The Issues of Ethnicity in Financial Accounting Studies

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Abstract
This paper aims to provide a critical review of the empirical literature on the effect of ethnicity in financial accounting studies such as financial reporting quality, transparency, disclosure and corporate governance with particular reference to Malaysia. Traditional corporate governance system of the board of directors as well as alternative business governance system, culture and religious societies have been considered as having a significant impact on business governance systems used in a multi-ethnic country. Ethnicity can function as an appropriate representation to culture where each ethnic group keeps its distinctive cultural identification as well as ideals. This particular evaluation elucidates the association between ethnicity and financial reporting quality, transparency, disclosure and corporate governance in a multiracial context.
Keywords: Ethnicity, transparency, financial accounting studies, Malaysia.

1. Introduction

National politics, cultural and historical roots tend to be key issues when discussing the corporate practices around the globe (Cornelius, 2005). In line with the cross-cultural function associated with Hofstede (1980, 1983), Gray (1988) suggests the framework linking Hofstede's cultural values using the improvement of accounting attitudes and systems internationally. In countries that are multiracial, the main value of the society may not represent the nation's value as a whole particularly if each ethnic group chooses to retain their values and individuality. The differences among the groups are particularly prevalent if there has been some historical conflicts that marked a socioeconomic or national difference (Pettigrew, 1979). Likewise, the levels of shared values and cooperation are determined by the system's formality and coordinating activities in the organization (Birnberg & Snodgrass, 1988). Hence, it is essential to realize the differences in value that may occur among groups within a nation (Specter & Solomon, 1991).

In the context of Malaysia, ethnicity is an important demographic factor to be considered in transparency and disclosure practice because it determines the economic incentives available to the individual. In fact, it was the policy of the Malaysian government to have 30% of the indigenous people, termed as Bumiputera, involved in listed companies. Furthermore, the restructuring of employment under the New Development Policy (NDP) and the Second Outline Perspective Plan (OPP2) will result in an increase in the number of Bumiputera occupying company management positions. Since there will be an expected increase in participation of the Malays in business, it is important to study their belief and its effects on work-related values. While there are limited proxies for culture, ethnicity acts as an appropriate representation for a multiracial society such as Malaysia where each ethnic maintains its own unique ethnic identity and values (R. Haniffa & Cooke, 2005; Salleh, Stewart, & Manson, 2006). Generally, the two main ethnics, Malays and Chinese, are the two biggest groups in Malaysia. The Malays and Chinese have a key function in politics and economics respectively; policy makers are mainly Malays while the Chinese are mainly involved in businesses (Abdullah, 2006).

The objective of this paper is to explore the effect of ethnicity on accounting aspect in the Malaysian context. The paper is organized as follows. The next section provides the literature review of issues of ethnicity in financial accounting studies. The final section provides conclusion to the issues with suggestions for future research.

2. Ethnicity in the financial accounting studies

From a theoretical viewpoint, empirical investigation proposes that ethnicity plays significant role in determining belief and can influence work-related values. In turn, these values may have impact on transparency and disclosure of company in annual reports. Summing up the prior empirical studies of ethnicity has found its linkage with the accounting aspect and corporate governance. The following section reviews findings of prior research with regards to the relationship between ethnicity and financial accounting studies such as financial reporting quality, disclosure, transparency, auditing and corporate governance with a particular reference to Malaysia.

2.1 Corporate governance

In a study by Mamman (2002), it was revealed that managers' ethnicity affected their attitudes in government roles in Malaysia. It was found that Malay managers tend to support the policies made by the government, while Indian and Chinese managers tend to support economic policies that are laissez-faire. Furthermore Ball et al. (2003) pointed out that government interference causes political costs for companies controlled by Chinese minority ethnic groups which motivate them to not report high profits.

The Bumiputera controlled companies' and politically connected companies' capabilities are often seen as having poor corporate governance practices and poor performances (Gul, 2006; Johnson & Mitton, 2003; Yatim, Kent, & Clarkson, 2006). Yatim et al. (2006) support this finding by claiming that more Bumiputera-controlled companies exploit the favorable corporate governance practices as compared to the non-Bumiputera companies. In contrast to earlier results by Johnson and Mitton (2003), these outcomes show that the corporate governance practices in Malaysia have transformed after the reforms made to corporate governance in 2001.

