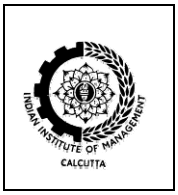

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Are Family firms in India managing their Earnings – An exploratory study

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Working Paper

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Introduction

"A House of cards" – is what Reliance Communications Ltd. has been described as by Veritas Investment Research, downgraded due to 'whimsical' accounting practices and questionable corporate governance norms[1].

"The last bastion falls" – is how Macquaire Equities Research titled its report in June 2012, downgrading HDFC to a rating of 'underperform' due to aggressive accounting practices related to inflated earnings and return on equity[2].

'A Crumbling Edifice' on DLF and 'A Pie in the Sky' on Kingfisher Airlines were some of the other reports of Veritas during the year 2012, highlighting some irregularities in their financial reporting practices.

Are Indian family businesses engaging in more earnings management than their non family counterparts? The issue is worth examining especially as the preliminary results for the Benford test (Carslaw 1988, Thomas 1989)[3] performed for unusual patterns in earnings number on a sample of 2315 firms taken from the CMIE Prowess database over a six year period (2006-2011) suggests that firms are managing their earnings (Jaiswall & Banerjee, 2012). Indian corporate sector with majority family owned and controlled firms, presents a case for type II agency problem (Villalonga & Amit, 2006) and hence would make an interesting context to explore earnings management by these firms via accruals segregating total accruals into innate accruals arising from the economic fundamentals of the firm and discretionary accruals reflecting firm's accounting policy choices.

The importance of family businesses need not be emphasized. They are the dominant form of corporate organizations worldwide. A reliable measure of their importance would be the relative proportion of family firms in incorporated businesses. The proportion is said to be between 75%

[1] http://www.moneycontrol.com/news/market-edge/veritas-takes-aim-at-rcomagain-values-stock-at-rs-15_719550.html

[2] http://www.indianexpress.com/news/macquarie-questions-hdfc-accounting-downgrades-stock/962110/

[3] The test basically looks for more number of zeroes and lesser number of nines than those predicted by probability for the second most digit in the reported earnings number.

in UK to about 95% in Latin America, India and the Far and Middle East[4]. In the US, family firms on an average comprise 33% of the S&P 500 (Anderson & Reeb 2003). Indeed the governance of the organization is influenced by its ownership structure. Research has shown that corporate governance characteristics such as concentrated shareholding influences the quality of financial reporting (Ball & Shivkumar 2005, Burgstahler et al. 2006). Better earnings reporting practices would be a consequence of good corporate governance practices at firms. But if we look at the initiation of corporate governance norms, these primarily focused on safeguarding the interests of the shareholders (for widely held firms) by the management. Thus there is a need to look at corporate governance norms for family businesses differently as we have here family interests (both ownership and control) quite distinct from the minority shareholder interests, famously known as the principal-principal problem.

The concept of dispersed ownership in corporate organizations as initiated by Berle & Means in 1932 highlighted the principal agent relationships and related agency problems (Agency problem I as defined by Villalonga & Amit, 2006). In order to safeguard the interests of the minority shareholders, effective corporate governance norms related to monitoring of management and board sub committees were emphasized upon. However, with family businesses in majority, the concept of widely held corporate organizations as advocated by Berle & Means is a rarity in emerging economies, being mostly characteristics of businesses observed in the US and UK (Shleifer & Vishny 1986, Holderness & Sheehan 1988, Anderson & Reeb 2003). It was believed that with family businesses in majority, the problem of self interested managers in compromising with the long term welfare of the firm would be addressed. Thus Agency problem I would be reduced as family members with substantial shareholding in management position would bring down monitoring cost. This greater insider ownership would in turn generate better corporate governance norms. Owners in managerial positions would not take decisions detrimental to the firm's interests as they have larger stakes tied up in the business. Generally these family owned firms were less diversified having longer horizons for business decisions with considerable weightage for family reputation and relationships[5]. With family businesses dominating in all major economies around the world (La Porta et al. 1999, Classens et al. 2000, Villalonga & Amit

[4] Sir Adrian Committee Report "Family firms and their Governance-creating tomorrow's company from todays" Egon Zehnder International

[5] Sir Adrian Committee Report as above.

2006) researchers were thus interested in exploring their corporate governance attributes and financial reporting practices. In this study we find that family firms in our sample have better corporate governance characteristics and engage in negative (lesser) earnings management proxied by discretionary accruals as compared to the non family firms. We find firms engaging in negative earnings management probably deferring higher earnings recognition in the current period as a tradeoff for meeting benchmarks in the next period. Thus the results found in similar asian contexts (Setia-Atmaja et al., 2009 for Australia, Jaggi et al., 2009 for Hong Kong) have not been corroborated for our sample family firms with regard to their earnings management practices. The reason largely being the considerably higher shareholder concentration of the family stake increasing the horizon of firm decision making, aligning the interests of the owners with that of the firm. Thus the rationale for exploring the issue in the Indian context with the strong 'familiness' comprising of age old culture, family reputation, family values and succession of the business for the next generation (Morck et al. 2000) is well justified.

Family businesses, though are said to bring down the conventional principal agent problem, they may create principal-principal problem with the proliferation of non promoter and institutional shareholders. Governance researchers focused on the interests of these minority shareholders in the firm and thus Agency problem II was identified as majority family owners in control expropriating the benefits of the public shareholders (Villalonga & Amit 2006). Thus we have argument for these family firms being inefficient and sub optimizing financial disclosure practices in firms, engaging in private benefits consumption (Classens et al. 2000, Bertrand et al. 2002) detrimental to the interests of the other shareholders. Lesser agency problem I should imply lesser earnings management due to lower monitoring and bonding costs of the opportunist managers in non family firms (A. Ali et al. 2007). However the costs of increased disclosure in financial reporting numbers (competitor's strategy, lost private benefits) versus the benefits due to enhanced transparency (lower cost of capital) can be argued for (R. Gopalan & S. Jayaraman, 2012). Owner managers may use their controlling position to benefit at the expense of the minority shareholders leading to Agency problem II and resulting in greater earnings management. The same can be analysed from two competing hypothesis of owner managers' behavior in the firm. The Entrenchment hypothesis posits that these owner managers in family

