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Impact of Outside Blockholders Over Link between Independent Directors and the Normal and Abnormal Related Party Transactions

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ABSTRACT

This study examines the effect of independent directors on related sales and related purchases using the normal and abnormal values from 2003 to 2022 of the total sample of 13,789 firms representing 89% of the total Taiwanese listed firms.

As a second tier of independent external mechanisms, impact of outside blockholders, on the association between independent directors and related party transactions is examined. This study hypothesizes that the level of related party transactions varies with independent directors. Further, the connection between related party transactions and independent directors varies with the impact of outside blockholders. This study finds that a greater number of independent directors is significantly linked with lesser levels of normal related sales, lower levels of normal related purchases, and higher levels of abnormal related purchases. Thus, the hypotheses are confirmed. This study also finds that the extent of impact of outside blockholders supports a lower level of normal related purchases but higher abnormal related purchases, thus, the hypotheses are supported. Implications include that firms should strengthen their monitoring mechanisms to oversee both normal and abnormal related transactions, emphasizing the importance of regular board reviews. Additionally, the influence of outside blockholders on purchasing decisions underscores the need for companies to engage with these stakeholders to align strategies with shareholder interests.

Keywords: Outside blockholders; Independent directors; Related party transactions

INTRODUCTION

An unqualified perception of a related party transaction (RPT) is an engagement whose parties involved are affiliated. An efficient transaction view espouses that RPT facilitates monetary and non-monetary exchanges among affiliated parties to cut transaction costs, maximize limited capital, or build financial profitability as a group. However, abuses of RPT are interpreted as a conflict-of-interest view. A person in an influential position likely initiates RPT to secure favorable terms of transactions at (below) market prices for inferior (quality) goods or services. An influential person may be a member or blood relation of management or a shareholder with significant ownership. Parties with expropriation behavior serve themselves at prices whichever is beneficial at the time. Results of studies on RPT find a positive effect on Taiwan firms' performance, and corporate performance of Taiwan electronic firms; other studies find that RPT is used to prop up share prices and financial data or financing allied firms at higher returns; and abnormal RPT negatively impacts firm value and is linked to propping up earnings. The level of abnormal RPT signals expropriation.

Thus, the potential risk of abuse brings in information disclosures and governance mechanisms. An appointment of independent directors to the board serves as one of the internal mechanisms of corporate governance. An independent director offers an objective opinion on matters taken and renders credibility to the approved business matters for the protection of minority interests and stakeholders. Starting in 2002, Taiwanese firms offering initial public offering (IPO) are mandatory to appoint at least two independent directors. In a study of the effect of independent directors on RPT, an uncertain association of independent directors with RPT was noted which motivate this study to further examine the role independent directors play in RPT. Studies conducted on independent directors are related to their consequences on the quality of earnings in Taiwan firms, corporate governance reform in Taiwan, RPT and corporate governance, the voluntary employment of independent directors in Taiwan firms, and the influence of independent directors as monitors in Taiwan.

On an issue of controlling parties influencing the engagement in RPT and the independent directors, impact of outside blockholders may be useful as an effective monitoring mechanism. Outside blockholders do not participate in the managing of the company and hold an independent voice. The mere presence of institutional blockholders or their cumulative shareholding may moderate the influence of controlling parties or the effect of independent directors on RPT. But the outcomes of studies on the monitoring role of blockholders are mixed. Outside blockholders stay long-term for the stability of the market prices, consequently, collecting information beneficial to monitor management. On the contrary, those who do not take a significant role gave up their blockholding in the short term [23]. While a positive influence on firm performance in German firms is noted, a negative impact in the United Kingdom firms and insignificant link in both the United States of America and Japan firms are documented.

The authors have no knowledge of any studies in the English language on the effect of independent directors on RPT in Taiwanese firms with the impact of outside blockholders. Outside blockholders as monitors, independent directors, and RPT are relevant issues for Taiwan-listed firms. Majority of the Taiwanese firms engage in RPT, furthermore, the disclosure requirements by International Accounting Standards (IAS) 24 for companies on RPT shows how vital the results of this study are for Taiwanese local and foreign investors, market regulators, and tax regulators. In a study on RPT and corporate governance from 1996 to 2008 using independent directors as one of the independent variables, [31] finds an unclear association between RPT and independent directors. Therefore, this study addresses the gap in the literature using a sample after the rule on the appointment of independent directors. This study covers data from 2003 to 2022 to examine the influence of independent directors on the normal and abnormal RPT, including the impact of outside blockholders as a second tier of independent external mechanisms.

