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Greenwashing and Earnings Quality of Family Firms in Indonesia and Singapore

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Abstract

This study aims to examine the impact of family ownership in moderating the relationship between greenwashing and earnings quality. There are 291 observations including companies listed on the Indonesia and Singapore Stock Exchanges. Singapore was chosen as the benchmark for Indonesia because it has the highest average ESG index in Southeast Asia. The results show that greenwashing reduces earnings quality, while family ownership weakens the negative impact of greenwashing on earnings quality. Practically, the greenwashing behavior that cover up the low quality of earnings for Singaporean companies is greater compared to Indonesian company. This study provides a theoretical contribution by offering empirical evidence regarding greenwashing in the form of selective disclosures which can distort the quality of company earnings. Family companies in Indonesia and Singapore are aware of the potential for distortions in earnings quality due to greenwashing. Moreover, this research will give a practical contribution so that investors are wary of ESG disclosures which can distort the quality of returns in Indonesia and Singapore. Distortion occurs because the companies only disclose positive information about ESG but keep silent about negative information.

Keywords: Greenwashing; Family ownership; Earning's quality; Selective disclosure; ESG.

1. INTRODUCTION

Environmental issues and sustainable development have become the company's and stakeholders' main focus (Ruan & Liu, 2021). Covid-19 pandemic has increased the demand for environmental and social corporate responsibility. This condition makes the disclosure of Environmental Social and Governance (ESG) even more important to improve the company's reputation (Arif et al., 2020). An increase in the number of corporate ESG claims creates another difficulty for stakeholders to distinguish between truly positive business performance or those that only appear to support sustainable development (Torelli et al., 2020). This condition is known as greenwashing which aims to form positive beliefs among stakeholders about the company's ESG practices but misleads them (Lee & Suh, 2022).

Several studies have found that companies that perform and disclose ESG are companies that commit in an unethical actions in financial statements. They try to cover up earnings manipulation by carrying out and disclosing ESG activities, thereby creating misperceptions of stakeholders. The manipulation mode used by the company is to carry out earnings management to maximize agent compensation. These problems lead to a decrease in the quality of company reporting because it gives a false impression to outsiders (Gerged et al., 2021). Greenwashing problems should be mitigated by implementing good corporate governance. Corporate Governance (CG) refers to the framework that governs the relationship between shareholders, board of directors, executive management, employees, and all other corporate stakeholders. The main objective of corporate governance is to

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create a transparent, accountable, and efficient structure to manage and oversee the company. Corporate Governance can also be defined as a series of processes, customs, policies, rules, and institutions that affect the direction, management, as well as control of a company. Thus, it is interesting to examine how the role of Corporate Governance in mitigating greenwashing behavior causes the decrease in quality of the company's financial reporting.

Greenwashing research is still quite sparse, particularly in ASEAN countries. It is well known that companies in Asia have the characteristics of concentrated family ownership. In addition, differences between developed and developing countries can also provide different empirical evidence. Therefore, this study will not only examine how greenwashing influences the quality of corporate earnings, but it also has novelty by adding the test how governance is able to mitigate this effect, and whether there are differences in behavior between developed and developing countries, namely Indonesia and Singapore. Based on the argumentation above, this study aims to test and obtain empirical evidence of how greenwashing behavior influences the quality of company earnings. In addition, this study also examines the role of governance in mitigating this influence and whether there are any behavior differences between Indonesia and Singapore.

2. LITERATURE REVIEW

2.1 Greenwashing dan Selective Disclosure Technique

Greenwashing is a form of misleading environmental, social, and governance (ESG) communication, both at the company level and product or service level. The company communicates low ESG performance to build a positive image and reputation of the company in the eyes of society. The form of communication can be by exaggerating ESG performance (overclaiming) or demonstrating actual performance but creating the false impression. Green-washer firms have low ESG performance but communicate positive news about the company's ESG performance. Greenwashing is not limited to demonstrating false claims, but also providing statements and disclosures that are technically correct, yet create a false and misleading impression (Delmas & Burbano, 2011; Shanor & Light, 2022).

