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Avoiding the risk of de-legitimation: Impact of internationalization on earnings management of emerging market firms

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Highlights

- Internationalization exposes emerging market multinational enterprises firms (EMNEs) to heightened scrutiny by meta-institutional field and host country stakeholders.
- EMNEs reduce earnings manipulation to avoid de-legitimation in the minds of host-nations' stakeholders.
- Internationalization induced 'external monitoring' plays a substitutive role for the 'internal monitoring' mechanisms of corporate governance on earnings management.

Abstract

This study examines the impact of internationalization on the corporate misconduct of earnings management by emerging market multinational enterprises. We propose that internationalization exposes these firms to heightened scrutiny by meta-institutional field and host country stakeholders, and EMNEs reduce earnings manipulation to avoid de-legitimation in the minds of host-nations' stakeholders. We find empirical evidence for our predictions on a multi-industry sample of 21,477 firm-year observations belonging to 2,461 Indian firms during 2005 – 2018. Additionally, we find that internationalization induced 'external monitoring' plays a substitutive role for the 'internal monitoring' mechanisms of corporate governance on earnings management.

Keywords: Corporate governance; earnings management; emerging markets; internationalization; and legitimacy

1. Introduction

The onset of pro-market reforms in several emerging economies during the late 1980s and early 1990s triggered internationalization by incumbent firms from these economies (Popli et al., 2017). However, prevalent institutional hazards such as bureaucracy, corruption, opaque governance practices, and weak enforcement of contracts in their home countries, emerging market multinational enterprises (henceforth, EMNEs) face legitimacy deficits in the minds of their host country stakeholders (Li et al., 2020; Suchman, 1995). As a result, EMNEs experience heightened stakeholder pressures and scrutiny (Surroca et al., 2013). Legitimacy is instrumental in gaining access to diverse resources and capabilities and earn a reputation in the minds of stakeholders (Marano et al., 2017), which are quintessential to the realization of the intended objectives of internationalization. Thus, in addition to other legitimacy-building strategies such as cross-listing, improving governance attributes, and implementing globally recognized audit and certification mechanisms (Deng & Zhang, 2018; Popli et al., 2021), EMNEs may avoid corporate misconduct that may put them at the risk of de-legitimation. Hence, we hypothesize and find support that EMNEs, under 'external monitoring' by host nation stakeholders, would signal higher transparency by reducing their involvement in earnings management.

Earnings management is a corporate misconduct practice that involves deliberate attempts on the part of the organization to alter its reported earnings to mislead stakeholders about the underlying economic performance of the firm (Li, 2019). Firms adopt earnings management practices to signal their future earnings potential to the capital markets and to shareholders. However, earnings management may have potential severe consequences for EMNEs, such as greater government scrutiny, lack of trust, and stewardship behavior amongst all stakeholders, thus jeopardizing their internationalization pursuits. While extant research has primarily considered the effects of firm-level governance attributes representing the effect of 'internal monitoring' on firms' engagement with earnings manipulation (Bergstresser & Philippon, 2006; Chung et al., 2018), the effects of monitoring by external stakeholders is seldom discussed. Addressing this critical yet understudied research gap, we surmise that 'external monitoring' by host nation stakeholder groups leads EMNEs to reduce earnings management and hence we hypothesize a negative relationship between the degree of internationalization by EMNEs and earnings management. We examine and find support for our prediction on a large multi-industry sample of 21,477 firm-year observations belonging to 2,461 firms from the emerging economy context of India during 2005–2018. Furthermore, our post hoc analysis finds that internationalization induced 'external monitoring' substitutes for 'internal monitoring' by corporate boards in containing the misconduct of earnings management.

This article aims to make two key contributions. First, we find that internationalization exposes emerging market firms to meta-institutional pressures leading to reduced propensity for corporate misconduct. In so doing, we extend prior research on corporate misconduct through earnings manipulation that accounts only for the role of home-nation institutions and firm-level determinants of governance (Chung et al., 2018; Garcia-Meca & Sanchez-Ballesta, 2009). We find that to signal transparency amongst host nation stakeholders (Connelly et al., 2011), EMNEs reduce their involvement in both accrual and real-earnings based manipulations. Second, our analysis yields that in emerging markets, these external mechanisms of control substitute for the internal monitoring provisions of corporate governance in mitigating earnings management.

