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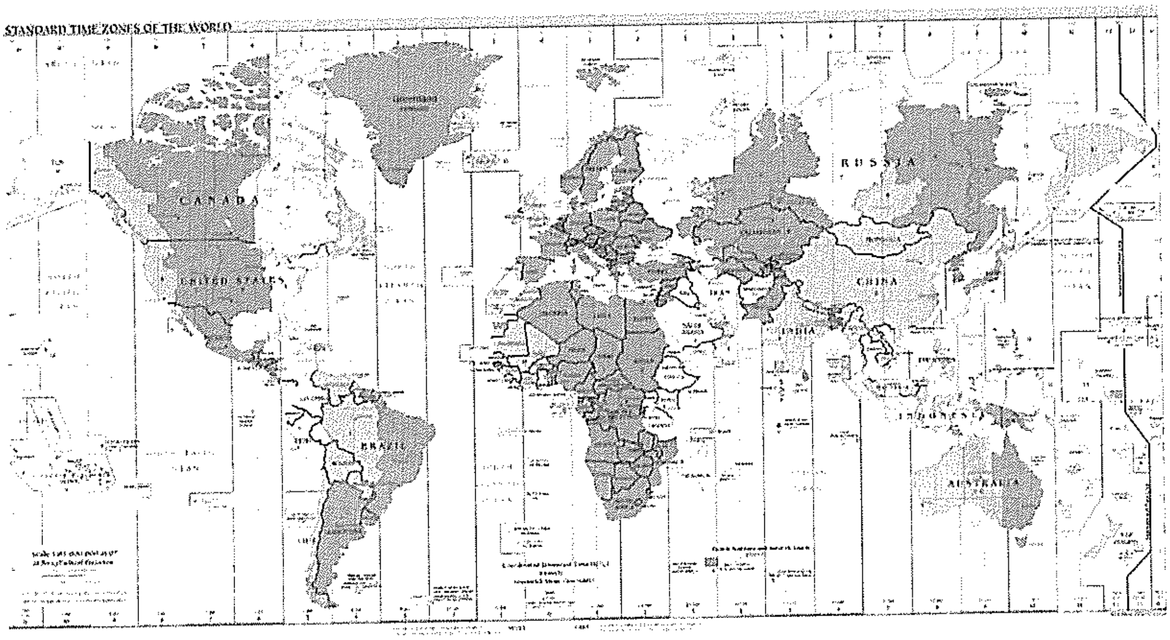

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Warmest regards,

Dr. Gamon Savatsomboon
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Managing Editors

June 4, 2010
Bangkok, Thailand

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CORPORATE PERFORMANCE CRITERIA IN THAILAND: INDIVIDUAL PERCEPTIONS OF COMPANY DIRECTORS' TASKS AND ROLES

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ABSTRACT

In more than 10 years since the financial crisis in Thailand in 1997, weaknesses in corporate governance have been identified as a major cause of the crisis. Thus, increased attention in the country has been paid to corporate governance reform and the roles of corporate boards of directors in relation to corporate performance. This paper is used to report on a study which examined the emphases that Thai directors place on corporate performance criteria, their individual tasks as board members and the extent to which they consider themselves to have a defined functional role. The study employed a quantitative approach based on questionnaires surveying 195 Thai directors of companies listed on the Stock Exchange of Thailand (SET) across various industries in the year 2009. It was found that the emphasis placed by directors on most corporate performance criteria, especially the financial aspect, was related to the degree to which they saw themselves in a monitoring role. Moreover, rather than general perceived roles, specific task involvement was more closely related to the performance criteria emphasised by directors. For practitioners, academics and policy makers, results raise awareness of directors' practices in the area of corporate governance and suggest a set of director tasks that are required for companies to achieve growth.

Keywords: *Corporate Governance, Board of Directors, Company Performance, Thailand*

1 INTRODUCTION

The focus on the corporate governance or CG has increased since the surge of financial crises around the globe during 1990s and the failure of major corporations in many countries since 2000 (Phan et al., 2003; Johnson et al., 2000; Giroux, 2008; Teall, 2006; Al-Abbas, 2009; Chang, 2009; Milhaupt and Pistor, 2008). The Asian financial crisis in 1997 (Nam et al., 2001) and the downfall of major corporations in the USA and in Australia (Robins, 2006) are two phenomena that triggered the importance of the reform of the corporate governance system to establish appropriate mechanisms for protecting against the return of similar crises.

1.1 BOARD OF DIRECTORS

Increasingly, corporate governance mechanisms, public attention and academic studies have focussed on the board of directors. Regardless of the type of ownership structure, the collapse of major corporations ranging from Enron in the USA, Parmalat in Italy to HIH in Australia, have resulted in criticisms about the causes of the collapse being centred around the boardroom (Salter, 2008; Melis, 2005; Mallahi, 2005; Deakin and Konzelmann, 2004; Kiel and Nicholson, 2007). Thailand is no exception as the weakness in corporate governance was identified as one of the primary reasons resulting in the financial crisis (Nikomborirak and Jitmanchaitham, 2001). Since then, the so-called 'Anglo-American' system of corporate governance has been applied to all public-listed firms on the Stock Exchange of Thailand or SET by the Thai government (Suehiro and Wailerdsak, 2004) and the major interest is on the roles of directors sitting on the Thai corporation boards (Persons, 2006). Thus, it can be implied that boards of directors are obligated to oversee the success of their major public corporation; as argued by Lorsch and Clarke (2008), organisations are regarded as national assets and significant engines in the nation's economic prosperity.

1.2 CORPORATE PERFORMANCE

Demb and Neubauer (1992) commented that corporate performance standards are in the eye of the beholder. In this regard, the comment implies that corporate performance is not a simple concept and is likely to be influenced by and vary from board to board. The view is supported by Ong and Lee (2000) whose studies related to the corporate board of directors and determined that the number of variables measuring company performance is few and, as such, measures should be extended to include aspects such as customer satisfaction, employee turnover, research development and market growth. In general, the performance companies has been measured by means of financial aspects such as return on investment, return on sales and return on equity (Wang and Yen, 2009).

1.3 RESEARCH PROBLEM AND QUESTIONS

Understanding how corporate boards and their members impact on corporate performance is a central question for the corporate governance agenda regardless of which types of director are on the board (Nicholson et al., 2004; Peng et al., 2001). The board of directors is viewed as the best constituent when establishing goals and evaluating the performance of the company (Monks and Minow, 2008). Although there appears to be some existing research on the roles of the board of directors in explaining corporate behaviours, the topic on how the board and its members perceive their roles and how their roles affect corporate performance are still limited, especially in contexts other than in the USA or in Europe.

Therefore, the central research question for the current study was: **'how are director personal attributes, the type of directors and director's task profile on the board related to the emphasis that a board member places on any corporate performance criterion and the extent to which directors see themselves in a defined functional role?'** It is expected that each of these elements is interrelated and the relationships can be explored within the context of the Thai experience.

The minor research questions in guiding the discovery of the answers to the central research question concern the classification of the position of board members, demographics characteristics, the importance board members place on tasks, board members' involvement in particular roles and the importance board members place on corporate performance criteria.

1.4 PURPOSE OF THE STUDY

The current study served four purposes. The first objective was to identify board member characteristics, the position of the directors, the importance that directors placed on their individual tasks, the degree to which board members were involved in the various roles on the board and their emphasis on various corporate performance criteria in Thailand. The second objective was to explore relationships between the tasks, roles and emphases placed on corporate performance measures.

The third objective was to answer a call by Peng et al. (2001) for an extension of corporate board governance research by further extending the theory of corporate governance in Thailand; i.e., on emerging multinationals from the third world country and the Asian crisis. The initial focus of the corporate governance study by Peng et al. (2001) was extended to explore all types of directors and all types of Thailand-based companies primarily listed on the Stock Exchange of Thailand and to include the study of corporate performance.

The fourth objective was to fill the research gap noted in the previous literature concerning the contingency studies of corporate board of directors which may influence the performance of the company as a result of the differences underpinning the corporate governance systems across countries (Daily et al., 2003; Gabrielsson and Huse, 2004).