There are three categories of greenwashing, namely (i) false statements or symbols; (ii) misleading statements or symbols, and (iii) actual statements or symbols (Shanor & Light, 2022). These false statements or symbols can be unsubstantiated or demonstrably false statements in advertising about a product, service, or a company's overall environmental performance. These false statements and symbols are quite specific and factual in nature, so that they can be verified as facts even if they are not verified. This category is arguably the core case of greenwashing and the easiest for police to handle. Both false statements and symbols, generally create a false factual impression on the public and are the essence of green washing. The public relies on company false statements or symbols to form their beliefs about a company's product or environmental performance.

The second category of greenwashing is a level of fraudulent (misleading) statements and symbols that are not outright false claims. This category includes statements and symbolic representations that are not directly factual and therefore may not be as readily or verifiable as statements in Category One. This category can include statements that may be technically correct but create the false impression among consumers or investors that a particular product or service has positive environmental attributes. The essence of greenwashing in Category Two is about creating a favorable impression by using fancy or meaningless language that cannot be proven true or false.

Greenwashing Category Three includes expressions, statements or symbols that are factual and accurate and create the right impression in the minds of the public. However, the public is not aware that companies carry out greenwashing by only conveying positive information, but not conveying negative one or using selective disclosure techniques (Marquis et al., 2016). One of the greenwashing characteristics is the selective disclosure of positive information about a company's environmental or social performance, while withholding negative information about its environmental and social performance.

Companies with good environmental performance tend to make less selective disclosures than companies with lower environmental performance. Companies that have higher environmental performance, on the one hand, may be because they feel that they have nothing to hide. Thus, they have more superior position in the eyes of stakeholders. This study uses the third category of greenwashing through selective disclosure techniques (Marquis et al., 2016).

2.2 Research Hypothesis

Legitimacy Theory has been widely used to explain corporate governance with corporate social responsibility that develops into ESG (Brammer et al., 2012). ESG reporting is seen as a mechanism for companies to regulate legitimacy and reputation, so that it is accepted by the social and environment (Lokuwaduge & De Silva, 2022). Legitimacy theory argues that organizations must not only comply with prevailing societal norms but also adapt to dynamic socio-cultural, economic, and environmental contexts. Legitimacy theory is a socially constructed concept that is influenced by interactions between organizations and their stakeholders.

In the context of greenwashing, companies are adopting a proactive strategy to build and maintain legitimacy regarding ESG performance. This strategy covers various practices such as strategic communication, transparency, community social responsibility initiatives, and addressing stakeholder issues, including ESG communication. Stakeholder perceptions and expectations change dynamically over time. As a result, companies must continuously engage with stakeholders, monitor emerging trends, and adapt ESG practices to maintain and increase their legitimacy. Companies can lose their legitimacy in the eyes of society if they practice greenwashing.

2.3 Greenwashing and Earnings Quality

Earnings quality is a function of the company's fundamental performance. The higher the quality of earnings, the greater the provision of relevant information that can be used in decision making. There are many proxies used to measure earnings quality indicators, such as earnings persistence, accruals, timeliness, loss avoidance, investor response, etc. (Patricia Dechow et al., 2010). Low earnings quality has the potential to distort an actual earnings performance. This study employs accrual quality as a proxy for earnings quality. The greater the difference between operating cash realization and accruals (working capital), the lower the company's earnings quality (P Dechow & Dichev, 2002).

Greenwashing can shape a person's behavior resulting from the formation of one's perceptions and beliefs (Braga Junior et al., 2019). Individuals and leaders play an important role that can encourage companies to conduct greenwashing. Being in a condition of uncertainty, a rational person will make a decision with a satisfactory choice rather than an optimal choice as explained in bounded rationality (Delmas & Burbano, 2011). In the context of greenwashing, companies choose to actively communicate on sustainability issues to reduce the cost of implementing sustainability practices. The cost of implementing sustainable practices that are expensive allows companies to carry out earnings management, thereby reducing the quality of company earnings. Companies that engage in greenwashing are likely to use similar tactics to manipulate financial information, leading to lower earnings quality. Both practices involve selectively presenting information to present a desired image, which has the potential to distort stakeholder perceptions.