2. Legitimacy challenges and earnings management

Legitimacy is defined as "a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions" (Suchman, 1995; pp. 574). It reflects a congruence between the firm's behavior and the cultural, social, or institutional environment. Legitimacy is instrumental for gaining stakeholder acceptance, trust, and support and has implications for firm performance, growth prospects, and even survival (Freeman et al., 2004; Zimmerman & Zeitz, 2002).

Although critical for all organizations, gaining legitimacy is even more important for EMNEs owing to institutional differences between their home and the host nations. Despite the evolution of pro-market reforms in emerging markets such as India (Popli et al., 2021a; Raithatha and Popli, 2021), the business environment is still characterized by institutional hazards of corruption, bureaucracy, weak and opaque implementation of governance practices. Exposure to such weak institutions in their home nations creates legitimacy voids for EMNEs, and to mitigate the imminent negative manifestations, these firms seek to comply with the meta-institutional pressures of the host country stakeholders (Kostova et al., 2008). EMNEs do so by pursuing a variety of market-based strategies such as granting greater autonomy to foreign subsidiaries (Wang et al., 2014), undertaking global standard audit and certification mechanisms (Deng & Zhang, 2018), enhancements in the structural attributes of corporate governance in their home markets (Popli et al., 2021b) and cross-listing (Temouri et al., 2016). Alternatively, firms also engage in non-market-based strategies of corporate social responsibility, philanthropic initiatives (Tashman et al., 2019), and relationship building with key stakeholders (Zhang et al., 2018)..

While informative, most of the prior research focuses on the firms' pursuit of positive actions. However, we argue that EMNEs, in addition to legitimacy-building actions, also reduce involvement in corporate misconduct which could lead to de-legitimation. Corporate misconduct of earnings manipulation results in the loss of stakeholder support and threatens legitimacy. Therefore, we hypothesize that a greater degree of internationalization would expose EMNEs to 'external monitoring'

by meta-institutional and host nations' stakeholders, and as a result, these firms would reduce their earnings manipulation.

Hypothesis 1 (H1): The degree of internationalization of emerging market multinational enterprises will be negatively related to earnings management

3. Data and Results

For this study, we used a sample of Indian firms to examine the hypothesis. We collected the data from the widely used database called *Prowess*, provided by the Centre for Monitoring Indian Economy. Our initial sample comprised of 32563 observations belonging to 3838 firms from the year 2005 to 2018. After dropping firms from the financial sector, regulated sectors, and removing observations with missing data, our final sample consists of 21,477 firm-year observations belonging to 2,461 firms. We winsorized all the continuous variables at 1% to contain the impact of outliers.

3.1 Main variables: Our main variable of interest of earnings management is captured using both accrual-based and real earnings management measures. Based on the Dechow, Sloan, and Sweeney (1995) modifications to the Jones (1991) accruals model, we adopted two operationalizations of the accrual-based measure of earnings management, i.e., *income increasing accrual earnings management* and *accruals earnings management*. Likewise, we followed prior studies (Bin et al., 2019; Roychowdhury, 2006) to calculate our measure of *real earnings management*.

We operationalized the degree of internationalization using three different measures that encompass different dimensions of internationalization: proportion of foreign sales, the proportion of foreign subsidiaries, and length of internationalization. We included several relevant control variables to account for possible confounding effects and controlled for industry and year fixed effects. We provide details about the operationalizations and descriptive statistics of all the variables in Table 1. We examined the variance inflation factors of all the variables¹ and found them to be well within the acceptable limits, thus alleviating any multicollinearity concerns.

Table 1. Variable operationalizations and descriptive statistics

¹ For the sake of brevity, we do not provide correlations table.

