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Multiple-Large Shareholders and Management Performance on Audit Quality of Listed Food and Beverages Firms

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ABSTRACT

Several researches have been conducted that aim to give a better explanation of audit quality, the majority of which are investigating the influence auditor and his work can have on the quality of his work. Contrastingly, this study seeks to investigate how those factors outside the influence of the auditor can affect the quality of his work. we simultaneously investigate how multiple large shareholders and management performance affect audit quality. Our study was conducted on the 32 food and beverage firms listed on IDX at the end of the financial year 2020. The binary logistic regression test revealed that there is a positive and significant relationship between management performance and audit quality, also, a positive but insignificant relationship exists between multiple large shareholdings and audit quality. This study, therefore, indicates that companies whose management is doing well tend to present more truthful financial statements and information to the auditor over the non-performing ones.

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1. INTRODUCTION

Auditing's main goal is to satisfy investors' curiosity to confirm and receive an expert judgment or opinion about the truthfulness and fairness of financial reports, audit quality, even though doesn't have one specific definition, (DeAngelo, 1981) in (Kilgore et al., 2014), stated that audit quality is the likelihood that an auditor will find a flaw or misstatement in the financial statements or accounting system and also disclose the flaw. This will reduce the tendency of the management to commit fraud. Accounting scandals that occurred in recent years have raised concerns among investors, financial regulators, academicians and researchers with regard to the confidence and reliability they can place in audited financial statements (Tian et al., 2011).

The scandals affected both national and multinational organisations. Some of the famous scandals include Enron, Arthur Anderson, World Com, among others. This called for the need to emphasise on the quality of the audit being performed on organisations' financial statements. The complete collapse of Arthur Anderson, for instance, one of the 5 big public accounting firms in the US, in 2002 sent shockwaves throughout the world and is sometimes seen as having put a great deal of strain on accounting standards (Gendron, et. al., 2006) in (Zureigat, 2011).

According to (Fargher & Jiang, 2008), soon following the several scandals, auditors resorted to offering going concern opinions for organisations in financial dilemma. This outcome would indicate that auditors no longer throw caution in the wind sequel to such a disaster, meanwhile, they are now more likely to carry out the audit work in an extremely ethical manner that will guarantee the quality of the audit work. Audit quality constitutes one of the key elements that affects the trustworthiness of financial reports, and the greater the quality of the auditor's work, the more accurate the report is. This may serve as motivation for in-depth study and analysis of audit quality and the variables that may influence it (Davidson and New 1993) in (Zureigat, 2011)

Countries like Australia, United States, United Kingdom etc, have formulated regulations due to dissatisfaction with corporate governance's effectiveness, the audit process's quality, and the roles of auditors and auditing, in order to tackle future occurrences of such disastrous scandals and collapse of organisations (Kilgore et al., 2014).

There is a widespread belief that an external auditor ensures the accuracy of the financial statements delivered to shareholders by the management (Mautz & Sharaf, 1961) in (Al-Matari et al., 2017), the auditor therefore needs to work on the financial statements to reduce the information asymmetry between the two parties in order to settle conflicts that may arise between them. (Kane and Velury, 2004) in (Al-Matari et al., 2017) found that firms are more likely to purchase audit services from big auditing firms for the quality of the audit when the company has multiple shareholders which is different from the ones having single large shareholder. Hence professional audit is connected with audit quality.

According to (John, Litov, & Yeung, 2008) in (Zhang & Li, 2022) Multiple large shareholders participation in corporate leadership has become the new norm in corporations. An entirely different kind of agency cost conflict may likely arise from a different direction when a number of large shareholders eventually acquire some kind of control over corporate governance and decision-making through their voting rights, however they utilize such control power to mutually supervise each other. This will in turn make them feel the urge to consider the service of a very reputable auditor like a Big Four auditor which will consequently make them pay higher audit costs compared to those with a non-multi large shareholder.

Over the years, the impact of management's performance on the quality of the work of the auditor has not received deserved attention, most of the practitioners and researchers in

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the audit profession, tend to focus on the auditor and his work, whereas the reality is that only the information provided by management can be audited by the auditor. So the audit work can be seen to be influenced to a large extent by the work of the management (Abate, 2018). Based on the foregoing, it is correct to state that for better audit quality, a more comprehensive and inclusive strategy is required. The "three-legged stool" of the auditor, audit committee, and management working together will surely strengthen the quality of the audit the most.

