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THE EFFECT OF COUNTRIES'S CULTURE IN FAMILY FIRMS' EARNINGS QUALITY: AN EXAMINATION ALIGNMENT VERSUS ENTRENCHMENT APPROACH IN AGENCY THEORY*

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Abstract

The studies of the family firms' earnings quality have not yet concluded about individual or family as majority owner in firm has positive or negative influence over the earnings quality. We conjecture that the prior researches use the different approaches: such as alignment versus entrenchment, to explain agency conflict between majority and minority shareholders. Prior researches have proved that culture has relation with accounting practice in a country. We argue that culture also stimulates the individual or family's behaviour in that firm to choose the alignment or entrenchment behaviour.

This study examines the accruals (discretionary accruals, discretionary current accruals, and discretionary long-term accruals) level, as the proxy of earnings quality, of the family firms in four culture dimensions which established by Hofstede's (1997). This study uses three groups of shareholders in family firms as samples (the one largest, the two largest, and the three largest shareholders) from 48 countries around the world.

Based on ANOVA, this study proved that the difference of culture level has the different earnings quality. The result also reveals that there are different accruals pattern in different culture, such as power distance and individualism (collectivism) have linear pattern, but femininity (masculinity) and uncertainty avoidance have non-linear pattern. The linear accruals pattern implies that large (small) power distance or individualism (collectivism) culture has low (high) earnings quality or high (low) earnings quality, respectively. However, for the non linear accruals pattern of femininity (masculinity) or uncertainty avoidance culture implies that the evidence do not conform the prior research that masculinity has positive correlation with corruption level in societies or strong uncertainty avoidance concerns to more precise law.

Key words: family firm, culture, earnings quality, entrenchment, alignment, and agency theory.

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1. Research Background

Traditional agency theory has predicted that the delegation of capital by principal (shareholders) to agent (managers) causes agency conflict between both of them (Watts and Zimmerman, 1986). Recently, agency problem has spread from principal-agent conflict to majority-minority conflict, because of the low investor protection level in a country (La Porta *et al.*, 1999). In that country, company ownership tends to concentrate on family or individual, so families own the majority of company's shares or as controlling shareholder. As the consequence, majority shareholder has power to expropriate minority shareholder (La Porta *et al.*, 1999).

The family firms' earnings quality issue is still interesting to study because the prior researches' result have not yet conclusive. Many studies have proved that family firms have higher earnings quality than non-family firms (Ali et al. [2007]; Wang [2006]). The owner also as the founder of the firm understands about the activities of their management and company deeply (Andersen and Reeb, 2003), therefore the owner has capability to control managers' behaviour directly (Demsetz and Lehn, 1985). As the result, managers feel reluctant to manipulate the company's financial statements (Ali et al., 2007). Contrast with Fan and Wong (2002) and Setia-Atmaja et al. (2008), family firms have lower earnings quality than non-family firms. The family also takes role in management activities, so the family has privilege to get private benefit or information (Setia-Atmaja et al., 2008). The owners tend to deteriorate the financial statements credibility, because the financial statements are created for their interest (Fan and Wong, 2002).

We conjecture that the inconsistency results are caused by the different approach to explain agency conflict in family firms. There are two approaches: alignment and entrenchment, which explain why family as owner and member of management maintains or deteriorates earnings quality. Based on alignment approach, the family attempts to align their interest with management's interest, so this condition can encourage the family firms achieve higher earnings quality than non family firms (Wang, 2006). However, based on entrenchment approach, family as controlling shareholder has privileged to get private benefit by sacrificing minority shareholder, so it will deteriorate the earnings quality (Wang, 2006).

The main problem is in what condition controlling shareholder chooses the alignment or entrenchment behaviour. This study argues that culture may become the encouragement for controlling shareholder's behaviour to tend to alignment or entrenchment. Culture indicates the pattern of thinking, feeling, potential acting that studied by human in whole his/her life (Hofstede, 1997). Then, culture is also the manifestation in accounting system and accounting practice (Gray, 1988). If culture surrounding family firm influences the accounting practice then it will be implemented in the firm. Therefore, the culture in a country also influences the family firms' behaviour which is manifested by the earnings quality of family firms.

This study uses Hofstede's 4 dimensions of culture, such as: power distance (from small to large), individualism versus collectivism, femininity versus masculinity, and uncertainty avoidance (from strong to weak) as moderating variables. Hofstede (1997) establish score to measure the culture dimension. The score created by survey in companies around the world. The score updated regularly and the last update was done in 2007, but the results still consistent with the first score released. Family firm is measured by the share percentage

owned by individual or family in firm and the earnings quality is measured by the accruals (discretionary accrual, discretionary current accrual, and discretionary long-term accrual).

This study divides countries' culture score into three groups: low, middle, and high level of cultures. According to the research's problem, this study examines the accrual level for the three groups. This study reveals three important evidences. First, any culture level has different earnings quality. Second, the family firms' earnings quality in power distance and individualism culture have linear pattern, but power distance's accruals have positive slope and individualism's accruals have negative slope. It confirms the prior research that large (small) power distance encourages low (high) transparency and professionalism, and also higher individualism culture leads to higher earnings management. Third, contrast with both of cultures, femininity (masculinity) and uncertainty avoidance culture have non linear earnings quality pattern. The evidence reveals the family firms' earnings quality is low (high) in extreme point of femininity or masculinity (uncertainty avoidance). Upon that, the entrenchment or alignment behaviour level of shareholder owners in family firms depend on the culture level.

This study contributes to agency theory literatures through the evidence of entrenchment and alignment behaviour in family firms because of the culture level. This study expands Chen and Nowland (2008)'s finding that association between family and corporate governance are non-linear. This study also contributes for regulators to formulate the good corporate governance. The corporate governance formula has to consider the environment surrounding the firms, especially family firms. Commonly, corporate governance is formulated in widely dispersed ownership and liberalism or democracy environment which gives high appreciate with individual right.

2. Literature Review and Hypothesis

2.1 Agency Problem and Family Ownership

Traditional agency theory emphasizes in conflict of interest between unmonitored manager and widely dispersed shareholders (Klein et al., 2005). Shareholders (as principal) delegate the decision authority to managers (as agent), unfortunately, shareholders can not exactly monitor managers' behaviour. Because both of groups have divergent interest, so managers concern to maximize their interests (Jensen and Meckling, 1976).