S.no	Variable	Operationalization	Mean	Standard deviation
<i>Dependent variables</i>				
1	Income increasing accrual earnings management	Value of discretionary accruals if discretionary accruals are positive, and 0 otherwise.	0.120	0.439
2	Accrual earnings management	The absolute value of discretionary accruals ² .	0.212	0.493
3	Real earnings management*	Sum of abnormal operating cash flows (*-1), abnormal discretionary expenses (*-1), and abnormal production costs. Abnormal levels are calculated as residuals from models proposed by Roychowdhury (2006). We multiply abnormal operating cash flows and abnormal discretionary expenses by -1 so that higher proxies indicate higher real earnings management.	-0.0383	0.6944
<i>Independent variables</i>				
4	Proportion of foreign sales	Foreign sales / Total sales	0.002	0.002
5	Proportion of foreign subsidiaries	Foreign subsidiaries / Total subsidiaries	2.275	1.036
6	Length of internationalization	Natural logarithm of the number of years since the firm started its first international operations	0.001	0.002
<i>Control variables</i>				
7	Corporate governance index	A composite index of – board size, proportions of independent directors, board member attendance, outside directorships, and institutional shareholding ³ (including domestic and foreign institutional investors)	0.102	1.229
8	Audit quality	A dichotomous variable with a value of '1' if the firm is audited by the top four auditing firms, and '0' otherwise	0.142	0.349
9	Operating loss dummy	A dichotomous variable with a value of '1' for a firm with a negative profit after tax for the previous two years and '0' otherwise	0.158	0.365
10	Business group affiliation	A dichotomous variable with a value of '1' if the firm is a business group affiliate and '0' otherwise	0.450	0.498
11	Leverage ratio	Debt / Total assets	1.005	26.715
12	Firm performance	Net income / Total assets	0.066	0.122
13	Firm size	Total assets (in millions Indian rupees)	14160.32	103244.1
14	Earnings volatility	Rolling average of the standard deviation of return on assets of the earlier three years	0.061	0.068
15	Cash flow volatility	Rolling average of the standard deviation of cash flow from operations of the earlier three years	0.083	0.070
16	Family ownership	Percentage of shares held by the promoters (Jain et al., 2019)	49.11	21.163

N = 21,477 firm year observations

*N=19,765

² We calculated the total accruals by following the modified versions of Jones (1991), as proposed by Dechow et al. (1995). Following extant studies (Kothari et al. 2005), we used a cross-sectional model to calculate discretionary accruals for each year and each industry with a minimum of ten observations. Following Dechow et al. (1995), total accrual is computed as the change in non-cash current assets minus the change in current liabilities excluding the current portion of long-term debt, minus depreciation and amortization, scaled by lagged value of total assets. Next, we estimated the non-discretionary component of total accruals by regressing total accruals on the change in sales and the gross level of property, plant, and equipment, scaled by the lagged value of total assets to avoid any problems of heteroskedasticity in the residuals. Using the regression coefficients and after adjusting for the change in sales for the change in accounts receivable to allow for the possibility that firms could have manipulated sales by changing credit terms (Dechow et al. 1995), we obtain non-discretionary component, which is then subtracted from total accruals to arrive at the discretionary accruals.

³ Use of institutional shareholding as a part of corporate governance index in India is important as discussed in Deb (2018).

3.2 Endogeneity correction: To correct for self-selection bias, we used the Heckman two-stage estimation procedure (Heckman, 1979). The first stage employed a Probit regression model to estimate a firm's probability to internationalize. For the first stage, we chose an instrumental variable that impacts selection but not the outcome (Hamilton & Nickerson, 2003). We use the import intensity variable (Cuervo-Cazurra, 2011) as the instrumental variable. The variable is computed as the percentage of raw material imported from international markets. Higher import intensity could influence its decision to internationalize but should not affect earnings management decision. In the second stage, we included the inverse mills ratio computed from the first stage and set of control variables to test the impact of internationalization on earnings management using the ordinary least square regression with standard errors clustered at the firm level.

3.3 Results

We report the results of the regression analysis on the relationship between the different measures indicating the degree of internationalization and earnings management using the Heckman two-stage regression in Table 2. Model 1 reports the selection model. While Models 2 – 4 report the hypothesis results using *income increasing accruals earnings management*, Models 5 - 7 report for *accruals earnings management*. Likewise, Models 8 – 10 tabulate the findings for the measure of *real earnings management*. The respective coefficients for the alternate operationalizations of the degree of internationalization are negative and significant across both the accrual-based and real earnings management. These results provide strong support for our arguments that internationalization subjects EMNEs to external monitoring, creates legitimacy pressures to overcome risks of de-legitimation, reducing earnings management.

