

DO POLITICAL CONNECTIONS MODERATE THE NEXUS BETWEEN OWNERSHIP STRUCTURE AND REAL EARNINGS MANAGEMENT?

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Abstract: *This study examines the moderating effect of political connections on the relationship between ownership structure and real earnings management (REM) among Malaysian listed non-financial companies. Drawing on agency theory, the study investigates whether ownership mechanisms—namely managerial ownership, blockholder ownership, and family ownership—effectively constrain managerial opportunism, and whether political connections influence this relationship. While ownership concentration is generally expected to align managers' and shareholders' interests, political connections may weaken governance effectiveness by reducing external monitoring and regulatory scrutiny. Using a sample of 850 firm-year observations from 2012 to 2016, the study employs regression analysis to test both direct and moderating relationships. The results show that managerial ownership, blockholder ownership, and family ownership are negatively associated with REM, indicating that these ownership structures are effective in limiting real earnings manipulation. However, further findings reveal that political connections significantly weaken this relationship, suggesting that politically connected firms may have greater flexibility to engage in opportunistic reporting behaviour despite the presence of internal governance mechanisms. This study contributes to the literature by highlighting the conditional role of political connections in shaping the effectiveness of ownership-based governance. The findings have important implications for regulators and policymakers seeking to strengthen governance frameworks and mitigate unethical financial reporting practices, particularly in emerging market settings.*

Keywords: *Real earnings management, ownership structure, political connections*

Introduction

Earnings manipulation is a practice undertaken by managers across the globe and may arise from either efficient contracting considerations or opportunistic motives (Siregar & Utama, 2008; Flayyih & Khiari, 2022). In the earnings management literature, considerable attention has been given to accrual-based earnings management, whereby managers exploit accounting choices and estimates within the flexibility permitted by accounting standards (Healy & Wahlen, 1999; Zang, 2012). However, managers may also engage in real earnings management (REM), which involves altering actual business activities to achieve desired accounting outcomes. Unlike accrual-based earnings management, REM directly affects firms' operating decisions, such as sales, production, and discretionary expenditures, and may consequently impose real economic costs on firms through reduced cash flows, higher production costs, and other operational consequences (Roychowdhury, 2006; Zang, 2012). The potential economic consequences of REM make it an important issue in understanding managerial behaviour and financial reporting quality.

The separation of ownership and control creates an agency relationship in which managers may pursue interests that differ from those of shareholders (Jensen & Meckling, 1976). As residual claimants, shareholders have limited direct control over managerial decision-making, creating opportunities for managers to act contrary to shareholders' interests and potentially distort reported financial information (Jensen & Meckling, 1976; Kamardin, 2014). Corporate governance mechanisms therefore play an important role in monitoring managerial behaviour and reducing agency conflicts. The Malaysian Code on Corporate Governance (MCCG, 2016) recognises effective governance as an important mechanism for promoting accountability and reducing opportunistic practices. Among these mechanisms, ownership structure can influence the effectiveness of managerial monitoring. Previous studies suggest that different ownership structures have different implications for corporate governance and earnings management (Klein et al., 2005). In particular, managerial ownership, blockholder ownership, and family ownership may strengthen monitoring by aligning the interests of owners and managers or by providing owners with greater incentives to monitor managerial decisions (Jensen & Meckling, 1976; Wang, 2006; Habib et al., 2022). Thus, ownership structure may serve as an internal governance mechanism for constraining managerial opportunism and improving financial reporting quality.

However, the effectiveness of ownership-based monitoring may not be uniform across firms because it can be influenced by the broader institutional environment in which firms operate. One potentially important institutional factor is political connectedness. Political connections have been widely associated with corporate behaviour and financial reporting quality, particularly in emerging markets. Malaysia provides an important setting in this regard because of the presence of politically connected firms within its corporate sector (Gul, 2006). Politically connected firms may benefit from preferential access to government resources, regulatory support, or other forms of political influence, which may reduce external monitoring and create greater opportunities for managerial discretion. Previous studies have reported that political connections are associated with lower earnings quality and greater opportunities for opportunistic reporting behaviour (Watts & Zimmerman, 1990; Chaney et al., 2011). In Malaysia, Al-Dhamari and Ku Ismail (2015), Abdul Wahab et al. (2020), and Tee and Kasipillai (2022) examined the relationship between political connections and earnings quality. These studies provide evidence that political connections are relevant to financial reporting outcomes. However, they primarily focus on the direct association between political connections and

earnings quality, rather than whether political connections alter the effectiveness of existing corporate governance mechanisms.