firms may resort to control enhancing mechanisms like risk avoidance[6], excess dividends, 'tunneling[7]' etc. to benefit by expropriating the minority shareholders (Faccio et al. 2001, Anderson & Reeb 2004). The controlling management may dominate the board composition which may not have a fair representation of independent directors (Morck et al. 2004). Thus entrenched family management would be associated with greater incentives for earnings management and poorer quality of earnings. Another competing Alignment hypothesis argues for alignment of interests of the owner managers with interests of the firm as they have longer horizon in business due to considerably higher and lesser diversified ownership stake in the firm. They have the family reputation, culture, family values and succession issues to take care of. Thus family firms will not have the owner managers having private information, misusing these for their own benefit, the tendency common with the managers of the non family firms. They would thus be associated with lower discretionary accruals and better quality of earnings. The argument may well be directed beyond agency problem per se (not type I & type II) to alternative theory of Stakeholder approach to management (Miller et al. 2006). The same extends to financial reporting disclosures in these family firms reporting lower earnings management and better earnings forecasts (A. Ali et al. 2007). The results reported by A. Ali et al.,(2007) support the notion that the alignment hypothesis dominates the entrenchment hypothesis as the difference in agency problem due to type I overpowers the difference in agency problem due to type II leading to lesser positive discretionary accruals for family firms (implying lesser earnings management) as compared to the non family counterparts. However they find that family firms would make fewer voluntary corporate governance related disclosures in favour of a bias in the board composition towards the family effect, to facilitate more family predominance in the board as compared to more independent directors. According to Wang (2006), there are competing forces with regard to both demand for and supply of quality earnings information from family firms in addition to the counterveiling entrenchment and alignment effects. The net impact dominating the result would be context specific and thus is worth exploring to determine whether the entrenchment effect dominates over the alignment effect or it is vice versa. Theory suggests that, if the entrenchment effect predominates, family firms engage in more earnings management (higher discretionary accruals). While if the alignment effect dominates, these firms manage

[6] Accepting even negative net present value projects to avoid risks which influence manager's incentive compensation.

[7] Transferring resources to sister concerns with higher cash flow rights of the owners.

earnings less (lower discretionary accruals). The net impact is in turn influenced by the net strength of demand for and supply of earnings information from the stakeholders too. However the fact whether the family firm ends up providing lesser earnings information (as per the low demand from the stakeholders) in case the alignment effect is primary (thus firms would be prone to provide more earnings information and manage earnings less) would be a function of another set of competing forces between demand for (from stakeholders) and supply of the said information (from the firm) and the demand force dominating as far as the contracting terms are concerned (say the costs of higher supply of better earnings information- say in terms of lost private benefits of expropriation are more than its advantages of better signaling to the market due to increased transparency and better corporate governance attributes). If the firm enjoys a better bargaining power with regard to its stakeholders, the lower supply incentive dominates the higher demand (for more earnings information) from the stakeholders in case the entrenchment effect is primary. On the other hand if the demand forces dominate in the contracting stage, the family would end up providing better quality earnings information even if the family management is entrenched. However, corporate governance attributes of the family firms would have a determining role to play in this situation, with better governance features in a family firm strengthening the supply side of information and vice versa. The strength of investor protection norms in the context being examined would also play a role in determining the dominating effect. Weak investor rights would strengthen the supply side of the framework given below making the bargaining power of the controlling management of family firms stronger vis a vis the demand for financial reporting disclosures (R. Gopalan and S. Jayaraman 2012)[8].

	Family Firms	Demand for Quality Earnings information	Supply of Quality Earnings information
1	Entrenchment Effect	High	Low
2	Alignment Effect	Low	High

Matrix for the Alignment versus the entrenchment Effect in Family firms

[8] However we notice that in the Indian context the existence of the regulations with regard to investor protection rights may be galore and comparable to the developed nations like US and UK, however implementation of these norms may be a determining factor in factoring in their net impact.

Research on earnings management practices by family firms largely subscribe to the view that family firms with concentrated shareholding are associated with lesser informative earnings in East Asian economies (Fan & Wong 2002) while the results show lower earnings management for family firms in the US context (Wang 2006). Thus the role of institutional framework and the regulatory mechanism cannot be ignored in view of these conflicting results. The choice that the family firms make between parting with more financial disclosures (the cost of lost private benefits) and the benefits of increased market confidence and favorable firm valuation (lesser discounting of family firms financials) is also influenced by the investor protection norms in the country. This suggests that family firms will be associated with increased earnings management practices as compared with the non family firms in contexts characterized by weak investor protection norms. The benefits from increased transparency in financial disclosures due to stronger investor protection regulations would incentivize family firms to engage in lesser earnings management (R. Gopalan and S. Jayaraman, 2012).

There is a need to look at the associations in the Indian context where about 70% of the businesses are family controlled (Piramal, 1996). India has a combination of the 'insider' or 'bank financed' & the 'outsider' or 'market' based system with considerable concentrated stock ownership & dominance of family owned and managed firms. Structural characteristics in Indian corporate sector are quite different from that of developed economies leading to a different set of corporate governance issues here. As pointed out earlier, the focus of good corporate governance would not only be directed towards safeguarding the widely dispersed shareholders in the firm against the opportunist management (agency problem of type I) but it should also take into consideration the controlling shareholders as managers and their opportunities for expropriating the interests of the non controlling minority shareholders (Agency problem of Type II). Thus the tradeoff between decreasing agency problem I versus the increasing agency problem II and the consequent dominance of the alignment versus the entrenchment hypothesis surfacing in Indian family businesses would determine the propensity for these owner managers to engage in earnings management. The direction of the tradeoff primarily made by the family firms in India is an empirical issue worth exploring. It is not clear whether family firms here would prefer lower or higher discretionary accruals in view of the counterveiling context specific factors, making it an apt empirical question for the study. The perception on the quality of investor protection regulations in India primarily is that these are weak. However, this has more to do

with the implementation of the norms in rather than their existence. India does rank at par with most of the developing countries as far as the quality of the regulations are concerned, however strength of the agencies institutionalizing these norms are debatable (Rajesh Chakrabarti..2005). Control pyramids are features of an institutionally deficient economy with concentrated shareholding and family control over businesses in India due to weak protection rights, thereby reducing transaction costs and asymmetric information problems in firms (Morck et al., 2000). This backdrop provides the motivation for this study about family firms in India and their earnings management practices.