Table 2. Ordinary Least Square Regression analysis using Heckman's correction for endogeneity

Variables	First stage – Probit Model (Heckman's correction)	DV= Income increasing accrual earnings management			DV= Accrual earnings management			DV= Real earnings management		
	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)	Model (6)	Model (7)	Model (8)	Model (9)	Model (10)
Import dummy	1.0017*** (0.046)									
Proportion of foreign sales		-1.8571* (1.016)			-1.7383 (1.069)			-7.8505*** (2.520)		
Length of internationalization			-0.0070* (0.004)			-0.0118*** (0.004)			-0.0323*** (0.008)	
Proportion of foreign subsidiaries				-2.3490** (0.947)			-1.8848* (0.964)			-5.7135*** (2.153)
Corporate governance index	0.1771*** (0.018)	0.0007 (0.003)	0.0007 (0.003)	0.0011 (0.003)	0.0019 (0.004)	0.0019 (0.003)	0.0032 (0.004)	-0.0207*** (0.006)	-0.0208*** (0.006)	-0.0197*** (0.006)
Audit quality	0.5565*** (0.081)	-0.0079 (0.006)	-0.0070 (0.006)	-0.0060 (0.006)	-0.0035 (0.004)	-0.0021 (0.007)	-0.0009 (0.005)	-0.0749*** (0.019)	-0.0698*** (0.019)	-0.0693*** (0.019)
Operating loss dummy	-0.3813*** (0.039)	0.0111 (0.012)	0.0131 (0.012)	0.0111 (0.012)	-0.0034 (0.015)	-0.0002 (0.013)	-0.0037 (0.016)	-0.0197 (0.020)	-0.0102 (0.020)	-0.0193 (0.020)
Business group affiliation	0.0841 (0.053)	0.0105* (0.006)	0.0125** (0.006)	0.0114* (0.006)	0.0075 (0.007)	0.0106 (0.007)	0.0087 (0.007)	-0.0141 (0.012)	-0.0052 (0.012)	-0.0111 (0.012)
Leverage ratio	-0.0025 (0.008)	0.0006*** (0.000)	0.0006*** (0.000)	0.0005*** (0.000)	0.0006*** (0.000)	0.0007*** (0.000)	0.0006*** (0.000)	-0.0077 (0.009)	-0.0067 (0.009)	-0.0076 (0.009)
Firm performance	0.7713*** (0.122)	0.0591 (0.041)	0.0561 (0.041)	0.0597 (0.041)	-0.0230 (0.031)	-0.0277 (0.043)	-0.0221 (0.031)	-0.4940*** (0.073)	-0.5077*** (0.072)	-0.4939*** (0.073)
Firm size	-0.3434 (0.321)	0.0839** (0.036)	0.0855** (0.036)	0.0819** (0.036)	0.1089 (0.073)	0.1120** (0.046)	0.0990 (0.067)	0.3196** (0.125)	0.3299** (0.133)	0.3140** (0.127)
Earnings volatility	-1.6406*** (0.291)	0.2191*** (0.082)	0.2314*** (0.082)	0.2177*** (0.082)	0.4138*** (0.072)	0.4344*** (0.092)	0.4054*** (0.070)	-0.1942* (0.117)	-0.1426 (0.118)	-0.1975* (0.117)
Cash flow volatility	-1.8505*** (0.287)	0.1331* (0.069)	0.1264* (0.069)	0.1296* (0.069)	0.3161*** (0.060)	0.3064*** (0.080)	0.3031*** (0.060)	0.2906** (0.115)	0.2582** (0.115)	0.2782** (0.115)
Family ownership	0.0028*** (0.001)	-0.0003** (0.000)	-0.0003** (0.000)	-0.0003** (0.000)	-0.0004** (0.000)	-0.0003** (0.000)	-0.0004** (0.000)	-0.0008*** (0.000)	-0.0008*** (0.000)	-0.0009*** (0.000)
Inverse mills ratio		0.0641*** (0.013)	0.0582*** (0.014)	0.0661*** (0.013)	0.0945*** (0.027)	0.0831*** (0.016)	0.0994*** (0.028)	-0.0034 (0.024)	-0.0307 (0.024)	0.0055 (0.023)
Accrual earnings management								-0.0007 (0.012)	-0.0002 (0.012)	-0.0007 (0.012)

Constant	0.1322 (0.394)	-0.0842* (0.044)	-0.0763* (0.044)	-0.0869** (0.044)	-0.1021 (0.127)	-0.0866 (0.055)	-0.1085 (0.115)	-0.1652 (0.144)	-0.1321 (0.151)	-0.1798 (0.146)
Observations	24,127	21,477	21,477	21,477	21,477	21,477	21,477	19,765	19,765	19,765
R-squared		0.151	0.151	0.151	0.206	0.207	0.209	0.072	0.073	0.072
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SE Clustered	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ (two-tailed tests)