This limitation highlights an important empirical gap in the literature. Although previous research has examined ownership structure as a monitoring mechanism and political connections as a factor associated with earnings quality, limited evidence exists on whether political connections moderate the relationship between ownership structure and REM. In particular, it remains unclear whether political connections strengthen or weaken the ability of managerial, family, and blockholder ownership to constrain REM. This distinction is important because political connections may influence managerial behaviour beyond their direct effect on earnings quality. Examining political connections as a moderator therefore provides a more comprehensive understanding of how ownership-based governance operates under different institutional conditions.

The study also addresses a theoretical gap in the application of agency theory. Agency theory suggests that ownership concentration can reduce agency conflicts by increasing shareholders' incentives and ability to monitor managers (Jensen & Meckling, 1976). From this perspective, managerial, family, and blockholder ownership should constrain opportunistic managerial behaviour, including REM. However, the effectiveness of these internal monitoring mechanisms may depend on the institutional environment surrounding the firm. Political connections may weaken the monitoring function of ownership structures by providing firms or managers with access to resources, preferential treatment, or reduced external scrutiny. Consequently, political connections may create conditions under which ownership-based monitoring becomes less effective. Investigating this moderating relationship extends the application of agency theory by recognising that the effectiveness of internal governance mechanisms may be conditional on external institutional influences.

The Malaysian context further provides an appropriate setting for examining this issue. Malaysian listed companies operate in an environment characterised by concentrated ownership structures and the presence of politically connected firms. The coexistence of these two characteristics provides an opportunity to investigate whether political connections influence the effectiveness of ownership-based monitoring. Despite the relevance of this setting, limited research has examined the combined effect of ownership structure and political connections on REM among Malaysian listed companies.

Therefore, this study investigates whether political connections moderate the relationship between ownership structure and REM among Malaysian listed non-financial companies. Specifically, the study examines whether political connections alter the effectiveness of managerial, family, and blockholder ownership in constraining REM. Using Malaysian listed companies from 2012 to 2016, REM is measured using abnormal discretionary expenses and abnormal production costs based on Roychowdhury (2006) and Zang (2012). The findings indicate that managerial, family, and blockholder ownership are negatively associated with REM, supporting the monitoring role of ownership structures. However, political connections weaken the effectiveness of managerial and family ownership in constraining REM, whereas the ability of blockholder ownership to mitigate REM is not significantly affected by political connections.

This study contributes to the literature in several ways. First, it extends the empirical literature on REM by examining the conditional effect of political connections on ownership-based

monitoring, rather than treating political connections solely as a direct determinant of earnings quality. Second, it extends agency theory by demonstrating that the effectiveness of ownership-based monitoring may depend on the institutional environment in which firms operate. Third, it contributes evidence from Malaysia, an emerging market characterised by both concentrated ownership and political connectedness. These findings provide useful implications for regulators, investors, and policymakers seeking to strengthen corporate governance and reduce opportunistic financial reporting practices.

The remainder of the paper is organized as follows. The next section presents the literature review and proposes the study's hypotheses. Section 3 discusses the methods used to produce the results presented in Section 4. The final section concludes the paper by highlighting the theoretical and practical contributions and directions for future research.

Malaysian Institutional Context

The relationship between ownership structure, political connections, and real earnings management should be considered within the institutional environment of Malaysia. Malaysia represents an emerging market characterised by concentrated ownership, family-controlled firms, and the presence of politically connected companies. These institutional characteristics are important because the effectiveness of ownership-based monitoring may differ from that observed in countries with more dispersed ownership and stronger external monitoring mechanisms. In firms with concentrated ownership, large shareholders and family owners generally have stronger incentives to monitor managers because they have substantial financial interests in the firm. However, the effectiveness of such monitoring may also depend on the relationships between firms and political actors.