Literature Review & Hypothesis development

Family Firms

Researchers have studied family firms, with incentives to monitor managers (and lower agency costs I) and engage in private benefits consumption (thereby increase agency costs II) generally increasing firm value and financial attributes (earnings) in the process (Classens et al. 2000, Bertrand et al. 2002). However the observations are largely influenced by the definitions of the family firm and the variations in the governance structures, institutional norms, agency conflicts etc. The definitions of family controlled firms broadly range from focusing on the extent of controlling shareownership – minimum threshold of 20% of firm ownership (Villalonga & Amit 2004) to validating the presence of more than one generation in the business (Ward 1987). Some definitions focus on the extent of family involvement in the operations of the firm (Shankar & Astrachan 1996). The inconsistencies in the definitions contribute to the non comparability of the results related to family firm research. Both Mazzi (2011) and Miller et al. (2007) have pointed out this inconsistency. The most seemingly simple definition of a family firm is ‘one where there is more than one family member involved in the business’ (Miller et al. 2008). A family firm is one where members of the founding family continue to hold positions in the top management, are on the board, or are blockholders in the company (Chen, et al. 2007). We adopt a slightly more encompassing definition of Rutherford et al. (2008) and Arosa et al. (2010) defining family firms on the strength of the family members’ engagement in the family business and control by

way of board positions. Thus for our study a family business is one having minimum two directors with the same surname.

Agency Problem

Consistent with the hypothesis of alignment effect, recent empirical evidences on US-firms suggest that founding family ownership has a negative impact on accounting earnings management (Wang, 2006, Ali et al., 2007). Relief from agency problem of type I is the biggest booty for the family firms to take pride on. Shareholders in controlling position do take measures to enhance firm value. We have evidence of better performance indicators for family firms in US (Anderson & Reeb 2003). However with control enhancing mechanisms in place, family firms may consolidate their ownership position by creating sister concerns and siphoning resources away from the firm in favour of their sister concerns, where these firms have majority shareholding. These consolidated family firms with complex shareholding structures may be prone to both type of agency problems (type I and type II). Bertrand et al. (2002) find evidence for such complex ownership structure firms misappropriating funds from the ones with lesser cash flow rights to the ones with higher cash flow rights in India. Earnings management and governance issues for these control enhancing firms are to be cautiously treaded upon. More so in a context like India where we have a dominance of family firms with such intricately complex ownership structure along with rare evidences of shareholder litigations and investor law suits in vogue. Evidences documented outside the US on average, support the hypothesis of entrenchment effect as these studies find a positive association between family influence and accounting earnings management (Setia-Atmaja et al., 2008 for Australia, Prencipe et al., 2008, Bar-Yosef & Prencipe, 2009 Tiscini, 2008 for Italy, Jaggi et al., 2009 for Hong Kong).

Earnings Management[9]

Earnings Management as a managerial incentive has been amply discussed in literature. Researchers have discussed various motives ranging from '..to alter financial reports to either

[9] The section on Earnings management and Corporate governance variables draws from our working paper Jaiswall & Banerjee, 2012.

mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend upon reported accounting income numbers' (Healy & Wahlen, 1999) to managing performance bonuses (Matsunga & Park, 2001) and to capital market expectations (Bartov et al., 2002). Irrespective of the motive, the issue with earnings management is that it is not directly measureable and hence aggregate abnormal or discretionary accruals are used as proxies. Though accruals primarily are supposed to overcome problems in measuring firm performance by bridging the gap between earnings and cash flows (Dechow, 1994),the discretionary accounting choices with managers[10] may represent opportunistic earnings management rather than decreasing information asymmetry for better signaling about financial performance of firms. The market efficiency in general is assumed to take care of these anomalies with adequate discounting of firms indulging in the said behavior. But the fact remains that earnings manipulations do exist and in turn influence the markets. The Jones (1991) model and modified Jones model are widely used for measuring discretionary accounting accruals, despite its limitations.

Corporate Governance

The role of corporate governance in curbing earnings management, especially in the developing economy context of India has been justifiably argued for. The corporate governance norms for the various sub committees of the board, delegated with the task of monitoring the management as shareholder representatives ensures adequate compliance with the disclosure and financial reporting standards and practices (Zahra and Pearce, 1989). Apart from ensuring alignment of the interests of the agents with the principal, adequate corporate governance practices enhance the credibility of the reported financial statements in compliance to the accounting standards and the regulations (Watts & Zimmerman, 1986).Thus we have a set of corporate governance attributes related to the subcommittees of the board to explore for their association with earnings management in reducing the perennial agency problem in India through safeguarding the interests of the minority shareholders[11].

Thus we hypothesize (stated in the alternative) that-

[10] For example Depreciation, R&D expenses, provisions & reserves.

[11] Jaiswall & Banerjee 2012 "Exploring the relation between Corporate Governance characteristics and Earnings Management in the Indian context"

H1: Family firms would have negative association with discretionary abnormal accruals.

In view of the argument laid earlier, with alignment effect overpowering the entrenchment effect for the controlling owners in family firms, they would make a trade off in favor of lower earnings management and supply more informative financial numbers.

H2: Family firms would have better corporate governance attributes as compared to the non family firms.

Effective corporate governance characteristics would strengthen the negative association between family firms and earnings management using discretionary accruals.

Research Design

Sample & Data

Our initial sample is drawn from the population of BSE 200 firms as given in the CMIE Prowess database, using Rutherford et al. (2008) definition of family firms. From this we deleted Banking and Financial services firms[12] (NIC code 64). This gave us a final sample of 948 firm year observations over six years, though the number of observations (firm years) used in the regressions vary as firms which do not have complete information on some of the variables are also removed. Thus all inferences in the study are limited by the given time period and sample firms.

Data related to board of directors characteristics are picked up from the corporate governance report disclosed as a part of the annual report by companies. All other financial and corporate governance variables are collected from Prowess, including the earnings, working capital, cash flow data for computing the abnormal accruals. The final numbers of observations were reduced primarily because we use modified Jones model to estimate the discretionary accruals for each sample firm. The model's parameters are estimated by industry and we require each firm-year to have at least 3 observations with the same two-digit NIC code.

[12] These companies in the banking and finance sector are governed by different set of regulations, with their working capital structure requirements being different (Klein 2002).

Earnings Management – Dependent variable measures

The use of accruals adjustment to proxy for earnings management has been widely used in literature as it is less discernible than say a change in an accounting method which needs to be adequately disclosed and justified. We start with using three variables to proxy for Earnings management based on existing literature (Dechow 1995). These are discretionary accruals (disc_acc), absolute discretionary accruals (abs_disc_acc) and dummy for discretionary accruals (disc_acc_dum) using the modified Jones model. Total accruals have been divided into discretionary and non discretionary. The non discretionary accruals reflect the underlying economic performance of the firm and are not influenced by managerial discretion with regard to say amount of receivables. Discretionary accruals are the abnormal part of accruals unexplained by change in revenue net of change in receivables and gross Property Plant & Equipment (PPE). These are scaled by average total assets to reduce heteroscedasticity problems.

