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Ownership Structure and Auditor's Ethnicity of Malaysian Public Listed Companies

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ABSTRACT

This study investigates the relationship between the ownership structure of Malaysian public-listed companies and the choice of auditor based on ethnicity. In addition, the study compares results for the years 2006, 2007 and 2008. The years were chosen as the Malaysian Code of Corporate Governance (MCCG) was revised in 2007. This enabled comparison to be made in the pre, during and post revision periods of the Malaysian Code of Corporate Governance. The data were derived from a sample size of 300 companies listed on Bursa Malaysia for three years i.e. 2006, 2007 and 2008. As such, it is possible to observe any impacts of the changes in the revised MCCG on ownership structure and auditor's ethnicity. Multinomial logistic regression was employed to analyse the relationship as the data levels support its use. It is found that in general MCCG 2007 influences the selection of auditor's ethnicity by companies. Future research is recommended to study the reasons and rationale of this result by employing other research strategies such as qualitative techniques and increasing the sample size to get more generalisable findings.

Keywords: Corporate governance, ethnicity, audit, Malaysian Code of Corporate Governance, Malaysia

INTRODUCTION

Even though a lot of research has been done in the area of corporate governance, not much research has been conducted on the Malaysian market especially focusing on dissecting the Malaysian corporate governance mechanism and its effects on the choice of auditor's ethnicity. The environment of the Malaysian market is

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somewhat 'unique' as the economic segment is divided along ethnic lines (Jesudason, 1989) and the fact that a substantial number of public listed companies are owned or controlled by families.

Many studies have suggested that cultural differences including ethnicity influence business and management practices e.g. Biggs *et al*. (2002) in Kenya, Davie (2005) in Fiji and Efferin and Hopper (2007) in Indonesia. In Malaysia, a similar phenomenon is discovered, such as by Haniffa and Cooke (2002) on voluntary disclosure, Iskandar and Pourjalali (2000) and Muniandy and Ali (2012) on accounting practice development, Gul (2003) on audit fees, Hashim (2002) on financial reporting quality and Yunos *et al*. (2012) on accounting conservatism.

The existence of multiracial communities in Malaysia further stimulates such an environment. There are three major ethnic groups in Malaysia viz. the Bumiputeras, Chinese and Indians. The Bumiputeras make up 62% of the total population, followed by the Chinese (22%) and the Indians (12%). The Bumiputeras comprise 50% Malays and other indigenous groups especially from Sabah and Sarawak, who make up the remaining 12% (Malaysian Department of Statistics, 2011). The two races that are most dominant are the Malays, who dominate politics and the Chinese, who dominate the economy.

The word 'Bumiputera' means 'sons of the soil'. In Peninsular Malaysia, the terms Malays and Bumiputeras are often used interchangeably because there, the majority of the Bumiputeras are Malays. However, the notion of Bumiputera is also applicable to other indigenous ethnic groups especially from Sabah and Sarawak (Siddique & Suryadinata, 1981). Various previous studies such as Che Ahmad *et al*. (2006), Yatim *et al*. (2006) and Johl *et al*. (2012) used the term Bumiputera instead of Malays. Nazri *et al*. (2012) and Haniffa and Cooke (2002) used the term Malay but they also referred to this term as Bumiputera. This study, however, only focused on the Malays and not other smaller indigenous groups. Future studies may want to explore the matter further.

These racial and cultural factors may influence the characteristics of a firm's corporate governance. Hofstede (1980) for example suggests that different cultures may lead to different specific behaviour, decision making and hence, ways of doing business. Therefore, it is interesting to study whether this proposition is also applicable to auditor selection in Malaysia. Due to the dearth of literature on the influence of ownership and culture on auditor selection, this study provides some insights to better understand the behaviour of business players in a complex multiracial society like Malaysia. The foundation of this study is anchored by the study of Lin and Liu (2009), who conducted research on auditor choice using China market data as well as the research done by Che Ahmad *et al*. (2006), which focused on the relationship between ethnicity ownership and auditor ethnicity of Malaysian listed companies.

Based on past studies in the Malaysian market such as that of Che Ahmad *et al*. (2006), ethnicity is one of the key variables used in analysing a firm's selection of an auditor. The ethnicity factor is peculiar to the Malaysian market since business success relies heavily on business network. Studies on the Malaysian market in this area are very limited, but Che Ahmad *et al*. (2006) found that there is evidence of high preference based on ethnicity in the process of auditor selection in Malaysia. Mutual undertsanding based on shared values including cultural and language similarities are among the key arguments for ethnic-based auditor selection. Studies done in different regions and geographical areas on the selection of auditors based on ethnicity may not identify ethnicity among the key determinants as the ethnicity issue is exclusive only to highly plural countries including Malaysia with highly distinguishable and less assimilated multiracial communities in significant proportions. The domination of key decision makers and ownership by certain ethnic groups may lead to the different monitoring styles of companies (Yatim *et al*., 2006)

Thus, the broad objective of this study is generally to investigate the relationship between the corporate ownership structure of companies and auditor's ethnicity in Malaysia. Specifically, this study intends to examine the relationship between ownership concentration, firms' ownership dominance, politically-connected firms and family-controlled firms and the choice of auditors based on ethnicity.