Recently, the study of agency conflict shift away from shareholders-managers toward majority-minority agency conflict. LaPorta et al. (1998) stated that investor protection has negative relationship with the ownership concentration in company. In countries with weak investor protection, the firm ownership tends to concentrate in family, so that family becomes controlling shareholder. In that situation, agency conflict can happen between controlling owners and outside investors as minority shareholder (Fan and Wong, 2002). Claessens et al. (2000) and Fan and Wong (2002) also have proved that ownership structure of publicity traded companies in East Asian is dominated by family. Most of countries in East Asian categorized as low level protection investor by La Porta et al. (1998).

This condition creates two opposite approaches possibility: entrenchment and alignment that illustrate the effect of the majority's ability to control earnings quality of the family firm. The entrenchment approach implies that controlling shareholder may take benefit from the firm at cost of minority shareholder (Wang, 2006), because controlling owner has privilege to oversee accounting

reporting policies (Fan and Wong, 2002). This condition encourages in-efficiency rather than non family ownership, because family as majority shareholder tends to expropriate minority: a process using control to maximize their utility by distribution from other wealth, i.e. the minority shareholder (Setia-Atmaja et al., [2008]; Claessens et al., [2000]). For that reason, majority concerns to control management by hire CEO from their family members (Claessens et al., [2000]; LaPorta et al. [2000]). The CEO will be expected to publish financial information as their interest (Fan and Wong, 2002). Claessens et al. (2000) also proved that separation of management from ownership is rare and also about 60% of top managements are widely held by the family or the relatives of controlling shareholders. Family involvement in management attenuates manager and shareholder agency conflict (Wang, 2006). According this situation, family firms have lower earnings quality rather than non family firms, because the owners not only have power to control management, but also, they have higher encouragement to run earnings in order to maximize their utilities (Fan and Wong [2002]; Setia-Atmaja et al., [2008]).

However, based on alignment approach, controlling shareholder concerns the long term orientation and good reputation protection (Wang, 2006). It shows that family ties to firm value family firm (Andersen and Reeb, 2003), so family firm concerns to higher quality earning information (Wang, 2006). According to this reason, controlling shareholder has incentive to monitor managers (Andersen and Reeb, 2003). It implies that family firm has effective monitoring mechanism, so managers feel reluctant to manipulate financial statements (Ali et al., 2007). Therefore, family firm is associated with lower abnormal accruals (Wang, 2006). In another side, transforming the ownerships from widely dispersed ownership to concentrated ownership, such as: family ownership (Earle et al., 2005) can align the shareholders and managers' interest, so it can increase the control of shareholders to managers (Wang, 2006).

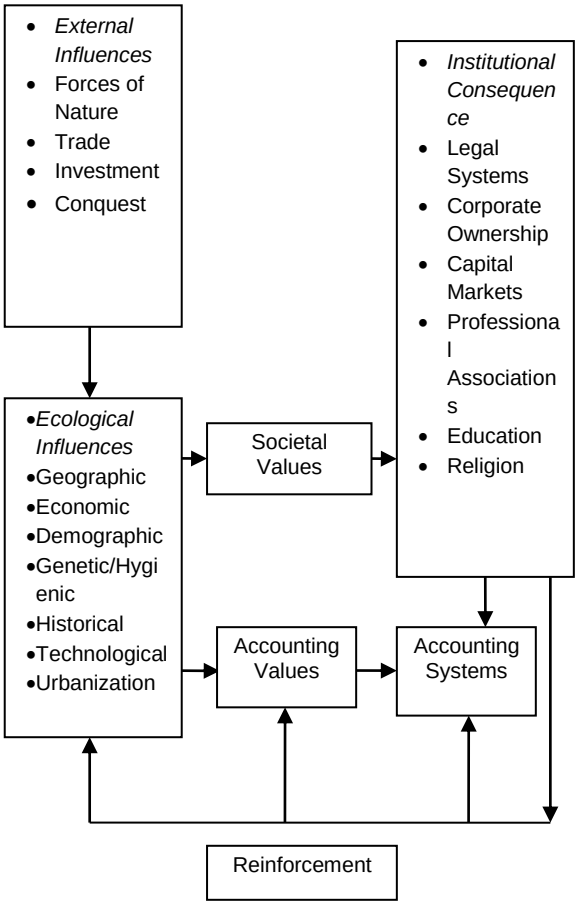
2.2 Culture Dimension and Accounting Practice

Hofstede (1997) defines culture as a collective phenomena, because it is learnt and studied by people who live together in certain social environment. People, child to adult, learn culture from their family, school, and work environments, moreover, these environments relate to each other. As a result, they bring culture from their family along to school and work.

Hofstede (1997) proposes four dimensions of culture that these are labelled, such individualism (versus collectivism), power distance (from small to large), uncertainty avoidance (from strong to weak), and masculinity (versus femininity). The dimensions are an extraction of the basic problems in this society which have become worldwide. The problems also have a consequence for the functioning of societies, of groups within those societies, and of individuals within those groups (Hofstede, 1997: 13). Understanding dimensions of culture is far a way to understand the culture of the certain environment.

Gray (1988) stated that Hofstede' s finding is probably one of the most extensive cross cultural surveys ever conducted because the survey conducted in more than the fifty countries. The finding also shows that countries could be grouped into culture areas based on their score on the four value dimensions. According to Gray (1988), the point of the finding is the relationship between the social value orientation and the development of accounting systems because it has institutional consequences in form of the legal system, political system, nature of capital market, pattern of corporate ownership, and so on (figure 1).

Figure 1: Culture, Societal Value and The Accounting Sub-Culture



Source: Gray (1988)

Culture is manifestation of value has to be obeyed by members of society (Hofstede, 1997). The values will be implemented in where they work or when they interact with others. Thereof, Gray (1998) stated if the cultures which are identified as dimension of the cultural value should be possible to establish accounting values, then, systems are implemented in society, such as: accounting system, actually as manifestation of culture in that society. Gray (1998) stated the relationship between cultures with accounting values and practice as in figure 2. Empirical evidence found by Ussahawanitchakit (2008) proved that organizational culture had positive correlation with earnings quality because it presents set of strongly held values, beliefs, norms, habits, and symbols according to which the members of an organization operate.

Figure 2: The Relationship Cultures and Values

	Professionalism	Uniformity	Conservatism	Transparency
Individualism	High	Low	Low	Low
Power Distance	Small	Large	No Relationship	Large
Uncertainty Avoidance	Weak	Strong	Strong	Strong
Masculinity	High	No Relationship	High	Low

Source: Gray (1998)

a. Large versus Small Power Distance and Earnings Quality

The manifestation of large power distance culture is shown by the dependency of society's members in their groups that also depends on certain the powered figure (Hofstede, 1997). It considers that extant power and hierarchical relationship is essential in the given culture (Kaasa and Vadi, 2008). Therein, a large power distance can be characterized by centralized decisions structure and extensively uses formal rules. Kaasa and Vadi (2007) revealed that power distance has negative effect on innovation initiation, because it relates with the low accommodation level of all member organization interest (Gray, 1988). Power distance level also has relationship with communication gap between superior and subordinates, because higher power distance associates with greater communication gap between superior and subordinates in organization (Khatri, 2009).