Management's perception of the audit's value grows as a result of management participation in the audit process. The most likely people to claim that the audit itself has little value are managers who are not involved in the auditing process. The more the involvement of the management towards achieving audit quality goal, the better the quality that will be achieved (Abate, 2018).

So, this paper seeks to study whether and how multiple shareholders can impact the level of the quality of the audit work of the auditor they hire, so that they can place some amount of reliability to the financial information they are being provided with, while simultaneously studying whether and how management's operations and performance are affecting the audit quality of the auditor. Unlike other researches that mostly tend to study the impact of the auditor on the quality of his work, this study tends to measure the relationship between two important variables, i.e., multiple large shareholders and management performance with the quality of the audit work performed. The two predictive factors seem to have receive little attention from previous researchers over the years.

Agency Theory

In studies on corporate governance, (Daily et al., 2003) in (Kultys, 2016) described agency theory to be a common theoretical paradigm. Due to two characteristics, it is popular for. First of all, it is straightforward because it divides big organizations into two distinct participant groups with distinct interests: managers and shareholders. The stockholders in a corporation are the principals, and the managers are the agents acting on their behalf and in the interests of the principals. Second, it presupposes the widely held belief that men are fundamentally egoistic and that everyone who is sensible acts in their own best interests. He elaborated that Agency theory presupposes that when control mechanisms are absent, opportunistic behaviour is always possible, even though shareholders' and managers' interests may vary to varying degrees depending on the scenario.

Kouaib & Jarboui (2014) asserts that the relationship between managers and shareholders is inherently conflictual, agency conflicts result from the division of the control and property roles and are brought about by the behaviour of an opportunistic manager in form of asymmetric information. In fact, the complexity of the organization is positively correlated with the necessity for shareholders to control the managers.

Kouaib and Jarboui (2014) cited (Jones, 2011; Usman, 2013) as saying that the primary function of audit, together with ownership structure, as governance instruments, is to lessen information asymmetry between managers and shareholders.

According to agency theory, business controls do not have a robust market, which causes a variety of issues, such as market failures, asymmetric knowledge, moral hazard, and adverse selection (Bonazzi & Islam, 2007). Another form of agency conflict usually arises within the shareholders. A potential second sort of agency cost conflict arises when a number of substantial shareholders eventually acquire some level of control over business decision-making and corporate governance through their voting rights (Zhang & Li, 2022). By using multiple large shareholder systems, which can also stimulate the supervisory optimism of non-controlling shareholders and jointly limit the largest shareholder's self-interest rationale and moral hazard, the problem of information asymmetry among shareholders in company's activities can be remedied (Zhang & Li, 2022).

Despite the fact that ownership concentration can successfully solve the first type of agency problem, its negative self-centred feature will harm business performance, create information asymmetry, and exacerbate the second type of agency clash. (Zhang & Li, 2022). This therefore, triggered the need to look for a remedy to the second type of the agency dilemma, several remedies have been considered part of which are; the observance of a qualitative audit, financial regulation, considering having conservative competition among others.

Audit Quyality

Due to recent audit failures, company failures, and the ensuing investigations that led to regulatory changes, there has been a problem with audit quality and perceptions of audit quality, as there is no single generally accepted definition or measure of audit quality. In most studies, "the market-assessed joint probability that a given auditor will both detect and report a breach in the client's accounting system" is used to define audit quality as cited by (DeAngelo, 1981) in (DeFond & Zhang, 2014) and (Kilgore et al., 2014). DeFond and Zhang, (2014) defined audit quality as a greater guarantee of high-quality financial reporting. Audit is valued by the process's ability to independently vouch for the accuracy of accounting data, which increases the effectiveness of resource allocation and contracting efficiency.

Zureigat (2011) cited Bradshaw et. al. (2001) as defining Audit quality to be the readiness of the auditor to disclose any material temperament, understatement or overstatement of any financial data that will result in increased material uncertainties and/or going concern issues.