The impact of greenwashing on earnings quality in previous studies was very limited, but several studies have shown that there is a relationship between CSR and earnings quality. According to empirical data, the earnings' response coefficient (ERC) and CSR have a negative association. CSR serves as a gauge of the quality of discretionary income as shown by earnings management techniques. Corporates are more likely to file positive CSR reports when they have higher discretionary accruals and profit changes that are either zero or somewhat positive. According to another study, management's propensity for greenwashing is more obvious when it controls earnings upward as opposed to downward. The association between CSR report tone and earnings management is lessened in businesses with trustworthy CSR reports and improved information disclosure environments. By showing how managers purposefully utilize the CSR report tone to conceal earnings management and establish stakeholders' expectations, those studies provide new insights into the literature (Li et al., 2023).

Many companies take part in CSR initiatives that aim to provide benefits to a larger group of stakeholders. These organizations usually encourage managers to consider these stakeholders when making operational and financial decisions. One of the decisions managers must make is how to handle earnings. The demonstrated dedication to CSR of a firm helps to regulate management efforts to control both increasing and downward earnings. Managers' consideration of diverse stakeholders has varying implications on accrual levels depending on the direction of the earnings management incentive. Our research provides insight into how CSR could influence employees' choices within the organization by reducing the impact of incentives on maximizing self-interest (Agoglia et al., 2022). By using a similar analogy, the practice of selective disclosure in greenwashing aims to meet stakeholder expectations and conceal earnings management. Based on the arguments above, the research hypothesis 1 is stated as follow:

H1: Greenwashing has a negative effect on earnings quality.

2.4 The Role of Family Ownership in Weakening the Negative Effect of Greenwashing on Earnings Quality

Previous studies have found a correlation between CG arrangements and earnings managements, even though there is a negative correlation between environmental disclosure (CED) and earnings managements (EM). CSR and earnings quality (EQ) have a positive correlation, and this correlation is larger for companies operating in countries with strong CG mechanisms and strong investor rights protection. The CSR-EQ association is influenced by the degree of institutional characteristics' monitoring roles at the national level. These studies provide managers with a set of recommendations tailored to the specific context regarding the critical need for more coordinated efforts to ensure corporate sustainability in emerging economies, as well as a deeper understanding of how managers respond to CED initiatives and CG reforms in relation to lowering earnings manipulations (Gerged et al., 2021).

The agency theory paradigm also claims that management opportunism can be used to leverage CSR. Board size and block ownership significantly affect the association between CSR and EM. The research advances our understanding of EM, CG, and CSR. through describing the factors and processes through which CG can have a significant influence on the CSR-EM nexus, it adds to the body of knowledge. The findings have significant implications for those who make decisions about corporate management, public policy, and other stakeholders. The study's findings will be used to create and implement rules that will strengthen CG structures, especially in emerging economies, in order to protect shareholders' interests and increase market trust (Buertey et al., 2020). However, previous research has not examined the role of family ownership in mitigating the negative effect of greenwashing on earnings quality in ASEAN countries where almost one third of companies are concentrated in family ownership (family own/FO).

The alignment effect theory states that companies with a concentration of ownership in certain parties will seek to increase the value of the company that benefits the controlling shareholder (Claessens et al., 1999). However, there are some opportunities that the controlling shareholder expropriates minority shareholders when the shareholder's cash flow rights are less than their voting rights. So that controlling shareholders may cause an entrenchment effect (Claessens et al., 2002; Yeh & Woidtke, 2005). However, expropriation of minority shareholders due to greenwashing is unlikely to occur, because there would not transfer of assets from the company to other company groups due to greenwashing. The FO's motivation for greenwashing is to build a positive image of ESG in the eyes of the public and investors by selectively communicating ESG performance.

In family firms, manager and owner conflicts are limited because the manager is generally occupied by the owner. Therefore, FOs tend to have lower incentives to carry out earnings management which can reduce earnings quality which has the potential to mislead them in making decisions. Thus, FO is expected to weaken the relationship between greenwashing and earnings quality.

H2: Family ownership weakens the negative effect of greenwashing on earnings quality.

2.5 Comparison of Differences in FO in Mitigating the Negative Effects of Greenwashing on Earnings Quality in Indonesia and Singapore

Indonesia and Singapore are two countries known in the ASEAN-6 group which are the target of global investors. Singapore's ESG performance is recorded as having the highest ESG score among ASEAN-6. Many factors can cause differences in ESG performance among ASEAN-6 countries, including between Indonesia and Singapore, including differences in strength of corporate governance (CG) attributes, quality of law enforcement and level of investor protection. Anglo-Americans, Europeans, and South-Eastern ASEANs had varied associations with CSR and EQ, according to a previous study. Findings CSR is positively correlated with EQ according to both univariate and GMM multivariate cross-country analyses, and this correlation is stronger for businesses located in nations with strong CG tools and higher levels of investor right protection. The findings, according to the authors, show that the degree of institutional characteristics' monitoring roles at the country level influences the CSR-EQ connection (Jouber, 2020).