This study hypothesizes that the level of related party transactions varies with independent directors. Further, the connection between related party transactions and independent directors varies with the impact of outside blockholders. This study finds that a greater number of independent directors is significantly linked with lesser levels of normal related sales, lower levels of normal related purchases, and higher levels

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of abnormal related purchases. Thus, the hypotheses are confirmed. Secondly, this study finds that the extent of impact of outside blockholders supports a lower level of normal related purchases but higher abnormal related purchases, thus, the hypotheses are supported. The outcomes of this study improve the discussion of the effect of independent directors as an internal governance mechanism by documenting evidence of its negative association with normal related sales and normal related purchases. Secondly, the results expand the knowledge of the normal and abnormal components of related sales and related purchases. Thirdly, a positive association of profit before taxes with abnormal related sales is confirmed. Finally, the results offer insights into supplementary mechanisms between the impact of outside blockholders and the function of independent directors on related accounts.

This study hypothesizes that the level of related party transactions varies with independent directors. Further, the association between related party transactions and independent directors varies with the impact of outside blockholders. This study finds that a higher number of independent directors is significantly linked with lower levels of normal related sales, lower levels of normal related purchases, and higher levels of abnormal related purchases. Thus, the hypotheses are confirmed. Secondly, this study finds that the extent of impact of outside blockholders supports a lower level of normal related purchases but higher abnormal related purchases, thus, the hypotheses are supported. The outcomes of this study improve the discussion of the effect of independent directors as an internal governance mechanism by documenting evidence of its negative association with normal related sales and normal related purchases. Secondly, the results expand the knowledge of the normal and abnormal components of related sales and related purchases. Thirdly, a positive association of profit before taxes with abnormal related sales is confirmed. Finally, the results offer insights into supplementary mechanisms between the impact of outside blockholders and the function of independent directors on related accounts.

The study is limited to the 20-year study period on the effect of independent directors on related sales and related purchases examining the monitoring role of outside blockholders. Future research may consider the inclusion of other control variables, per industry, or across five events within the twenty years commencing on the requirement of two independent directors in the board in 2002, covering the Transfer Pricing Audit Rules was introduced in 2005 in line with the Organization for Economic Cooperation and Development Guidelines, with attention on RPT in tax havens [6] as a baseline of this study, a corporate income tax rates cut followed in 2010 [28], adoption of International Financial Reporting Standards in 2013 [33]; a corporate income tax rates hike in 2018 [28], and the COVID-19 occurrence in late of 2019 [15]HSU.

This paper is organized as follows. Section 2 covers a literature review on independent directors, related party transactions, and outside blockholders; and the development of the hypotheses. Section 3 demonstrates the research method. Section 4 discourses the results. The conclusion is in section 5.

RELATED LITERATURE

A. Background

The RPT facilitate monetary and non-monetary exchanges among affiliated parties to cut transaction costs, maximize limited capital, or build financial profitability as a group [22] and [27]. This is acknowledged as an efficient transaction view [12]. While ex-ante RPT is a commitment that may arise before the affiliation of parties, ex-post RPT arises after any of the parties gained an influential position which may involve a conflict of interest on the party holding an influential position [29]. An unqualified perception of a RPT is

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an engagement whose parties involved are affiliated which falls on the latter classification of [29]. Popular RPT comprises loans or guarantees, leasing or licensing agreements [22]; sales and purchases of goods, services, and assets; [3] clusters diverse RPT into operating, financial, and investment dimensions. An influential position may have been a factor in the initiation or completion of the RPT to secure favorable terms of transactions [19] and [22], may not use reference to prevailing market prices or arm's length transaction or inferior quality of goods or services at market prices. Parties with expropriation behavior serve themselves at prices beneficial at the time. Second, RPT may have been facilitated by an insider who likely has the authority or with expropriation behavior. Insiders who may influence the use of RPT are managers or controlling parties with significant shareholding holding management functions or even without one but affiliation with one who does. Abuses of the use of RPT are interpreted as extracting controlling parties' personal benefits of controls. References [31] and [14] discuss that benefits of controls can be for personal or shared with all shareholders which motivate blockholding. Results of studies show that the use of RPT is prevalent in Taiwan firms [21] where the value of related sales comprises three-quarters of the RPT in Taiwan firms [34]; consequently, both related sales and purchases positively impact Taiwan firms' performance [21], and the corporate performance of Taiwan electronic firms [30]. The RPT is utilized by the management of Chinese firms before the initial public offering (IPO) [8] for impressive financial data and share prices. The related-loan guarantees move value from firms with smaller stakes to firms with larger stakes used by shareholders [2]. On the other hand, the use of RPT serves for efficient transactions but the level of abnormal RPT signals expropriation [34]. A study by [32] uses abnormal RPT and finds that it negatively affects firm value, moreover, political connection excruciates the negative impact on firm value. Likewise, [17] finds that an abnormal portion of related sales is used to prop up earnings.