Differentiated from other studies such as the one conducted by Che Ahmad *et al*. (2006), this study examines the relationship before and after the revision to the Malaysian Code of Corporate Governance (MCCG) in 2007. In other words, this study considers the effects of the revision to the MCCG 2007 on auditor selection by companies. Furthermore, the study conducted by Che Ahmad *et al*. (2006) used rather outdated data i.e. 1993-1995. These were data prior to the Asian financial crisis in 1997 and the implementation of the first MCCG in 2000. The financial crisis in 1997 taught many companies the importance of conducting business based on good corporate governance practices. Due to limited studies on the relationship between ownership structure and auditor's ethnicity by other researchers, we want to revisit and further explore this area of study. Besides, findings by Che Ahmad *et al*. (2006) may no longer hold true with the application of corporate governance in 2000 and its revised version in 2007 by public listed companies.

This study was thus conducted to advance knowledge in corporate governance on a firm's preferences towards the auditor's ethnicity. Corporate governance in Malaysia can be considered rather unique as the foundation of many Malaysian companies is built based on ethnicity and family-orientation, which is very rare in other parts of the world. Research regarding auditor's ethnicity in Malaysia are very limited. Besides, much of the research in this area is not up-to-date and this study intends to fill the void.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Prior studies show that appropriate company ownership structure may lead to good corporate governance. Generally, ownership structure can be divided into two main categories, namely, concentrated ownership and dispersed ownership. A company is considered to have concentrated ownership if the majority of shares are in the hands of a single or a few people, who in turn control the company. On the other hand, dispersed ownership or widespread shareholding arises when none of the shareholders has clear control of the company. These shareholders, however, can still control the company but this is complicated and difficult as anyone of them who seeks to do so needs to form alliances based on mutual interest (Sheilfer & Vishny, 1997).

Based on the Agency Theory, concentrated ownership will reduce the occurrence of the Type I problem as the owner does not have much problem monitoring the managers of the firm, and this leads to fewer conflicts. However, at the same time, the Type II problem may be increased as the majority of the shareholders are in a good position to divert the wealth of the firm from the minority shareholders.

Due to this, arguably, corporate governance cannot function effectively if ownership is highly concentrated (Allen, 2000; Globerman *et al*., 2011) especially when the legal system to protect shareholders is poor. Although this model is able to reduce agency cost (Roe, 2003) and overcome weak shareholder protection (La Porta *et al*., 1998) it can result in conflict between minority-majority shareholders (Chen *et al*., 2011), abuse of power (Chin *et al*., 2006; Solomon, 2010; Korczak & Korczak, 2009), concealment of material financial information (Bhasa 2004; Klassen, 1997; Kothari *et al*., 2009), expropriation of company wealth (Fan & Wong, 2002; Singam, 2003; Eriotis *et al*., 2007; La Fond & Watts, 2008; Young *et al*., 2008; Shuto & Takada, 2010), lowering of company performance (Schiehll, 2006) and reduced commitment to corporate responsibility (Ghazali, 2007). Many Asian firms including those in Malaysia operate using this type of shareholding model (Thillainathan, 1999), which is one of the contributing factors to the Asian financial crisis of 1997 (Tam & Tan, 2007). As a consequence, other monitoring mechanisms such as the hiring of external auditors are required to strengthen the governance of these companies.

Previous researchers have found that hiring good quality auditors is crucial to protecting the interest of stakeholders by enhancing reliability and adding value to the usefulness of corporate financial statement. The collapse of Arthur Andersen is a stern warning for business people on how compromised quality and integrity among auditors will shake financial stability around the world (Broberg, 2013). The stream of research that has followed have focused on factors that influence the decision of companies to select a higher level of audit (Knechel *et al*., 2013) such as to get higher assurance (Karim & Van-Zijl, 2013), to secure foreign ownership (Wang *et al*., 2008; Guedhami *et al*., 2009), to cope with complexity and financial reporting uncertainty (Karim & Zijl, 2013), to deal with technical competency and industry specialisation (Hakim & Omri, 2010), to improve corporate governance (Piot, 2005) and to manage higher risk (Copley & Doutheet, 2002).