Furthermore, in a growing economy, corporate environmental disclosure (CED) and earnings management (EM) practices are related, but the relationship is moderated by internal corporate governance (CG) processes. The CED-EM nexus is moderated by some CG structures, including board size, managerial structure, and institutional ownership structure. Our study emphasizes how important it is to consider internal CG mechanisms when attempting to understand how CED and EM are related in the context of emerging economies. It is recommended

that managers respond to CED initiatives and CG reforms in relation to reducing earnings manipulations, which offers policymakers, board directors, and managers a set of recommendations tailored to the particular context regarding the critical need for more concerted efforts to ensure corporate sustainability in emerging economies (Gerged et al., 2021). Therefore, we argue that there are differences in the moderating effect of governance proxied by FO on the relationship between greenwashing and earnings quality between Indonesia and Singapore.

H3a: There is a difference of negative effect of greenwashing on earnings quality between companies in Indonesia and Singapore.
H3b: There is a difference role of family ownership in mitigating the negative effect of greenwashing on earnings quality between companies in Indonesia and Singapore.

3. METHOD

3.1 Data and Sample

The research conducted on published companies in Indonesia and Singapore from 2012 – 2021 for all sectors, which selected based on certain criteria, such as: company has concern on ESG activities, has complete data need for the statistical estimation. Table 1 shows the sampling procedure for the research, which total final sample data is 291 firms' years.

Table 1: Sampling Procedures

Description	Indonesia	Singapore
Listed companies	825	631
Companies' ESG Data Not Available	(795)	(607)
Period of 7 years (2015-2021)	210	168
Reduction for uncomplete data & outliers	50	37
Final Samples (firm years)	160	131

Source: Research Data, Geraldina, et al. (2023)

The research uses unbalanced panel, and from Table 1, the total final samples is 291 firm years, which is consists of 7 years data observations. The main reason of using 2015 Data, because as United Nation's concern for Sustainable Development Goals is starting in 2015, and this become one breakthrough moment for business in global to be more serious in shifting from economics/profit oriented to be sustainable. This new focus is captured by more companies are publishing a sustainability report or Environmental, Social and Governance (ESG) Reports starting 2015, and Singapore is country in ASEAN which have best score for ESG Reporting, therefore this research focusses to analyze from two countries point of view, Indonesia, and Singapore.

3.2 Research Model

Based on Bayer et al (2019), and objectives of this reseach, the estimation method for hypotheses testing is panel data regression using an empirical model as follows:

$$EQ_{it} = \alpha + \beta_1 PRGS_{it} + \beta_2 FO1_{it} + \beta_3 FO1*PRGS_{it} + \beta_4 PGRS_{it}*DCountry_{it} + \beta_5 PGRS_{it}*FO1*DCountry_{it} + \beta_6 DCountry_{it} + \beta_7 DIndustry_{it} + \beta_8 ROA_{it} + \beta_9 MBV_{it} + \beta_{10} AGE_{it} + e_{it} \quad (1)$$

where:

EQit	= earnings quality company i year t
PRGSit	= Peer Relative Greenwashing Score
FO1it	= Percentage of Family Ownership
DCountryit	= Dummy Country, valued 1 if Indonesia, 0 if Singapore
DIndustry	= Category for sector Industry
ROAit	= firm's return on asset
MBVit	= Market to book ratio
AGEit	= length periods of firm's operation

Earning Quality is derived from the measure of Dechow dan Dichev (2002), which consists of persistence, predictability, and smoothness:

$$\Delta WC_t = b_0 + b_1 CFO_{t-1} + b_2 CFO_t + b_3 CFO_{t+1} + e_t \quad (2)$$

From above equation, earnings quality is the deviation standards of working capital residual values, which indicates the discretionary portion of working capital that represent of earnings management activities from the manager. Changes in working capital itself defined as (ΔWCt) = $\Delta AR + \Delta Inventory - \Delta AP - \Delta TP + \Delta Other\ Assets$

(net), where, AR is Account Receivable, AP is Account Payable, and TP is Taxes Payable. Delta working capital is determined by the level of Cash Flow from operation during this year, prior and subsequent this year.