1.5 SIGNIFICANCE OF THE STUDY

For academics, there was an opportunity to extend current models of board membership behaviours together with helping raise the level of public awareness of corporate board practices of a different country, namely Thailand. Policy makers and regulators would be able to use generated data and models to form appropriate rules and policies on corporations and their directors, thereby preventing conflicts of interests arising from other concerned constituents, including society-at-large and at the same time guiding the long-term development and prospects of companies. Executives, shareholders and other companies' stakeholders may well benefit from data that highlights the advantages and disadvantages of board practices as part of their corporate strategies and involvement.

2 LITERATURE REVIEW

2.1 CORPORATE GOVERNANCE: DEFINITION, MODELS AND THEORIES

The definition of corporate governance can be focussed mainly on two aspects; one emphasis is on the shareholders of the corporation; another is on the stakeholders.

The definition from the shareholders' perspective by Shleifer and Vishny (1997, 737) identifies that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment". Denis and McConnell (2003, 2) define corporate governance as "a set of mechanisms—both institutional and market-based—that induce the self-interested controllers of a company (those that make decisions regarding how the company will be operated) to make decisions that maximize the value of the company to its owners (the suppliers of the capital)". However, the definition from the shareholders' perspective is argued to be narrow and only focussed on management and shareholders' legal relations (Mason and O'Mahony, 2008). Thus, a wider scope for the definition of corporate governance, one that captures not only the shareholders' return on investment as a concern towards the stakeholders, is that of the OECD (2004, 11) which explicitly refers to corporate governance as "involving a set of relationships between a company's management, its board, its shareholders and other stakeholders".

Concerning models of corporate governance, currently there are two major models for governing companies across different countries around the globe; one is the market model and the other is the control model. Lane et al. (2006) contrasted the characteristics of the two models, as shown in Table 1.

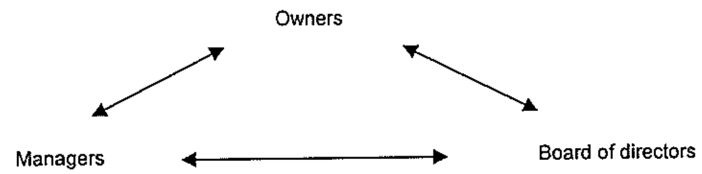
TABLE 1: CHARACTERISTICS OF THE MARKET AND CONTROL MODELS

Market Model	Control Model
Setting • Prevalent in UK, USA • More reliance on public markets • High ownership liquidity • Shareholders are anonymous investors, not managers • Widely dispersed shareholders • Shareholders only have financial connections to the company Elements of governance • High level of disclosure • Focus on short-term strategy • Independent board members • Shareholders view company as one of many assets held • Ownership and management are separate and at arm's length	Setting • Prevalent in continental Europe, Asia and Latin America • More reliance on private capital • Illiquid ownership • Concentrated shareholders base often overshadows minority shareholders • Shareholders view company as more than an asset and as interested in financial and non-financial returns Element of governance • Secretive • Focus on long-term strategy • Shareholders with control rights in excess of cash flow rights • Shareholders have connections to the company other than financial (i.e. managers, board members, family) • Insider board members • Ownership and management overlap significantly

Source: Lane et al. (2006, 149)

Regardless of the distinct models mentioned, Lorsch and MacIver (2004) and Clarke (1998) argued that the basic relationship among three groups needs to be realised (see Figure 1) and there are agency, managerial hegemony, resource dependence, institutional, network governance, stewardship and stakeholder theories explaining the development of corporate governance (Eisenhardt, 1989; Mace, 1971; Pfeffer and Salancik, 2003; Fiss, 2008; Jones et al., 2004; Davis et al., 1997; Freeman and Evan, 1990).

FIGURE 1: A MODEL OF CORPORATE GOVERNANCE



Source: Clarke (1998, 60)

Hilb (2006) proposed theories encompassing perspectives from the corporate governance systems across different countries are ranged not only from agency or shareholder and stakeholder theories, but also include shareholder/stakeholder and firm-interest theories. Another emergent view promoting the theory that guides boardroom practices that can be applicable to the corporate governance systems around the world is the global corporate governance theory introduced by Carver (2010).

2.2 ROLES OF BOARD OF DIRECTORS

In corresponding to the main theories on corporate governance, the roles of boards of directors can be explained in the following aspects.

The role of boards of directors, according to the agency theory, is to ensure that top management teams are working to their best interests in line with the shareholders' interests or the interests of the suppliers of capital. Jensen and Meckling (1976) proposed that the boards have responsibilities in controlling and monitoring existing company policies, proposing as well as adopting new policies and playing a crucial role in hiring, firing and compensating top managers. Davis (1991) suggested that the boards of directors, according to the agency theory, are also to monitor the decision-making performance of top management teams.

As for the managerial hegemony, Mace (1971) explained the role of the boards of directors as being passive and acting as 'an ornament on the Christmas tree'. There is no connection between the nominated and actual roles of the boards of directors. Management rules the company and the role of the board is to simply act as a rubber stamp or a watchdog for management actions and initiatives (Hilmer and Donaldson, 1996). An example of the managerial hegemony theory is the CEO's influence on his/her compensation on the board (Kalyta, 2008).

Referring to the boards of directors from the resource dependence theory, normally interlocking directorates' roles are mentioned (Kosnik, 1987). Interlocking directors are known to provide cooptation and control roles such as those that are found in Japanese corporations (Pfeffer and Salancik, 2003; Gerlach et al., 1992); they offer the coordination role (Maman, 1999), provide the control role such as that among family-owned companies (Mok et al., 1992), provide the legitimacy role (Mizruchi, 1996) and are a source of inter-organisational information concerning business practices that can influence other boards' and companies' behaviours (Davis, 1991; Haunschild and Beckman, 1998). Another example of the role of board members under the resource dependence theory is that of resource dependence (Johnson et al., 1996) such as appointing ex-politicians on boards of directors linking corporations with governments in order to provide necessary information and access to the corporations' focus (Hillman, 2005).

The 'institutional' perspective places a great 'emphasis on environmental norms and the weight of a company's history in explaining organisational norms and actions' (Judge and Zeithaml 1992, 769). The three pillars under the institutional theory are regulative, normative and cultural-cognitive (Scott, 2008). Therefore, the role of boards of directors is to comply with those constraints such as laws, regulations and accepted norms in the society. An example of the roles of boards of directors under this institutional aspect includes appointing board members who have political backgrounds providing a window-dressing role as regulations are changed (Helland and Sykuta, 2004).

Jones et al. (2004, 160) proposed that the network governance is defined as 'a select, persistent and structured set of autonomous companies (as well as non-profit agencies) engaged in creating products or services based on implicit and open-ended contracts to adapt to environmental contingencies and to coordinate and safeguard exchanges'. Provan and Kenis (2007) commented that autonomous companies or organisations are working towards the common, collective goal. The roles of boards of directors under the network governance theory include the team member role whereby the defined roles of each board member are clearly defined and match board members' abilities; they are accepted on the board in order to help accomplish specific company projects that are interconnected with other companies (Albert and Fetzer, 2005). Another role is the strategic role of board members for the different types of networking among corporations; e.g., Japanese Keiretsu, Korean Chaebol and Chinese business networks (Heracleous and Murray, 2001).

It is expected that under stewardship theory, the interests of top management teams and those of shareholders are aligned (Davis et al., 1997). Therefore, the role of boards of directors is to oversee the company's policies and strategies developed by the company's management team (Hilmer and Donaldson, 1996). In addition, the boards of directors have service and advisory roles (Sundaramurthy and Lewis, 2003).

In contrast to agency theory, the role of boards of directors according to the stakeholder theory is to ensure that the interests of the top management team are in line with those of the company's stakeholders (Clarke, 2007). In other words, boards are accountable not only to shareholders, but also to all stakeholders related to the company. The suggested roles accordingly to the stakeholder perspective are the control, service and strategic roles (Huse and Rindova, 2001; Christensen and Westenholz, 2000).

Nonetheless, to date, the general standard accepted roles or functions of the board of directors in the literature are monitoring, resource dependence and service as well as advisory roles (Langevoot, 2001).