However, another possible reason for auditor selection that is less researched is on the selection of auditors based on ethnicity. This is important as when a company selects an auditor based on race but not quality, it may impair the independence of the auditor. The auditor also may not be competent and capable enough to give opinions about the company. Furthermore, the selection of an auditor based on other than quality may signal to outsiders that the owner of the company could be driven by other incentives by choosing a sub-standard governance mechanism that may result in adverse effects to others but not themselves. Studies show that auditors' quality judgment can be adversely affected by incentives such as potential loss of clients (Blay, 2005), intention to retain clients (Chang & Hwang, 2003), economic benefits gained (Beeler & Haounton, 2002) and client engagement pressures (Kadaous *et al*., 2003).

The practice of nepotism and cronyism is not only confined to selecting an auditor by a company but also to other business transactions. Performing business transactions based on favouritism and not competency often leads to higher inherent risk and greater agency problems (Johnson & Mitton, 2003; Gomez & Jomo, 1999).

The policy of positive discrimination in Malaysia started when the government initiated the New Economic Policy in 1970 with the objective of helping the Bumiputeras gain an equal level of social and economic status as their Chinese counterparts. This policy is often perceived rightly or wrongly as anti-Chinese and anti-foreigners when Bumiputeras were given preferential treatment in almost all aspects such as access to education, financing, employment and equity ownership of productive sources. The Chinese community, however, strengthened its grip on economic dominance by being more inward-looking, community orientated, less accepting of trust in others and more prejudiced. The Chinese even communicate in their own dialect when conducting business (Stoever, 1985).

This was evidenced by Che Ahmad *et al*. (2006). They found that cultural and language similarities as well as the role of the Chinese networks that provided capital and market information to their members had basically influenced the selection of auditors among the Chinese-controlled firms. On the other hand, for the same reason, the Bumiputeras, especially the Malay entrepreneurs were also encouraged by the government to give priority to their fellow ethnic members in business dealings. Based on such arguments, ownership dominance by an ethnic group in an organisation may dictate the preference of an auditor of the same ethnicity.

The largest block shareholder technically has more power to influence the decision of a company, including selecting an auditor. The largest block shareholder is represented by a single individual with the largest shareholding in the firm as a percentage of the total share (Lin & Liu, 2009) Based on this, it is posited that the ethnicity of the largest block shareholder can influence the selection of similar ethnicity of the auditor.

> ***Hypothesis 1****: Ceteris paribus, there is a relationship between largest block shareholder and auditor's ethnicity*

Whenever an entity is controlled by a group of people with the same background such as via business alliance, their voice may be heard louder. Using a similar argument with the previous hypothesis, it is posited that ownership dominance by an ethnic group may influence the selection of the auditor of the same ethnicity, but with a few dominant shareholders forming a pact, the power base may become stronger. As compared to the argument of hypotheses 1 that identifies only one (1) or a single shareholder, ownership dominance in this context is determined through the combination of a few of the largest shareholders with the same ethnic origin, specifically identified by a combination of more than 5% shareholding and the top 30 major shareholdings. The following hypothesis is thus derived:

> ***Hypothesis 2****: Ceteris paribus, there is a relationship between ownership dominance and auditor's ethnicity*

Bumiputeras, especially the Malays, are the main players in the political power structure of Malaysia. As Government-Linked Companies (GLCs) are exclusively controlled by the government through the ownership of the Government-Linked Investment Companies (GLICs), politically-connected firms are also largely associated with Malay individuals who reside within them. As a corollary to that, it is argued that generally there is an existence of a relationship between politically-connected firms with the ethnic selection of auditors. Specifically, it is posited that there is a relationship between politically-connected firms with the selection of Malay auditors. Johl *et al*. (2012) found that Bumiputera (or Malay) managers tended to be more politically connected with a prevalence for selecting Bumiputera (or Malay) auditors. These managers were exhorted to lend support to their fellow ethnic Bumiputeras (or Malays) not only in business dealings but also in auditing in order to increase Bumiputera (or Malay) auditors' market share that had long been dominated by non-Bumiputera (or non-Malay) firms (Nazri *et al*., 2012).

Besides this, Saleh *et al*. (2006), based on the theoretical framework by Hofstede (1980) and Gray (1988) and a study by Haniffa and Cooke (2002), noted that the Malays were less professional regarding accounting value and exhibited low compliance with legal requirements of accounting practices. In China, Wang *et al*. (2008) found that companies owned by the state and federal governments were less likely to hire big auditors (proxy for higher audit quality). As the GLCs enjoy assistance from the government such as pre-determined market share, capital injection and bailout in cases of financial distress, there was no incentive for the government-owned enterprises in China to signal positively to outside potential investors by hiring better quality auditors. Wang *et al*. (2008) also forwarded a collusion argument whereby the government exerted influence on the auditors. Furthermore, GLCs may hire non-quality auditors to gain private benefits (Sheilfer, 1998) and pursue social and political agenda (Lin *et al*., 2003).