Political connections may alter the governance environment in which ownership structures operate. Politically connected firms may obtain preferential access to government resources, financing, contracts, or regulatory support, potentially reducing their dependence on conventional monitoring mechanisms. Such connections may also reduce the level of external scrutiny faced by firms and provide managers with greater discretion in making operating and reporting decisions. Consequently, political connections may weaken the monitoring role of ownership structures when politically connected firms perceive lower risks associated with managerial opportunism. This institutional feature is particularly relevant to the Malaysian setting, where political relationships have historically been an important characteristic of the corporate environment (Gul, 2006).

The 2012–2016 period is particularly relevant for examining these relationships because it represents an important period in the development of Malaysia's corporate governance environment. During this period, Malaysian listed companies were subject to the corporate governance framework applicable at the time, including the Malaysian Code on Corporate Governance (MCCG) 2012. The governance framework emphasised strengthening board effectiveness, shareholder rights, and accountability, while ownership concentration and political connections continued to be important characteristics of the Malaysian corporate sector. Thus, firms during this period operated under a combination of formal governance requirements and informal institutional relationships. This combination provides an appropriate setting for examining whether ownership-based monitoring was equally effective across politically connected and non-politically connected firms.

Importantly, the institutional characteristics of the 2012–2016 period should not be interpreted as identical to those prevailing in 2026. Rather, the purpose of focusing on this period is to examine the governance relationships under a specific institutional environment in which concentrated ownership and political connections coexisted. The findings therefore provide historical evidence on how political connections may condition the effectiveness of ownership-based monitoring in Malaysia. Although subsequent regulatory and institutional developments may have changed the strength of these relationships, understanding the 2012–2016 environment remains relevant for identifying the institutional conditions under which ownership structures can either constrain or fail to constrain real earnings management.

Accordingly, political connections are expected to influence not only the level of earnings management directly but also the effectiveness of ownership-based governance mechanisms. In the Malaysian context, politically connected firms may face different levels of external scrutiny and possess different access to resources compared with non-connected firms. These institutional differences may weaken the ability of managerial, family, and blockholder ownership to constrain managerial opportunism. Examining political connections as a moderating variable therefore provides a more institutionally grounded explanation of the ownership structure–real earnings management relationship.

Literature Review and Hypothesis Development

Agency theory posits that managerial ownership aligns the interests of managers with those of shareholders (Jensen & Meckling, 1976). Higher managerial ownership reduces the likelihood of accounting misbehavior, as managers have less incentive to manipulate earnings (Warfield et al., 1995). However, some studies suggest a positive relationship between managerial ownership and earnings management, attributed to entrenchment problems (Al-Fayoumi et al., 2010). Despite this, agency theorists argue that managerial ownership serves as a monitoring mechanism, mitigating agency problems (Jensen & Meckling, 1976; Fama & Jensen, 1983). Managers, perceiving the company as their own, make decisions to enhance its value (Jensen & Meckling, 1976). Because managers are responsible for maximizing owners' wealth, their equity stake enhances control and reduces incentives for earnings manipulation (Warfield et al., 1995). Empirical evidence supports the negative association between managerial ownership and earnings management, indicating aligned interests between managers and shareholders (Akter et al., 2024; Mardnly et al., 2021; Alzoubi, 2016).

Farrer and Ramsay (1998) suggest that agency theory views external blockholder ownership as a significant governance mechanism. External blockholders possess the resources and ability to effectively monitor managers, aligning with the efficient monitoring hypothesis, which posits that higher external blockholder ownership leads to increased oversight of management activities and reduced earnings management (Cornett et al., 2008).