To take away the opportunity for deception and protect the minority interest, the identity of insiders and ultimate beneficial owners are made transparent through IAS 24 Related Party Disclosures which require disclosures of related party relationships and transactions; defining related party is described as one party or a close member of that party's family exercise substantial impact over the reporting party [11]. The appointment of independent directors to the board serves as one of the internal mechanisms of corporate governance. Being independent offers an objective opinion on matters taken in the board and renders credibility to the approved business matters for the protection of minority interests and stakeholders.

Reference [34] describes how the corporate boards in Taiwanese listed firms are structured. Taiwanese firms involve two parallel groups, a board of directors and a board of supervisors. A board of directors oversees the administration of the firm as a board of supervisors does not take part in the decision or election process but oversee the directors. Only current shareholders are eligible to serve as directors and institutional investors are allowed to assign representatives to serve as directors. However, no existing directors or employees are eligible as supervisors. Family members of existing employees or directors are eligible to be elected as supervisors. Both directors and supervisors are elected by shareholders. The study by [34] uses independent directors and supervisors as one of the corporate governance attributes and is expected to have a negative association with the level of RPT. However, the results of their study reflect an unclear association between the independent directors and supervisors, and RPT. To counter the unclear appointment process of directors and supervisors and enhance board independence, a regulation requires all newly IPO firms in Taiwan after 2002 to appoint at least two independent directors to the board [34]. Thus, this study encompasses a study period from 2003 to 2022 to cover the new regulation on the appointment of independent directors. The sample from 2002 to 2015, Taiwanese firms consists of great board sizes, with existing independent supervisors, with concentrated ownership, or with institutional investors tend to voluntarily appoint additional independent directors but the firms controlled by family members are hesitant [18]. Consequently, the effectiveness of independent directors as monitors in Taiwan is examined. Reference [10] finds that independent directors have insufficient time and difficulty in accessing information which may imply areas related to RPT and are not free of the controlling shareholders' influence. Using a sample from 2002 to 2010 of Taiwan-listed firms, [20] finds that independent directors improve the quality of earnings; those with compulsory employment provide a larger optimistic effect compared to those who were voluntarily hired. However, [20] finds that controlling shareholder alleviates the effect of independent directors in Taiwanese firms. In this connection, [7] analyzes the reform of Taiwan firms from a double board system to a unitary board structure in 2013 and propose institutional changes for independent directors to fulfill their intended purpose. Proposed changes involve the issues of appointment of independent directors by shareholders who hold control which may cause partiality of the performance of independent directors; an establishment of a nomination committee may offer neutrality; clarity on overlapping functions of independent directors and statutory supervisors; and the monitoring role of courts or stock exchanges on the true independence of directors. Given the aforementioned environment of independent directors, this study includes a second tier of external governance mechanism, the monitoring of outside blockholders.

Blockholders hold significant outstanding common shares with voting rights, of which the issuing Asian firms are to report disclosure [24]. Blockholders may be motivated by shared or personal benefits of controls that arise with large investments [30] and [14]. Specifically, outside blockholders do not participate in the management of the company [9]; may be composed of individuals, corporations, and institutions [23]. The mere existence of corporate blockholders may serve as practical external mechanism [22] PARK. Moreover, outside blockholders may consolidate votes on issues they have common views on, thus, this study expects an outside blockholder with a cumulative percentage of shareholding may impact related party engagements. The outcomes of studies on the impact of outside blockholders are mixed. Outside blockholders stay long term for the stability of the market prices [35], consequently, amassing material useful to monitor management [25]. Outside blockholders do not take a significant role when they hold their block in the short term [26]. The institutions and blockholders have a positive impact on firm performance in German firms but make a negative impact on the United Kingdom firms, and insignificant dealings in both the U. S. and Japan which might be due to local regulations [30]. Cumulative abnormal returns of block purchases are substantial signifying a monitoring part [25], however, the investors view unaffiliated outside blockholders as effective monitors and affiliated ones as ineffectual [4].

Studies conducted on independent directors are related to its effect on the quality of earnings in Taiwan firms [20], corporate governance reform in Taiwan [7], RPT and corporate governance [34], voluntary selection of independent directors in Taiwan firms [18], and the effectiveness of independent directors as monitors in Taiwan [10]. The authors have no knowledge of any studies in the English language on the effect of independent directors on RPT in Taiwanese firms with the monitoring of outside blockholders. While [34] examines the RPT and corporate governance from 1996 to 2008 using independent directors as one of the independent variables, the result reflects an unclear association between RPT and independent directors and supervisors. Therefore, this study addresses the gap in the literature using a sample from 2003 to 2022 to examine the effect of independent directors on normal and abnormal RPT.