2.3 BOARD OF DIRECTORS AND CORPORATE PERFORMANCE

It is noted that a common goal of corporate governance theories is to find a link between the board's characteristics and corporate performance (Kiel and Nicholson, 2003). The majority of previous studies on boards of directors and their impact on corporate performance have been based largely on the so-called 'four usual suspects' (Finkelstein and Mooney, 2003). The four usual suspects are the number of independent directors on the board, the ratio of inside and outside directors on the board, the CEO/Chairman duality and the director ownership in the companies. However, so far, there is no conclusive evidence on the association between the four usual suspects and firm performance (Abdullah, 2004; Bhagat and Black, 2002: Dalton et al., 1998; Dalton et al., 2003: Elsayed, 2007; Lam and Lee, 2008; Rhodes et al., 2000). Moreover, Finegold et al. (2007) reviewed the studies from 1989 to 2005 and reported that, in relation to corporate performance, studies based on corporate board structure and composition have produced mixed results.

2.4 INTRODUCTION OF THE BOARD TASKS

Outputs from the corporate board of directors are cognitive in nature and directly influenced by task performance (Forbes and Milliken, 1999). The control and service tasks include decisions concerning hiring or replacing senior managers, approval of initiatives from the management, providing expert opinions, and analysing strategic options (Forbes and Milliken, 1999). Other functions include making sure that the activities of companies and financial conditions are reported to shareholders accurately (Kim and Nofsinger, 2007).

2.5 CONTEXT OF THE STUDY: THAILAND

After the financial crisis in 1997, Thailand adopted corporate governance reforms following the same logic as *agency theory*. Corporate governance in Thailand, according to the Stock Exchange of Thailand, for a publicly-listed company is defined as "a set of structural and process relationships between the company's management, its board and its shareholders to enhance its competitiveness towards business prosperity and *long-term shareholder value* by taking into consideration the interests of other stakeholders" (SET 2001, 4, italics added). In terms of the composition of the board, the Thai board of directors is comprised of executive directors involved in the company's management and non-executive directors such as independent and external directors (SET, 2009) who have no management function in the company and may or may not sit independently on the board (SEC, 2007a). The role of each director is jointly to think and be responsible for the operation of the company in order to ensure that the interests of the shareholders are best served (SEC, 2007b).

As for the corporate ownership structure in Thailand, Claessens et al. (2000) found that there is no separation between the ownership and the management of the companies. Thai corporations remain family-owned or highly concentrated prior- and post-crisis whereby many of the family-run corporations survived the crisis in 1997 (La Porta et al., 1998; Wiwattanakantang, 2001; Yabushita, 2006). As part of the Thai way of governing corporations, Peng et al. (2001) noted that board ties or interlocking directorships existed among the Thai multinationals even before the crisis. Also, it was confirmed that board ties still continued to exist after the financial crisis, especially among the Thai family businesses (Suehiro and Wailerdsak, 2004).

3 RESEARCH METHOD

3.1 QUANTITATIVE APPROACH

Up to the present, when conducting business research there are three approaches for resolving research issues; they are quantitative, qualitative and mixed methods approaches (Bryman and Bell, 2007). Regardless of the research problems, the focus of choosing an appropriate approach depends on the research questions (Creswell, 2003). Therefore, the current study employed the quantitative approach based on the fact that the research question sought to identify the functional roles of Thai directors that are related to directors' emphases on corporate performance criteria. Moreover, the current study was guided by theories developed in previous literature; therefore, the quantitative approach was considered most appropriate.

3.2 QUANTITATIVE RESEARCH DESIGN

The current study employed the survey method for two reasons. One reason was in order to measure the degree of directors' role involvement in corporate performance criteria as perceived by respondents in response to the research objectives (de Leeux et al., 2008). The second reason was that the survey method was used to identify trends in attitudes, opinions and behaviours of a large group of people (Creswell, 2008). The sample of population comprised directors in all types of corporations listed on the Stock Exchange of Thailand (SET). The random sampling scheme was used to ensure the representativeness of the population (Onwuegbuzie and Leech, 2007); therefore, a simple sampling technique was selected whereby all directors had an equal opportunity and independent chance of being chosen (Onwuegbuzie and Collins, 2007).

3.3 QUESTIONNAIRE CONSTRUCTION AND VALIDITY ISSUE

The two basic forms of data collection under the survey method are interviews and self-administrative questionnaires (de Leeux, 2008). The current study employed a questionnaire instrument with closed-ended questions.

Two common steps in questionnaire construction are first to identify the concepts involved in the research questions, followed by the formulation of specific questions for analysis (Bradburn et al., 2004). The key concepts in the current study were the tasks and roles of Thai directors as well as corporate performance criteria. The operational concepts and indicators related to the key ideas mentioned were found in the previous literature and some instrument items were borrowed from studies conducted by Wan and Ong (2005) on the board process, structure and performance among Singapore-listed firms and by McNulty and Pettigrew (1999) concerning the strategic involvement of being directors for the companies.

The Likert-type scale has been described as useful to measure attitudes (Cooksey, 2007), which in the current study were the attitudes of board members towards their company's performance criteria; a uni-polar dimension was used in the Likert-type scale design for measuring the different degree of the same attributes of concepts (Schwarz, 1999) put forward in the current study. The five-point Likert-type scale was used for measuring the attitudes of board members towards their company's performance criteria (ranging from 0 = Not relevant to 4 = Critical) and the six-point Likert type scale was used for measuring the attitudes of board members towards their involvement in defined roles and the importance directors placed on each task (ranging from 0 = Not important to 5 = Extremely important).

In terms of the demographic variables, participants reported on their gender (male or female), age (ranging from below 30 to above 60), their educational background, their highest level of education, the location of the highest degree obtained, the company's industrial background, the best described current position of the board member, completed years of employment and experiences as a director. The participants also reported on corporate performance criteria used by their companies. Ong and Lee (2000) commented that the corporate performance criteria should not be limited to the financial or accounting-based aspect only; therefore the current study loosely included the accounting-based (i.e., return on assets and return on investment), market-based (i.e. market-to-book ratio) and other non-financial corporate performance criteria (i.e. growth rate in domestic or international market or research and development) in the questionnaire. Apart from identifying the roles of board members (i.e. strategic, monitoring and service as well as advisory roles) that are related to corporate performance criteria, the current study also measured board members' attitudes towards their importance placed on various tasks such as working with the CEO in developing the strategic plan (as part of the strategic role), evaluating performance of the top executives (as part of the monitoring role) and providing advice as well as counsel to top managers (as part of the service and advisory roles). Other variables such as the chairmanship and the percentage of the director ownership in the company from an input-output model were also added.

Before the questionnaires were distributed, a number of discipline area experts with both academic and practitioner backgrounds were recruited in order to provide feedback to or validate the developed instrument (Campanelli, 2008). Apart from completing the questionnaires, experts were required to provide suggestions on the content and the format of the instrument. Amendments regarding the choice of words and the labelling of the scales were made accordingly before the distribution to the research participants. Since the current study focussed on individual directors of companies listed on the Stock Exchange of Thailand, the questionnaires were mailed to the Chairmen of the 400 publicly-listed companies on the Stock Exchange of Thailand, as the Chairmen were considered to be the senior officers of the board (Garratt, 1999), in order for the Chairmen to complete one questionnaire and to further distribute to the respective companies' directors accordingly.

4 RESULTS AND ANALYSIS

4.1 SURVEY DATA AND ANALYSIS

In Thailand, 195 directors completed the questionnaires. Out of the 195 directors, 160 or 82.1% were males. In this regard, it can be inferred that female directors are still considered to be a minority at the top-tier level of corporations (Wailerdsak, 2009). When considering the ages of board members, they were mainly in their 50s or above (77.5%). There were only 44 or 20.5% directors whose age was below 50. Only 4 or 1.2% directors were 30 years old or below. In terms of directors' educational background, the data showed that the number of directors holding masters' and doctoral degrees in Thailand is 130 (approximately 67%) out of 194 directors. The result suggests that Thai boards place their importance on directors who have high degrees.