In ownership perspective, Chakrabarty (2009) found that higher the power distance level in a country then larger the domination of family firms in capital market. Because of family as a majority owner in firm, the family can control, decide management policy, and also choose managers (Ali et al. 2007). This condition encourages low flexibility, low transparency, and low professionalism in accounting values (Guan et al., 2005). Hence, the power distance culture

will diminish earnings quality if larger of firm shares owned by individual or family.

Hypothesis 1: the different power distance level in family firms has the different earnings quality

b. Individualism versus Collectivism and Earnings Quality

Individualism is the one side versus its opposite, collectivism, that is degree to which individuals are integrated into groups (Desender et al., 2007). In collectivistic societies people are connected to each other through strong and cohesive groups that protect them during their life: it assumed that people are loyal to these groups (Kaasa and Vadi, 2008). This condition causes regulation of societies and political system unbalanced. Therefore, Kaasa and Vadi (2007) suggested that there is a positive relationship between individualism and innovation initiation.

Chakrabarty (2009) revealed that higher the collectivism level in country then larger firms in that country owned by family. In one side, domination family in firm reduces agency cost or conflict between shareholders and managers. Family has power to hire CEO and will point CEO who will align her/his interest with family's interest (Wang, 2006). It means family directly can control their managers (Demsetz dan Lehn, 1985). In other side, because family directly can access information or understand about company activities deeply (Andersen dan Reeb, 2003), of course, managers will feel reluctant to manipulate the company's financial reporting (Ali et al., 2007). As a result, manager is also suspected unfair as regard to majority-minority interest, because people in cohesive in-groups society continue protect them in exchange for unquestioning loyalty (Desender et al., 2007). Therefore, Desender et al. (2007) proved that higher collectivism level could lead to higher earnings management level.

Hypothesis 2: the difference of individualism (collectivism) level in family firms has the different earnings quality

c. Femininity versus Masculinity and Earnings Quality

Femininity-masculinity orientates toward achievement and competition (Kaasa and Vadi, 2008). If masculine culture that dominated by men prefers being independent or self assertiveness in career, then, femininity culture describes about discretion, modesty, tolerance, and solidarity. Then, femininity focuses on people and a more supportive climate, so that is why masculinity has negative relationship with innovation initiation and economic creativity (Kaasa and Vadi, 2008).

In firm dominated by family, the owner has privilege to get private information from manager who hired by the family. Perhaps, owners only disclose information which they want to disclose, as the finding of Fan and Wong (2002) that CEO will be expected to publish financial information as their interest. Chan and Cheung (2008) stated that femininity culture in family firm encourage the owners to prioritize the societies interest. It implies majority owners will prioritize firm sustainability and will not expropriate minority. Therefore, Chan and Cheung (2008) suggested that masculinity culture has positive correlation with corruption level in societies.

Hypothesis 3: the difference of femininity level in family firms has the different earnings quality

d. Strong versus Weak Uncertainty Avoidance and Earnings Quality

Uncertainty avoidance (from high to low) culture relates to the anxiety level of society (Hofstede, 2007). Hofstede (1997) stated that in countries with strong uncertainty avoidance tend to have more and more precise laws than that in those with weak uncertainty avoidance, because they want to avoid high uncertainty avoidance.

Therefore, in societies with low uncertainty avoidance, organization rules can be violated for pragmatic reasons, conflicts are considered as a natural part of life, and ambiguous situations regarded as natural and interesting (Kaasa and Vadi, 2008). As a result, the strong uncertainty avoidance culture adopts rules to minimize ambiguity, because the culture open minds of positive idea and concern to reform it good (Chen and Cheung, 2008). Perhaps, the societies implement accounting principles rigidly.

Family owner is concerned with reputation, survival, wealth, and heritage for descendant (Wang, 2006). To maintain their interest, as majority, family wants to control management by hired CEO from their member (LaPorta et al., 1999). Actually, family can control the manager behaviour directly (Demsetz dan Lehn, 1985) and has information or understand about company activities deeply (Andersen dan Reeb, 2003), Majority's privilege which surrounding with low uncertainty avoidance culture encourages the rules violation, includes: accounting principles, then the situation can deteriorate the earnings quality.

Hypothesis 4: the difference of uncertainty avoidance level in family firms has the different earnings quality

3. Research Method

3. 1 Data Collection and Sample Selection

This research uses secondary data served by Osiris Database from 2002-2008 to determine accrual and to identify family firms. This research uses manufacture firms as sample because these firms do not have unique heavily regulation as financial firms and match for the modified Jones's accrual accounting formula. They are taken from capital market of countries that culture scores have been identified by Hofstede (1997). There are 53 of the countries' culture scores, but Osiris Database only provides data for 48 countries. The total of manufacture companies from the countries is 14,276 (see Appendix). Then, this study chooses the firms that their shares owned by individuals or families. There are 7,055 companies in 48 countries which have individual or family as shareholders.

This study examines the level of accruals for three groups of samples: such as the one largest, the two largest, and the three largest shareholders. For this objective, every group has to hold more than 20% shares in their firms. We sort shareholders in every firm based on the share ownership percentage to identify the largest shareholder. It means, the one largest sample determined by one individual or family who has the largest share and has more than 20% shares. For the two largest shareholders, they are sum of the two largest individual shareholders who has more than 20% shares. Then, sum of three largest individual shareholders who has more than 20% shares are the three largest shareholders. The samples of the one largest shareholder are 1,484 family firms, the two largest shareholders are 2,117 family firms, and then the three largest shareholders are 2,418 family firms.

To execute the accrual level estimation of family firms from 2002-2007, we only include the firms which have consecutive data from 2002-2007. Finally, we got 872 samples for the one largest shareholder, 1,275 samples for the two largest shareholders, and 1,489 samples for the three largest shareholders. Because every country does not have the same samples and the unit of analysis is country level, this study takes the ten largest firms for each country. It means, we eliminate the countries which have less than ten family firms. The number of countries that have the one largest, the two largest, and three largest shareholders in a

firm are, respectively, 17, 19, and 20 countries.