The behavioural literature supports the idea that audit quality can be thought of as a collection of qualities valued by groups interested in, or impacted by, the audit process and audit reports, and that the qualities and weight given to them vary among various interest groups (Kilgore et al., 2014). In the same vein, (Abate, 2018) also argued that the degree of a stakeholder's direct involvement in the audit and the framework they use to evaluate audit quality influence how they perceive the quality of the audit. So, the question of whether audit is qualitative or not depends on the stakeholder assessing it. Shareholders may measure audit quality from a different angle while management will also measure it from an entirely different angle.

According to Craswell (2000) as cited by (Kilgore et al., 2014), agency and contracting theory supports interest groups' demands for high-quality, differentiated audits in agency relationships, and audit quality evaluations are based on metrics and/or factors that can be observed by particular interest groups.

The Indonesian Government has in one of its regulations declared that all audit work should be of good quality, according to the government, audit work is regarded qualitative if it meets the standards set by the government, which include among others, accuracy of audit findings; compliance with audit standards; clarity of reports; derivable benefits etc.

Fees paid to auditors can have double impacts on audit quality through: first, high fees may encourage auditors to be more effective and efficient in the course of doing their work, which will improve audit quality. On the other hand, high fees given to auditors, especially those associated with non-audit services, will interfere with auditors' financial independence. Such dependence on finances may result in a situation where the auditor is unwilling to ask the right questions during the audit for fear of forgoing highly lucrative fees (Hoitash et al., 2007). He finally concluded that larger fees provided to auditors may motivate them to work more, which would improve the audit quality. In addition to that, (Niskanen et al., 2011) asserts that based on evidences, businesses are more inclined to engage Big 4 auditors if they have larger monitoring demands as a result of higher agency expenses.

In this research, audit quality can be assessed through the reputation of the auditor carrying the audit work, i.e., Big 4 or Not Big 4.

Multiple Large Shareholders

Participation of multiple large shareholders in corporate governance has become the new global trend (John, Litov, & Yeung, 2008) as cited by (Zhang & Li, 2022). A potential second sort of agency cost conflict arises when a number of substantial shareholders gradually acquire control over business decision-making and corporate governance through their voting rights (Zhang & Li, 2022). La Porta et al., (1999); Barca and Becht (2001) in (Maury & Pajuste, 2005) asserts that recent empirical research has demonstrated that control is often held by a limited group of large stockholders.

Burkart et al. (1997) in (Maury & Pajuste, 2005) specify that there are certain costs and benefits of having large shareholders in control. The main risk is that large shareholders can pursue their own goals, which can differ substantially from profit maximization. Some of these goals can come at the expense of minority shareholders. When the benefits of monitoring offset the loss of managerial incentives, multiple ownership concentration can be advantageous for minority shareholders. The (partial) free-rider issue in takeovers is also resolved (in part) by the existence of a large shareholder (Shleifer and Vishny, 1986) in (Maury & Pajuste, 2005).

Multiple significant shareholders are considered to be an entrusted agent, which is a crucial example of connection and human capital (Jiang & Kim, 2015) in (Zhang & Li, 2022). Schoenfeld (2020), Attig, Guedhami, & Mishra (2008) as cited by (Zhang & Li, 2022) states that the problem of information asymmetry among shareholders in business activities can be remedied by multiple large shareholder systems, which can also ignite the supervisory zeal of minority shareholders.

The multiple large shareholder system is seen in China as a significant accomplishment of the country's shareholding reform.(Zhang & Li, 2022). Also, they cited (Gul, Kim, & Qiu, 2010) where they stated that there are numerous instances of shareholding reforms that tries to mitigate clash of interests among the company's major shareholders while trimming the rights and interests of the largest shareholders in several countries such as the United Kingdom, the United States, China, just to mention a few.

Companies with a number of significant shareholders have a strong incentive to enhance their internal accounting controls through the request of excellent external audits. Large shareholders have a propensity to voice their dissatisfaction with the company's financial system, which in turn fuels demand for a higher-quality audit service. The desire for improved audit quality may therefore be influenced by the rise of companies with multiple large shareholders (Dhillon & Rossetto, 2015); (Edwards & Pinkerton, 2020), as cited in (Zhang & Li, 2022),

The ownership structure's representation of corporate governance will unavoidably have an impact on the firm's decision to purchase external audit services. (Zhang & Li, 2022) concluded that Firms with many significant shareholders cost more to audit and are more likely to hire one of the Big Four auditor than those with a non-multiple large shareholder.