Directors' interests in academic subjects are found to be those traditional business-related topics such as management, economics, finance and accounting. Also, the data demonstrated interest in areas related specifically to the business of the companies such as medical science for health care or communication arts for media and publishing companies. Other non-business related disciplines found among directors in Thailand included military education, public policy and social science. However, the study of law can be considered as useful formally such as in law firms or informally such as a support service in companies. A law background was identified as common for members of Thai boards. Furthermore, it was found that 27.7% of Thai directors obtained their highest degree from abroad. Therefore, it can be inferred that graduating from abroad is recognised as important for Thai corporate boards.

When looking at the number of members on the boards in Thailand, the size is quite even. The most frequent upper limit is 15 directors and the most dominant board numbers lie between 9 and 15. The highest number of Thai board members from data collected is 17. The number of research participants who are Chairmen was 40. In this regard, Chairmen who responded to the questionnaires can be the Chair of the corporate board, the executive committee or the audit committee. When considering the structure and composition of Thai boards, the current study found that they are comprised of executive, non-executive and other types of directors. The executive directors can be Chief Executive Officers (CEOs), Presidents, Managing Directors, Chief Finance Officers (CFOs) or other types of executive directors such as department managers or editor-in-chief for the media and the publishing companies. The other types of director or so-called a non-executive director are those independent directors who are from audit committees or are consultants for the companies. In this regard, it should be noted that the position called 'Director' in the data collected can be a non-executive or executive director. Concerning the director ownership in the companies, the most dominant situation is that, largely, board members in Thailand have no shares in their companies. The results derive from the compliance of the rule for the publicly listed companies put forth by the Stock Exchange of Thailand indicating that independent directors cannot hold shares of more than 1% of total voting rights of the company and the company's related entities such as a parent or subsidiary company (SET, 2009).

4.2 REPORT ON FINDINGS

Having reported on the demographic data and other directors' attributes in the pervious section, the following section is used to report findings from data analysis.

The first finding results from the mean scores ($\bar{X}$) of the five-point and six-point Likert rating scale types for measuring the perceptions of board members towards three aspects. The first aspect is the directors' perception towards the importance placed on corporate performance criteria for their companies. The second aspect is directors' perception of their tasks and the third aspect is directors' perception of their involvement in defined functional roles: strategic, monitoring, service as well as advisory roles. The results of the mean scores with the maximum score being four, the order of the priorities of corporate performance criteria as perceived by directors are as shown in Table 2.

TABLE 2: THE PRIORITIES OF THAI CORPORATE PERFORMANCE CRITERIA

Corporate Performance Criteria	Mean^{a} ($\bar{X}$)
Net Profit	3.72
Operating Performance	3.71
Net Income	3.66
ROE	3.59
ROI	3.55
Sales	3.52
Earnings Per Share	3.51
ROA	3.41
ROS	3.37
Growth Rate in Domestic Market	3.36

TABLE 2: THE PRIORITIES OF CORPORATE THAI PERFORMANCE CRITERIA

Corporate Performance Criteria	Mean[a] ($\bar{X}$)
Market Share	3.21
Progress in Research and Development	3.19
Market to Book Value Ratio	3.09
Position in relation to Industry Avg Performance	3.04
Increase in Financial Capital	3.01
Employee Turnover	2.98
Long-term Debt	2.87
Lending Growth	2.81
Growth Rate in International Market	2.65

The net profit and the operating performance are ranked highest and second to highest ($\bar{X}$ = 3.72 and $\bar{X}$ = 3.71), respectively from the directors' viewpoints in Thailand. The lowest criterion is the growth rate in the international market ($\bar{X}$ = 2.65).

Turning to the viewpoints of directors towards the importance they place on their tasks, directors on Thai company boards showed their highest interest in 'debate the strategic plan' task for the companies ($\bar{X}$ = 4.55) as shown in Table 3 and the lowest interest is in the 'evaluation of other board members task ($\bar{X}$ = 3.71) as shown in Table 4.

TABLE 3: THE TOP-FIVE PRIORITIES OF THAI DIRECTORS' TASKS

Board Member Tasks	Mean[a] ($\bar{X}$)
Debate strategic plan	4.55
Evaluate annually the company's strategic direction	4.54
Conform to the regulations	4.54
Assist in formulating the company vision and mission	4.52
Assist in formulating the company policy	4.49

[a]Maximum score is five.

Apart from the 'debating the strategic plan' task, Table 3 showed the remaining four tasks listed on the top-five priorities list on which directors on the company boards in Thailand focussed. The tasks included 'evaluate annually the company's strategic direction', 'conform to the regulations', 'assist in formulating the company vision and mission' and 'assist in formulating the company policy' tasks.

Table 4 showed the five tasks that were listed as least important among the other tasks; they are 'engage in planning for top manager (besides CEO) succession', 'provide relevant contacts to the company', 'help the management team prepare the capital investment proposals', 'serve as a link to government agencies' and 'evaluate other board members' tasks.

TABLE 4: THE BOTTOM-FIVE PRIORITIES OF DIRECTORS' TASKS IN THAILAND

Board Member Tasks	Mean[a] ($\bar{X}$)
Engage in planning for top manager (besides CEO) succession	3.52
Provide relevant contacts to the company	3.34
Help the management team prepare the capital investment proposals	3.31
Serve as a link to government agencies	3.21
Evaluate other board members	3.19

[a]Maximum score is five.

As for directors' involvement in defined functional roles, the strategic role is ranked highest ($\bar{X}$ = 4.65) followed by the monitoring role ($\bar{X}$ = 4.45) and the service, including advisory roles ($\bar{X}$ = 2.46).

Having explored the perceived order of priorities of importance on tasks and corporate performance criteria and also directors' involvement in specific roles for companies, correlation and multiple regression analyses were conducted in order to help understand better the relationships between the pairs of different concepts. The relationships included those between the type and the tasks of directors, directors' tasks and attributes, directors' attributes and corporate performance criteria, directors' tasks and roles, and directors' roles and company performance criteria. The results showed that the type of directors is significantly related to 'age', business-related educational background', the level of education' and 'ownership of director in the company'. The Pearson Chi-square Sig. equal to 0.000 illustrated that, out of 181 Thai directors, the most dominant group of outside directors is at the age of 60 or above (22.1%) followed by the 50-59 age group (14.4%). However, the least age group of directors is of 40 or below (7.7%). Furthermore, the age distribution of inside directors differs substantially from that of the outside directors where the lowest proportion of the dominant age group of inside directors is between 50 and 59 years old (19.9%) and the least dominant age group is over 60 year old of age (7.7%). As for the interlocking directors' age group, the pattern resembled the results of the outside directors. However, the number of respondents was less; therefore, the percentage was less (1.1% for least dominant group that is around 40 years old or lower and 6.6% for the most dominant age group at the age of 60 or above).

When looking at directors' educational background, the Thai pattern is similar between that of the outside and inside directors. The majority of outside directors (74.7%) and inside directors (89.5%) out of 180 directors have a business-related or functional background in the industry where the companies operate. Although the number of interlocking directors responding to the questionnaire was less, the result of the data analysis also showed that interlocking directors did possess the business-related or functional education background to the companies they sit on and with which they are interlocked. However, among the three types of directors, inside directors possessed non-business related educational background (10.5%) less than the outside directors (25.3%). Also, the proportion of interlocking directors who possessed the non-business related educational background was 4.3% or approximately 8 directors.

In terms of the level of education, 34 outside directors (18.9%) of the 180 Thai directors obtained their master's degrees other than in Business Administration followed by the degree at the bachelor level (21 or 11.7%) and then at the doctor of philosophy level (16 or 8.9%). As for the inside directors, the largest group (28 or 15.6%) obtained their bachelor level and 27 directors (or 15%) obtained their master's degree in Business Administration. The master's degree in fields other than in Business Administration (15 or 8.2%) and the doctor of philosophy degree (6 or 3.3%) were obtained less by inside directors. The pattern of educational level distribution of interlocking directors is slightly similar to that of the outside directors whereby 6 interlocking directors (3.3%) obtained their master's degree in fields other than in Business Administration and 6 (or 3.3%) more interlocking directors obtained their doctoral degree. The master's degree in Business Administration was obtained less by the interlocking directors (4 or 2.2%).