3.2 Culture Index (CLI) Variable

This research uses Hofstede's culture score as culture index for countries. We uses Hofstede' s index culture because the score is used in prior several researches and Hofstede also have updated the scores as the last update at 2007. The study arranges the culture's score of every culture from the lowest to highest and then it is divided by three levels: low, middle, and high culture levels. Therefore, this study distinguishes the level of earnings quality between three levels of cultures (power distance, individualism, masculinity, and uncertainty avoidance).

3.3 Earnings Quality (EQ) Variable

Earnings quality is determined by managers' operational discretion and long-term investment discretion. According to Setia-Atmaja (2008), we employ discretionary current accruals to capture managers' operational discretion, because managers are likely to manage discretionary accruals (also referred to working capital accruals), such as: expedite or delay delivery of goods and services in the last month of financial year in order to fit their reporting incentive and/or interest. We also argue that it is important to observe discretionary long-term accruals, because managers may use their discretion to expedite or delay investment in long-term assets (plant, property and equipment) (Setia-Atmaja, 2008).

Then, the modified Jones (1991) model used to measure discretionary accrual level. Discretionary current accruals (*DCA*) calculated by subtracting non-discretionary current accruals (*NDCA*) from total current accruals (*TCA*). Equation 1 is used to calculate total current accruals (*TCA)*. The *TCA*, or non-cash working capital accruals, is computed as changes in non-cash current assets, excluding changes in short-term investments (*STI*), minus changes in current liabilities (*CL*) excluding changes in short term debt (*STD*), which is derived from the current maturity of long-term debt.

We use the regression model in equation 2 to capture the coefficients of the cross-sectional variables α_0 and α_1 for the control firms (i.e., non-family firms) in the same industry sector for each financial year over the period 2002-2007. These control (non-sample) firm coefficients are used as the basis to estimate the non-discretionary current accruals for sample firms for each financial year. To compute non-discretionary current accruals, we apply these coefficients to the variables $\alpha 0$ and $\alpha 1$ representing the sample firms to equation 3 for the family firms data in period 2008.

$$TCA\ t = \Delta CA_t - \Delta Cash_t - \Delta STI_t - \Delta CL_t - \Delta STD_t \quad (1)$$

Notes:

TCAt = Total Current Accruals in year *t*

ΔCasht= Cash t less Cash*t-1*

ΔCAt = Current Assets in year t less Current Assets in year*t-1*

ΔSTIt = Short-term Investment in year *t* less Short-term Investment in year*t-1*

ΔCLt = Current Liabilities in year *t* less Current Liabilities in year*t-1*

ΔSTDt = Short-term Debt in year t less Short-term Debt in year*t-1*

$$\frac{TCA_{j,t}}{A_{j,t-1}} = \alpha_0\left(\frac{1}{A_{j,t-1}}\right) + \alpha_1\left(\frac{\Delta REV_{j,t} - \Delta TR_{j,t}}{A_{j,t-1}}\right) + \varepsilon_{j,t} \quad (2)$$

$$NDCA_{i,t} = \alpha_0\left(\frac{1}{A_{i,t-1}}\right) + \alpha_1\left(\frac{\Delta REV_{i,t} - \Delta TR_{i,t}}{A_{i,t-1}}\right) \quad (3)$$

Notes:

j = Control (non-family) firms

i = Sample (family firms)

TCA = Total

$A_{j,t-1}$ = Total Assets in year*t-1*

$\Delta REV_{j,t}$ = Revenue in year *t* – Revenue in year *t-1*

Current Accruals $\Delta TR_{j,t}$ = Trade Receivables in year *t* – Trade Receivables in year *t-1*
NDCA = Non-Discretionary Current Accruals
ε j,t = Error term in year *t* for control (non-family) firms j

We calculate discretionary current accruals (*DCA)* for the family firm data in period 2008 by subtracting non-discretionary current accruals (*NDCA)* (see equation 4) from total current accruals (*TCA*) scaled by lagged assets respectively.

$$DCA_{i,t} = (TCA_{i,t}/A_{i,t-1}) - NDCA_{i,t} \quad (4)$$

We calculate discretionary long-term accruals (*DLA*) by subtracting discretionary current accruals (*DCA*) from discretionary accruals (*DA*). To derive *DA*, we first calculate the nondiscretionary accruals (*NDA*). To obtain *NDA*, we calculate the coefficients α_0, α_1 and α_2 on the control (non-family) firm variables for each financial year by employing the regression model in equation 5. *NDA* is derived by applying the coefficients obtained from equation 5 to equation 6 on sample firm variables for the family firm data in period 2008. *DA* is calculated using equation 7. After obtaining *DA* and *NDA*, we calculate *DLA* and *NDLA* by subtracting *DCA* and *NDCA* from *DA* and *NDA*, respectively (see equations 8 and 9).

$$\frac{TA_{j,t}}{A_{j,t-1}} = \alpha_0\left(\frac{1}{A_{j,t-1}}\right) + \alpha_1\left(\frac{\Delta REV_{j,t} - \Delta TR_{j,t}}{A_{j,t-1}}\right) + \alpha_2\left(\frac{PPE_{j,t}}{A_{j,t-1}}\right) + \varepsilon_{j,t} \quad (5)$$

$$NDA_{i,t} = \alpha_0\left(\frac{1}{A_{i,t-1}}\right) + \alpha_1\left(\frac{\Delta REV_{i,t} - \Delta TR_{i,t}}{A_{i,t-1}}\right) + \alpha_2\left(\frac{PPE_{i,t}}{A_{i,t-1}}\right) \quad (6)$$

$$DA_{i,t} = \alpha_0\left(\frac{TA_{i,t}}{A_{i,t-1}}\right) - NDA_{i,t} \quad (7)$$

$$DLA_{i,t} = DA_{i,t} - DCA_{i,t} \quad (8)$$

$$NDLA_{i,t} = NDA_{i,t} - NDCA_{i,t} \quad (9)$$

Note: Total Accruals (TA) = Net Profit After Tax (NPAT) – Operating Cash flows (OCF)

4. Result and Analysis

4.1 Descriptive Statistics

This study deploys ANOVA to screen the tendency of the family firms' entrenchment or alignment behaviour. We expect that the different level of culture also has different accruals level. Based on Hofstede's culture score, we divide it into three levels (low, middle, and high), then we examine the family firms' accruals on it.

Based on the accruals data of the one largest shareholder, the low level of the power distance culture has the lowest DA (Discretionary Accrual), DCA (Discretionary Current Accrual), and DLA (Discretionary Long Term Accrual) mean compare with the others level (Table 1 Panel A). The middle level of the power distance culture has higher mean of accruals rather than the low one. Therefore, the high level of the power distance culture has the highest accruals mean among the three level of the power distance culture score. This result implies that power distance culture has linear relationship with accruals for the one largest shareholder (Figure 3).