TA_t – Non DAC_t = DAC_t

$$TA_t = \Delta CA_t - \Delta Cash_t - \Delta CL_t + \Delta STD_t - DEP_t$$

Where:

ΔCA_t is change in current assets in year t

$\Delta Cash_t$ is the change in cash and cash equivalents in year t

ΔCL_t is the change in current liabilities in year t

ΔSTD_t is the change in short term debt included in the current liabilities in year t

DEP_t is depreciation and amortization expense in year t

Dicretionary accruals is the difference between Total Accruals and Non Discretionary Accruals.

We compute Non Discretionary Accruals as given below:

$$\text{Non } DAC_t = \alpha_1(1/A_{t-1}) + \alpha_2(\Delta REV_t - \Delta REC_t / A_{t-1}) + \alpha_3(\Delta PPE_t / A_{t-1}) + \varepsilon$$

Where:

ΔREV_t is revenues in year t less revenue in year t-1

ΔPPE_t is gross property plant and equipment at the end of year t

ΔREC_t is net receivables in year t less net receivable in year t-1.

A_{t-1} is Average total assets at the end of year t-1

$\alpha_1,\alpha_2,\alpha_3$ are firm specific parameters

ε is the residuals

Thus $DAC_t = TA_t$ - Non DAC_t

The data needed to compute abnormal/discretionary accruals like revenue, receivables, property plant & Equipment (PPE), etc. are taken from the CMIE Prowess database. A cross sectional regression model for Jones (1991) is used to estimate the unadjusted abnormal accruals for each firm in the sample. Following the NIC 2 digit classification code and the firm years, the accruals are estimated by OLS with industry and year combination, having at least 3 firms in the industry as a prerequisite.

The main dependent variable thus is discretionary accruals (disc_acc) with two variations. One is a dummy of absolute discretionary accruals (disc_acc_dum) with a value derived by splitting the sample from the median value of absolute discretionary accruals measured as '1' for greater than equal to (>=)and as '0' for less than (<) median of absolute discretionary accruals. This would take care of high vs. low earnings management, if not income increasing vs. income decreasing earnings management and the other proxy is absolute discretionary accruals (abs_disc_acc) which is used in the regression model[13].

Variable definitions are as follows:

[13] We have also checked for Total absolute accruals, Total accruals relative to size (measured by average total assets) and Non discretionary accruals.

S.No.	Variable	Definition
1	Size of the Board	Number of directors on the Board at the end of financial year
2	No. of Independent Directors	Number of independent directors on the Board at the end of financial year
3	% of Independent Directors	No. of Independent Directors/Size of the Board
4	Avg. No. of Board Meetings Attended	Average number of board meetings attended during the year by all the directors, who are on the Board at the end of financial year
5	Max. No. of Board Meetings	Maximum number of board meetings attended by any director, who is on the Board at the end of financial year (Proxy for Total Number of Meetings)
6	% of Board Meetings Attended	Avg. No. of Board Meetings Attended/Max. No. of Board Meetings
7	Avg. no. of other Chairpersonships held	Average number of Chairpersonships held in other companies by all the directors,who are on the Board at the end of financial year
8	Avg. no. of other Directorships held	Average number of Directorships held in other companies by all the directors, who are on the Board at the end of financial year
9	CEO_Chair	1 if Chief Executive Officer of the firm is also Chairperson of the Board of at the end financial year, else 0
10	Promoters - Shares held	% shares held by promoters
11	Indian Promoters - Shares held	% shares held by domestic promoters
12	Foreign Promoters - Shares held	% shares held by foreign promoters
13	Foreign Promoters	Dummy; 1 if % held by foreign promoter > 0, else 0
14	Institutional %	% shares held by institutions
15	Institutional_For %	% shares held by foreign institutions
16	Foreign Institutional Promoters	Dummy; 1 if % held by foreign institutional promoter > 0, else 0
17	Institutional_Dom %	% shares held by domestic institutions
18	Block 5% Share	% shares held by blockholders (where blockholder is defined as any shareholder holding >=5%)
19	Block 5% Count	Number of blockholders (where blockholder is defined as any shareholder holding >=5%)
20	Block 10% Share	% shares held by blockholders (where blockholder is defined as any shareholder holding >=10%)
21	Block 10% Count	Number of blockholders (where blockholder is defined as any shareholder holding >=10%)
22	Auditor_Top_3	Dummy; 1 if Auditor is among member companies of Top 3, else 0 (where Top 3 are Deloitte, PwC and E&Y)
23	Auditor_Top_4	Dummy; 1 if Auditor is among member companies of Top 4, else 0 (where Top 4 are Deloitte, PwC, E&Y and KPMG)
24	Average Total Assets	log of Average total assets in Rs crores
25	Total Absolute Accruals	change in Current assets – change in cash - change in Current liabilities + change in short term debt – Depreciation
26	Total Accruals relative to size	absolute total accruals/average total assets
27	Non Discretionary Accruals	A function of change in revenue net of change in receivables and gross Property Plant & Equipment (PPE)
28	Discretionary Accruals	Total Accruals relative to size - Non Discretionary Accruals
29	Absolute Discretionary Accruals	ITotal Accruals relative to size - Non Discretionary AccrualsI
30	Family Firm	%age of family members in the Board
31	Family Firm Dummy	Dummy; 1 if it is a family firm as per the definition adopted, else 0

Results and Analyses

Descriptives statistics for the variables used in the study are given in the table below. The mean and median statistics for discretionary accruals proxy reveal both income increasing and income decreasing earnings management in the sample firms, which is taken care of by absolute discretionary accruals showing a mean value of 0.16 and a range of 2.72. On an average sample firms have 11 directors on board (size), with 50% of them being independent (ind), with a median average of 11 directors. On an average 74% of board meeting were attended by the directors (att). Promoter shareholding (pro_sh) median value of 53% shows the contextual concentrated ownership issue being a determining factor for examining the association with regard to the nature of promoters' shareholding being primarily indian or foreign and its impact on the associaton between earnings management and corporate governance attributes for family firms. Institutional shareholding –domestic and foreign in sample firms show an average 32.83%. Audit quality proxied by the presence of one of the big three auditors is measured as a (0,1) dummy variable showing that roughly 50% (55%) of the sample firms engage the services of the big three (Big Four) audit firms as their auditors, implying thereby that not all big firms in India (in the sample chosen – BSE 200 firms) engage the big three auditors. Standard deviations for most of the corporate governance attributes are low, signaling probably a kind of standardized adherence to similar norms of good corporate governance among firms in India. Family firm, our main independent variable shows that on an average about 26% of the board positions are held by family members in the sample companies (with minimum two members in the board being family members).