Concerning the director's ownership in the company, the majority of outside directors in Thailand (51 or 30.9%) out of 165 directors have no ownership in their companies whereas inside directors in Thailand (44 or 31.9%) have ownership in their companies. The pattern of ownership in the company by interlocking directors is similar to that of outside directors whereby 13 or 7.9% interlocking directors have no ownership in their companies. However, because the sample size is rather small, the number shown may be biased.

A one-way analysis of variance or one-way ANOVA was used to find which directors' tasks are associated with particular type of director. The results of the Levene's test and the Kruskal-Wallis test were also reported. Out of the thirty-five tasks in total, seven tasks were statistically significant related to the type of director regardless of outside, inside or interlocking directors (as shown in Table 5).

TABLE 5: RELATIONSHIP BETWEEN TYPE OF DIRECTOR AND PERCEIVED IMPORTANCE OF DIRECTOR TASKS

Tasks	Levene's test Sig.	ANOVA Test F Sig.	Kruskal-Wallis Test Sig.	Conclusion
Work well with the CEO in developing the strategic plan	0.002	0.004	0.003	Significant
Design company strategies	0.490	0.044	-	Significant
Help the management team prepare the capital investment proposals	0.003	0.001	0.003	Significant
Engage in planning for CEO succession	0.000	0.003	0.014	Significant
Provide opinion independently from other board members	0.692	0.026	-	Significant
Be influential/Enhance the status of the company in the community/society	0.880	0.041	-	Significant
Conform to the regulations	0.000	0.002	0.009	Significant

Tasks that are associated significantly with the type of directors are 'work well with the CEO in developing the strategic plan', 'design company strategies', 'help the management team prepare the capital investment proposals', 'engage in planning for CEO succession', 'provide opinion independently from other board members', 'be influential/enhance the status of the company in the community/society' and 'conform to the regulations'.

Whether the director is an outside, inside or interlocking director, in analysing the association between directors' attributes and directors' tasks, two statistical methods were employed. Those methods are the one-way ANOVA and Spearman's rho correlation. The one-way ANOVA was used with variables such as gender, the business-related educational background, the location of the highest education obtained and the chairmanship attributes. Spearman's rho was employed with variables such as age, the level of education, the number of the board members, the directors' ownership in the company, the years being a director as well as working in the industry. The results showed that out of all directors attributes mentioned, the number of board members and the level of education are the dominant attributes in Thailand. It is hard to find any task not associated with the two attributes.

The lists of the top-five tasks that are associated with the level of education and the number of board members are showed in Table 6 and Table 7.

TABLE 6: A RESULT OF CORRELATION ANALYSIS OF THE LEVEL OF EDUCATION AND DIRECTOR TASKS

Analysis	Tasks		Level of Education
Spearman's rho	Evaluate corporate performance in relation to industry benchmarks	Correl. Coeffi. Sig. (2-tailed)	.223** .002
	Evaluate the board performance as a whole unit	Correl. Coeffi. Sig. (2-tailed)	.220** .002
	Serve as a link to government agencies	Correl. Coeffi. Sig. (2-tailed)	.245** .001
	Balance interests of stakeholders	Correl. Coeffi. Sig. (2-tailed)	.241** .001
	Be influential/Enhance the status of the company in the community or society	Correl. Coeffi. Sig. (2-tailed)	.239** .001

*Correlation is significant at the 0.05 level (2-tailed)
**Correlation is significant at the 0.01 level (2-tailed)

TABLE 7: A RESULT OF CORRELATION ANALYSIS OF THE NUMBER OF BOARD MEMBERS AND DIRECTOR TASKS

Analysis	Tasks		No. of Board Members
Spearman's rho	Provide relevant contacts to the company	Correl. Coeffi. Sig. (2-tailed)	.412** .000
	Promote goodwill by supporting stakeholders	Correl. Coeffi. Sig. (2-tailed)	.360** .000
	Ensure communications with stakeholders/public are effective	Correl. Coeffi. Sig. (2-tailed)	.279** .000
	Balance interests of stakeholders	Correl. Coeffi. Sig. (2-tailed)	.258** .000
	Be influential/Enhance the status of the company in the community or society	Correl. Coeffi. Sig. (2-tailed)	.255** .000
	Conform to the regulations	Correl. Coeffi. Sig. (2-tailed)	-

*Correlation is significant at the 0.05 level (2-tailed)
**Correlation is significant at the 0.01 level (2-tailed)

In this regard, the results on the relationship between the number of board members and directors' tasks in Thailand indicated that the more people on the board, the more likely it is that almost every task is seen as important. The strongest task is 'provide relevant contacts to the company' (Correlation Coefficient = 0.412 at the 0.01 Sig. level two). The interpretation regarding the result on the associated relationship between the level of education and directors task is similar to that between the number of board members and directors' tasks.

The methods used to explore the relationship between directors' attributes and corporate performance criteria are similar to those used to find the relationship between directors' attributes and directors' tasks. The results showed that the gender variable has no significant relationship with any particular corporate performance criteria and the reason may be due to the fact that the number of female board members is low; therefore, the concept may require further study. Concerning the age of the director, the results illustrated that the older the board member, the more importance is placed on certain company performance criteria such as 'lending growth' (Correlation Coefficient = 0.146 at the 0.05 Sig. level two-tailed) and the 'return on assets' (Correlation Coefficient = 0167 at the 0.05 Sig. level two-tailed). The educational background that is traditionally or functionally related specifically to the company business has a positive influence on criteria such as the 'market-to-book value' (ANOVA Sig. = 0.007) and the 'position of the companies in relation to the industry average benchmark' (ANOVA Sig. = 0.027). The number of board members, however, has a negative relationship with 'sales' (Correlation Coefficient = -0.160 at the 0.05 Sig. level two-tailed) and has a positive relationship with 'employee turnover' (Correlation Coefficient = 0.155 at the 0.05 Sig. level two tailed). The chairmanship of the company board tends not to be related to any corporate performance criteria in particular. Nevertheless, the result may be due to incidental characteristics of the sample. In terms of the level of education, the result yielded quite a number relationship ideas to the corporate performance criteria such as the 'return on assets' (Correlation Coefficient = 0.170 at the 0.05 Sig. level two-tailed), the 'long-term debt' (Correlation Coefficient = 0.266 at the 0.01 Sig. level two-tailed), and the 'progress in research and development or R&D' (Correlation Coefficient = 0.243 at the 0.01 Sig. level two-tailed). The positive relationship between the level of education and the corporate performance criteria meant that when the level of education increases and the qualification becomes higher, directors may have a stronger interest in a particular criterion such as those mentioned earlier.

When considering finding the relationship between directors' tasks and their defined functional roles, multiple regression analysis was performed; the results showed the strategic role comprised of the 'debate on the company's strategic plan', the 'evaluation annually of the company's strategic direction', the 'assistance of the board members in formulating the company vision and mission', the 'evaluation of the top executives' performance' and the 'respond to the top management team's request for board assistance' tasks. The model has an R square of 0.381 and adjusted R Square of 0.361, which means that the model accounted for 36% of the strategic role in Thailand as predicted by the five aforementioned tasks. In this regard, the standardised regression coefficients showed that the 'evaluation annually of the company's strategic direction is the most powerful predictor in helping predict the strategic role of directors in Thailand (Beta = 0.240 and Coefficient Sig. = 0.001). Pertaining to the monitoring role, the model that has an R square equal to 0.453 and the adjusted R square of 0.432 produced six tasks of directors; viz., 'providing advice and counsel to top managers', the 'debate on the strategic plan', 'ensuring of communications with stakeholders/public being effective', the 'evaluation of performance of top executives', 'monitoring the environment trends that are all relevant to the company's success and survival' and 'critique the capital investment proposal of the top management team'. Most tasks are roughly equal in their importance for the monitoring role as shown by the Beta values. The results of the service and advisory roles showed five tasks; they are 'providing advice and counsel to top managers', 'influence the CEO selection', 'debate on the company's strategic plan', 'helping the management team prepare the capital investment proposals' and 'promoting goodwill by supporting stakeholders'. In this regard, the model accounted for 39% of variation and the most powerful task in helping predict the service and advisory roles is 'providing advice and counsel to top managers' (Beta = 0.428 and Coefficient Sig. = 0.000).