By concentrating on a single country, this study upholds recognized factors such as level of legal enforcement, and financial disclosure and accounting recognition rules in the period across all industries in exchange-listed firms. Given the basic forces in the TSEC stock market, agency problem, and fiscal and tax reporting setting, this research on Taiwan is very relevant as an emerging market. Secondly, it is important because Taiwan-

listed firms engaged in RPT. Further, the disclosure requirements by IAS 24 for companies on RPTs show how vital the results of this study are for Taiwanese local and foreign investors, market regulators, and tax regulators. The finding of this study complements the discussion of the literature on independent directors as an internal mechanism of corporate governance, outside blockholders as monitors, and related party transactions.

B. Hypotheses

This study hypothesizes that the level of related party transactions varies with the effect of independent directors on the board. Reference [34] expects a negative link between independent directors and supervisors and the related party transactions using a sample from 1996 to 2008. However, they find a result contrary to their expectation. The reason that the unclear result may be due to a new regulation in 2002 on independent directors of all firms' newly conducted IPO to include at least two independent directors on the board. To cover the implementation of new regulations on independent directors, this study uses a sample starting from 2003 to 2022. The direction of the relationship between the RPT and independent directors is, therefore, an empirical question. This study examines the related sales and related purchases separately. Further, the related sales are segregated into normal related sales and abnormal related sales. The related purchases are segregated into normal related purchases and abnormal related purchases. The hypothesis statement is:

Hypothesis 1a. The level of normal related sales varies with independent directors.

Hypothesis 1b. The level of abnormal related sales varies with independent directors.

Hypothesis 1c. The level of normal purchases varies with independent directors.

Hypothesis 1d. The level of abnormal purchases varies with independent directors.

Outside blockholders serve as a second tier of mechanism for this study. Outside blockholders may consolidate votes on issues they have common sentiments, thus, this study expects outside blockholder ownership may impact the decisions on the engagement of RPT. The second hypothesis statement is:

Hypothesis 2a. The relationship between normal related sales and independent directors varies with the monitoring of outside blockholders.

Hypothesis 2b. The relationship between abnormal related sales and independent directors varies with the monitoring of outside blockholders.

Hypothesis 2c. The relationship between normal related purchases and independent directors varies with the monitoring of outside blockholders.

Hypothesis 2d. The relationship between abnormal related purchases and independent directors varies with the monitoring of outside blockholders.

DESIGN AND METHOD

A. Test on the Effect of Independent Directors on Related Party Transactions

To test hypotheses 1a, 1b, 1c, and 1d, the effect of independent directors on related party transactions is examined using the following model:

$$RPTS = \beta_0 + \beta_1 INDE + \sum \beta_2 \text{ Controls} + \varepsilon \quad (1)$$

where RPTS alternatively takes the value of RPTS, RPTP, ARPTS, and ARPTP. The normal related sales (RPTS) is the ratio of related sales divided by total sales [34], [1] and [33]; and normal related purchases (RPTP) is the ratio of related purchases divided by total purchases. Following [17], abnormal RPT are examined using the residual term of the regression model, control variables, and industry classification. The abnormal related sales (ARPTS) are the residual term of the regression model of RPTS, and abnormal purchases (ARPTP) is the residual term of the regression model of RPTP. The INDE is an aggregate of independent directors.

The control variables in the [15] regression model are: SIZE denotes the natural logarithm of firm's total assets [13] and [17]; LEV is total liabilities divided by its total assets [17]; and MB denotes the growth of a firm measured as market-to-book equity [34] and [17]. The SIZE is to control for any firm size effects; and firms with LEV or with poor return on assets performance [5] are more likely to use upward income procedures. Additional control variables used in Eq. 1 are: PTBI refers to the profit before tax; TTE denotes the total tax expense; IN is a dummy variable to control the industry fixed effect; and YR is a dummy variable used to control the year fixed-effect. The IN takes the value of one if the firm is in the industry; zero if otherwise. The YR takes the value of one if the firm is in the year; zero if otherwise. The use of RPT may create book-tax differences which are speculated to manipulate book or tax income, or both incomes. The PTBI is used to control for the effect of RPT on book income. The TTE is used to control for the effect of RPT on tax expenses. The coefficient of interest is β_1, the independent directors. A positive coefficient on β_1 indicates that the effect of independent directors supports higher related party transactions.

B. Test on the Impact of Outside Blockholders on the Relationship between Independent Directors and Related Party Transactions

To test hypotheses 2a, 2b, 2c, and 2d, the monitoring of outside blockholders on the association between independent directors and related party transactions is examined using the following model:

$$RPTS = \beta_0 + \beta_1 INDE + \beta_3 INDE * OUT + \sum \beta_4 \text{Controls} + \varepsilon \quad (2)$$

where RPTS alternatively takes the value of RPTS, RPTP, ARPTS, and ARPTP which have been defined earlier including the INDE. The OUT denotes the cumulative percentage of shareholdings of outside persons, unlisted companies, foundations, and listed companies. The INDE * OUT is an interaction term that signifies the extent of the effect of the monitoring of outside blockholders on the relationship between independent directors and related party transactions. The coefficient of interest is β_3, an interaction term INDE * OUT. A positive coefficient on β_3 indicates that the effect of OUT on independent directors supports higher related party transactions.