Thus the following hypothesis is derived:

> ***Hypothesis 3:*** *Ceteris paribus, there is a relationship between politically-connected firms and auditor's ethnicity*

The Chinese in Malaysia are more involved in business and economic activities relative to the other ethnicities. Due to that, it is assumed that there is a strong connection between family-controlled firms and Chinese ownership dominance in Malaysia.

Perkin (2000), Backman (2001) and Ashtrom *et al*. (2010) posited that Confucian traditions such as the importance of family, the primacy of relationship and loyalty influence the way the Chinese community conducts business and establishes their corporate empire. Family ties are important in constructing the internal organisation while inter-firm transactions are bound by affiliations with dialect groups and clan relationships (Wang, 1996).

In addition, with the relatively high involvement and participation of Malaysian Chinese in the professional accountancy bodies, their involvement in the audit industry too is regarded as high. With shared values in terms of language and culture, family-controlled firms may be more inclined to select their fellow Chinese as their auditors. Yatim *et al*. (2006) found that the ownership and control of Chinese companies are in the hands of the family members and due to this, the family members also like to select personnel of key positions such as the CEO and board chair from among themselves.

Other findings also show that there is an incentive for family-controlled companies to hire auditors not based on their quality reputation. Steijvers (2010) posited that family-controlled firms are vulnerable to agency problems such as the extraction of wealth for private benefits and lack of transparency. In order to mask these shortcomings, these firms are prone to hiring low quality auditors to protect family interests (Niskanen *et al*., 2011). Cheung *et al*. (2006) and Lei and Song (2011) found that companies in Hong Kong have a tendency of funnelling and expropriating wealth away from minority shareholders. According to Darmadi (2012), family-controlled firms listed on the Indonesian stock market generally do not choose higher quality auditors to sustain opaqueness in gain. Other researchers also came out with similar findings, for example, Dey *et al*. (2011) in the US, Francis *et al.* (2009) in France, Niskanen *et al*. (2011) in Finland and El-Ghoul *et al*. (2007) in Western Europe.

Based on the above arguments, the following hypothesis is derived:

> ***Hypothesis 4****: Ceteris paribus, there is a positive relationship between family-controlled firms and the selection of a Chinese auditor*

RESEARCH METHODOLOGY

The hypotheses relating to auditor's ethnicity will be tested on a simplified model based on the work of Che Ahmad *et al*. (2006). The new modified model is as follows:

$$y_{it} = \beta 0 + \beta 1 x1_{it} + \beta 2 x2_{it} + \beta 3 x3_{it} + \beta 4 x4_{it} + \varepsilon_{it}$$

where

y_{it} = auditor ethnicity for firm i in year t

$x1_{it}$ = block shareholder for firm i in year t

$x2_{it}$ = ownership dominance for firm i in year t

$x3_{it}$ = political influence for firm i in year t

$x4_{it}$ = family controlled for firm i in year t

ε_{it} = error term

The dependent variable is auditor's ethnicity while the independent variables are block shareholder, ownership dominance, political influence and family-controlled.

MEASUREMENTS

Auditor's ethnicity

Consistent with the findings of Che Ahmad *et al*. (2006), auditor's ethnicity was determined by looking at the name of the engagement partner of the Certified Public Accountant firm. The name of the engagement partner is usually stated at the bottom of the 'signing page' of the audited report, specifically, at the bottom of the 'report of the auditors'. A Chinese name will be taken to indicate Chinese ethnicity while a Malay name will be assumed to indicate a person of Malay ethnicity. If the auditor's name is neither Malay nor Chinese, it will be classified as other ethnicities. Although this method of racial identification is not always foolproof, it is to a very large extent reasonably accurate. In fact, this method is in consonance with the method used by Yatim *et al*. (2006) in determining the ethnicities of the directors in their study.

Block shareholder

As proposed by Lin and Liu (2009), block shareholder is the largest owner's shareholding as a percentage of the total shares. This type of information is available in the substantial shareholders' report within the corporate annual report. A substantial shareholders' report is usually available within the shareholding analysis section. Block shareholder is distinguished from ownership dominance in that block shareholder is only represented by one entity in percentage value but ownership dominance is identified through collective ownership based on ethnicity.