Descriptives Table

Variable	N	Mean	Median	Min	Max	S.D.
size	932	11.00	11.00	2.00	27.00	3.27
ind	932	0.45	0.50	0.00	1.00	0.18
ind_num	932	4.95	5.00	0.00	14.00	2.32
meet_num	932	4.96	4.63	0.00	19.80	2.23
meet_max	932	6.80	6.00	0.00	32.00	3.05
att	909	0.74	0.75	0.32	1.00	0.12
chp	932	0.12	0.00	0.00	4.62	0.47
dir	932	4.79	4.45	0.00	18.63	2.90
ceo_chair	932	0.01	0.00	0.00	1.00	0.12
pro_sh	888	54.26	52.78	0.00	99.59	20.16
indpro_sh	888	42.48	43.95	0.00	99.59	27.45
forpro_sh	888	10.90	0.00	0.00	80.58	21.07
forpro_num	888	0.33	0.00	0.00	1.00	0.47
inst	888	32.83	28.61	0.12	99.97	23.04
inst_for	888	14.20	12.96	0.00	57.44	10.43
inst_dom	888	18.64	11.05	0.00	99.97	23.15
forinstpro_num	888	0.98	1.00	0.00	1.00	0.14
bigthree	910	0.50	1.00	0.00	1.00	0.50
bigfour	910	0.55	1.00	0.00	1.00	0.50
block5_sh	888	9.34	5.88	0.00	134.44	13.57
block5_num	888	1.00	1.00	0.00	6.00	1.18
block10_sh	888	3.42	0.00	0.00	76.49	8.84
block10_num	888	0.24	0.00	0.00	4.00	0.55
avgta	936	122376.00	45602.80	442.85	2680749.00	245450.60
tacc_abs	939	2385.90	559.22	-167317.90	235640.70	20293.51
tacc_rel	936	0.03	0.01	-0.74	1.35	0.13
nondisc_acc	917	0.01	0.01	-2.74	2.95	0.31
disc_acc	917	0.01	0.01	-2.72	2.72	0.33
abs_disc_acc	917	0.16	0.08	0.00	2.72	0.29
ff	948	0.257797	0.181818	0	1	0.266399
ff_dum	948	0.208861	0	0	1	0.406709

Quartiles Analyzed

Firm size has been an important influencing variable in literature (Becker et al., 1998), thus we use firm size measured as average total assets and segregate the sample into quartiles. We analyzed the means of all the variables within these quartiles with the smallest firm being in Quartile 1 and the biggest ones in Quartile 4. The general observation was that the bigger firms tend to manage their earnings upwards due to targets to be met in terms of market expectations (tacc_abs - Rs 5870 crores), while the smaller firms manage their earnings downwards to create a buffer for the next year (tacc_abs - Rs 378 crores). Firms with higher discretionary accruals (.04) were smaller in size, while those with higher assets size had smaller discretionary accruals (-0.01). Big firms would have larger analysts following and benchmarks to be achieved while smaller firms would have lower external expectations. Thus variables like board size, Indian promoter shareholding and institutional shareholding (domestic) are increasing with firm size; while absolute discretionary accruals are higher for smaller firms implying that income decreasing earnings management is more popular among smaller firms in India.

Table 2 Quartlies

avgta	avgta	size	ind	ind_num	meet_num	meet_max	att	chp	dir	ceo_chair	pro_sh	indpro_sh
1	11622.76	9.81	0.41	4.11	4.46	6.41	0.71	0.06	4.43	0.01	56.71	39.67
2	31034.05	10.59	0.48	5.02	4.42	6.03	0.74	0.11	4.92	0.04	50.44	39.44
3	73314.39	11.11	0.48	5.25	4.80	6.39	0.76	0.18	5.25	0.00	52.74	40.93
4	373532.80	12.45	0.44	5.39	6.18	8.36	0.75	0.13	4.53	0.00	57.20	49.72
Mean	**122376.00**	**10.99**	**0.45**	**4.94**	**4.97**	**6.80**	**0.74**	**0.12**	**4.78**	**0.01**	**54.24**	**42.49**

avgta_dum	forpro_sh	forpro_num	inst	inst_for	inst_dom	forinstpro_num	bigthree	bigfour	block5_sh	block5_num	block10_sh	block10_num
1	15.39	0.43	25.45	13.58	11.87	0.97	0.53	0.56	8.46	1.07	1.75	0.11
2	10.13	0.33	30.40	15.54	14.86	0.99	0.53	0.57	8.17	0.99	2.88	0.23
3	11.16	0.31	32.64	15.54	17.10	0.97	0.56	0.61	9.19	0.95	3.34	0.23
4	7.14	0.26	42.43	12.09	30.34	0.98	0.39	0.45	11.53	1.01	5.63	0.36
Mean	**10.88**	**0.33**	**32.85**	**14.20**	**18.66**	**0.98**	**0.50**	**0.55**	**9.35**	**1.00**	**3.43**	**0.24**

avgta_dum	tacc_abs	tacc_rel	nondis_acc	disc_acc	abs_da	ff	ff_dum
1	377.99	0.03	-0.01	0.04	0.23	0.28	0.25
2	877.12	0.03	0.02	0.01	0.19	0.31	0.32
3	2443.70	0.03	0.01	0.03	0.14	0.26	0.17
4	5869.99	0.01	0.03	-0.01	0.10	0.1844257	0.09829
Mean	**2392.2**	**0.0256624**	**0.0115652**	**0.014256**	**0.1616205**	**0.258535**	**0.20833**

The Regression Model

We examine the association between family firms and earings management proxied by discretionary accruals by estimating the following pooled OLS regession for each of the three variations of the dependent variable, being absolute discretionary accruals (abs_da), a dummy variable for absolute discretionary accruals (abs_da_dummy) and natural logarithm for the absolute discretionary accruals proxy (lnabs_da). We have controlled for firm size and the corporate governance variables of the sample firms.