The coefficients are estimated by ordinary least squares using EViews. Table 1 describes the variables used in the study.

Table 1: Description of The Variables Used In This Study

Variables	Definition
RPTS	Refers to normal related sales calculated as a ratio of related sales divided by total sales
RPTP	Refers to normal related purchases calculated as a ratio of related purchases divided by total purchases
ARPTS	Refers to abnormal related sales calculated as the residual term of the regression model of RPTS, control variables, and industry classifications
ARPTP	Refers to abnormal related purchases calculated as the residual term of the regression model of RPTP, control variables, and industry classifications
SIZE	Denotes the natural logarithm of the firm's total assets
LEV	Denotes the total liabilities divided by its total assets
MB	Denotes the growth and computed as the firm's market-to-book equity
INDE	Is an aggregate of independent directors
OUT	Denotes the cumulative percentage of shareholdings of outside persons, unlisted companies, foundations, and listed companies.
INDE * OUT	Refers as an interaction term that signifies the extent of the effect of the monitoring of outside blockholders on the relationship between independent directors and related party transactions
IN	Is a dummy variable to control the industry's fixed effect.
YR	Is a dummy variable to control the year fixed-effect

C. Sample selection

Taiwanese firms exhibit weak corporate governance, insufficient investor protection, and the absence of effective governance mechanisms contributes to the agency, further, the domestic individual stock market investors are dominant, and the domestic institutional investors lack credibility to monitor firm management. problems [16]. As an internal governance mechanism, independent directors face the

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influence of controlling shareholders, insufficient time, and limited access to information in the performance of their function [10].

With the aforementioned forces in the corporate environment, corporate governance, and tax and financial reporting rules in the country, Taiwan offers a unique setting relevant to this study covering a period from 2003 to 2022. The data for this study are collected from the Taiwan Economic Journal database, a data vendor in Taiwan. The total listed firms accounted for 15,493. The sample is restricted using the following selection criteria. Financial companies are excluded because they follow rules specific to their industries, and firms with unconsolidated financial reports. To alleviate the sample selection partiality, firms are included in the sample irrespective of engagement of RPT [3], presence of independent directors, and outside blockholders. The sample of 13,789 firms representing 89% of the total listed firms.

D. Descriptive statistics

Drawing from the dimensions made by [3], RPT of the firm sample are grouped under operating, financing, and investing activities in New Taiwan Dollar (NT$) for the period from 2003 to 2022. A significant portion of RPT falls under the operating activities involving sales and accounts and notes receivable, purchases and accounts and notes payables. While the sales and reprocessing income (RPT Sales) comprise from 37% in 2003 to 41% in 2022, the purchases and reprocessing expense (RPT Purchases) cover from 41% in 2003 to 44% in 2022. The combined accounts range from a sum of 78 to 89%, the highest is at 89% in 2009. Transactions involving financing and investing activities are minimal. Given the significant portions of related sales and related purchases, the focus of this study on RPT Sales and RPT Purchases is appropriate.

The sample is winsorized at the top and bottom 1% of the variable distribution. Table 2 shows the mean value of the variables. The mean size of 16.10 signifies that the firms in the sample are large. The leverage stands at a moderate level of 0.44 and the growth opportunity is at 1.55. The profit before income tax PTBI stands at NT$1.891 million and the TTE is at NT$0.3 million. The RPTP registers at 4.43% which is lower than the RPTS which is at 5.09%. The maximum number of independent directors is 6, however, the mean is 1.72, indicating that firms in the sample have less than two independent directors. The firms in the sample include newly listed firms in 2002 which are required to appoint at least two independent directors and existing listed firms before 2002. The cumulative outside blockholders ownership stands at 13.91% which is higher than the median.

Table 2: Descriptive Statistics (N=13,789)

Variables	Mean	Standard deviation	Median	Minimum	Maximum
RPTS	5.09	12.59	0.22	0.00	88.27
RPTP	4.43	11.73	0.10	0.00	86.11
ARPTS	(0.19)	12.44	(4.20)	(10.84)	82.07
ARPTP	(2.87)	31.02	(3.67)	(437.77)	334.36
SIZE	16.10	1.37	15.90	13.38	20.54

LEV	0.44	0.18	0.44	0.05	0.91
MB	1.55	1.18	1.22	0.02	10.91
INDE	1.72	1.36	2.00	0.00	6.00
PTBI	1,891,690	6,387,238	376,965	(8,188,133)	116,000,000
TTE	348,832	2.400.902	70,648	(1,025, 675)	17,599,025
OUT	13.91	11.0	11.55	0.00	85.16

PTBI and TTE are in NT$

Table 3 reports the correlations for the sample. The variables ARPTS and ARPTP are excluded because they are related to RPTS and RPTP; likewise, TTE is not presented because it is related to PTBI. No Pearson correlation coefficients are very high; thus, multicollinearity is not a serious issue.