Ownership dominance

Che Ahmad *et al*. (2006) proposed that ethnic ownership of a firm be identified by the ethnicity of the majority substantial shareholders. A substantial shareholder is defined as having 5% or more of the firm's shareholding. Section 69 of the Company Act 1965 specifically requires the disclosure of substantial shareholder's information in the report. Alternatively, rather than identifying ethnicity dominance by 'law', a more thorough analysis is proposed to ensure a more accurate result. This study not only utilises 5% of the substantial shareholding listed to identify ethnicity dominance, but also uses a list of the top 30 major shareholders which is usually available in the annual report. The amount of shareholding based on ethnicity was added up and compared to each other to identify the most dominant ethnic group.

Politically-connected firms

This study has identified three types of political connection: strong, weak or no connection. Politically-connected firms in Malaysia are identified if one or more of the following conditions prevail:

a.) whenever it is a Government-Linked Companies (GLCs); or

b.) when the key personnel of the firms have a direct or indirect family relationship with any political figure; or

c.) whenever at least one Government-Linked Investment Company (GLIC) has more than 5% of the company's shareholding

The Putrajaya Committee on GLC High Performance (PCG) has defined GLCs as companies that have a primarily commercial objective and in which the Malaysian Government has a direct controlling stake. Controlling stake refers to the Government's ability (not just percentage ownership) to appoint senior management including board members and to make major decisions (e.g. contract awards, strategy, restructuring and financing, acquisitions and divestments etc.). A GLC can either be controlled directly by other GLCs or through GLICs including companies where the GLCs themselves have a controlling stake i.e. subsidiaries and affiliates of GLCs.

Both (a) and (b) are identified as having a strong political connection and (c) as having a weak political connection. In this study, actual politically-connected firms were identified by referring to the same list used by Wahab *et al*. (2009) which was derived from the research done by Johnson and Mitton (2003). The list of GLCs from 2006-2008 was obtained from the PCG's website. Since the focus was on the listed companies on Bursa Malaysia's main market, non-listed firms stated by Johnson and Mitton (2003) were filtered out from the test. As the list by Johnson and Mitton (2003) was prepared for the periods 1999 to 2003, this study had taken a step further by re-examining the key personnel attributable to political connection and identifying whether the companies concerned could still be rightly considered as being npolitically-connected for the periods 2006-2008.

Family-controlled firms

This study identified family-controlled firms by using the same method proposed by Ibrahim and Samad (2011). Family-controlled firms were identified based on two characteristics. First, there must be the existense of family members on the board and second, family members must hold at least 20% of the equity stake as the cut-off benchmark. Even though Ibrahim and Samad (2011) allow for family-controlled firms to be identified whenever there is the existence of any of the two characteristics, this study maintains that both characteristics must exist together for more accurate results. The information relating to family-controlled characteristics is usually available at the corporate information section as well as within the shareholding analysis section of the corporate annual report.

SAMPLE AND DATA COLLECTION

Most of the financial data were collected from the financial database of DataStream and Thomson One Banker. This applies to all public listed companies on Bursa Malaysia excluding banks and other related financial institutions for the periods 2006 to 2008. In order to extract other data that were not available on both databases, content analysis of individual companies' annual reports or their official corporate websites was carried out.

The year 2007 was chosen as the cut-off year as 2007 was the year in which the Malaysian Corporate Governance Code was revised by the Malaysian Securities Commission. The year 2006 was, therefore, considered as a pre-MCCG 2007 year while the year 2008 was considered as a post-MCCG 2007 year. By doing so, it is possible to see and assess the key changes in the determinants of the dependent variable during the pre, transition and post revision periods of the MCCG 2007.

The population of this study included all the companies listed on Bursa Malaysia's main market and second market from 2006 to 2008. Since this study employed a convenient sampling based on industries, the companies were selected without prejudice regardless of their financial year ends. However, the sampling excluded banks and financial institutions as these companies are governed by separate legislation. The final samples consisted of 900 firm years (300 firms for each year from 2006 to 2008).

FINDINGS

The percentages of the companies by ownership dominance are as per Table 1. The table shows that Chinese ownership dominance represents more than half of the samples (62% in 2006, 61% in 2007 and 62% in 2008).

CORRELATION RESULTS

The coefficient of correlation was determined through Pearson's correlation matrix. Table 2 depicts the correlation coefficient matrix of the dependent and independent variables. The auditor's ethnicity is significantly correlated with percentage of block shareholder, $r = 0.07$, $p<.05$; Chinese dominance, $r = -0.24$, $p<.01$; institutional dominance, $r=0.21$, $p<.01$;

strong political connection, r= 0.17, p<.01; and family-controlled firms, r= -0.19, p<.01. In addition, there is no indicator suggesting any multicollinearity problem on the explanatory variables.