The multiple regression analysis was also performed to find the relationship between directors' defined roles and corporate performance criteria. The result showed that the majority of the corporate performance criteria are sensitive to the monitoring role of Thai directors; criteria are such as 'return on assets', 'return on equity', 'return on sales', 'return on investment', 'net profit', 'long-term debt' and 'increase in financial capital'. The conclusion from the analysis suggests that directors in Thailand specialise in the monitoring aspect. When the result on the relationship between directors' roles and corporate performance indicated that the majority of company performance criteria are only sensitive to the monitoring role of directors, correlation analysis was conducted on the relationship between directors' tasks and corporate performance criteria in order to test whether the result on the relationship between two concepts would be different. Spearman's rho correlation analysis revealed that nearly all tasks of directors are associated with corporate performance criteria. The implication can be that directors in Thailand possess a balanced view of the importance placed on company performance criteria. Therefore, exploratory factor analyses, by means of principal component analyses, on directors' tasks and company performance criteria were performed separately and then the Pearson correlation analysis was tested upon the results of the exploratory factor analyses in order to examine their relationship.

Directors' tasks could be further subdivided into six groups of related tasks. The result of the factor loadings of director tasks for Thailand is as shown in Tables 8A and 8B.

TABLE 8A: FACTOR LOADINGS FOR TASKS OF THAI DIRECTORS

Rotated Component Matrix[a,b]

Corporate Performance Criteria	Component					
	1	2	3	4	5	6
Review corporate performance against strategic plan	.786	.008	.120	.095	.137	.084
Critique the capital investment proposals of the top management team	.754	.031	.129	.127	.020	.097
Compare budget allocation with corporate performance	.707	-.113	.142	.037	.064	.199
Evaluate performance of top executives	.706	.252	.088	.073	.015	-.275
Use an internal mechanism to evaluate top management performance	.689	.183	-.002	.162	.144	-.212
Review financial information to identify important trends and issues	.679	.071	-.073	.082	.265	.078
Monitor top management in decision-making	.666	.064	.030	.225	.118	.153
Oversee the plans for acquiring more resources and capital for the company	.652	.028	.193	.142	.191	.323

[a]Extraction Method: Principal Component Analysis.
[b]Rotation Method: Varimax with Kaiser Normalization.

The first group of related tasks or the 'company evaluation and monitoring' component, comprises tasks that are related to the control, evaluation and the compliance functions to the institution such as 'review corporate performance against strategic plan', 'evaluate performance of top executives', and 'conform to the regulations' (Table 8A). The second component or the 'internal evaluation' factor is composed of items such as 'engage in planning for CEO succession', 'evaluate other board members' and 'evaluate the board performance as a whole unit' (Table 8B).

Table 8B: Factor Loadings for Tasks of Directors in Thailand (Continued)

Rotated Component Matrix[a,b]						
Corporate Performance Criteria	Component					
	1	2	3	4	5	6
Monitor environment trends that are all relevant to the company's success and survival	.620	.009	.282	.171	.152	.013
Evaluate annually the company's strategic direction	**.617**	**.109**	**.237**	**.050**	**.014**	**.163**
Evaluate corporate performance in relation to industry benchmarks	.615	.179	.012	.215	.243	.076
Conform to the regulations	**.581**	**.122**	**-.013**	**.087**	**.296**	**-.170**
Debate strategic plan	.528	.051	.514	.045	.149	-.253
Monitor implemented company strategies	**.486**	**.159**	**.367**	**-.028**	**.278**	**-.304**
Influence the selection of the CEO	.008	.848	.143	.047	.057	.072
Engage in planning for CEO succession	**.128**	**.846**	**.118**	**.006**	**.145**	**-.096**
Engage in planning for top managers (besides CEO) succession	.122	.819	.123	.089	.037	.173
Evaluate the board performance as a whole unit	**.097**	**.806**	**.272**	**.086**	**.069**	**.025**
Evaluate other board members	.047	.749	.191	.271	-.111	.210
Respond to the top management team's request for board assistance	**.224**	**.513**	**.089**	**.481**	**.086**	**.089**
Assist in formulating the company policy	.134	.163	.827	.022	.163	.039
Assist in formulating the company vision and mission	**.300**	**.238**	**.700**	**.119**	**.051**	**-.242**
Design company strategies	.114	.351	.696	.058	.074	.286
Work with the CEO in developing the strategic plan	**.053**	**.301**	**.633**	**.071**	**-.131**	**.297**
Provide relevant contacts to the company	.081	.156	.102	.746	.203	.212
Serve as a link to government agencies	**-.005**	**.353**	**.088**	**.724**	**-.035**	**.197**
Provide alternative viewpoints	.367	-.051	.064	.706	.124	-.128
Provide opinions independently from other board members	**.341**	**.008**	**-.133**	**.590**	**.309**	**.040**
Provide advice and counsel to top managers	.503	.134	.123	.588	.028	-.206
Balance interests of stakeholders	**.387**	**.022**	**.097**	**.168**	**.794**	**-.044**
Ensure communications with stakeholders/public are effective	.402	-.011	.049	.131	.784	.026
Promote Goodwill by supporting stakeholders	**.007**	**.434**	**.082**	**.069**	**.684**	**.226**
Be influential/Enhance the status of the company in the community or society	.437	-.052	.156	.293	.580	.022
Help the management team prepare the capital investment proposals	**.096**	**.349**	**.316**	**.145**	**.023**	**.715**
Acquire information showing the progress of corporate performance	.332	.266	-.100	.116	.198	.589

[a]Extraction Method: Principal Component Analysis.
[b]Rotation Method: Varimax with Kaiser Normalization.

Pertaining to the third component or a so-called 'involvement in strategic development' factor, it includes items such as 'assist in formulating the company policy', 'design company strategies', and 'work with the CEO in developing the strategic plan' (Table 8B). The fourth, the fifth, and the sixth components are named respectively 'independent input', 'stakeholders' interests', and 'board management interaction' factors. The 'independent input' component includes items such as 'provide relevant contacts to the company' and 'provide alternative viewpoints' (Table 8B). The fifth and the sixth components include items such as 'balance interests of stakeholders' (Table 8B) and 'help the management team prepare the capital investment proposals' (Table 8B).

In the case of corporate performance criteria, all criteria could be further grouped into four separate components. The first factor or 'the long-term capital performance' comprises items such as 'long-term debt', 'lending growth', and 'growth rate in international market'. 'ROE', 'ROA' and 'ROI' are items that are part of the second component or 'accounting-based measures'. The third or 'short-term and competitiveness' factor and the fourth or 'sales-oriented' factor are composed of items such as 'net profit' and 'sales', respectively.

When Pearson correlation was conducted on the task and the corporate performance criteria factors, the result is as shown in Table 9. The results showed that the importance placed on 'long-term capital performance (Pearson correlation = 0.464 at the Sig. level of 0.01), 'short-term and competitiveness' (Pearson correlation = 0.409 at the Sig. level of 0.01), and to a lesser extent on 'accounting-based measures' (Pearson correlation = 0.298 at the Sig. level of 0.01) were significantly and moderately related to the importance placed on 'company evaluation and monitoring' task factor.