Table 3: Pearson Product Moment Correlation

Variables	RPTS	RPTP	SIZE	LEV	MB	INDE	PTBI
RPTS	1.00						
RPTP	0.29	1.00					
SIZE	0.06	0.14	1.00				
LEV	(0.02)	0.01	0.32	1.00			
MB	0.03	0.07	(0.04)	(0.04)	1.00		
INDE	(0.03)	(0.02)	0.14	(0.02)	0.19	1.00	
PTBI	0.00	0.11	0.54	0.01	0.14	0.15	1.00
OUT	0.08	0.02	(0.04)	(0.02)	0.18	0.13	0.02

RESULTS AND DISCUSSION

A. Results from tests of the effect of independent directors on related party transactions

To determine the effect of independent directors on related sales and related purchases, Eq. (1) is used. Columns 2 and 3 of Table 4 display the outcomes of the test of normal (Panel A) and abnormal (Panel B) related sales while columns 4 and 5 show the results of the test of normal (Panel A) and abnormal (Panel B) related purchases.

Normal related sales have a negative and significant relationship with the INDE at 1%, thus, supporting hypothesis 1a. The higher number of independent directors is linked to lower levels of normal related sales. However, INDE is insignificantly linked to abnormal related sales, consequently, hypothesis 1b is not supported.

Normal related purchases have a negative and significant association with the INDE at 1% so hypothesis 1c is supported. The higher number of independent directors is linked to lower levels of normal related purchases. On the contrary, the INDE is positively linked with abnormal related purchases at a 10% level of significance, thereby confirming hypothesis 1d. A greater number of independent directors is linked to higher levels of abnormal related purchases.

The expected negative connection between independent directors with normal related accounts is confirmed in this study which was unclear from the results of [34]. However, the connection between INDE and abnormal related accounts is unclear, consistent with the results of [34].

The coefficients on SIZE, PTBI, and MB are positive and significant, and the coefficients on LEV and TTE are negative and significant in normal related accounts. The result indicates that higher RPTS and RPTP are linked with larger firms, higher profit before tax, higher growth opportunities, lesser leverage, and lower tax expense. The signs and significance of the coefficients on SIZE, PTBI, LEV, and TTE under abnormal related accounts are consistent with normal related accounts previously presented in Panel A of Table 4. The sign and significance of PTBI are the same as the result of [17] that abnormal related sales are linked with upward profits. The result on SIZE is consistent with the finding of [34] that size is positively associated with the use of RPT. While the association of leverage with normal related accounts and abnormal related purchases is negative and significant, its association with abnormal related sales is insignificant. Thus, the link between leverage and abnormal related accounts is unclear. On the other hand, the association of market-to-book equity with normal related accounts and abnormal related sales is positive and significant, however, its association with abnormal related purchases is negative and significant. Thus, the link between market-to-book equity and abnormal related accounts is unclear.

Except for LEV and MB, the result of control variables under abnormal related accounts is consistent with the result under normal related accounts. Thus, the link between normal and abnormal related accounts with higher profit before tax and lower tax expense suggests that engagement of RPT pursues the aims of an efficient transactions view.

Table 4: Indpendent Directors and Related Party trans actions

	Coefficient	t-statistic	Coefficient	t-statistic
PANEL A	RPTS		RPTP	
Intercept	(8.65)***	(5.61)	(17.73)***	(12.44)
INDE	(0.29)***	(3.55)	(0.38)***	(4.99)
SIZE	0.94***	9.36	1.40***	15.01

LEV	(3.22)***	(4.98)	(1.79)***	(2.99)
MB	0.38**	4.11	0.72**	8.34
PTBI	0.00***	4.79	0.00***	10.40
TTE	(0.00)***	(6.22)	(0.00)***	(10.03)
IN	Yes		Yes	
YR	Yes		Yes	
Adjusted R^2	0.03		0.05	
F-statistic	***	62.44	***	95.83
N	13,789		13,789	
PANEL B	ARPTS		ARPTP	
Intercept	(3.28)**	(2.14)	(45.71)***	(12.09)
INDE	(0.08)	(0.98)	0.33*	1.63
SIZE	0.19*	1.89	3.54***	14.35
LEV	(0.08)	(0.12)	(31.11)***	(19.64)
MB	0.17*	1.84	(0.62)***	(2.73)
PTBI	0.00***	4.20	0.00***	6.72
TTE	(0.00)***	(5.15)	(0.00)***	(7.09)
IN	Yes		Yes	
YR	Yes		Yes	
Adjusted R^2	0.03		0.05	
F-statistic	***	45.28	***	83.00
N	13,789		13,789	

*, **, *** indicates significant at the p<0.10, 0.05, 0.01 level.