Large shareholders play an important role in the internal control mechanisms of companies. The degree of engagement may impact their ability to incentivize and guide the firms in which they hold investments (Shleifer & Vishny, 1997). Moreover, prior research has established that a greater proportion of external blockholder ownership is an effective mechanism of corporate governance for overseeing management accounting decisions, leading to enhanced reporting quality (Wang, 2006). Furthermore, Yeo et al. (2002) have documented that the presence of external blockholders in a company's governance structure reduces the incidence of earnings management. They believed that by acquiring a substantial ownership stake, it would be impossible for them to cause the downfall of the enterprises under their control. However, some

studies indicate that greater external shareholdings may exacerbate agency problems, leading to potential conflicts between majority and minority shareholders (Claessens & Fan, 2002; Boubakri et al., 2005; Hanafi et al., 2024). Despite their potential to enforce private interests, external blockholders can influence management decisions and may inadvertently lead to earnings management (Jensen & Meckling, 1976).

Fama and Jensen (1983) argue that family-owned companies are more efficient than those with dispersed ownership due to reduced monitoring costs and lower agency problems arising from aligned interests between owners and managers. Schulze et al. (2001) support this, citing three reasons for lower agency costs in family-owned firms: aligned interests, restricted property rights, and higher family ownership. This discourages opportunistic behavior, wealth expropriation, and accounting misbehavior while enhancing monitoring and discipline. Family-owned firms also maintain a positive image through close monitoring and concentrated ownership, mitigating agency problems from ownership-control separation. They prioritize long-term sustainability, passing investments to future generations and sustaining their reputation for long-term wealth maximization. Family involvement strengthens managerial monitoring and discipline due to enduring family relationships (Wang, 2006).

Alzoubi (2016) and AL-Duais (2022) observe a negative link between family ownership and earnings management, whereas Bona-Sanchez et al. (2011) find that family-owned firms exhibit higher earnings quality than their non-family counterparts, suggesting a positive relationship between family ownership and earnings quality. This supports agency theory's premise that greater family ownership reduces agency costs, thereby enhancing earnings quality. Jiraporn and DaDalt (2009) and Jaggi et al. (2009) suggest that family ownership acts as a monitoring mechanism, reducing the likelihood of earnings management.

Malaysia's corporate governance system, while influenced by Western models, deviates from the Anglo-American approach, particularly in the presence of political ties. Political connections can undermine corporate governance mechanisms, leading to diminished financial reporting quality—a phenomenon often associated with "crony capitalism" (Ball et al., 2003). Connected firms may prioritize protecting their interests over transparent reporting, incentivizing managers to resort to earnings management practices (Guedhami et al., 2014). Chaney et al. (2011) find that politically affiliated companies tend to exhibit lower financial reporting quality due to heightened incentives for non-disclosure compared to non-political firms. Similarly, Ahmad et al. (2023) report that high political uncertainty impairs the credibility of earnings. Such connections may prompt managers to employ earnings management strategies, favoring real over accrual-based methods to mask unfavorable information (Watts & Zimmerman, 1990; Ahmed et al., 2022).

Political influence often shields connected companies from regulatory scrutiny, enabling them to engage in earnings management practices with impunity (Chaney et al., 2011). This close association with politicians grants easier access to resources while reducing the pressure for transparent reporting. Consequently, firms with political ties may benefit from special treatment, including protection and access to resources, thereby further incentivizing earnings management practices. Thus, the relationship between ownership structure and earnings management is likely more pronounced in politically connected firms. Given the discussions above, the monitoring roles of managerial, blockholder, and family ownership may be compromised by political connections. Thus, this study hypothesizes that:

- H1. Political connections moderate the relationship between managerial ownership and real earnings management.
 H2. Political connections moderate the relationship between external blockholder ownership and real earnings management.
 H3. Political connections moderate the relationship between family ownership and real earnings management.

Research Design

Sample Selection and Data

This study considers all 904 non-financial companies listed on the Malaysian stock exchange, Bursa Malaysia from 2012-2016. 33 financial institutions, comprising banks and other financial institutions, are excluded from this study because of the uniqueness of their reporting structure and regulations. Meanwhile, from the dataset, the study also excludes 97 companies with a fiscal year change, 21 companies under PN17 and 41 companies with missing annual reports. Finally, 712 companies are gathered as the initial sample of the study. Using a technique for determining sample size suggested by Green (1991), the final sample for this study comprises 170 companies (850 firm-year observations). The financial data are gathered from Thomson Reuters DataStream, while the non-financial data are hand-collected from the annual reports of the listed companies.