CFO_{t-1} = Cash Flow from Operation (prior the year) (3)
CFO_t = Cash Flow from Operation (this year) (4)
CFO_{t+1} = Cash Flow from Operation (subsequent the year) (5)

Meanwhile, PRGS is an indicator of greenwashing behavior of managers, which is derived from the gaps of ESG Reporting and the ESG performance, relative to the respective industry sectors, more higher values of PRGS indicates more greenwashing is the manager. The ownership structure (FO1), this research is focus on the highest percentage of companies shares ownership held by family. Control variables in this research are profitability, firm's size, and age, which indicates-respectively by ROA, natural logarithm of total assets, and firm's value also as control variable, indicates by MBV (Market to Book Value).

The expected result from empirical estimation is, for Hypothesis 1, β_1 is expected to have negative sign with level of significant is 5%. Then, criteria for Hypothesis 2 acceptance is β_3 expected to have negative value with level of significant is 5%, meanwhile hypothesis 3a is expected the β_4 to be both positive or negative significant with level of significant is 5%, finally, the expected sign for β_5 is to be positive or negative as well for he Hypothesis 3b acceptance criteria. For control variables, ROA, MBV and AGE are expected to have positive effect with level of significant 5%.

4. RESULTS AND DISCUSSION

Table 2 shows descriptive statistics with a sample of 2 countries, namely Indonesia and Singapore. Earnings quality (EQ) is measured by looking at the number of accruals made by the company. To facilitate interpretation, the accrual figures are absolute and then multiplied by -1 so that the higher the accrual value indicates the lower the quality of earnings. On average, the earnings quality of companies in Indonesia and Singapore is low. As from the magnitude of the accrual value, it shows that on average the earnings management that is carried out is downward earnings management (income decreasing) which can be seen from the average value of -0.053.

Table 2: Descriptive Statistics of Main Variables.

Variables	Observations	Mean	Median	Maximum	Minimum	Std. Dev.
EQ	291	-0.053	0.000	0.167	-7.709	0.626
PRGS	291	0.033	0.134	1.656	-2.963	0.811
FO1	291	0.497	0.521	0.999	0.103	0.186
ROA	291	0.059	0.037	0.474	-0.067	0.068
MBV	291	3.366	1.593	85.181	0.294	8.839
AGE	291	63.074	62.00	93.00	33.00	11.816
DCOUNTRY	291	0.555	1.000	1.000	0.000	0.497
DINDUSTRY	291	0.129	0.000	1.000	0.000	0.336

Notes: EQ=earnings quality; PRGS=peer-relative greenwashing score; FO1=family ownership; ROA=firm's profitability; MBV=market to book value; AGE= firm's age (length periods of firm's operation); DINDUSTRY= dummy industry 1 for finance and 0 for other; DCOUNTRY=dummy country 1 for Indonesia and 0 for Singapore

The highest greenwashing score (PRGS) is 1.656 and the lowest score is -2.963. Both come from Indonesia. The highest score (positive) indicates a company conducting greenwashing compared to the average company. Meanwhile, the lowest score (negative) indicates that the company has no indications of greenwashing. On average, the companies in this study sample are indicated conducting greenwashing as indicated by a score of 0.033. The average value corporate family ownership (FO1) is 49.69%. Its coveys that the companies are owned by concentrated family ownership. This strengthens empirical evidence that ASEAN countries are indeed companies with concentrated family ownership.

Furthermore, the sample in this study shows that 55% come from Indonesian companies, and the rest are Singapore companies. While the industry that became the sample in this study was 12.96% of the financial industry, while the rest were non-financial companies. The regression results for Hypotheses 1, 2 and 3 is demonstrated in Table 3 below. It shows the results of hypothesis testing. Hypothesis 1 states that greenwashing has a negative effect on earnings quality can be proven by looking at the PRGS coefficient. Based on the regression results in Table 3, it shows that greenwashing has a negative effect (i.e. -0.018 and significant) on earnings quality, thus hypothesis 1 cannot be rejected. Companies that are indicated to be carrying out greenwashing disclose CSR reports that are not in accordance with the actual situation, to cover up fraudulent behavior in financial reporting. This is indicated by the low quality of the company's earnings, which indicates greenwashing.