For the two largest shareholders, the low level of the power distance culture also have the lowest accruals mean, then the accruals of the middle power distance culture level has the second lowest accruals mean (Table 1 Panel B). Thereof, the high level of the power distance culture has the highest accruals mean compared to others power distance level. The increasing accruals are same as the increasing of the power distance level, so it shows the linear relationship between accruals and culture level for the two largest shareholders (Figure 3). The accruals mean: DA, DCA, and DLA of the three

largest shareholders are also linear with the level of power distance culture (Table 1 Panel C). It shows that the highest level of the power distance culture tends to have the highest accruals and the lowest level of power distance culture also has the lowest accruals (Figure 3). However, for DCA, the high level of culture has the highest accrual mean, then it is followed by the low level as the second highest accrual mean, and finally the middle level is the lowest accrual mean.

Most of lines in the one, two, and three shareholders that relates with power distance and accruals level have positive slope (Figure 3). It implies the low power distance level in family firms has low accruals. Then, for middle level has middle accruals and the high power distance culture level has high accruals level.

Table 1: Power Distance Culture

Panel A: The One Largest Shareholder

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1555	0.1672	0.1943
		SD	0.10201	0.19621	0.12585
2	DCA	Mean	0.0702	0.0911	0.1469
		SD	0.07351	0.19081	0.54002
3	DLA	Mean	0.1714	0.1985	0.2235
		SD	0.11336	0.35674	0.46720
4	The Mean of Accruals	Mean	0.1324	0.1523	0.1883
		SD	0.07332	0.23576	0.35304

Panel B: The Two Largest Shareholders

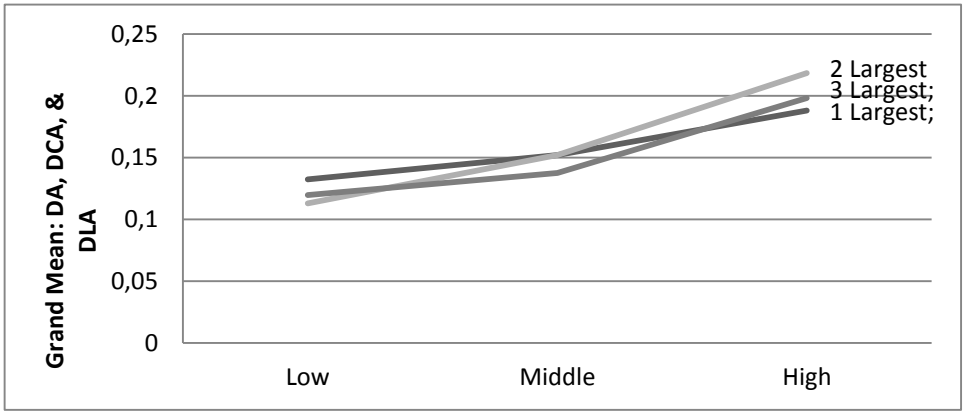
No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1433	0.1882	0.2186
		SD	0.09998	0.18125	0.15741
2	DCA	Mean	0.0578	0.0742	0.1640
		SD	0.05800	0.16062	0.52678
3	DLA	Mean	0.1378	0.1943	0.2727
		SD	0.09881	0.32696	0.51532
4	The Mean of Accruals	Mean	0.1130	0.1523	0.2184
		SD	0.06739	0.21533	0.37382

Panel C: The Three Largest Shareholders

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1499	0.1887	0.2135
		SD	0.11881	0.18439	0.15619
2	DCA	Mean	0.0806	0.0704	0.1642
		SD	0.22283	0.16057	0.52668
3	DLA	Mean	0.1547	0.2032	0.2741

		SD	0.15661	0.32996	0.51511
4	The Mean of Accruals	Mean	0.1284	0.1541	0.2172
		SD	0.15038	0.21692	0.37368

Figure 3: Power Distance



In individualism culture, the one largest shareholder group has the lowest mean of the discretionary accrual (DA) for the high culture level (Table 2 Panel A). However, the low culture level has the highest DA mean, then the high culture level has the second highest level of DA mean. According to discretionary current accrual (DCA) and discretionary long-term accrual (DLA), the one largest shareholder has the lowest level of accruals mean for the middle level, then it is followed by the high level as the second lowest accruals mean, and the low level has the highest level accruals mean.

For the two largest shareholders, the low level of individual culture has highest accruals mean, then the middle level has the second highest accruals mean, and the high level has the lowest level of accruals mean (Table 2 Panel B). For the three largest shareholders, the examination results show that the low level of individual culture has the highest level of the accruals mean: DA, DCA, and DLA, but the high level has the lowest accruals mean (Table 2 Panel C). The lines in the one, two, and three shareholders that relates individualism and accruals level are dominated by the linear line but they have negative slope (Figure 4) It implies the low individualism level in family firms has high accruals. The middle level has middle accruals, but the high individualism level has low accruals level.

Table 2: The Individualism (Collectivism) Culture

Panel A: The One Largest Shareholder

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.2129	0.1578	0.1368
		SD	0.19745	0.10380	0.11008
2	DCA	Mean	0.1636	0.0598	0.0724
		SD	0.51551	0.07112	0.10777

3	DLA	Mean	0.2494	0.1672	0.1677
		SD	0.53709	0.11484	0.14130
4	The Mean of Accruals	Mean	0.2086	0.1283	0.1256
		SD	0.38601	0.07444	0.09186

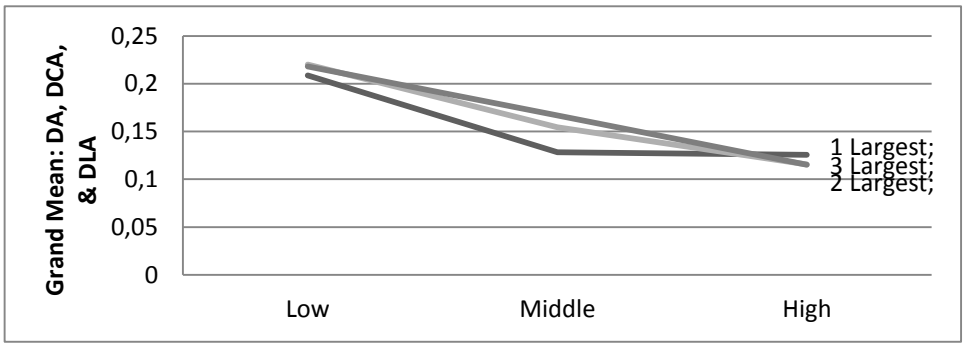
Panel B: The Two Largest Shareholders

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.2227	0.1864	0.1478
		SD	0.19916	0.14510	0.10263
2	DCA	Mean	0.1583	0.0888	0.0525
		SD	0.51713	0.20426	0.04519
3	DLA	Mean	0.2794	0.1877	0.1458
		SD	0.53435	0.31765	0.10621
4	The Mean of Accruals	Mean	0.2202	0.1543	0.1154
		SD	0.38617	0.20841	0.06955