Measurement of Real Earnings Management

Based on the model developed by Roychowdhury (2006), real earnings management can be conducted when managers tend to intentionally mislead at least some stakeholders into believing certain financial reporting goals have been met in the normal course of operations through (i) giving discounted price to boost in sales temporarily, (ii) reducing in discretionary expenses to refine companies' margin and (iii) overproduction to disclose small value of cost of goods sold to avoid losses in its short term cash flows.

In Roychowdhury's model, real earnings management can be predicted using abnormal cash flows from operations (ACFO), abnormal discretionary expenses (ADISEXP), and abnormal production costs (APROD). The activities are estimated as follows:

$$CFO_t / A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \alpha_2(St/A_{t-1}) + \alpha_3(\Delta St / A_{t-1}) + \epsilon_t, \quad (1)$$

where CFO_t is cash flows from operations. A_{t-1} is the total assets at the beginning of year. St is sales and ΔSt is the change in sales.

$$DISEXP_t / A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \alpha_2 (St-1/A_{t-1}) + \epsilon_t, \quad (2)$$

where DISEXP_t is the sum of R&D, advertising, selling, general, and administrative expenses.

$$PROD_t / A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \alpha_2(St/A_{t-1}) + \alpha_3(\Delta St / A_{t-1}) + \alpha_4(St-1/A_{t-1}) + \epsilon_t \quad (3)$$

where PROD_t is the sum of the cost of goods sold and changes in inventory.

After the estimation of parameters in Equations 1,2 and 3, ACFO, ADISEXP and APROD are measured as the residual value of the equations.

This study uses a modified Roychowdhury (2006) model introduced by Zang (2012). Zang (2012) argues that the abnormal cash flows from operations element should be excluded from the three proxies. This is because the abnormal cash flow activities have different impacts and the net effect is ambiguous in deriving real earnings management. This study uses two combined proxies as suggested by Zang (2012) which exclude the element of abnormal cash flow activities from the basic three proxies and focus only on proxies of (1) abnormal discretionary expenses and (2) abnormal production costs in deriving at companies' real earnings management. The modified model employed is as follows:

$$\text{REM} = [(\text{abnormal discretionary expenses} * -1) + \text{abnormal production costs}]$$

The abnormal level of discretionary expenditures (ADISEXP) is estimated cross-sectionally for each industry-year with at least 15 observations and the estimated residual is gathered from the regression in Equation 2 while the abnormal level of production costs (APROD) is also estimated cross-sectionally for each industry-year with at least 15 observations and the estimated residual is gathered from the regression residual in Equation 3. The higher the residual, the larger the amount of inventory overproduction, and the greater the increase in reported earnings through reducing the cost of goods sold. Real earnings management (REM) is derived by multiplying the abnormal discretionary expenses by -1 and adding it to abnormal production costs. This could lead to a higher amount of this aggregate measure, the more likely the firm engage in real earnings management activities.

Regression Model

In this study, ownership structures are proxied by managerial ownership, external blockholders ownership and family ownership. To test the effect of political connections on the relationship between ownership structure and REM, the study designed the following research model.

$$\text{REM} = \alpha_{it} + \beta_1 \text{PC}_{it} + \beta_2 \text{MANOW}_{it} + \beta_3 \text{EXBOW}_{it} + \beta_4 \text{FAMOW}_{it} + \beta_5 \text{MANOW}_{it} * \text{PC}_{it} + \beta_6 \text{EXBOW}_{it} * \text{PC}_{it} + \beta_7 \text{FAMOW}_{it} * \text{PC}_{it} + \beta_8 \text{SUKST}_{it} + \beta_9 \text{SIZE}_{it} + \beta_{10} \text{REVGR}_{it} + \beta_{11} \text{ROA}_{it} + \beta_{12} \text{LEV}_{it} + \beta_{13} \text{AQ}_{it} + \sum \beta_{14} \text{Year_Indicator}_{it} + \sum \beta_{15} \text{Industry_Indicator}_{it} + \mu_i \quad (4)$$