Table 3: Regression results for Hypotheses 1, 2 and 3

Variable	Coefficient		Prob.
C	-0.006		0.337
PRGS	-0.018	**	0.002
FO1	0.016	*	0.083
FO1*PRGS	0.027	*	0.094
ROA	0.071	**	0.044
MBV	-0.000	*	0.029
AGE	-0.000	*	0.061
DINDUSTRY	0.023	***	0.000
DCOUNTRY	-0.006		0.208
DCOUNTRY*PRGS	0.048	***	0.000
DCOUNTRY*PRGS*FO1	-0.078	***	0.002
Adjusted R-squared	0.169		
F-statistic	6.926		
Prob(F-statistic)	0.000		

Notes:
PRGS=peer-relative greenwashing score; FO1=family ownership; ROA=firm's profitability; MBV=market to book value; AGE= firm's age (length periods of firm's operation); DINDUSTRY= dummy industry 1 for finance and 0 for other; DCOUNTRY=dummy country 1 for Indonesia and 0 for Singapore

Meanwhile, the results for Hypothesis 2 stated that family ownership may mitigate the negative effect of greenwashing on earnings quality, can be seen from the FO1*PRGS coefficient, where the regression coefficient shows a positive value of 0.027 and significant. These results indicate that the behavior of companies that carry out greenwashing to cover up fraudulent financial statements can be mitigated by the existence of concentrated family ownership. Concentrated family ownership can provide family members, who will hold a management post, the ability to be more actively involved in decision making and operational control of the company. By having direct control, the family can ensure that the company's management runs the business properly and in accordance with the company's values and long-term goals. Thus, it shows that family ownership would weaken the negative effect of greenwashing on earnings quality.

On the other hand, Hypothesis 3a tests whether there are any behavior differences between companies in developed and developing countries, it can be seen from the significance of the DCOUNTRY*PRGS coefficient. Based on the test results in Table 3, it is found that the DCOUNTRY*PRGS coefficient has a positive value of 0.048, which indicates that there is a significant difference in the effect of greenwashing on earnings quality between Indonesia and Singapore. The positive coefficient demonstrates that greenwashing behavior to cover up low earnings quality is higher for companies in Singapore compared to Indonesia. Alternatively, for Hypothesis 3b, it states that there are differences in the role of family ownership in mitigating the negative effect of greenwashing on earnings quality between countries is also proven. The DCOUNTRY*PRGS*FO1 coefficient is statistically significant at -0.078, so it can be concluded that theconcentrated role of family ownership in mitigating greenwashing behavior is higher in Singapore than Indonesia.

5. CONCLUSION

It can be concluded that the study provides additional empirical explanations on greenwashing can reduce earnings quality. In the context of ASEAN countries, where ownership is concentrated in state ownership, the research results support the alignment effect regarding the role of family ownership in mitigating the negative effect of greenwashing on earnings management. Expropriation of minority shareholders due to greenwashing is unlikely to occur, because there is no transfer of assets from the company to other company groups due to greenwashing. The FO's motivation for greenwashing is to build a positive image of ESG in the eyes of the public and investors by selectively communicating ESG performance. The implication is that FOs tend to have lower incentives to carry out earnings management which can reduce the quality of earnings which has the potential to mislead them in making decisions. Furthermore, the results of the study strengthen the differences in country characteristics that impact greenwashing behavior, earnings management, and the role of family ownership in mitigating the negative effects of greenwashing on earnings management. Countries that are relatively more developed, have better governance and investor protection have a lower negative impact of greenwashing. This research has implications for regulators to encourage better governance practices and law enforcement to reduce the negative impact of greenwashing.

This research has several limitations. Firstly, this study did not explore the role of the board of directors in greenwashing activities and corporate earnings management in ASEAN. The characteristics of the board of

directors in the context of countries in ASEAN are relatively unique compared to developed countries. Therefore, further research is suggested to explore this limitation. Secondly, greenwashing measures use selective disclosure proxies which have different interpretations using other measures, such as the deviation between disclosure and ESG performance. Hence, future research can use several different measurements to ensure the robustness of the results.

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