Panel C: The Three Largest Shareholders

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.2165	0.1899	0.1460
		SD	0.20099	0.15237	0.10371
2	DCA	Mean	0.1517	0.1088	0.0530
		SD	0.51805	0.28492	0.04661
3	DLA	Mean	0.2862	0.2013	0.1462
		SD	053535	0.31860	0.10575
4	The Mean of Accruals	Mean	0.2181	0.1667	0.1151
		SD	0.38725	0.23417	0.06979

Figure 4: Individualism (Collectivism)



In masculinity culture, the middle level of masculinity culture has the highest DA mean, then the low level has the second highest mean of DA. Of course, the high level of masculinity culture has the lowest mean. The DCA and DLA in low level of culture is the

lowest accruals mean (Table 3 Panel A). Then, the high level has the second lowest accruals mean and the middle level has the highest accruals.

For the two largest shareholders, the lowest accruals mean level belong to the high level of masculinity culture (Table 3 Panel B). The middle level has the highest accruals mean, then the low level has the second highest accruals mean. For the three largest shareholders, the middle level of masculinity culture has the highest accruals mean and the high level has the lowest accruals mean (Table 3 Panel C). The low level has the second highest accruals mean.

Contrast with power distance and individualism (collectivism) culture, the graph pattern of masculinity culture is non-linier (Figure 5). In low level of culture, the masculinity culture has low accruals mean, then the accruals mean increases to the certain point (the middle culture level). After that, the accruals mean decreases, so the high culture level has the lowest accruals level.

Table 3: The Masculinity Culture

Panel A: The One Largest Shareholder

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1603	0.2275	0.1348
		SD	0.09801	0.21823	0.09725
2	DCA	Mean	0.0798	0.1646	0.0668
		SD	0.08758	0.56404	0.09948
3	DLA	Mean	0.1447	0.3003	0.1613
		SD	0.10218	0.58268	0.13087
4	The Mean of Accruals	Mean	0.1283	0.2308	0.1210
		SD	0.06804	0.42106	0.08538

Table 3: The Masculinity Culture (continued)

Panel B: The Two Largest Shareholders

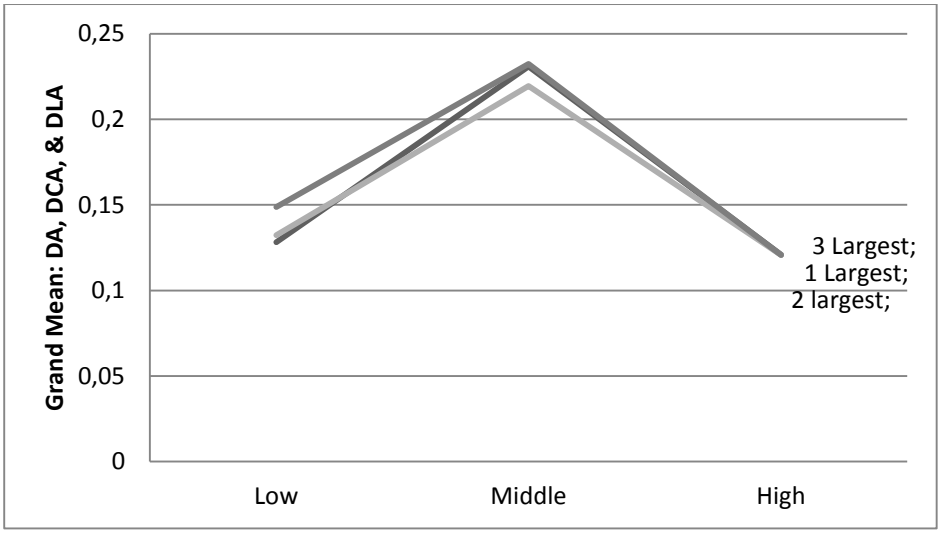
No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1749	0.2148	0.1560
		SD	0.09562	0.21707	0.09937
2	DCA	Mean	0.0683	0.1576	0.0563
		SD	0.07083	0.50806	0.06327
3	DLA	Mean	0.1538	0.2860	0.1497
		SD	0.09914	0.56587	0.10892
4	The Mean of Accruals	Mean	0.1323	0.2194	0.1207
		SD	0.06788	0.40084	0.07239

Panel C: The Three Largest Shareholders

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1803	0.2159	0.1562
		SD	0.11971	0.22754	0.10318

2	DCA	Mean	0.0886	0.1731	0.0548
		SD	0.22510	0.54748	0.06057
3	DLA	Mean	0.1773	0.3081	0.1514
		SD	0.16344	0.60752	0.10843
4	The Mean of Accruals	Mean	0.1487	0.2324	0.1208
		SD	0.15089	0.43073	0.07293

Figure 5: Masculinity



The accruals: DA, DCA, and DLA data of the one largest shareholder in uncertainty avoidance culture show that the low level has the highest accruals mean (Table 4 Panel A). The middle level has the lowest accruals mean. Finally the high level has the second lowest accruals mean.

However, for the two largest shareholders' discretionary accrual (DA), the low level of uncertainty avoidance culture has the second highest accrual mean (Table 4 Panel B). Then, the highest mean belongs to the high level of uncertainty avoidance culture. Finally, the lowest mean belongs to the middle level of uncertainty avoidance. For discretionary current accrual (DCA), the highest accrual mean belongs to high level of uncertainty avoidance, the second highest mean belongs to the middle uncertainty avoidance, and the lowest mean belongs to the low level of uncertainty avoidance culture. For discretionary long-term accrual (DLA), the middle culture level has the lowest accrual mean, the high culture level has the second lowest mean, and the low level has the third lowest accrual mean.

In the three largest shareholders, the highest DA mean is in the high level of uncertainty avoidance (Table 4 Panel C). Then, the second highest DA mean is in the low level of culture and the lowest DA mean is in the middle level. For the DCA, the low level has the highest DCA mean, the high level has the second highest DCA mean, and then, the middle level has the lowest DCA mean. For DLA, the low level has the highest accrual mean. The high level has the second highest accrual mean and the middle level has the lowest accrual.