TABLE 9: PEARSON CORRELATION OF THAI DIRECTOR TASK FACTORS AND CORPORATE PERFORMANCE CRITERIA FACTORS

Associated Corporate Performance Factors / Associated Task Factors		Long-term capital performance	Accounting-based	Short-term and competitiveness	Sales-oriented
Company evaluation and monitoring factor	Pearson correlation	**0.464****	**0.298****	**0.409****	0.054
	Sig. (2-tailed)	**0.000**	**0.000**	**0.000**	0.493
Internal evaluation factor	Pearson correlation	0.042	-0.036	0.017	-0.130
	Sig. (2-tailed)	0.594	0.646	0.826	0.100
Involvement in strategic development factor	Pearson correlation	-0.097	0.030	0.146	0.035
	Sig. (2-tailed)	0.220	0.706	0.064	0.661
Independent input factor	Pearson correlation	**0.212****	0.079	-0.092	0.077
	Sig. (2-tailed)	**0.007**	0.315	0.245	0.333
Stakeholders' interests	Pearson correlation	**0.266****	0.032	**0.221****	**-0.160***
	Sig. (2-tailed)	**0.001**	0.687	**0.005**	**0.043**
Board management interaction	Pearson correlation	0.079	**-0.206****	-0.052	**0.157***
	Sig. (2-tailed)	0.315	**0.009**	0.509	**0.046**

** Correlation is significant at the 0.01 level (2-tailed)
* Correlation is significant at the 0.05 level (2-tailed)

The 'internal evaluation' and 'involvement in strategic development' task factors were not related to any corporate performance task component. However, there is a significant, but relatively weak relationship between the importance placed on the 'long-term capital performance' component and the 'independent input' task factor (Pearson correlation = 0.212 at the Sig. level of 0.01). Moreover, there is a small, but significant and inverse relationship between the importance placed on the 'sale-oriented' company performance factor and the 'stakeholders' interests' (Pearson correlation = -0.160 at the Sig. level of 0.01). The 'board management interaction' task factor also has an inverse relationship that appears to be significant with the 'accounting-based measures' company performance factor (Pearson correlation = -0.206 at the Sig. level of 0.01), but has a significantly positive relationship with the 'sales-oriented' task factor (Pearson correlation = 0.157 at the Sig. level of 0.05).

When considering responses that were initiated by research participants regarding the corporate performance criteria and tasks of directors in Thailand, 'customer satisfaction', 'corporate social responsibility', criteria specifically to the company or to the industry such as the 'aging of the debtors' or the 'quality of the television programme' were suggested as being part of the criteria measuring the performance of the company in Thailand. As for the additional tasks of directors, items such as 'true independence of board members' and 'performing duty as directors with loyalty' were recommended.

5 CONCLUSIONS

5.1 SUMMARY OF THE CURRENT RESEARCH INVESTIGATION

The research question for the current study concerns the discovery of two aspects: the identification of the importance placed corporate performance criteria, including tasks and the degree of involvement of roles by directors in Thailand; and the relationship between each element. Results indicated that Thai corporate directors focussed on the long-term performance of companies and employed a monitoring role towards their company performance. Pertaining to the tasks of directors, sets of tasks contributed to sets of corporate performance criteria such as the 'company evaluation and monitoring' task factor related to 'the long-term capital performance', 'accounting-based measures' and 'short-term and competitiveness' performance factors.

5.2 IMPLICATIONS FOR ACADEMICS AND PRACTICTIONERS

Instead of using the defined functional roles for studying the performance of the company, the current study suggests that director tasks need to be studied alongside corporate performance measures as their uncovered relationships provide a better understanding and results. By using both sets of concepts in determining the relationship linking directors' roles and company performance, performance criteria as perceived by directors can be tied with other criteria to help predict the companies' positions. In this regard, shareholders can use the available data and analysis to assess and strengthen the performance of the board and, by considering a scope of directors' tasks and responsibilities, a board can improve its performance in relation to a set of criteria that is focussed timely and helps advance the companies. Concerning the implication for the policy makers, it is necessary to understand and update the current practices of directors of companies so that policy-makers can impose regulations in time to support or to change corporate directions in corresponding to local and global challenges.

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THE EFFECT OF ENTRENCHMENT AND ALIGNMENT TO EARNINGS MANAGEMENT

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ABSTRACT

The objective of this research was to investigate whether controlling shareholder doing earnings management. This issue was most important to be revealed because phenomena of ownership of public companies in Indonesia were being concentrated and there were low minority shareholders protections. Earnings management was also less detected by public. Therefore, controlling shareholder was being motivates to do earnings management.

This research also investigated whether increasing control rights would increase earnings management. The issue related to the entrenchment effect. This research was also to investigate whether increasing of cash flow rights would reduce earnings management. The issue related to alignment effect.

This research used the data of ultimate ownership and financial statement of manufacturing companies listed on Indonesia Stock Exchange during the period of 2001 to 2007. There were 786 year companies during 7 years.

This study documented that the increasing of control rights motivated the controlling shareholder to do earnings management. Controlling shareholders also conducted earnings management opportunistically. The conclusion stated that the increasing of control rights would cause the entrenchment effect. The increasing of cash flow rights motivated controlling shareholder to reduce earnings management. To give signal of good company's financial condition, controlling shareholder do earnings management efficiently. The increasing of cash flow right leverage motivated the controlling shareholder to do earnings management. This research also documented that controlling shareholder conducted earnings management opportunistically.

Keywords: control rights, cash flow rights, cash flow right leverage, and earnings management

1. INTRODUCTION

The objective of this research was to investigate whether controlling shareholder doing earnings management. This issue was most important to be revealed because phenomena of ownership of public companies in Indonesia were being concentrated (Claessens *et al.*, 2000; Febrianto, 2005; and Siregar, 2006) and there were low minority shareholders protections (Johnson *et al.*, 2000; and Leuz *et al.*, 2003). Earnings management was also less detected by public (Sloan, 1996). Therefore, controlling shareholder was being motivates to do earnings management.

According to Claessens *et al.* (2000), most public company in Indonesia were owned by single controlling stockholder. Controlling shareholder was also as the biggest ultimate ownership. Febrianto (2005) found that 92% public companies were owned ultimately. This finding was consistence with the result of Siregar's (2006) research. He documented 99, 09% public companies in Indonesia owned ultimately at 10% cut of point of control rights. This concentration would generate the separation between cash flow rights and control rights the controlling shareholder.

The increasing control rights would lead to entrenchment effect whereas increasing cash flow rights would generate alignment effect. According to Morck *et al.* (1988), entrenchment was managerial behaviour of controlling companies who was opposed to shareholders. According to Ding *et al.* (2007), entrenchment of controlling shareholder was as the same as entrenchment of manager.

The increasing control, which was compared to the ownership of share entrenched the controlling shareholder to do expropriation to get private benefit. Private benefit was benefit being obtained by controlling shareholder in the form of finance and non finance through domination of control being owned. This benefit was referred as private benefit because the other shareholders do not get the same benefit (Gilson and Gordon, 2003). In the case of Robert Tantular as controlling shareholder of PT. Bank of Century Tbk is the fact of expropriation in Indonesia.

Entrenchment effect that would suffer minority shareholders emerging from increasing control rights lead to reduction value of the firm and dividend (Claessens *et al.*, 1999; La Porta *et al.*, 2002; Claessens *et al.*, 2002; Lins, 2003; Faccio *et al.*, 2001; and Siregar, 2006). Expropriation was happened because controlling shareholder get lower finance incentive compared with his/her control to the company. This situation indicated to the agent problem between minority shareholders and controlling shareholder. Controlling shareholder made decisions only for her/his benefit and not for the minority shareholders or the company benefits.

Furthermore, alignment effect represented the reverse of entrenchment effect. Alignment effect emerged because the percentage of share ownership by controlling shareholder was increase. This was reflected on cash flow rights. Alignment was the interests the controlling shareholder effort of lining up behaviours and minority shareholders. Increasing of cash flow rights leads to the controlling shareholder to align his interests to the minority shareholder or company interests. Controlling shareholder will bear the biggest expense when he/she transfer the company cash (assets) into his/her own pocket because he/she owned the biggest share percentage. This situation reduced agency problem, when on the other side cash flow rights is increase.

Based on entrenchment and alignment effects, this research investigated whether increasing control rights would increase earnings management. The issue related to the entrenchment effect. This research was also to investigate whether increasing of cash flow rights would reduce earnings management. The issue related to alignment effect.

The research also analyzed whether controlling shareholder doing earnings management opportunistically when his/her control rights was increase. The analysis was important to be done to support the argument that increasing of control rights could generate the entrenchment effect that would lead to controlling shareholder behave opportunistically. This research also analyzed whether controlling shareholder doing earnings management efficiently when the cash flow right was increase. Increasing of cash flow rights generates the alignment effect.

2. THEORY AND HYPOTHESIS DEVELOPMENT

2. 1. Agency Theory

According to Scott (2006), agency theory was the branch of the game theory. Agency theory explained about the design contract that affected the agent to act the best for the principal interests. The contract was hoped to reduce the difference between agent and principal interests. The difference of interests was happened because of the difference of goal and attitude to risk preferences between principals and agent (Eisenhardt, 1989). According to Eisenhardt (1989), agency theory developed into two research belief which was positive belief stream and principal-agent belief.