Where,

REM	=	real earnings management, measured as abnormal discretionary expenses and abnormal production costs.
PC	=	political connection, measured as dummy variable that equals 1 if at least one director is a member of parliament, minister, head of state, state assemblyman, or a person who is or was working under a government bureaucrat on the board to operationalize the presence of political influence gathered from www.parlimen.gov.my and 0 otherwise.
MANOW	=	managerial ownership, measured as the percentage (%) of executive directors' shareholdings, direct and indirect.

EXBOW	=	external blockholder ownership, measured by the ownership which held at least 5% interest in shares by several classes of ownerships. The classes are; (1) banks, (2) investment companies (e.g. Employee Providence Fund), (3) insurance companies, (4) industrial and commercial companies, (5) individual investors, (6) federal and regional authorities and (7) realty investment companies.
FAMOW	=	family ownership, measured by the percentage of family shareholding.
SUKST	=	Sukuk issuance status, measured as a dummy variable that equals 1 if firm <i>i</i> issued Sukuk or disclosed related information in year <i>t</i> , and 0 otherwise.
SIZE	=	size of the companies, measured as the natural logarithm of total assets
REVGR	=	growth, measured as current period net sales – prior period net sales divided by prior period net sales.
ROA	=	profitability, measured as return on assets.
LEV	=	leverage, measured as total debt divided by total assets.
AQ	=	audit quality, measured as a dummy variable that equals 1 if companies are audited by a Big 4 audit firm and 0 otherwise.
<i>A</i>	=	constant
$\beta_1 - \beta_{15}$	=	coefficient of the explanatory variables
μ_i	=	Error or disturbance terms

In Equation 4, the coefficient on the interaction between political connections and ownership structure is estimated cross-sectionally for each industry-year. It signals the different effects on real earnings management among politically and non-politically connected companies. If the coefficients β_5 , β_6 , and β_7 are significantly positive, ownership structure in politically connected companies is not effective at mitigating real earnings management, unlike in non-politically connected companies. It is believed that, with political connections influencing the ownership structure, the likelihood of REM being engaged is higher than for companies with non-political connections. Thus, it is expected that companies' earnings quality will be reduced by the influence of PC.

Empirical Results

Descriptive Analysis

Table 1 presents the mean, median, standard deviations, minimum, and maximum values of the variables. The results show that REM has a mean of -0.049, a median value of -0.045 with a reported standard deviation of 0.045, a minimum value of -0.180 and a maximum value of 0.042. Of the 170 companies, 33.5% are political connection companies. The MANOW variable has a mean of 43.903 percent and a maximum ownership of 81 percent. The data suggest that executive directors own around 44 percent of shares in Malaysian corporations.

The mean and standard deviation values of EXBOW are 20.579 and 20.337 percent, respectively. The result indicates that external blockholders own around 20% of the shareholding in Malaysian-listed companies. Meanwhile, FAMOW showed a mean of 14.772 percent with a standard deviation of 16.417.

Regarding control variables, the results show that 33.6 percent of firms issued Sukuk during the year under study. The mean of firm size is 13.694 and 0.047, on average, is the growth of the company. ROA averages 5.7 percent and the average level of company leverage is 20.1%. Finally, almost 53 percent of firms are being audited by the Big 4 audit firms.