Hassan, Marimuthu, and Johl (2015) study examined the association between ethnic diversity between board members and market value of listed firms in Malaysia. Ethnic diversity is defined as the number of non-bumiputra (Chinese, Indian) on the board of directors. The concept of value-in-diversity argues that a diverse workforce is beneficial for business organization. Diverse members of boards enhance the overall performance of the organization. The results seem to be inconsistent. There is a need to investigate this issue in a more holistic way. This research is unique and first of its kind that considers the relationship between ethnic diversity on boards with market value. The results indicate that ethnic diversity does have an impact on market value, but they are inversely correlated. The results also indicate that the proportion of non-bumiputra on boards tends to increase with the increasing members on board. Nonetheless, ethnic diversity is negatively associated with market performance. The outcomes of the research help to shareholders, and other stakeholders, including the potential investors and policy makers to understand the significance of ethnic diversity at top level management.

2.2 Disclosure and transparency

Researches by Haniffa and Cooke (2005) prove that Bumiputera companies utilize voluntary disclosures as a legitimate strategy to appease the different stakeholders by ensuring a continuous effective opinion at the institutional and governmental stages. The same studies also pointed out that boards dominated by Malays are related positively to disclosure that is voluntary and disclosure of a corporate social nature. The Malay-dominated boards adopt a reactive legitimating strategy to change perceptions and divert the attention of its various stakeholders away from the close-relationship they enjoy with government. This is done by increasing the level of social responsibility disclosures. On the other hand, Archambault and Archambault (2003) revealed that firms in countries with majority Muslim population showed a higher level of transparency in their companies' annual reports. Consequently this higher level of transparency reduces the information asymmetry between companies, investors and lenders. Further, Mohd Ghazali (2004) and Haniffa and Cooke (2002) found positive and significant relation between the number of directors in a board who are Malays and voluntary disclosure in annual reports in Malaysian firms.

Table 1 offers the interrelationship in between Hofstede's social values as well as Gray's accounting values and practice, that's, transparency as well as disclosure respectively. It might be observed that uncertainty avoidance and individualism vary between the two cultural groups in Malaysia. Based on a Hofstede–Gray theoretical framework, the Malays may be expected to be relatively more secretive compared to their Chinese complements, and high secrecy denotes lower disclosure. Likewise, the domination of boards and the proportion of shares held by one race could also affect business disclosure strategy.

Table1. The interrelationship between Hofstede's societal values, transparency and disclosure (R. M. Haniffa & Cooke, 2002)

Hofstede societal values	Ethnic groups	Gray Accounting Value transparency	Accounting Practice disclosure
	Malay		
Power distance	High		
Masculinity	Low	High secrecy	Low disclosure
Uncertainty avoidance	High		
Individualism	Low		
	Chinese		
Power distance	High		
Masculinity	Low	Low secrecy	High disclosure
Uncertainty avoidance	Low		
Individualism	High		

According to (Zawawi, 2008) compared the cultural ethics between the Malay, Chinese, and Indian management employees, mostly through a case study of Nestlé, one of the main multinational organizations in Malaysia. The results show several new outlines of cultural values emerging among the employees of the organization. In a country with a variety of subcultures resulting from the different ethnicity, the understanding of these organizational cultural values is important to ensure that the organizational activities are able to provide the maximum influence on the employees' performance.

2.3 Disclosure and Transparency

A study by Hashim (2012) examined the linked between quality of financial reporting and national culture. His research utilized the discretionary aspect of the accrual quality model for measuring the quality of financial reporting to determine the link between quality of financial reporting and ethnicity. The findings showed no relevant linkage between ethnicity of the chairman and CEO with the quality of accrual. However, the findings showed a higher level of quality of financial reporting linked to companies with higher number of Malay directors. This shows that that financial reporting quality is not free of culture and in fact, government policies have a large impact on them.