$$disc\_acc_{it} = \beta_0 + \beta_1 ff_{it} + \beta_2 ff\_dum_{it} + \beta_3 lnavgta_{it} + \beta_4 size_{it} + \beta_5 ind_{it} + \beta_6 meet\_max_{it} + \beta_7 att_{it} + \beta_8 pro\_sh_{it} + \beta_9 forpro\_sh_{it} + \beta_{10} inst_{it} + \beta_{11} forinstpro\_num_{it} + \beta_{12} block10\_num_{it} + \beta_{13} bigthree_{it} + \varepsilon_{it} \quad (1)$$

$$abs\_disc\_acc_{it} = \beta_0 + \beta_1 ff_{it} + \beta_2 ff\_dum_{it} + \beta_3 lnavgta_{it} + \beta_4 size_{it} + \beta_5 ind_{it} + \beta_6 meet\_max_{it} + \beta_7 att_{it} + \beta_8 pro\_sh_{it} + \beta_9 forpro\_sh_{it} + \beta_{10} inst_{it} + \beta_{11} forinstpro\_num_{it} + \beta_{12} block10\_num_{it} + \beta_{13} bigthree_{it} + \varepsilon_{it} \quad (2)$$

$$disc\_acc\_dum_{it} = \beta_0 + \beta_1 ff_{it} + \beta_2 ff\_dum_{it} + \beta_3 lnavgta_{it} + \beta_4 size_{it} + \beta_5 ind_{it} + \beta_6 meet\_max_{it} + \beta_7 att_{it} + \beta_8 pro\_sh_{it} + \beta_9 forpro\_sh_{it} + \beta_{10} inst_{it} + \beta_{11} forinstpro\_num_{it} + \beta_{12} block10\_num_{it} + \beta_{13} bigthree_{it} + \varepsilon_{it} \quad (3)$$

We ran the pooled OLS regression with all the three dependent variable proxies, but did not get significant results, then we did a factor analysis identified factor scores and ran regressions using the factor scores. The results were not encouraging. Simple t test for our sample of family versus the non family firms for the BSE 200 sample did not show the corporate governance variable as significantly different for them. There were about 113 family firms in the BSE 200 sample we had chosen. We had limited the sample to BSE 200 as it was manual data collection based on the definition of family firm we had chosen for the study.

There was a probability that we were picking up the good firms in the sample, with better corporate governance characteristics, not engaging in significant earnings management practices. Thus we chose a different sample for the study. We took the 2697 BSE A and B group firms and ranked them in descending order of their market capitalization. The ranked firms were then

divided into deciles of about 200 firms each. We dropped firms where we had no market capitalization data available. The 5th decile of 204 firms, with market capitalization ranging between Rs 475 million to Rs 800 million was selected for further analysis. This method of sampling helps to capture a sample of mid cap firms with higher concentration of family firms.

We followed the same procedure for identifying the family firms out of these 204 firms with six years (2006-2012) of data. We had about 1078 firm year observations with about 770 family firm observations.

We started with the Difference of means t test for the corporate governance variable for these 1078 firm year observations to explore how these variables were different for the family firms as compared to the non family firms in the sample. Most of the important corporate governance variables were significantly different for the family firms in the sample.

t-test Results

Corporate Governance Characteristics					
Variable	**ff = 0**	**ff = 1**	**Diff (High - Low)**	**t_value**	**p_value**
board_size	7.2583	7.7161	-0.4578	-2.88	***
ind	0.4957	0.4752	0.0205	1.29	*
meet_max	6.0849	6.7699	-0.685	-2.75	***
att	0.7331	0.7524	-0.0194	-1.7	**
bigfour	0.1331	0.0929	0.0402	1.61	*
forinstpro_num	0.2852	0.3348	-0.0496	-1.39	*
block10_num	1.1373	1.2745	-0.1373	-1.66	**

***, ** & * p values denote significance at < 0.001, 0.01 & 0.05 usual levels

The results show that family firms in the sample had bigger board size, more number of board meetings, higher attendance of members in those board meetings, higher foreign institutional

promoter shareholding and greater number of blockholders holding greater than 10% shares. Family firms in the sample have lesser percentage of independent directors and relatively lesser number of family firms gets audited by Big Four auditors as compared to the non family firms in the sample. Thus other than the proportion of independent directors and audit by Big Four, all the corporate governance variables indicate better governance indicator for family firms. This supports the existing literature discussing the need for family firms to opt for better corporate governance attributes as a mechanism for building family and business reputation

Descriptives statistics for the variables used in the new sample are given in the table below. Again we find both income increasing and decreasing earnings management in the sample and range for the earings management proxies is quite considerable. On an average sample firms have 7 directors on board, with 48% of them being independent (ind), with a median average of 8 directors. On an average 75% of board meeting were attended by the directors (att). Family firm, our main independent variable shows that on an average about 61% of the board positions are held by family members in the sample companies (with minimum two members in the board being family members)[14]. We have introduced some new independent variables for the sample – roa – measuring the return on total assets[15], age of the firm, debt_asset for the leverage exposure of the firm and a dummy variable for a possible loss in the previous year.

The sample firms on an average reported roa of about 9% p.a., leverage of 21% and firm age of 25 years.

[14] The statistic has gone up significantly as compared to the BSE 200 sample of firms, indicating better concentration of family firms having more number of board positions filled up by family members.

[15] Roa – Net Income/total assets, age – year under consideration (2006-12) minus the year of incorporation, loss – dummy; 1 if the firm had a loss in the previous year, else 0 and debt_asset – total debt/total assets.

Descriptives Table

Descriptive Statistics								
Variable	**N**	**Minimum**	**Lower Quartile**	**Mean**	**Median**	**Upper Quartile**	**Maximum**	**Std Dev**
disc_acc	681	-0.0951	-0.0243	0.0006	-0.0093	0.0137	0.3521	0.0432
abs_disc_acc	681	0.0000	0.0105	0.0282	0.0209	0.0350	0.3521	0.0328
disc_acc_dum	770	0.0000	0.0000	0.3403	0.0000	1.0000	1.0000	0.4741
ff	770	0.0000	0.0000	0.6143	1.0000	1.0000	1.0000	0.4871
size	758	2.4159	6.4767	7.0751	7.0525	7.6950	10.1983	1.0948
roa	753	-0.8906	0.0419	0.0910	0.0856	0.1356	1.0555	0.1259
debt_asset	617	0.0000	0.0829	0.2057	0.1740	0.3007	0.9833	0.1595
inst	718	0.0000	0.0100	4.4326	0.3600	4.2400	89.5200	10.5749
ind	736	0.0000	0.4300	0.4827	0.5000	0.6000	1.0000	0.1943
age	758	3.0000	16.0000	25.5765	21.0000	31.0000	78.0000	15.1513
loss	763	0.0000	0.0000	0.1415	0.0000	0.0000	1.0000	0.3488
bod_size	736	2.0000	6.0000	7.5476	8.0000	9.0000	14.0000	2.0873
meet_max	736	0.0000	5.0000	6.5177	6.0000	8.0000	24.0000	3.3870
att	699	0.3300	0.6500	0.7456	0.7500	0.8400	1.0000	0.1447
bigfour	726	0.0000	0.0000	0.1074	0.0000	0.0000	1.0000	0.3099
forinstpro_num	718	0.0000	0.0000	0.3162	0.0000	1.0000	1.0000	0.4653
block10_num	153	1.0000	1.0000	1.2288	1.0000	1.0000	4.0000	0.5560