3.4. Robustness tests

To further establish the robustness of our findings, we perform robustness checks. It is established that matching techniques such as Propensity Score Matching (henceforth, PSM) help in overcoming sample selection bias (Bettis et al., 2014), caused by a non-random sample, widely prevalent in studies on earnings management (Lee & Masulis, 2011). PSM is deemed effective because it requires the formation of treatment and control groups with similar observable factors, thus reducing correlations between the treatment and observable variables. We classified our treatment group as firms that have reported foreign sales (internationalized) and control groups as firms that do not have any sales revenue from foreign market (non-internationalized). For each firm in the treatment group, we identified a firm in the control group that is most similar using firm characteristics (as reported in Table 3A). We test our hypothesis by running regression on the matched sample. As reported in Table 3 (Panel 3b), using ordinary least square regression, we find a negative relationship between the various measures of degree of internationalization and earnings management, supporting our theorization and replicating our primary findings. Second, following extant studies, we investigated the robustness of our results using an aggregate measure of the various facets of the internationalization trajectory of EMNEs (Abdi & Aulakh, 2018). We calculated an index as sum of the proportion of foreign sales, the proportion of foreign subsidiaries, and the length of internationalization. This approach is similar to the one used by Sullivan (1994). Here too, our results, as indicated in Table 4, are similar to our initial results.

Table 3 PSM analysis**Panel 3A:** Covariate balance tests between the treatment and control firms

	Mean before PSM				Mean after PSM			
	(1) Treated	(2) Control	(3) Difference	(4) t-statistics	(5) Treated	(6) Control	(7) Difference	(8) t-statistics
Corporate governance index	0.30311	-0.43995	0.74306	45.68***	-0.17319	-0.10288	-0.07031	-3.08***
Audit quality	0.18863	0.03971	0.14892	32***	0.05933	0.06011	-0.00078	-0.17
Operating loss dummy	0.09279	0.28849	-0.1957	-40.04***	0.1823	0.16213	0.02017	2.7**
Business group affiliation	0.49756	0.34974	0.14782	21.77***	0.38496	0.38849	-0.00353	-0.37
Leverage ratio	0.38838	2.0103	-1.62192	-4.65***	0.49982	0.5735	-0.07368	-1.05
Firm performance	0.0853	0.02889	0.05641	34.91***	0.05598	0.05537	0.00061	0.26
Firm size	0.98642	0.98816	-0.00174	-2.12***	0.98415	0.98644	-0.00229	-1.52
Earnings volatility	0.04911	0.08217	-0.03306	-36.36***	0.06161	0.05892	0.00269	2.09**
Cash flow volatility	0.07053	0.10804	-0.03751	-39.53***	0.08827	0.0856	0.00267	1.98**
Family ownership	51.406	43.498	7.908	26.97***	47.955	48.684	-0.729	-1.67

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ (two-tailed tests). Panel 3A shows the first step of PSM. We determined the similarity of observable characteristics between treatment and control firms using one-to-one matching. To check the efficiency of PSM, we show the covariate balance between the treatment and control firms in Panel 3A above. As it is evident, for 7 out of 9 firm characteristics, the difference between the mean values of firm characteristics of treatment and control firms is statistically not different from zero.

Panel 3B: Ordinary least square regression analysis on a matched sample

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	DV= Income increasing accrual earnings management			DV= Accrual earnings management			DV= Real earnings management		
Proportion of foreign sales	-3.2797* (1.982)			-5.3440*** (1.894)			-11.4112** (4.445)		
Length of internationalization		-0.0089* (0.005)			-0.0192*** (0.005)			-0.0257*** (0.009)	
Proportion of foreign subsidiaries			-3.8825* (2.027)			-5.6059** (2.419)			-5.2371 (4.148)
Constant	-0.1353** (0.066)	-0.1357** (0.066)	-0.1384** (0.067)	-0.1663 (0.141)	-0.1654** (0.078)	-0.0875 (0.120)	-0.3046* (0.163)	-0.3086* (0.167)	-0.3153* (0.168)
Observations	8,424	8,424	8,424	8,424	8,424	8,424	7,853	7,853	7,853

R-squared	0.130	0.130	0.130	0.175	0.176	0.181	0.075	0.075	0.074
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	(included)	(included)	(included)	(included)	(included)	(included)	(included)	(included)	(included)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
SE Clustered	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ (two-tailed tests)