Positive belief focussed on principal-agent which was the principal and agent would have conflicted goal. Jensen and Meckling study's (1976) were on the positive belief. Jensen and Meckling (1976) defined agent relation as a contract between someone or more (principals) and others (agent) to conduct some work for of principle interests including authority delegation to agent to make decisions. If both parties in this relation maximize the utilities, so there was a strong reason that agent do not always act for the best principal interests. This situation generates the agency conflict between principals and agent. In this case, principals tried to limit the difference interests through the best incentive for agent and monitoring activities to limit the activities diverging from agent.

Principals also gave the fee to agent to expend the firm's resources (bonding costs) so that agent did not conduct the activities suffering principals. Costs of monitoring and bonding caused agency cost. Agency cost also arose when there was a difference of decision between agent and principals in the effort to maximize the principal wealth. This cost also called as residual loss. Jensen and Meckling (1976) define agency cost as expenditures of monitoring, bonding, and residual loss.

Jensen's study (1986) is one of empirical research in positive stream. Jensen (1986) showed conflict between principals and agent when there was cash payment to all shareholders. Cash payment would reduce the resources which are under controlled of manager.

Second belief in agency theory is principal-agent belief. The belief focused at common theory about relation between agent and principals. The theory can explain the relation between employers and workers, lawyers and clients, and also suppliers and customer. The belief of principal-agent has broader range than positive belief. Positive belief only focused on relation between principal and agent. Shleifer and Vishny's study (1997) is one of the beliefs of principal-agent. According to Shleifer and Vishny (1997), the essence of agency problem is the separation between ownership and control. On dispersed ownership, the company control is on manager.

Shleifer and Vishny's study (1997) became basis theory to explain and predict the agency problem on the phenomenon of concentrated ownership. On concentrated ownership, conflict is occurred between controlling shareholder and minority shareholders. This conflict is caused by wide deviation between control rights and cash flow rights (Claessens and Fan, 2002).

2. 2. Explanation of Agency Theory to Earnings Management

Agency theory is often used on earnings management researches (Chen and Cheng, 2002). In the context of concentrated ownership, manager managed earnings to fulfil willingness and the goal of controlling shareholder. Manager is a professional individu or family member of controlling shareholders. Shleifer and Vishny (1997) commented that manager is tightly controlled by controlling shareholder so that manager makes decision just for controlling shareholder interests.

Earnings management is a direct management on the process of external financial reporting to obtain certain advantages. For the context of concentrated ownership, conflict of interests between minority shareholders and controlling shareholder become the root of problem on earnings management (Ding *et al.*, 2007). According to Leuz *et al.* (2003), the opportunity to misrepresented company's performance through earnings management would appear on the conflict of interest between minority shareholders and controlling shareholder. Controlling shareholder can use his/her control for his advantages by generating cost for other shareholders.

Increasing control of controlling shareholder would generate entrenchment effect. This would potentially influence the financial reporting because controlling shareholder arranges the policies during the process of financial reporting. This situation showed that controlling shareholder has the strong opportunity to conduct action opportunistically to hamper the minority shareholders (Fan and Wong, 2002). From time to time, company was operated by manager but manager is tightly controlled and observed by controlling shareholder. In fact, controlling shareholder also became manager on the company, such on PT. Andhi Candra Automotive Products Tbk.

3. 2. Ownership Structure of Company

According to Jensen and Meckling (1976), there are three company's ownership structure variables. Those are:

1. Inside equity, this is owned by manager.
2. Outside equity, this is owned by someone from the outside company.
3. Debt, which is owned by someone from outside company.

Inside equity added by outside equity is equal to total market value of company's equity. Total market value of the company is total market value of equity plus debt. When outside equity offered to public is getting bigger, the agency cost is bigger too. When outside equity increase, claim of management ownership decrease. In that case, manager motivates to take additional non financial benefit.

The more offer of outside equity, the more investors have claim to company. So, ownership structure of the company becomes dispersed and company's control is on management. These phenomena are generally happen in US and UK. Whereas, companies' ownership in East Asia and East Europe are concentrated on certain owners because companies' ownership can be conducted on pyramid form and cross ownership form (La Porta *et al.*, 1999; Claessens *et al.*, 2000; and Faccio and Lang, 2002).

2. 2. 1. Company's Ownership in the Form of Pyramid

Ownership structure in the form of pyramid is happen if the structure has an ultimate ownership and minimal there is one company listed in stock exchange on the chain of control rights of ultimate ownership (Claessens *et al.*, 2000). The situation indicates that the company's ownership can be done directly and indirectly through the other companies.

2. 2. 2. Company's Ownership in the Form of Cross Ownership

Cross ownership is the ownership of controlling shareholder of two or more companies which own each other. The main requirement of ownership is if two or more the companies are owned each other (Siregar, 2006)

2. 2. 3. Company's Ownership in the Form of Concentrated Ownership

La Porta *et al.* (1999) is the first researcher who conducted research about ultimate ownership. Based on 20% cut off vote rights, La Porta *et al.* (1999) found 36% world companies in world owned widely. There are 30% companies controlled by family and 18% companies controlled by state and also 15% controlled by the other. There were 26% companies owned by ultimate shareholder through pyramid form. Mostly on all countries, ultimate shareholder is family. There were 69% companies controlled by family which also became the manager on the company.

The study of La Porta *et al.* (1999) is developed by Claessens *et al.* (2000). Claessens *et al.* (2000) investigates separation of ownership and controller of the company in nine countries of East Asia. Claessens *et al.* (2000) found that in Indonesia, control rights of controlling shareholder were bigger than his/her cash flow rights. More than 2/3 companies was controlled by single controlling shareholder. There were 60% of all companies, which were concentrate owned and top management had blood relation with the controlling shareholder.

The research of La Porta *et al.* (1999) and Claessens *et al.* (2000) are developed again by Faccio and Lang (2002). Faccio and Lang (2002) found that 36, 93% of all companies were dispersedly owned and 44, 29% of all companies were controlled by family. Demirag and Serter (2003) developed research about ultimate ownership on Istanbul Stock Exchange. Demirag and Serter (2003) found that most companies in Turkey are owned by ultimately and controlled by family who formed the company through pyramid form of ownership.

Siregar (2006) investigated about ultimate ownership in Indonesia. Siregar (2006) indicated that most of all public companies in Indonesia were controlled by controlling shareholder. Based on 10% cut off, there were 99, 09% of public companies in Indonesia had a concentrated structure of ownership. Based on 10% cut off, Siregar (2006) found that 66, 44% of all controlling shareholder used the pyramid structure to increase control exceeding cash flow rights. The control of public companies with the pyramid form of company's ownership conducted by a controlling shareholder was done by owning other public companies and non public companies. Owning non public companies was 79, 25% of pyramid form of company's ownership at 10% cut off point.

2. 2. 4. Consequences of Concentrated Ownership

Concentrated ownership structure with control rights exceeding the cash flow rights will generate entrenchment effect. This effect will reduce the value of the company and the dividend. If cash flow rights increases and so with the control rights, it will generate the alignment effect. This effect will improve the value of the company and the dividend. If these two effects are attributed with agency problem, the agency problem becomes bigger just when the control rights are bigger than the cash flow rights. If control rights are the same with cash flow rights, the agency problem will be smaller.

Claessens *et al.* (1999) documented that the increasing of cash flow rights will improve the value of the firm. This is the alignment effect. The increasing of control rights will decrease the market value of the firm. The increasing of the wedge will decrease the value of the firm. This is the entrenchment effect. Faccio *et al.* (2001) found that the increasing of O/C ratio will increase the dividend. La Porta *et al.* (2002) documented that the increasing of cash flow rights will increase the value of the firm. Claessens *et al.* (2002) documented that the increasing of cash flow rights will increase the value of the firm. However, Claessens *et al.* (2002) also documented that the increasing of control rights will decrease the value of the firm. Lins (2003) also found that the value of the firm is lower when the control of the company is getting bigger. These results supported the hypothesis of managerial entrenchment.