Correlations

The correlation table shows that we have significant negative correlation between signed accruals and the family firm variable (ff), but none between absolute accruals and ff. The same also reflects in the regression results shown later and indicates that family firms have lower discretionary accruals but more importantly, they indulge in downward earnings management as is evident form the difference in signs for signed versus absolute discretionary accruals. We also observe that the larger firms in our sample are family run. Family firms also have higher leverage, larger boards and better board meeting attendance. On the other hand, family firms have lesser proportion of independent directors and have lesser possibility of being audited by a big four auditor.

Correlation table

Spearman's Correlation Matrix																	
Variables	disc_acc	abs_disc_acc	disc_acc_du	ff	size	roa	debt_asset	inst	ind	age	loss	bod_size	meet_max	att	bigfour	forinstpro_n	block10_num
disc_acc	1	-0.06813*	0.8427***	-0.12149***	-0.03578	0.05386	-0.04105	0.03223	-0.02481	-0.11978	0.05849	-0.08017	0.05609	0.01748	0.02839	0.053	0.01335
abs_disc_acc	-0.06813*	1	0.10661***	0.02621	-0.12442**	-0.04188	-0.01753	-0.07434	-0.00988	-0.06847*	0.12278***	-0.05375	0.04463	-0.01465	-0.02647	-0.07308*	0.03845
disc_acc_du	0.8427***	0.10661***	1	-0.1292***	0.01506	-0.02369	-0.00844	0.00527	0.03583	-0.0585	0.08642**	-0.01775	0.03109	0.00337	-0.01244	-0.00421	0.02928
ff	-0.12149***	0.02621	-0.1292***	1	0.09658***	0.055	0.15774***	0.01361	-0.08189**	-0.03222	-0.03723	0.09563***	0.05974	0.07585**	-0.06241*	0.05171	0.11136
size	-0.03578	-0.12442**	0.01506	0.09658***	1	-0.19404***	0.32946***	0.393***	0.2543***	0.07766**	0.01669	0.21214***	0.17399***	0.0102	0.07168*	0.25138***	0.02778
roa	0.05386	-0.04188	-0.02369	0.055	-0.19404***	1	-0.2184***	-0.06483*	-0.10738***	0.0094	-0.33962***	-0.01364	-0.01064	0.06034	-0.01683	-0.03912	0.16**
debt_asset	-0.04105	-0.01753	-0.00844	0.15774***	0.32946***	-0.2184***	1	0.15038***	-0.03023	-0.10164**	0.22957***	0.12151***	0.04216	-0.08098*	0.01212	0.03244	0.04361
inst	0.03223	-0.07434	0.00527	0.01361	0.393***	-0.06483*	0.15038***	1	0.11652***	-0.05219	0.00801	0.08651**	0.01686	-0.02925	0.12105***	0.52413***	0.05722
ind	-0.02481	-0.00988	0.03583	-0.08189**	0.2543***	-0.10738***	-0.03023	0.11652***	1	0.04896	0.0284	-0.08877**	0.20996***	0.03247	-0.05058	0.10904***	-0.10311
age	-0.11978	-0.06847*	-0.0585	-0.03222	0.07766**	0.0094	-0.10164**	-0.05219	0.04896	1	0.01181	0.08492**	-0.14466***	0.07486**	0.16586***	-0.11183***	0.06316
loss	0.05849	0.12278***	0.08642**	-0.03723	0.01669	-0.33962***	0.22957***	0.00801	0.0284	0.01181	1	0.08326**	-0.02634	-0.08686**	0.10993***	-0.05828	-0.13935*
bod_size	-0.08017	-0.05375	-0.01775	0.09563***	0.21214***	-0.01364	0.12151***	0.08651**	-0.08877**	0.08492**	0.08326**	1	-0.05483	-0.33365***	0.0622*	0.06121	-0.19159**
meet_max	0.05609	0.04463	0.03109	0.05974	0.17399***	-0.01064	0.04216	0.01686	0.20996***	-0.14466***	-0.02634	-0.05483	1	-0.04828	-0.0781**	0.05344	0.13021
att	0.01748	-0.01465	0.00337	0.07585**	0.0102	0.06034	-0.08098*	-0.02925	0.03247	0.07486**	-0.08686**	-0.33365***	-0.04828	1	-0.10981***	-0.03288	0.08621
bigfour	0.02839	-0.02647	-0.01244	-0.06241*	0.07168*	-0.01683	0.01212	0.12105***	-0.05058	0.16586***	0.10993***	0.0622*	-0.0781**	-0.10981***	1	0.03367	0.02253
forinstpro_num	0.053	-0.07308*	-0.00421	0.05171	0.25138***	-0.03912	0.03244	0.52413***	0.10904***	-0.11183***	-0.05828	0.06121	0.05344	-0.03288	0.03367	1	-0.05704
block10_num	0.01335	0.03845	0.02928	0.11136	0.02778	0.16**	0.04361	0.05722	-0.10311	0.06316	-0.13935*	-0.19159**	0.13021	0.08621	0.02253	-0.05704	1

The following regression equations were run for all the three proxies of discretionary accruals for our sample of family firms.

$$disc\_acc_{it} = \beta_0 + \beta_1 ff_{it} + \beta_2 firm\ size_{it} + \beta_3\, roa_{it} + \beta_4 debt\_asset_{it} + \beta_5 inst_{it} + \beta_6 ind_{it} + \beta_7 age_{it} + \beta_8 loss_{it} + \varepsilon_{it} \quad (1)$$

$$abs\_disc\_acc_{it} = \beta_0 + \beta_1 ff_{it} + \beta_2 firm\ size_{it} + \beta_3\, roa_{it} + \beta_4 debt\_asset_{it} + \beta_5 inst_{it} + \beta_6 ind_{it} + \beta_7 age_{it} + \beta_8 loss_{it} + \varepsilon_{it} \quad (2)$$

$$disc\_acc\_dum_{it} = \beta_0 + \beta_1 ff_{it} + \beta_2 firm\ size_{it} + \beta_3\, roa_{it} + \beta_4 debt\_asset_{it} + \beta_5 inst_{it} + \beta_6 ind_{it} + \beta_7 age_{it} + \beta_8 loss_{it} + \varepsilon_{it} \quad (3)$$

We got the best results for discretionary accruals proxy. The difference in means t tests shows the corporate governance variables which are significantly different for the family firms in the sample. Thus we have not included all the corporate governance variables in the regression model. We have run the regressions on the model similar to the one used in Wang (2006).