B. Results from tests of impact of the outside blockholders on the relationship between independent directors on related party transactions

To assess the monitoring of outside blockholders on the relationship between independent directors and related party transactions, Eq. (2) is used. Columns 2 and 3 of Table 5 display the results of the test of normal (Panel A) and abnormal (Panel B) related sales. Columns 4 and 5 of Table 5 show the results of the test of normal (Panel A) and abnormal (Panel B) related purchases.

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While normal related sales have a negative (0.36) and significant link with the INDE, it has a positive (0.09) and significant association with OUT. The level of related sales is pulled in opposite directions. A larger number of independent directors in a firm tend to have a stronger drive for lesser normal related sales than the effect of a higher outside blockholders ownership for higher normal related sales. However, an interaction between INDE and OUT is insignificant, thus, hypothesis 2a is not supported. The abnormal related sales have a positive and significant connection with OUT with an insignificant relation with INDE. The interaction between INDE and OUT is insignificant, thus, hypothesis 2b is not supported.

Normal related purchases have a positive and significant link with OUT and no link with INDE. An interaction between INDE and OUT is negative and significant, indicating the effect of monitoring of outside blockholders supports lower normal related purchases. Thus, hypothesis 2c is confirmed. Under abnormal related purchases, INDE and OUT have a positive and significant interaction that indicates the effect of monitoring of outside blockholders supports higher abnormal related purchases. Thus, hypothesis 2d is confirmed.

An analysis between normal related sales and normal related purchases shows that INDE has a negative and significant connection with RPTS but none with RPTP, thus, the link between INDE and normal related accounts is unclear, consistent with the findings of [34]. The OUT has a positive and significant relationship connection with both normal related accounts consistently.

An analysis between abnormal related sales and abnormal related purchases shows INDE has an insignificant connection with both abnormal related accounts consistently. There is a positive and significant association between OUT and ARPTS but none with ARPTP, thus, the link between OUT and abnormal related accounts is unclear.

As a single mechanism, INDE has a negative and significant association with RPTS but none with RPTP, ARPTS, and ARPTP. On the other hand, OUT has a positive and significant link with RPTS, RPTP, and ARPTS but none with ARPTP. Individually, neither INDE nor OUT has a significant link with ARPTP, however, a positive interaction between INDE and OUT at a 5% level of significance (Panel B of Table 5) is operative under ARPTP. The results offer insights into supplementary mechanisms between the monitoring of outside blockholders and the function of independent directors on related accounts.

In summary, INDE mitigates the high level of RPTS but OUT intensifies the high levels of RPTS, RPTP, and ARPTS. But the interaction between INDE and OUT is significant with RPTP and ARPTP as dependent variables, revealing the extent of the effect of monitoring of outside blockholders supports lower normal related purchases but higher abnormal related purchases. Driving for a higher level of abnormal related purchases suggests a signal of expropriation.

Panel A of Table 5 displays that the coefficients on SIZE, MB, and PTBI are positive and significant and the coefficients on LEV and TTE are negative and significant in RPTS and RPTP. The signs and significance are consistent with the results in RPTS and RPTP previously presented in Panel A of Table 4. Panel B of Table 5 presents that the signs and significance of coefficients on SIZE (positive) PTBI (positive), MB (negative), LEV (negative), and TTE (negative) in ARPTP are consistent with the results in ARPTP previously presented in Panel B of Table 4. Further, the signs and significance of coefficients on SIZE (positive) PTBI (positive), and TTE (negative) under ARPTS are consistent with the results in ARPTS previously presented in Panel B of Table 4 except for the coefficients on LEV and MB which are insignificant. The link between abnormal related accounts and LEV is unclear, so thus, the link to MB. In comparison, a higher MB is associated with RPTS and RPTP while a lesser MB is connected with ARPTP.

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The positive coefficient on PTBI and its significance is similar to the result of [17] that abnormal related sales are linked with upward profits.