2.4 Corporate Social Responsibility

Louis & Osemeke (2017) investigated the influence of cultural differences between ethnic directors on Corporate Social Responsibility (CSR) of Public Liability Companies (PLCs) in Nigeria. They used the cultural trait theory; the study focuses on how the ethnic directors are influenced when making decisions concerning CSR. The study investigated the three major ethnic groups (Yoruba, Igbo and Hausa) and finds cultural differences between the ethnic directors affect the adoption of CSR. Empirical results indicate that ethnic directors (Yoruba, Igbo and Hausa) were positively and significantly related to CSR. The paper contributes to the corporate governance and CSR debate concerning how ethnic directors' decisions impact on CSR activities, particularly on the directors who are individualistic and collectivists towards CSR.

2.5 Auditing

Based on Lowe et al. (2001) study, its provides theory-based experimental evidence regarding the effects of gender, ethnicity, and other individual differences on performance evaluations of audit seniors. Results indicate that gender and ethnic heritage are important factors in the career prospects of audit seniors. The behavior of an auditor was also important as an interactive factor and influences judgments differently depending on the gender or ethnic origin of the auditor evaluated. An important implication of Ahmad et al. (2006) findings relates to auditor independence. The Malaysian Institute of Accountants (MIA) has made rules prescribing the code of professional conduct and ethics of public accountants known as the MIA By-Laws (on Professional Conduct and Ethics) but it seems to neglect the diversity of local culture in addressing independence. Whilst the auditor is divorced from financial and familial interests, the ethnic sentiments might impair auditor independence especially in an audit conflict situation.

In a study by Nazri et al. (2012) ,they evaluates the effects of various independent variables on auditor choice behavior, particularly ethnicity of auditor and ethnicity of management, using a logistic regression analysis approach for 300 companies listed on the Bursa Malaysia over an 18 year period. Ethnicity was found to be a significant factor influencing auditor choice only for auditor switches between non-Big 4 and Big 4 firms.

According to Johl et al. (2012) study, they extends the literature on audit pricing by examining the relationship between ethnicity (bumiputra vs non-bumiputra), corporate governance attributes, and audit fees using data from 559 publicly-listed companies in Malaysia in 2005. The results show that firms with bumiputra CEOs incur higher audit fees, but they do not find an association for firms with bumiputra-dominant audit committees. In additional analysis, they find that the audit premium paid by firms with a bumiputra CEO is higher for the smaller client firms. Further, they find that firms managed by a bumiputra CEO with a fully bumiputra-composed audit committee tend to pay higher audit fees than the other firms, indicating that there is a combined ethnicity effect on audit fees.

2.6 Different approach in ethnicity and financial accounting studies

Based on Mansor and Kennedy (2000) study on the leadership of firms and culture in Malaysia, it was revealed that the cultural value of the Malays is derived from a traditional background of living in communities. The Malays are often mentioned as being high on collectivism and a Malay leader is expected to place the group' interests before those of his own. Even though, the majority of the population falls under this ethnic group, the Malays have been left out of the economic activities during the colonial period (Mamman, 2002). Likewise, it is found that the Malays have lower level of entrepreneurial ability compared to the other groups and this is shown through the low performance level in their roles as leaders (Mansor & Kennedy, 2000).

On the other hand, leaders from the Chinese ethnic group have revealed a higher level of entrepreneurial capability along with strategic thinking and high self-discipline (Wah, 2002). These leaders utilize strategic thinking in leading their firms and successfully growing their family-owned companies into corporate and professional firms (Wah, 2002). This scenario is apparent in many countries in East Asia where Chinese family-owned conglomerates have played an active role in the economy (Ball et al., 2003). However, companies run by ethnic minorities have more tendencies to face political costs from having high profit reports and as a result, ethnic Chinese in the minority tend to report lower profits (Ball et al., (2003). Nonetheless, more studies are needed to substantiate this claim. Rahman and Ali (2006) attempted to test this claim by examining the link between earnings management and ethnicity but did not discover any significant evidence.