The hypothesis here, therefore, is

H1: Multiple large shareholders (MLS) affect the quality of external audit service.

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Management Performance

The impact management can make on audit quality has not been given the deserved attention by researchers. Whereas the truth is that the auditor is limited to reviewing the data that management has provided. To increase audit quality, a more comprehensive and inclusive strategy is required. The "three-legged stool" of the auditor, audit committee, and management working together strengthens the quality of the audit the most (Abate, 2018).

Research was done by CPA Canada and FEI Canada to determine how well management understood the Research was done by CPA Canada and FEI Canada to determine how well management understood the value of their contribution to the effectiveness of the annual financial statement audit. They wrote an article titled "How Management Contributes to Audit Quality" which seek to examines what audit quality means to managers, how long do they need stay working on various audit areas, where it believes time should be spent, and the value it provides to audits. They concluded that managers can contribute with data analytics to the auditor in order to enhance the quality of the audit process.

Data analytics offers a chance to significantly improve audit quality by giving managers more robust performance statistics, deeper insights into an organization's systems and controls, and more effective and efficient interactions between auditors and management (Abate, 2018). Data analytics can be used to find inefficiencies, monitor spending and revenue, and improve business processes. Managers may offer crucial insights that support the expansion and success of firms by integrating data analytics into their workflow. Management’s operation and performance can therefore undoubtedly affect audit quality.

Olatunde (2015) as cited by (Otekunrin et al., 2019) concluded that business performance can be influenced by management maintaining and improving a correct liquidity coverage ratio. He also cited U. Uwuigbe, Eluyela, O. Uwuigbe, Obakpro, and Falola (2018) and Eluyela et al. (2018a), banks that have enough liquidity but not too much are more successful because the excess liquidity can be used to finance other profitable investments that will generate more returns for the banks rather than tying them up in just one line of work.

Going by the above, liquidity performance of firms can be used as proxy for their management’s performance. This study therefore uses liquidity as an indicator of management’s performance. The hypothesis therefore is as thus;

H1: Management performance affects external audit quality

3. METHODS

This research uses quantitative approach. The data used for analysis were extracted from the annual financial reports of the companies under study. The population of the study comprises of all the companies that fell under the food and beverages subsector listed on the Indonesian Stock exchange. The sampling technique used is all population sampling technique. The reason was to have more coverage and also reliable sample. This study used secondary data which was sourced from the annual financial reports of the companies under study for the year 2020.

Our study used both ratio and nominal scale variables, with multiple large shareholders and management performance being the explaining variables while audit quality is the predicted variable. The table below elaborates more on the variables used for this study.

Table 1. Research Variables And Their Indicators.

S/N	Variables	Definition	Indicator	Scale
1	Management performance	Management's ability to maintain a sound liquidity performance	Liquidity ratio (current ratio)	ratio
2	Multiple large shareholders	Having more than one shareholder with more than 20% shareholding	Shareholding structure	nominal
3	Audit quality	Greater guarantee of high-quality financial reporting	Audit by big 4	nominal

The current ratio measures a company's ability to pay off its current liabilities (payable within one year) with its total current assets such as cash, accounts receivable, and inventories. The higher the ratio, the better the company's liquidity position. It is calculated by dividing current assets by current liability. If the company has multiple large shareholders, we give it 1 whereas if it has single large shareholder, we give it 0. Shareholders are considered as large shareholders if they possess 20% or more of the company's shares. This is supported by submission of (Earle et al., 2005) who state that if shareholders possess at least 20% of the total shares, such shareholders are considered to be large shareholders. In the same vein, we give 1 and 0 if the company was audited by big 4 and not big 4 respectively.