Table 1: Descriptive Statistics of Variables (n=850)

Variables	Mean	Median	Std. Dev.	Min	Max
REM	-0.049	-0.045	0.045	-0.180	0.042
PC	0.335	0.000	0.423	0.000	1.000
MANOW (%)	43.903	47.735	23.884	0.000	81.000
EXBOW (%)	20.579	13.125	20.337	0.000	77.000
FAMOW (%)	14.772	8.205	16.147	0.000	83.027
SUKST	0.336	0.000	0.473	0.000	1.000
SIZE	13.694	13.422	1.686	10.610	18.081
REVGR	0.047	0.026	0.223	-0.386	0.666
ROA	0.057	0.050	0.070	-0.120	0.287
LEV	0.201	0.164	0.171	0.001	0.700
AQ	0.529	1.000	0.499	0.000	1.000

Table 2 presents the correlations between the test variables. Based on the table, none of the correlations among the independent variables was highly correlated. The variance inflation factor (VIF) test results also showed that none of the VIFs exceeded 10 (not tabulated).

Table 2: Pearson Correlation for Variables (n=850)

	REM	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
MANOW(1)	-0.054									
EXBOW(2)	0.032	0.462 ^a								
FAMOW(3)	-0.032	-0.251 ^a	-0.106 ^b							
SUKST(4)	0.141 ^a	-0.221 ^a	0.186 ^b	0.116 ^a						
PC(5)	0.144 ^a	-0.024	0.051	-0.153 ^b	0.153 ^b					
SIZE(6)	0.453 ^a	-0.238 ^a	0.369 ^b	-0.032	0.483 ^b	0.181 ^a				
REVGR(7)	0.091 ^a	0.004	-0.013	-0.047	0.017	-0.012	-0.031			
ROA(8)	0.068 ^b	0.038	-0.015	-0.081 ^b	0.014	-0.101 ^a	0.108 ^b	0.210 ^b		
LEV(9)	0.062 ^c	0.092 ^a	-0.043	-0.111 ^a	0.108 ^b	0.052	0.104 ^a	-0.019	-0.085 ^b	
AQ	-0.052	0.006	0.055	-0.060 ^c	-0.002	-0.079 ^b	0.105 ^a	-0.023	0.097 ^b	0.015

Note: a, b, c represent significance at 1%, 5% and 10%, respectively.

Multivariate analysis

Table 3 presents the regression results for this study. The results indicate that the model is significant, with an R^2 of 0.5743. The table illustrates that MANOW, EXBOW, and FAMOW have a significant negative relationship with REM at a p-value of less than 1%, indicating that managerial ownership, blockholder ownership, and family ownership reduce REM practices.

For the interaction effect, the table shows that PC affects the relationship of MANOW and FAMOW on REM. With regard to the significant p-values, this table indicates that PC positively influences MANOW at 0.000 ($p < 0.01$) with a coefficient of 0.0004 and FAMOW at 0.021 ($p < 0.05$) with a coefficient of 0.0004, respectively. Thus, H1 and H3 are accepted, and this indicates that the moderating variable, political connections weaken the negative relationship between managerial ownership and family ownership on REM.

Table 3: Moderating Effect of Political Connections on the Relationship Between Ownership Structure and Real Earnings Management (n=850)

REM	Expected Sign	Coefficient	Std. Err	z-value	p-value
_cons		- 0.1387	0.0126	- 10.98	0.000
PC		- 0.0250	0.0078	- 3.18	0.001
MANOW	-	- 0.0003	0.0001	- 4.08	0.000***
EXBOW	-	- 0.0005	0.0001	- 5.88	0.000***
FAMOW	-	- 0.0003	0.0001	- 3.22	0.001***
MANOW*PC	+	0.0004	0.0001	3.57	0.000***
EXBOW*PC	+	0.0002	0.0001	1.24	0.214
FAMOW*PC	+	0.0004	0.0002	2.31	0.021**
SUKST	-	- 0.0074	0.0026	- 2.90	0.004***
SIZE	+	0.0108	0.0008	13.12	0.000***
REVGR	+	0.0120	0.0047	2.54	0.011**
ROA	+	0.1218	0.0162	7.53	0.000***
LEV	+	0.0140	0.0062	2.25	0.024**
AQ	-	- 0.0070	0.0021	- 3.38	0.001***
Year control included		Yes			
Industry control included		Yes			
R^2		0.5743			
Wald Chi2 (12)		1188.60			
Prob> chi2		0.000			

Note: ***Significant at 1%; and **Significant at 5%.

