. Firms' performance was measured using the return on equity, the return on assets and Tobin's Q ratios whilst "discretionary accruals" was used as a proxy for earnings management. Using multiple proxies, different regression models and controlling for other variables, left the findings somehow ambiguous but not impossible to parse and to bear useful policy recommendations. The results suggest on the one hand, that earnings management is not a good practice to firm performance and that, Chinese firms are more prone to a culture of integrity in financial reporting. Note that this claim needs further analysis. One can use data to estimate the effect of earnings management on the firm performance. On the other hand, the choice of executive members requires a meticulous

decision and reveals for instance that Chinese firms do not like overstaffing the board, but have high preference for outside directors. While these findings may not be representative nationwide, we suggest however that they may be an important hint for new business ventures, local and foreign investors partnering or wanting to partner with Chinese firms on the domestic market or overseas. In practice, business networks in China are more likely to be based on small board size where decisions and trust can be handled quickly, and it's even worth handing a deserved management position to independent directors for the sake of better performance.

References

Abdul Rahman, R., & Ali, F. (2006). Board, Audit committee, Culture and Earnings Management: Malaysian Evidence. *Managerial Auditing Journal, 21(7), 783-804.* http://dx.doi.org/10.1108/02686900610680549

Abed, Suzan; Al-Attar, Ali; Suwaidan, Mishiel(2012) "Corporate Governance and Earnings Management: Jordanian Evidence". *International Business Research Vol. 5, No. 1; January*

Adam and Santos (2005), https://www.virtusinterpress.org/IMG/pdf/10-22495_cocv5i3c4p5.pdf

Baliga B. R., Moyer R. C., Rao R. S. (1996), CEO Duality and Firm Performance: What's The Fuss? *https://doi.org/10.1002/(SICI)1097-0266(199601)17:1<41::AID-SMJ784>3.0.CO;2-%23*

Beasley, M. S. (1996), An Empirical Analysis of the Relation between the Board of Director Composition and Financial Statement Fraud, *The Accounting Review, 71(4), 443-465*

Brown, L., Caylor, M. (2004), Corporate governance and firm performance, Working paper.

Choi, J. J., Park, S. W., & Yoo, S. S. (2007), The value of outside directors: Evidence from corporate governance reform in Korea, *Journal of Financial and Quantitative Analysis, 42(4), 941–962*

Coles, J., L., Daniel, N., D. and Naveen, L. (2008), Boards: Does one size fit all?. *Journal of Financial Economics, 87(2), 329-356*

Chtourou, S.M., Bedard, J. and Courteau, L. (2001), Corporate Governance and Earnings Management, *http://papers.ssrn.com/abstract=275053*

Dahya J. and John J. McConnell J. J. (2005), Outside Directors and Corporate Board Decisions *Journal of Corporate Finance, 2005, vol. 11, issue 1-2, 37-60*

Dahya, J. and Travlos, N. (2000), Does the one man show pay? Theory and evidence on the dual CEO revisited, *https://doi.org/10.1111/1468-036X.00113*

Daily C. M., Dalton M. R. (1997), Separate, But Not Independent: Board Leadership Structure in Large Corporations, *https://doi.org/10.1111/1467-8683.00053*

Daines R. (2001), Does Delaware Law Improve Firm Value? *Journal of Financial Economics, Vol. 62, pp: 525-558.*

Dechow, P.M., Sloan, R.G., & A. Sweeney. (1996), Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC, *Contemporary Accounting Research, 13, 1-36*

Ezzamel, M. A., & Watson, R. (1993), Organizational form, ownership structure, and corporate performance: A contextual empirical analysis of U. K. companies. *British Journal of Management, 4(3), 161–176*

Fauzi, F. and Locke, S. (2012), Board Structure, Ownership Structure and Firm Performance: A Study of New Zealand Listed-Firms*, Asian Academy of Management Journal of Accounting and Finance, AAMJAF, Vol. 8, No. 2, 43–67, 2012*

Gani, L. and Jermias, J. (2006), Investigating the effect of board independence on performance across different strategies, *The International Journal of Accounting, vol. 41, issue 3, 295-314*