The population of the study was made up of all the food and beverages firms listed on the Indonesian Stock Exchange (IDX), meanwhile 32 food and beverages listed firms were found on the 31st December 2020. All population sampling technique was used, therefore all the members of the population i.e., all the 32 listed companies made up the sample, this technique was considered suitable giving the fact that the data is not extremely big to mandate for partial or smaller sampling. We used secondary data which we extracted from the Annual Financial Statements of the companies under study as published by IDX for the year 2020.

The first data analysis technique to be implored by this study is descriptive statistics, in order to be able to get the basic information about the data. Nevertheless, going by the peculiarity of the data used in this study, we found Binary Logistic Regression technique to be suitable for the analysis, in order to measure the relationship that exists between the dependent and independent variables. The data has met all the criteria/assumptions, the dependent variable for example, is dichotomous in nature; the independent variable is more than one, one continuous and one categorical; the sample size is large and there is no multicollinearity among the independent variables. The logistic regression equation for the analysis is therefore stated below:

$$\text{Ln}\ (\bar{P}/1\text{-}P) = \beta o + \beta 1 SML + \beta 2 CR$$

4. RESULTS AND DISCUSSION

Descriptive statistics for Multiple Large Shareholders (MLS), revealed that a total of 13 firms out of the 32 firms under study have MLS, this accounts for 40.6 percent of the population. On the other hand, 19 out of the 32 have Single Large Shareholders (SLS), which represents 59.4 percent of the population. This is illustrated in table 4.1 below.

Table 2. Descriptive Statistics Analysis For Mls

	Frequency	Percentage	Valid percentage	Cumulative percentage
SLS	19	59.4	59.4	59.4
MLS	13	40.6	40.6	100.0
Total	32	100.0	100.0	

Nevertheless, the Descriptive statistics for the auditor revealed that 22 out of the 32 firms had non-big 4 as their auditors, which represents 68.8 percent of the population, which according to this study, denotes less qualitative audit. Conversely, the statistics observed 10 firms constituting 31.1 percent of the population to be audited by Big 4 accounting firm. This implies that only 10 companies were observed to have qualitative audit. This can be seen in table 4.2 below

Table 3. Descriptive Statistics Analysis For The Auditor

	Frequency	Percent	Valid Percent	Cumulative Percent
Non big 4	22	68.8	68.8	68.8
Big 4	10	31.3	31.3	100.0
Total	32	100.0	100.0	

Moreover, the descriptive statistics for the current ratio revealed a mean of 194.5 (St. Deviation=110.5), which indicates that companies with current ratio close to the mean ratio tends to appreciably perform better than those with a current ratio close to the minimum values (51.8) i.e., low current ratio rate. This is in consideration of the rule of thumb relating to current ratio, which provides that the higher the current ratio, the better for the firm. the recommended ratio should peg around 2:1 or 200 percent or more which in this case is similar to our computed mean. It is however worthy to note that a low current ratio, signifies liquidity problems, where as an extremely high current ratio is also not recommended as it signifies idle cash, which means that excess cash and its equivalents are not well utilized by investing it to fetch more income to the firm. Therefore instead of tying down excess cash in one line, the management can seek more profitability which will improve their performance by investing in different lines. Both scenarios tend to undermine management's performance. The statistics is presented in table 4.3 below.

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Table 4. Descriptive Statistics Analysis For The Current Ratio

	N	Minimum	Maximum	Mean	Std. Deviation
Current Ratio	32	51.80	466.3	194.5	110.5
Valid N (listwise)	32				

Binary Logistic Regression Analysis

In order to ensure that the assumptions of binary logistic regression methods are met, we started by running a multicollinearity test against the independent variables and insignificant coefficient was observed, indicating that there is no multicollinearity problem between them. Subsequently, the binary logistic regression was runned, and we found out that, firstly, the Omnibus Test of Model Coefficient to be significant at 0.016 which indicates that our predictors fully explained the model, i.e., the model is relevant.

Secondly, the Nagelkerke's R square appeared to be 0.32, meaning to say that 32% variation in our dependent variable (Audit Quality) is accounted for or explained by our independent variables (current ratio and MLS). Additionally, the Hosmer and Lemeshow Test was found to be insignificant indicating the goodness of fit of our model, which was found fit. Also, the overall percentage of the prediction accuracy was found to be high at 78%.