REGRESSION RESULTS

Multinomial logistic regression was employed to analyse auditor's ethnicity in this study. Table 3 reports the regression results in relation to auditor's ethnicity. The model in general consists of four independent variables. The first variable is percentage of block shareholder (*x1*). The second variable is ownership dominance (*x2*), which comprises three sub-variables: Chinese dominance (*x2a*), Malay dominance (*x2b*) and institutional dominance (*x2c*). The third variable is political connection (*x3*), represented by strong political connection (*x3a*) and weak political connection (*x3b*). The last variable is family-controlled firms (*x4*). *x*4 is a dummy variable where 1 denotes 'yes' and 0 denotes 'no'.

The dependent variable is auditor's ethnicity (*Y*), which is coded to represent the auditor as Chinese, Malay or other ethnicity. In this case, 'other ethnicity' is defined as the baseline group.

TABLE 1
Company Ownership by Dominance

	2006	2007	2008
Chinese	62%	61%	62%
Institutional	28%	28%	27%
Malay	6%	7%	7%
Other ethnicities	4%	4%	4%
Total	100%	100%	100%

TABLE 2
Correlation Coefficient Matrix of Dependent and Independent Variables (2006-2008)

	y	x1	x2a	x2b	x2c	x3a	x3b	x4
y	1.00							
x1	0.07**	1.00						
x2a	-0.24***	-0.12***	1.00					
x2b	0.04	0.03	-0.34***	1.00				
x2c	0.21***	0.15***	-0.79***	-0.17***	1.00			
x3a	0.17***	0.16***	-0.23***	-0.02	0.27***	1.00		
x3b	-0.01	0.13***	-0.14***	-0.06*	0.19***	-0.14***	1.00	
x4	-0.19***	0.07**	0.49***	0.06*	-0.55***	-0.23***	0.01	1.00

The variables are defined as: Y=Auditor ethnicity; X1=Percentage of block shareholder; X2a=Chinese dominance; X2b=Malay dominance; X2c=Institutional dominance; X3a= Strong political connection; X3b=Weak political connection; X4=Family-controlled firm

* Significant at the 10% level
** Significant at the 5% level
*** Significant at the 1% level

TABLE 3
Multinomial Logistics Regression Results

				95% CI for Odds Ratio			Pseudo R2		
Auditor ethnicity (Y)		**Prediction**	**B (SE)**	**Lower**	**Exp (B)**	**Upper**	**Cox & Snell**	**Nagelkerke**	**Model Chi Square**
2006 (Pre-MCCG 2007)							0.18	0.24	58.66 P<0.001
Chinese	Intercept		2.11 (0.78)***						
	x1	?	0.31 (1.39)	0.09	1.36	20.70			
	x2a-0	?	-0.73 (0.43)	0.21	0.48	1.12			
	x3a=0	?	0.37 (0.60)	0.45	1.45	4.69			
Malay	Intercept		-1.48 (1.00)						
	x1	?	4.16 (1.71)**	2.25	63.90	1816.69			
	x2a=0	?	1.34 (0.60)**	1.18	3.80	12.22			
	x3a=0	?	-0.80 (0.67)	0.12	0.45	1.67			
2007 (Transition to MCCG 2007)							0.13	0.18	42.24 p<001
Chinese	Intercept		2.76 (0.80)***						
	x2a=0	?	-0.70 (0.46)	0.20	0.50	0.23			
	x3a=0	?	-0.08 (0.79)	0.20	0.92	4.29			
Malay	Intercept		1.46 (0.85)*						
	x2a=0	?	0.90 (0.56)	0.82	2.46	7.40			
	x3a=0	?	-1.58 (0.81)*	0.04	0.21	1.01			
2008 (Post MCCG 2007)							0.11	0.16	36.21 p<001
Chinese	Intercept		2.36 (0.65)***						
	x2a=0	?	-0.98 (0.47)**	0.15	0.38	0.94			
	x3a=0	?	0.61 (0.61)	0.55	1.83	6.12			
Malay	Intercept		0.85 (0.74)						
	x2a=0	?	0.50 (0.59)	0.52	1.64	5.23			
	x3a=0	?	-0.89 (0.67)	0.11	0.41	1.52			

The variables are defined as Y=Auditor ethnicity; X1=Percentage of block shareholder; X2a=Chinese dominance; X3a=Strong political connection

*Significant at the 10% level
** Significant at the 5% level
*** Significant at the 1% level

The logistic regression results of the study are reported in Table 3, in which the hypotheses regarding selection of auditor based on ethnicity were tested. The pseudo R^2 (based on Nagelkerke) in this study is $R^2=0.24$ in 2006, $R^2=0.18$ in 2007 and $R^2=0.16$ in 2008. The pseudo R^2 values in this study are consistent with a past study in Malaysia by Che Ahmad *et al*. (2006). However, the interpretation of the pseudo R^2 measures should be made with extra caution. According to Field (2009), reasonably similar values of both Cox and Snell and Nagelkerke for R^2 (which are found in this study) represent a relatively decent-sized effect. In terms of the model's goodness-of-fit measure, the model is a good fit for all the years observed. For all three years, both Pearson and deviance statistics measure at $p>.05$. In other words, the predicted values are not significantly different from the observed values, indicating the model is a good fit.