Table 5: Outside Blockholders, Independent Directors, and Related Party Transactions

	Coefficient	t-statistic	Coefficient	t-statistic
PANEL A	RPTS		RPTP	
Intercept	(10.17)***	(6.52)	(18.69)***	(12.95)
INDE	(0.36)***	(2.86)	(0.10)	(0.87)
SIZE	0.98***	9.75	1.41***	15.18
LEV	(3.23)***	(5.00)	(1.83)***	(3.06)
MB	0.26***	2.73	0.68***	7.85
PTBI	0.00***	4.81	0.00***	10.38
TTE	(0.00)***	(6.28)	(0.00)***	(10.00)
OUT	0.09***	5.57	0.06***	4.21
INDE*OUT	(0.00)	(0.09)	(0.02)***	(3.38)
IN	Yes		Yes	
YR	Yes		Yes	
Adjusted R^2	0.04		0.05	
F-statistic	***	58.38	***	78.53
N	13,789		13,789	
PANEL B	ARPTS		ARPTP	
Intercept	(4.65)***	(3.00)	(45.18)***	(11.80)
INDE	(0.16)	(1.30)	(0.16)	(0.50)
SIZE	0.22**	2.25	3.54***	14.34
LEV	(0.08)	(0.13)	(31.05)***	(19.60)

MB	0.05	0.57	(0.65)***	(2.81)
PTBI	0.00***	4.21	0.00***	6.74
TTE	(0.00)***	(5.21)	(0.00)***	(7.12)
OUT	0.08***	5.05	(0.04)	(1.03)
INDE*OUT	0.00	0.12	0.03**	1.98
IN	Yes		Yes	
YR	Yes		Yes	
Adjusted R^2	0.03		0.05	
F-statistic	***	43.51	***	66.88
N	13,789		13,789	

*, **, *** indicates significant at the p<0.10, 0.05, 0.01 level.

The result of a White test for heteroskedasticity indicates there is no evidence of heteroscedasticity. For brevity, the industry- and year-fixed effects are not reported.

CONCLUSION, IMPLICATIONS, AND FUTURE DIRECTIONS

This study tests the effect of independent directors on related sales and related purchases using the normal and abnormal values from 2003 to 2022. A second tier of independent and external mechanisms is included using outside blockholders monitoring. This study hypothesizes that the level of related party transactions varies with independent directors; further, the relationship between related party transactions and independent directors varies with the monitoring of outside blockholders. This study finds that a higher number of independent directors is significantly linked with lower levels of normal related sales, lower levels of normal related purchases, and higher levels of abnormal related purchases. Thus, the hypotheses are confirmed. Secondly, this study finds that the extent of monitoring of outside blockholders supports a lower level of normal related purchases but higher abnormal related purchases, thus, the hypotheses are supported.

The outcomes of this study improve the discussion of the effect of independent directors as an internal governance mechanism by documenting evidence of its negative association with normal related sales and normal related purchases. The result of this study made clear the uncertain finding of [34]. Secondly, the results expand the knowledge of the normal and abnormal components of related sales and related purchases. Thirdly, a positive association of profit before taxes with abnormal related sales is confirmed, in support of the finding of [17]. Finally, the results recommend into supplementary mechanisms between the monitoring of outside blockholders and the function of independent directors on related accounts.

Implications include that companies should carefully consider the composition of their board of directors, particularly the number of independent directors. Increasing the proportion of independent directors can potentially lead to reduced levels of normal related sales and purchases. This suggests that independent directors might bring more scrutiny and oversight, leading to a more conservative approach to business operations. Secondly, firms should strengthen their monitoring mechanisms, especially in relation to normal and abnormal related transactions. This could involve enhancing internal controls, establishing clear policies and procedures for such transactions, and ensuring regular reviews by the board of directors. Thirdly, the presence of outside blockholders appears to have a significant influence on purchasing decisions. Companies should be aware of the impact these stakeholders may have on their normal and abnormal related purchases. Engaging with blockholders and understanding their perspectives can help management align their strategies with shareholder interests. Lastly, management should be cognizant of the potential risks associated with abnormal related purchases. While these transactions may sometimes be necessary for strategic reasons, they may also indicate unusual or risky behavior. Companies should conduct thorough risk assessments before engaging in abnormal related purchases and ensure proper oversight by the board. Enhancing transparency and disclosure practices can help build investor confidence and mitigate concerns related to abnormal related transactions. Companies should provide clear and comprehensive information about their business operations, including the rationale behind any abnormal related purchases. Companies should foster a culture of integrity, accountability, and ethical behavior throughout the organization. This can help reduce the likelihood of engaging in abnormal related transactions and ensure that all business activities are conducted in the best interests of shareholders.

The study is limited to the 20-year study period on the effect of independent directors on related accounts examining the role of outside blockholders. Future research may consider the inclusion of other control variables, per industry, or across five events within the twenty years commencing on the requirement of two independent directors in the board in 2002, covering the Transfer Pricing Audit Rules was introduced in 2005 in line with the Organization for Economic Cooperation and Development Guidelines, with attention on related party transactions in tax havens [7] as a baseline of this study, a corporate income tax rates cut followed in 2010 [28], adoption of International Financial Reporting Standards in 2013 [33]; a corporate income tax rates hike in 2018 [28], and the COVID-19 occurrence in late of 2019 [15].

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