Table 4.4 below presents the result of the binary logistic regression test, i.e., the analysis of the relationship that exist between the two independent variables and the dependent variable. One of them showed significant and positive relationship with the dependent variable whereas the other one showed an insignificant relationship. The correlation coefficient of current ratio against the type of auditor a firm hire, whether Big 4 or Non-Big 4 is found to be significant at 0.015, meaning to say that the odd of a firm with a good current ratio having a big 4 auditor is 1.012 times higher than companies with a low current ratio. This therefore is an indication that management's performance affects the quality of the audit, it is against this background, that we reject the null hypothesis II and accept the alternative one. The aforementioned finding, concurs with the findings of (Abate, 2018) and (CPA Canada and FEI Canada, 2018) that stressed how management performance can affect the quality of audit of the financial statements of a firm.

On the other hand, the correlation coefficient of the independent variable, Multiple Large Shareholder, against the dependent variable was insignificant at 0.35. despite being insignificant the result revealed that the odd of MLS firm hiring a Big 4 auditor is 2.591 times than a Single Large Shareholder (SLS) firm This therefore is in tandem with our null hypothesis I, consequently we have to accept it and reject the alternative one. This result concurs with findings of (Zureigat, 2011) who revealed that there is an insignificant association between ownership concentration and audit quality of the financial statements of a firm. In contrast to the above, (Zhang & Li, 2022) found out that State-owned businesses and huge businesses with multiple large shareholders frequently incur more expensive audit costs and are more likely to hire the Big Four. Also, (Kane and Velury, 2004) in (Al-Matari et al., 2017) found that firms are more likely to purchase audit services from big auditing firms for the quality of the audit when the company has multiple large shareholders. They found a significant and direct relationship between MLS and audit quality of financial statements.

Table 5. Summary Of Binary Logistic Regression Result

Variables	B	S.E.	Wald	df	Sig.	Exp(B)
MLS	.952	1.016	.879	1	.349	2.591

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Current Ratio	.012	.005	5.941	1	.015	1.012
Constant	-3.841	1.511	6.466	1	.011	.021

5. CONCLUSION

This study seeks to test the relationship between multiple large shareholdings in Indonesian companies and the quality of audit on one hand, and between management performance and audit quality on the other hand. Taking companies that have more than one shareholder owning 20% of the total shares of the company to constitute MLS in that firm, Liquidity performance (using current ratio) on the other hand was taken to constitute management performance while having Big 4 or Non-big 4 as an external auditor was taken to represent audit quality. Two hypotheses were developed to connote the existence of relationship between the two independent variable and the dependent variable (audit quality) whether positively or negatively, significantly or insignificantly.

The need for the study was as a result of more explanation required on audit quality, especially after the occurrence of several global and national accounting scandals which have caused clients of audit services to question the quality of services they receive from their agents. In addition to that, researchers tend to get inclined to investigating those factors that influences audit quality from the angle of the auditor's qualities, while neglecting the impact management performance can make, after all management are the ones who prepare the financial statements that the auditor seek to work on. The results of the analysis, revealed that there is a positive and significant relationship between management performance and audit quality, this result tallied with findings of (Abate, 2018) who posited that the three-legged stool of the management, audit committee and auditor will undoubtedly improve the audit quality. The trio need to collaborate for achievement of a qualitative audit of financial statements.

Nevertheless, the result revealed on the other hand a positive relationship between multiple large shareholdings and audit quality but the relationship was insignificant. This finding is in line with the findings of (Zureigat, 2011), who revealed that there is insignificant association between ownership concentration and audit quality of the financial statements of a firm. But this was different from the findings of (Zhang & Li, 2022) and (Kane & Velury, 2004) in (Al-Matari et al., 2017) who found significant relationship between multiple large shareholders and audit quality.

Based on the above findings, the researcher therefore recommends that one of the ways to improve audit quality, different from looking at the issue just from the auditor's qualities angle, is through pushing for increased management's performance and promotion of a professional and healthy collaboration between the auditor, management and the audit committee in order to attain even better audit quality. Future studies should focus on taking different and even more indicators of management performance in to their model such as ROA, ROI or even management's use of IT. Different methodologies can also be considered in making same analysis.

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