This study applied the stepwise method in the regression model. Specifically, this study chose the backward elimination method. Due to the initial issue of the unfit model based on Pearson and deviance statistics, the stepwise method was chosen and it helped solve the problem. The backward elimination method was chosen over a typical forward entry method so that the 'suppressor effect' could be taken into consideration. The 'suppressor effect' occurs whenever "a variable has a significant effect but only when another variable is held constant" (Field, 2009, p. 272). Forward method is more likely to exclude a 'suppressor effect' rather than a backward method. Furthermore, Field (2009) does not recommend the forward method as he argues that there is a higher risk to commit Type II error whenever applying the forward method while executing the stepwise procedure. For the purpose of hypotheses testing, only significant levels of 1% and 5% were regarded as significant.

Based on Table 3, the percentage of block shareholder (*x1*) is significant to the model formulation only in 2006. In the first half of 2006, the percentage of block shareholder does not significantly predict the choice of Chinese auditors, $b=0.31$, Wald $\chi^2(1)=0.049$, $p>.05$. The latter half of 2006, meanwhile. indicates that the percentage of block shareholder significantly predicts the selection of Malay auditors, $b=4.16$, Wald $\chi^2(1)=5.93$, $p<.05$. The odds ratio indicates that the change in the odds of choosing a Malay auditor (rather than choosing other ethnic auditors) is 63.90. In short, there is more likelihood of choosing a Malay auditor than not choosing one if the percentage of block shareholder moves in a positive direction. Thus, H1 is supported only for 2006.

Ownership dominance consists of three types of dominance: Chinese, Malay and institutional. Table 3 confirms that Chinese ownership dominance variable (*x2a*) is significant to the model formulation in all the years from 2006 to 2008. As shown in Table 3, in the year 2006, the Chinese ownership dominance does not significantly predict the choice of a Chinese auditor, $b=-0.73$, Wald $\chi^2(1)=2.89$, $p>.05$. However, other ownership dominance significantly predicts the selection of a Malay auditor, *b*=1.34, Wald χ^2 (1)=5.03, *p*<.05. The odds ratio indicates that the change in the odds of choosing a Malay auditor (rather than choosing other ethnicities) is 3.80. Thus, H2 is supported for 2006.

As for 2007, *x2a* does not show a significant sign at both the individual parameters (Chinese and Malay auditors). Chinese ownership dominance does not significantly predict the choice of a Chinese auditor, *b*=-0.70, Wald χ^2(1)=2.30, *p*>.05. Similarly, other ownership dominance does not significantly predict the choice of a Malay auditor, *b*=0.90, Wald χ^2(1)=2.56, *p*>.05. Thus H2 is rejected for 2007.

Finally for 2008, Table 3 indicates that Chinese ownership dominance does significantly predict the choice of a Chinese auditor, *b*=-0.98, Wald χ^2(1)=4.34, *p*<.05. The odds ratio indicates that the change in the odds of choosing a Chinese auditor (rather than choosing other ethnicities) is 0.38. In other words, the odds of Chinese ownership dominance to choose a Chinese auditor compared to the other ethnicities are 1/0.38=2.63 times more than the other ownership dominance. Thus, H2 is supported for 2008.

Variables relating to political connection are divided into strong political connection (*x3a*) and weak political connection (*x3b*). In Table 3, only the strong political connection variable is included to the model formulation from 2006 to 2008. However, this variable does not significantly predict the choice of auditor's ethnicity in all three years with p>.05. Thus, H3 is not supported.

The family-controlled firm variable (*x4*) however, is not significant in the model formulation and was excluded from the model during the backward elimination process. *x4* is not significant individually and is also not significant whenever another variable is held constant. Because of this, H4 is not supported. The results of all the hypotheses are summarised in Table 4 below.

DISCUSSION

Auditor's Ethnicity in 2006 (Prior to MCCG 2007)

Even though the results of the study in relation to auditor's ethnicity are somewhat vague, this study still found evidence that ownership dominance has a significant relationship with auditor's ethnicity.

TABLE 4
Summary of Results of Hypotheses Tested

Hypothesis	2006 (Pre-MCCG 2007)	2007 (Transition to MCCG 2007)	2008 (Post MCCG 2007)
H1	Supported	Not supported	Not supported
H2	Supported	Not supported	Supported
H3	Not supported	Not supported	Not supported
H4	Not supported	Not supported	Not supported

Furthermore, the largest block shareholder is also identified as having a similar relationship. Another finding of this study is that strong political connection has an influence on other variables in the selection of auditors based on ethnicity. This can be seen in the logistic regression results where strong political connection is included in the model estimation for each year. The backward elimination method took into consideration the 'suppressor effect', which included influential variables in the model estimation.