Table 4: OLS regression on a composite index of the degree of internationalization

	(1)	(2)	(3)
VARIABLES	DV= Income increasing accrual earnings management	DV= Accrual earnings management	DV= Real earnings management
Degree of internationalization	-0.0070* (0.004)	-0.0118** (0.005)	-0.0323*** (0.008)
Constant	-0.0767* (0.044)	-0.0865 (0.122)	-0.1319 (0.151)
Observations	21,477	21,477	19,765
R-squared	0.151	0.207	0.073
Controls	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
SE Clustered	Yes	Yes	Yes

Degree of internationalization is a composite index of all the three proxies of internationalization: Proportion of foreign sales, Proportion of foreign subsidiaries, and Length of internationalization.

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ (two-tailed tests)

3.5. Post hoc analysis

As a post-hoc test, we intended to examine whether the legitimacy pressure of internationalization, as a source of 'external monitoring', has a complementary or substitutive effect with the 'internal monitoring' mechanism of firm's corporate governance on earnings management. First, using principal component factor analysis, we created a *Corporate governance index* with important governance attributes of board size, board independence, average board attendance, institutional shareholding, and non-duality of CEO and Board chairperson. Based on prior literature, we expect that firms having a larger board, a greater proportion of independent directors and with better attendance would have better monitoring. Also, the presence of institutional shareholding and separation of CEO and board chair positions would also lead to better governance. Next, we created two dichotomous variables – *corporate governance dummy* and *internationalization dummy*, which take a value of '1' if a focal firm's corporate governance index and degree of internationalization⁴ is greater than its respective industry's mean value. With the variable *Internationalization dummy*, we aim to capture firms with a greater proportion of foreign sales to total sales compared to the average of intensity industry. Using these two dichotomous variables, we performed the super-modularity test (Topkis, 1998) and conducted the following tests:

$$\beta_{11} - \beta_{10} > \varphi_{01} - \varphi_{00} \text{ (indicates complementary effect)}$$

$$\beta_{11} - \beta_{10} = \varphi_{01} - \varphi_{00} \text{ (indicates substitutive effect)}$$

where β_{11} is the coefficient of the interaction term, *corporate governance dummy* \times *internationalization dummy*, β_{10} and φ_{01} are the coefficients of *corporate governance dummy*, and *internationalization dummy*, respectively, and φ_{00} is the intercept of the regression model. As shown in Table 5, the F statistics across the three measures of earnings management do not reject the null hypothesis *p-values* ($p > 0.1$) (substitutive effect). Thus, findings of the super-modularity test imply that scrutiny of EMNEs by meta-institutional fields in host nations is a substitutive mechanism to the 'internal monitoring' of corporate governance in mitigating earnings management. We present in results in Table 5.

⁴ Here, we used the measurement of proportion of foreign sales to total sales

Table 5: Post hoc: Super-modularity test

VARIABLES	(1)	(2)	(3)
	DV= Income increasing accrual earnings management	DV= Accrual earnings management	DV= Real earnings management
Corporate governance dummy × Internationalization dummy	0.0274***	0.0306***	0.0123
Corporate governance dummy	-0.0206***	-0.0238***	-0.0454***
Internationalization dummy	-0.0280***	-0.0348***	-0.0411**
Intercept	-0.0813*	-0.1056*	-0.1276
F statistics	0.01	0.07	0.04
p value	0.9194	0.7976	0.8509

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ (two-tailed tests)

4. Conclusions

EMNEs pursue several actions in the market and non-market domain to gain legitimacy in the minds of the host nation stakeholders. However, it is crucial that these firms also reduce their involvement in actions that expose them to the risk of de-legitimation. To that end, this study theorizes and find support that EMNEs' degree of internationalization negatively impacts corporate misconduct of earnings management. Our findings yield considerable evidence to show that EMNEs tend to reduce earnings management, thereby adhering to the expectations of diverse stakeholder pressures and increased stakeholder monitoring resulting from internationalization. We surmise that they do so to reduce their risk of de-legitimation and ensure stakeholder participation in their internationalization pursuits. Our results are robust to alternate measures of our key dependent and independent variables and estimation methods. Furthermore, in our post-hoc analysis, we find that 'external' and 'internal' monitoring mechanisms stemming from firms' internationalization and corporate governance respectively, are substitutive mechanisms in reducing corporate misconduct of earnings manipulation.

Author Statement

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