The accruals of uncertainty avoidance have non-linear pattern, but it has opposite shape with masculinity (Figure 6). Contrast with masculinity, the middle level of uncertainty avoidance culture has the lowest

accruals level. Therefore, the accruals mean is high in the low culture level, then the accruals decline until certain point (the middle culture level). After that, the accruals incline toward to high culture level.

Table 4: The Uncertainty Avoidance Culture

Panel A: The One Largest Shareholder

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1970	0.1323	0.1881
		SD	0.12867	0.10441	0.18902
2	DCA	Mean	0.1552	0.0648	0.0896
		SD	0.54133	0.09954	0.17209
3	DLA	Mean	0.2602	0.1510	0.1884
		SD	0.46364	0.13222	0.34792
4	The Mean of Accruals	Mean	0.2041	0.1161	0.1554
		SD	0.35181	0.08712	0.22795

Table 4: The Uncertainty Avoidance Culture (Continued)

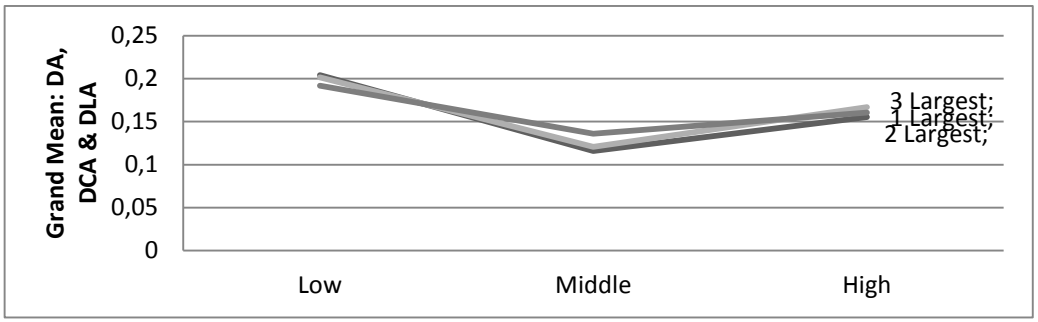
Panel B: The Two Largest Shareholders

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1930	0.1612	0.2005
		SD	0.16714	0.10886	0.18263
2	DCA	Mean	0.1496	0.0537	0.0962
		SD	0.52639	0.05888	0.17773
3	DLA	Mean	0.2623	0.1468	0.2036
		SD	0.51737	0.10074	0.35047
4	The Mean of Accruals	Mean	0.2016	0.1206	0.1668
		SD	0.37742	0.07234	0.22820

Panel C: The Three Largest Shareholders

No	Variable		The Low Level of Culture	The Middle Level of Culture	The High Level of Culture
1	DA	Mean	0.1874	0.1640	0.1935
		SD	0.15875	0.12111	0.18094
2	DCA	Mean	0.1351	0.0819	0.0864
		SD	0.48823	0.24097	0.16654
3	DLA	Mean	0.2528	0.1617	0.2015
		SD	0.48126	0.16158	0.33031
4	The Mean of Accruals	Mean	0.1918	0.1359	0.1605
		SD	0.35084	0.15932	0.21597

Figure 6: Uncertainty Avoidance



4.2 Hypothesis Testing

The one largest individual shareholder in family firms have insignificant DA, DCA, and also DLA for power distance culture (Table 5, panel A). However, the two largest shareholders in family firms also only have significant DA (0.026). As well as the one largest shareholder, they do not have insignificant DCA or DLA for power distance culture. The result of the three largest shareholders in family firms also shows that they have significant DA (0.064), but they have insignificant DCA and DLA for power distance culture. The significant result of DA implies that there is different DA level in the different power distance level. According to H1, the difference of power distance level in family firms has different earnings quality, therefore, H1 supported by the result. The difference of DA between the three of power distance culture level shows the different earnings quality in family firms owned by the two or three largest shareholders, because of the different power distance level. However, the one largest shareholder as the owner in family firms does not have low earnings quality as well as the others.

For individualism (collectivism) culture, the DA of firm families is significant for the one largest (0.018), the two largest (0.021), and the three largest shareholders (0,033) (Table 5). However, the only DCA of the two largest shareholders and the only DLA of the three largest shareholders are moderate. According to H2, the difference of collectivism level in family firms has the different earnings quality, therefore H2 supported by the result. The difference of DA between the three of individualism (collectivism) culture level shows the different earnings quality in family firms owned by the one, two, or three largest shareholders.

For femininity (masculinity) culture, the one largest shareholder has significant DA (0.003) and DLA (0.031), but it has insignificant DCA (Table 5 Panel A). For the two largest shareholders, they have significant DCA (0.043), moderate DA, and insignificant DCA (Table 5 Panel B). The three largest shareholders have significant DLA (0.029), moderate DA (0.094), and insignificant DCA (Table 5 Panel C). According to H3, the difference of femininity level in family firms has the different earnings quality, H3 supported by the result. The difference of DA between the three of femininity (masculinity) culture level shows the different earnings quality in family firms owned by the one, two or three largest shareholders.

For uncertainty avoidance culture, the only DA of the one largest shareholder is significant (0.039) (Table 5 Panel A). Although most of results are insignificant, the H4 states the difference of uncertainty avoidance level in family firms has the different earnings quality is supported, because there is evidence of the different DA in three uncertainty avoidance culture levels.

Table 5: The ANOVA Testing for Accruals

Panel A: The One Largest Shareholder

No	Variable		PDI	IDV	MAS	UAI
1	DA	F-Test	0,965	4,121	5,926	3,311
		Sig.	0,383	0,018	0,003	0,039
2	DCA	F-Test	0,837	1,906	1,502	1,167
		Sig.	0,435	0,152	0,226	0,314
3	DLA	F-Test	0,328	1,160	3,540	1,475
		Sig.	0,721	0,316	0,031	0,232
4	The Mean of Accruals	F-Test	0,742	2,264	3,553	1,845
		Sig.	0,478	0,107	0,031	0,161

Panel B: The Two Largest Shareholders

No	Variable		PDI	IDV	MAS	UAI
1	DA	F-Test	3,742	3,950	2,524	1,217
		Sig.	0,026	0,021	0,083	0,299
2	DCA	F-Test	2,025	1,873	2,068	1,507
		Sig.	0,135	0,157	0,129	0,224
3	DLA	F-Test	2,181	2,352	3,189	1,698
		Sig.	0,116	0,098	0,043	0,186
4	The Mean of Accruals	F-Test	2,728	2,866	3,092	1,702
		Sig.	0,068	0,059	0,048	0,185

Panel C: The Three Largest Shareholders

No	Variable		PDI	IDV	MAS	UAI
1	DA	F-Test	2,790	3,471	2,393	0,625
		Sig.	0,064	0,033	0,094	0,536
2	DCA	F-Test	1,524	1,457	2,166	0,534
		Sig.	0,220	0,235	0,117	0,587
3	DLA	F-Test	1,833	2,542	3,594	1,069
		Sig.	0,163	0,081	0,029	0,345
4	The Mean of Accruals	F-Test	2,006	2,612	3,268	0,764
		Sig.	0,137	0,076	0,040	0,467

5. Discussion and Limitation

This study examines the accruals: discretionary accrual, discretionary current accrual, and discretionary long-term accrual level of family firms in power distance (large versus small), individualism versus collectivism, femininity versus masculinity, and uncertainty avoidance (strong versus weak) culture. This study's objective provides evidence about in what condition the majority shareholder owners in family firms behave alignment or entrenchment, because this

behaviour has implication for the family firms' earnings quality.