Board diversity is important particularly in countries which practice a one-tier board system, such as Malaysia. Under the system, board appointments are usually controlled by the firm's substantial shareholders, and as a result, directors are chosen based on "the old-boy" network or "people like us", who are typically middle-aged males and from similar ethnicity which could lead to "group think". Board diversity ensures breadth and depth of the board's judgments (Abdullah, Ismail, & Izah, 2013). In study by Abdullah et al. (2013) examined board diversity of the top 100 non-financial Malaysian firms, specifically directors' gender, ethnicity and age and their effects on firm performance. Data are collected from the 2007 annual reports of the sample firms. The evidence indicates the lack of diversity of the Malaysian boards of directors. Results from the multivariate analyses reveal that gender diversity is negatively associated with Tobin's q and ROA. Age diversity is found to be negatively related to ROA. Ethnic diversity, on the other hand, is found to be positively associated with ROA. Hence, findings on the effect of board diversity and firm performance are mixed. However, this study offers insights to policy makers in enhancing corporate governance in Malaysia where diversity is one of the areas that could strengthen the efficiency of the board.

In summary, ethnicity is chosen because it is a significant marker of class relations and provides a principle according to which conflicts over wealth and state power take place (van Fossen, 1998). Based on the cultural theory, a country which consists of multi-cultural society and where most businesses are developed as family run firms (N.A. Mohd Ghazali & Weetman, 2006) would make offer good basis for research. In addition, the effect of ethnicity may be of significance in multicultural societies where each ethnic group prefers to maintain its ethnic identity (Sendut, 1991). Thus, the cultural factors such as ethnicity and religion would have an effect on the corporate policies and transparency. Therefore, best practices of corporate governance reduce the information asymmetry in capital market by high level of transparency of corporate policy. Table2 shows summary of academic studies on ethnicity.

Table2. Summary of academic studies on ethnicity

Authors (year of publish)	Focus	Finding
(Mamman, 2002)	Ethnicity and corporate governance	Malay managers tend to support the policies made by the government, while Indian and Chinese managers tend to support economic policies that are laissez-faire.
(R. Haniffa & Cooke, 2005)	Ethnicity and Disclosure or transparency	Boards dominated by Malays are related positively to disclosure that is voluntary and disclosure of a corporate social nature.
(Archambault & Archambault, 2003)	Ethnicity and Disclosure or transparency	Firms in countries with majority Muslim population showed a higher level of transparency in their companies' annual reports.
(Hashim, 2012)	Ethnicity and Fanatical reporting quality	Findings showed a higher level of quality of financial reporting linked to companies with higher number of Malay directors
(Lowe et al., 2001)	Ethnicity and auditing	Results indicate that gender and ethnic heritage are important factors in the career prospects of audit seniors.
(Nazri et al., 2012)	Ethnicity and auditing	Ethnicity was found to be a significant factor influencing auditor choice only for auditor switches between non-Big 4 and Big 4 firms.
(Louis & Osemeke, 2017)	Ethnicity and corporate social responsibility	Indicate that ethnic directors (Yoruba, Igbo and Hausa) were positively and significantly related to CSR
(Rahman & Ali, 2006)	Ethnicity and earnings management	Did not discover any significant evidence.
(Johl et al., 2012)	Ethnicity and auditing	The results show that firms with bumiputra CEOs incur higher audit fees, but they do not find an association for firms with bumiputra-dominant audit committees.

3. Conclusion

In theory as well as empirically, ethnicity functions as a suitable representation to culture especially for a multiracial nation like Malaysia. This is particularly true when each section of the ethnic group still maintains its own unique ethnic identity and values. Countries within the Asia–Pacific as well as Southeast Asian countries where racial, cultural as well as linguistic discrimination and inequality exist include Philippines, Fiji, Hong Kong, and Indian. Variations in between cultural organizations within these types of nations might be institutionalized actually towards the degree to be enshrined within lawful techniques. Nevertheless, racial, cultural as well as linguistic variations tend to be minimal essentially within the Anglo-Saxon nations such as New Zealand, Australia, and Hawaii. Therefore overview of empirical investigation offers additional implications with regard to these types of nations. There are few areas that can be the focus of future research. First, the impact of ethnicity on financial accounting in emerging markets such as the East Asia and Eastern Europe should be undertaken so as to enable generalization of research findings. Secondly, future research could also draw on cross-countries comparisons by examining the influence of different level of accounting principles and finance aspect such as cost of capital of companies.

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