Before the revision on the MCCG in 2007, the largest block shareholder was identified as having a positive relationship with the Malay auditor. This might have happened whenever the largest block shareholder had a strong political connection. Political connection is close relationship with the government of any kind. During the observed periods from 2006 to 2008 (and even until today), the United Malays National Organisation (UMNO), which is controlled by the Malays, is the most dominant political party among the government's coalition pact, known as 'Barisan Nasional', that has governed Malaysia since independence. Thus, companies with their largest shareholder having a strong political connection generally employ a Malay auditor as well.

For example, GLCs that belong to the government (as the largest shareholder) such as Petronas and Proton tend to employ the big four audit firms but under the supervision of Malay audit partners. This is actually in tandem with the view of Che Ahmad *et al*. (2006) who reported that whenever possible, Bumiputeras (or Malays) were called upon to prioritise their fellow Bumiputeras (or Malays) in business dealings including auditor selection. This study suggests that with the absence of the influence of political connection on the largest block shareholder, there is no difference in the choice of auditors based on ethnic preference before the revision to the MCCG 2007.

This study also found that Malay and institutional ownership dominance have a positive relationship with Malay auditor. Again, similar to the previous argument, the influence of a strong political connection on Malay and institutional ownership dominance needs to exist in order for a Malay auditor to be chosen. Even with the exclusion of the political connection factor, one of the plausible explanations for Malay and institutional based companies to choose Malay auditors is due to the business rivalry between the Chinese and the non-Chinese, especially the Malays, in Malaysia. This is again relatively in line with the view of Che Ahmad *et al*. (2006), who noted that Bumiputera (or Malay) business persons perceived the Indians as more "friendly" to their business than the Chinese. This may be taken to mean that the non-Chinese ethnic groups in Malaysia have formed their own tacit business alliance and this influences their judgment on the selection of auditors.

Auditor's Ethnicity in 2008 (Post MCCG 2007)

This study found that after the revision to the MCCG 2007, surprisingly, Chinese-dominated firms are positively related to the selection of Chinese auditors. This may suggest the continued existence of business networking among the Chinese community irrespective of the nature of the Malaysian Corporate Governance Code. This finding thus confirms the outcome of the study by Che Ahmad *et al*. (2006), who reported that Chinese firms seemed to prefer for Chinese auditors.

Another possible explanation for the post MCCG 2007 findings may have something to do with the audit committee restructuring and the lesser reliance on the big four audit firms for better quality auditors due to the compulsary establishment of a strong restructured internal audit function. The employment of more non-executive directors in the audit committee in which most of them were Chinese might have ramped up the pressure to continue recruiting Chinese auditors to maintain traditional business networking. Family-controlled firms, for example, were the most affected firms by the revision to the MCCG 2007. This was due to their poor governance and audit committee structure. In order to respond to the requirements of MCCG 2007, most of these firms had to restructure their audit committee (internal audit function) which previously, most of the time, included executive directors as members. It should be noted that family-controlled firms represent a large chunk of companies on Bursa Malaysia with the majority of family-controlled firms being Chinese owned and choosing Chinese auditors.

CONCLUSION AND LIMITATIONS OF THE STUDY

The results of the study on the selection of auditor based on ethnic grounds are mixed. In pre-MCCG 2007, ownership dominance and largest block shareholder by Malays and institutions had a significant relationship with auditor's ethnicity, specifically Malay auditors. After MCCG 2007, this relationship disappeared but Chinese-dominated firms were positively related to the selection of Chinese auditors. This provides some evidence of alliance as well as business rivalry between the Malays and institutional companies on one hand and the Chinese-controlled companies on the other hand. There was also an indication of business networking among the Chinese with a clear sustained preference for Chinese auditors.

At the time this study was completed, the Securities Commission of Malaysia (SC) had just released a new MCCG 2012. A 31-page document has been released to supersede the previous MCCG 2007. It is worth noting that the MCCG 2012 has been developed based on the SC's Corporate Governance Blueprint 2011 and this time around, the MCCG 2012 focuses on the clarification of the role of the board as a leader and further strengthens its composition as well as independence. A few disclosures are also introduced such as the disclosure on the commitment to respecting the shareholders' rights. The actual impact of this new MCCG 2012 is yet to be known but it is going to open a new opportunity for future researchers. Despite the fact of being superseded, the study on the MCCG 2007 is still considered relevant as it will take quite some time for the assessment of the MCCG 2012 to be available for research.

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