This study uses the three shareholder groups: one largest, two largest, and three largest shareholders in family firms over 48 countries. Their accruals level is examined for the three culture levels: low, middle, and high level. This study proves that every culture level has different accrual level. This study also proves that the majority owner in family firms tends to choose the entrenchment behaviour if the family firms have high power distance, and vice versa. As prior result, the family firms which have high power distance culture level encourages low flexibility, low transparency, and low professionalism in accounting values (Guan et al., 2005). Hence, the stronger power distance culture will diminish family firms' earnings quality.

This study also reveals that the majority owner in family firms tends to choose the entrenchment behaviour if the family firms have low individualism level. This evidence matches with prior evidence that higher collectivism level could lead to higher earnings management level (Desender et al., 2007), then it will deteriorate family firms' earnings quality. It implies majority owner directly can control their managers (Demsetz dan Lehn, 1985), and can access information or understand about company activities deeply (Andersen dan Reeb, 2003), but people in cohesive in-groups society continue protecting them in exchange for unquestioning loyalty (Desender et al., 2007).

However, the majority shareholders behave as the highest entrenchment in the middle masculinity culture level, but the lowest entrenchment is in low or high masculinity level. This condition implies that the entrenchment behaviour will turn up until reach certain the level, it will turn down over that level. This evidence contrasts with prior result that femininity culture in family firm encourages the owners to prioritize the society interest (Chan and Cheung, 2008) and masculinity culture has positive relation with corruption level in societies (Chan and Cheung, 2008). Especially, there is one or three largest shareholders as owners imply the majority has privilege to get private information from manager who hired by the family.

In uncertainty avoidance culture, the majority owner (one largest shareholder) behaves as the highest entrenchment in low uncertainty avoidance, but the lowest entrenchment level is in middle level. This evidence confirms prior research that in countries with strong uncertainty avoidance tend to be more and more precise laws than that in those with weak uncertainty avoidance, because they want to avoid high uncertainty avoidance (Hofstede, 1997). However, the lowest level behaves in middle level shows that the one largest shareholder may afford the uncertainty, but this situation is different if the share ownership dispersed.

Samples become as this main limitation in this study. Countries that used as sample do not have the same number of family firms, because this study also faces difficulty to trace the ultimate ownership. Osiris Database does not provide the ultimate ownership data. The future research has to use survey method for the more robust result.

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Appendix

The number of Family Firms Samples

Number	Country	A	B	C	D	E	F	G	H
1	Argentina	43	2	0	0	0	0	0	0
2	Australia	362	276	21	12	39	26	50	30
3	Austria	38	11	1	1	1	1	1	1
4	Belgium	62	23	0	0	3	1	3	1
5	Brazil	159	12	1	1	2	2	2	2
6	Canada	427	125	35	22	50	32	50	32
7	Chile	59	5	0	0	0	0	0	0
8	Colombia	27	0	0	0	0	0	0	0
9	Costa Rica	6	0	0	0	0	0	0	0
10	Denmark	59	26	2	2	3	3	6	6
11	Ecuador	13	0	0	0	0	0	0	0
12	Finland	62	55	7	7	9	9	10	10
13	France	298	178	56	40	72	52	76	56
14	Germany	339	175	63	42	79	53	84	58
15	Greece	126	104	61	60	75	72	81	78
16	Guatemala	1	0	0	0	0	0	0	0
17	Hong Kong	53	37	4	3	6	4	6	5
18	India	1870	631	99	40	149	58	186	69
19	Indonesia	154	14	2	2	3	3	3	3
20	Ireland	17	17	2	2	2	2	2	2
21	Israel	212	25	9	9	10	10	11	11
22	Italy	124	100	10	9	14	13	16	15
23	Jamaica	9	1	1	1	1	1	1	1
24	Japan	1664	105	20	13	26	18	26	18
25	Korea	1084	995	415	81	585	120	637	135
26	Malaysia	450	395	79	77	111	108	126	123
27	Mexico	46	2	1	1	1	1	1	1
28	Netherland	58	35	1	1	1	1	1	1
29	New Zealand	37	35	4	4	5	5	10	9
30	Norway	50	33	1	1	1	1	2	2
31	Pakistan	306	6	0	0	1	1	2	2
32	Panama	3	1	0	0	0	0	0	0
33	Peru	57	18	6	6	10	10	10	10
34	Philippines	50	32	2	2	2	2	3	2
35	Portugal	20	14	5	2	5	2	5	2
36	Singapore	300	251	55	54	78	77	91	89
37	South Africa	89	30	3	2	6	5	6	5
38	Spain	54	54	6	6	6	6	6	6
39	Sweden	173	79	17	16	23	22	23	22
40	Switzerland	117	71	16	15	24	23	26	25

The number of Family Firms Samples (Continued)

Number	Country	A	B	C	D	E	F	G	H
41	Taiwan	1187	1123	42	39	125	118	208	194
42	Thailand	224	20	5	4	5	4	5	4
43	Turkey	143	42	15	12	22	17	24	19
44	United Arab Emirates	22	3	2	2	2	2	2	2
45	United Kingdom	434	397	45	36	81	65	91	74
46	United Stated of America	3160	1497	370	245	479	325	525	364
47	Uruguay	5	0	0	0	0	0	0	0
48	Venezuela	23	0	0	0	0	0	0	0
SUM		14276	7055	1484	872	2117	1275	2418	1489

A = Number of manufacturing companies
B = A that owned by individual/family
C = B that the 1 largest family ownership has 20% or more
D = C that has completed data
C = B that the 1 largest family ownership has 20% or more
D = C that has completed data
E = B that the 2 largest family ownership has 20% or more
F = E that has completed data
G = B that the 3 largest family ownership has 20% or more
H = G that has completed data

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