The results support both our alternate hypotheses about family firms engaging in negative earnings management and having better corporate governance characteristics as compared to the non family firms in the chosen Indian sample firms. We can extend the theoretical argument laid out earlier with regard to the difference in agency cost I superseding the difference in agency cost II for family firms in the sample leading to a net trade off in favor of alignment effect versus the entrenchment effect for the family firms. This could be interpreted as the cost of lost reputation and unfavorable signaling to the stakeholders in case of higher earnings management measured using the discretionary accruals proxies, being greater than the benefits from positive reputation due to lesser earnings management for the family firm (A. Ali et al. 2007).

Firm size is still significantly negatively associated with earnings management. Board independence is picking up the association given by the correlations and is significantly negatively associated with discretionary accruals implying that firms with independent boards would manage earnings less due to their positive governance influence. Older companies manage earnings less, probably lending strength to the higher reputation at stake argument for the family firms. As was expected, the variable loss in the previous year is significantly positively

associated with discretionary accruals implying, a loss in the previous period increases the incidence of upwards earnings management to cover up for the loss and reflect better results for the firm. Higher return on assets (roa) is again positively associated reflecting higher discretionary accruals. This however could imply either increase in roa through managing earnings or better accrual rather than cash based performance for the firms.

Thus we largely find that family firms in the given sample in general display better corporate governance features supporting existing literature. However the evidence of downward earnings management is quite interesting a phenomenon though it is considered less damaging. It can be primarily reasoned out as efforts by firms to postpone current earnings recognition as a tradeoff for meeting thresholds in the following period. However with majority shareholding scope of private benefits consumption (R Gopalan and S. Jayaraman 2012) increases manifold necessitating the reason to understand the need for managing earnings downward by these firms.

Regression results Table 1 Dependent Variable is Discretionary Accruals (disc_acc)

Dependent variable - disc_acc					
Variable	**Coefficient**	**t-value**	**Std. Error**	**p-value**	
Intercept	0.06359	2.96	0.0215	0.0032	***
ff	*-0.00736*	*-2.34*	*0.0032*	*0.0198*	**
size	-0.00200	-1.09	0.0018	0.2775	
roa	0.03893	2.22	0.0176	0.0271	**
debt_asset	-0.01059	-0.94	0.0113	0.3483	
inst	-0.00027	-1.51	0.0002	0.1318	
ind	-0.02174	-2.68	0.0081	0.0076	***
age	-0.00017	-1.79	0.0001	0.0745	*
loss	0.00940	2.12	0.0044	0.0345	**
R-squared	25.35%				
Adjusted r-squared	19.58%				

*** p values denote significance at < 0.001, 0.01 & 0.05 usual levels

Regression results Table 2 Dependent Variable is Absolute value of Discretionary Accruals (abs_disc_acc)

Dependent variable - abs_disc_acc					
Variable	**Coefficient**	**t-value**	**Std. Error**	**p-value**	
Intercept	0.06237	3.93	0.0159	0.0001	***
ff	*0.00051*	*0.22*	*0.0023*	*0.8276*	
size	-0.00479	-3.53	0.0014	0.0005	***
roa	0.01581	1.22	0.0130	0.2234	
debt_asset	0.00473	0.57	0.0083	0.5710	
inst	0.00013	1.00	0.0001	0.3201	
ind	-0.00158	-0.26	0.0060	0.7917	
age	-0.00012	-1.77	0.0001	0.0767	*
loss	0.01360	4.15	0.0033	0.0000	***
R-squared	12.68%				
Adjusted r-squared	5.93%				

*** p values denote significance at < 0.001, 0.01 & 0.05 usual levels

Regression results Table 3 Dependent Variable is of Discretionary Accruals Dummy (disc_acc_dum)

Variable	**Coefficient**	**t-value**	**Std. Error**	**p-value**	
Intercept	1.02528	3.40	0.3016	0.0007	***
ff	*-0.13880*	*-3.14*	*0.0442*	*0.0018*	***
size	-0.00628	-0.24	0.0257	0.8070	
roa	0.28011	1.20	0.2338	0.2314	
debt_asset	0.19976	1.27	0.1575	0.2052	
inst	-0.00163	-0.66	0.0025	0.5120	
ind	-0.16716	-1.46	0.1141	0.1436	
age	-0.00228	-1.73	0.0013	0.0845	*
loss	-0.03129	-0.51	0.0613	0.6102	
R-squared	23.28%				
Adjusted r-squared	16.97%				

*** p values denote significance at < 0.001, 0.01 & 0.05 usual levels

Summary and Conclusions

Indian corporate sector with a predominance of family firms has to largely share the legacy of the common perception that results corroborated for some of the Asian contexts (largely non US contexts) may be true for Indian firms as well. Thus some of the evidence documented outside the US largely supporting the dominance of the entrenchment effect for family firms leading to considerable earnings management was extended for the Indian family firms too (Setia-Atmaja et al., 2009 for Australia, Prencipe et al., 2008, Bar-Yosef & Prencipe, 2009 Tiscini, 2008 for Italy, Jaggi et al., 2009 for Hong Kong). The reasoning primarily being weak investor protection rights and expropriation of the minority shareholders taking precedence over long term positive decision making by the family for the benefit of the firm value as a whole. The need to explore the issue in the Indian context was well justified as we have the 'family effect' ingrained in firm decision making considerably strong enough to positively influence the said tradeoff between entrenchment versus the alignment effect favorably for the firm. Moreover the strength of the institutional arrangements in place (though combined with relatively weaker enforcement) cannot be ignored. Thus we document negative earnings management by the family firms with better corporate governance attributes in our sample strengthening the importance of family businesses in our economy. However we need to extend the study further by examining the reason for the downward earnings management and the strength of the costs and the benefits in making the said tradeoff between the alignment versus the entrenchment effects.

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