As reported in Table 3, MANOW*PC reveals a significant positive relationship with REM. This result shows that PC weakens the negative relationship between MANOW and REM, indicating that MANOW is not an effective monitoring mechanism in politically connected companies. The result supports H1, which posits that PC moderates the relationship between managerial ownership and real earnings management. The quality of reporting decreased in companies controlled by politicians which influenced managerial ownership to be less effective in monitoring the operations of the companies. Table 3 also shows that FAMOW*PC reveals a significant positive relationship with REM. This indicates that PC weakens the monitoring

function of FAMOW. The result is consistent with agency theory, which predicts that family firms with political influence have an incentive to distort earnings and exhibit inferior financial reporting quality (Watts & Zimmerman, 1990; Al-Dhamari & Ismail, 2015; Braam et al., 2015; Chaney et al., 2011).

In contrast, as shown in Table 3, EXBOW*PC has no significant impact on REM with a p-value of 0.214 ($p > 0.10$). It shows that PC does not influence the relationship between EXBOW and REM, indicating that EXBOW is still effective in mitigating REM in politically connected firms. This can be proved when the coefficient of EXBOW*PC is insignificant. This means that the strength of EXBOW in mitigating REM is higher and can be considered as an effective monitoring mechanism either with or without the influence of PC. Large blockholder ownership can use various formal and informal mechanisms such as their voting power, shareholder activism, election of board members, and their ability to influence the management. Generally, the result is consistent with Yeo et al. (2002), who report that external blockholders may reduce earnings management and have greater incentives and capability to monitor management effectively. Parallel to Agency theory, external blockholders play an important role in companies' internal control, as the extent of their participation motivates them to influence and monitor the firm's strategy in which they have invested (Shleifer & Vishny, 1997; Yeo et al., 2002). This indicates that external blockholders should be efficient in monitoring companies' operations (Jensen & Meckling, 1976), lower opportunism managerial behaviour (Fama & Jensen, 1983; Shleifer & Vishny, 1997) and have a positive effect on financial reporting quality, since maximising monitoring by shareholder participation decreases the motives by the owners to expropriate minority shareholder wealth (Boubakri et al., 2005).

Conclusion

This study examines real earnings management practices among companies in Malaysia. In particular, this study tests the influence of political connections on the relationship between ownership structure and real earnings management. The sample selected for this study comprises 850 company-year observations from the main market of Bursa Malaysia. This study documents evidence that political connections have influenced the relationship between managerial ownership and REM. The study also finds that political connections moderate the association between family ownership and REM. The results are consistent with the notion that political influence impairs the monitoring role of ownership structure and REM. However, the study finds that political connection has no significant impact on the relationship between external blockholder ownership and REM. Although the influence of political connection on external blockholder ownership is insignificant, the direct relationship of external blockholder ownership reveals a significant negative relationship with REM.

The conclusions derived from this research are contingent upon certain limitations that need careful consideration before interpreting the results. First, this study primarily examines the financial years from 2012 to 2016, but due to the timing of data collection, there are limited observations available for this five-year period. Second, the choice of earnings management proxy and its ability to accurately measure reporting quality limits the strength of the evidence provided in this study. This study used Zang (2012)'s modified model to measure real earnings management. Hitherto, no consensus has been found on the measurement of the various earnings management proxies, and thus the measurements have the potential to exhibit high measurement errors. Third, the study's sample is composed of companies randomly selected using the sample selection method recommended by Green (1991). Consequently, while the findings may have broader applicability, they should be interpreted with caution when

generalizing to the entire population of Malaysian publicly listed companies. The sample encompasses a range of industries; however, it is worth emphasizing the manufacturing sector to gain deeper insights into the actual dynamics of activities such as (i) overproduction, (ii) discounted pricing, and (iii) expense reduction. Policymakers and regulators can use the findings of this study to comprehend how political ties influence the relationship between ownership structure and real earnings management. Acknowledging the impact of political ties, fortifying corporate governance principles, and ensuring equitable and transparent financial reporting procedures in Malaysia are essential steps toward fostering a robust and transparent business environment.

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