Garg, A. K. (2007), Influence of Board Size and Independence on Firm Performance: A Study of Indian Companies, *VIKALPA, VOLUME 32, NO 3, 39-59*

Hossain, M. A., Prevost, M. A., & Roa, R. (2001), Corporate governance in New Zealand: The effect of the 1993 companies act on the relation between board composition and firm performance. *Pacific Basin Finance Journal, 9(2), 119–145*

Jensen, M. C. (1993), The modern industrial revolution, exit, and the failure of internal control systems, *Journal of Finance, 48, 831-880*

Klein, A. (1998), Firm Performance and Board Committee Structure. *Journal of Law and Economics, 41(1), 275-303*

Lehman, E. & Weigand, J. (2000), 'Does the governed corporation perform better? Governance structures and corporate performance in Germany', *European Financial Review 4, 157—195.*

Li C. and Nai, J. (2004), "Does Board Characteristics Affect Firms Performance? *Journal of Chinese Financial Research, 65-77 (5)*

Lipton, M. and Lorsch, J. W. (1992), A modest proposal for improved corporate governance, *Business Lawyer, 48, 59- 77.*

Okpara J. O., (2011) "Corporate governance in a developing economy: barriers, issues, and implications for firms", Corporate Governance: *The international journal of business in society, Vol. 11 Issue: 2, pp.184-199*

Pearce, J. A., II, & Zahra, S. A. (1991), The relative power of board of directors: Association with corporate performance, *Strategic Management Journal, 12(2), 135–153*

Pfeffer, J. (1972), Size and Composition of Corporate Boards of Directors: The Organization and its Environment, *Administrative Science Quarterly, 17(2), 218-228.*

Pi, L. and Timme, S. G. (1993), Corporate control and bank efficiency, *Journal of Banking & Finance, vol. 17, issue 2-3, 515-530*

Shah, S & Butt, S 2009, 'Governance and Earnings Management an Empirical: Evidence Form Pakistani Listed Companies, *European Journal of Scientific Research, vol.26, no.4, pp. 624-638*

Shah, S & Zafar, N & Durrani, T 2009, 'Board composition and earnings management an empirical evidence from Pakistani listed companies', *Middle eastern finance and economics, vol.3, no.29, pp. 30-44*

Shome, D.K. Singh, S. (1995). "Firm value and external blockholdings" *Financial Management, Vol. 24, No. 4, (Winter, 1995), pp. 3-14.*

Supawadee S., Yarram S. R. and Al-Farooque O. (2013)" Earnings Management and Board Characteristics in Thai Listed Companies", *The 2013 IBEA, International Conference on Business, Economics, and Accounting 20 – 23 March 2013, Bangkok – Thailand*

Uwuigbe, U., Ranti, O. and Bernard, O. (2015), "Assessment of the effects of firms' characteristics on earnings management of listed firms in Nigeria", *Asian economic and financial review, vol.5, no.2, pp. 218-228.*

Wallison,P. J.(2006). All the Rage: Will Independent Directors Produce Good Corporate Governance? *American Enterprise Institute for Public Policy Research*

Xie, B., Davidson, W. and DaDalt, P.J. (2003), "Earnings management and corporate governance: the roles of the board and the audit committee", *Journal of Corporate Finance, Vol. 9, pp. 295-316.*

Yermack, D. (1996), Higher market valuation of companies with a small board of directors, *Journal of Financial Economics 40 (1996) 185-211*

Zeghal, D. and Maaloul, A. (2010). Analyzing value added as an indicator of intellectual capital and its consequences on company performance, *Journal of Intellectual Capital, Vol. 11, No. 1, pp. 39-60.*

Cite this article:

Sow, I. & Tozo, K. W. (2019) The Impact of Corporate Governance on Firms' Performance and Earnings Management: The Case of China's Listed Firms. ***International Journal of Science and Business,*** *3(1),* 84-96. doi: https://doi.org/10.5281/zenodo.2550622

Retrieved from http://ijsab.com/wp-content/uploads/309.pdf

Published by