Manager Characteristics and Earnings Management: A Literature Review

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ABSTRACT

From the five perspectives of manager's gender, audit background, political connections, overconfidence, risk preference et al., this paper has reviewed the domestic and foreign related literatures on manager characteristics and earnings management in recent years, not only found the research and development trends in this field, but also provides some ideas for the future research direction.

KEYWORDS

Earnings management, female executives, audit background, political connections, managerial overconfidence, risk preference

INTRODUCTION

"Top Management Team" that people on the company's complex and special internal and external environment perception is limited, human characteristics will affect people's behavior decisions, thus to enterprises, including earnings management behavior have an important impact (Hambrick and Mason, 1984) [1]. Zahra and Pearce (1989) divide the manager characteristics into "label background" and "internal characteristics". The former mainly reflect the external characteristics of the manager's gender, social relations, work experience and so on, the latter mainly reflect the manager's personality, whether excessive self-confidence, preference, etc.[2]. A large number of literature studies have shown that different manager characteristics can have different effects on financial decision-making behavior. Schipper Katherine (1989) argued that earnings management was an intervention in the external financial reporting process by the corporate authorities in order to seek self-interest [3]. In recent years, domestic and foreign listed companies accounting fraud often occur, through the in-depth analysis of these events can be found, most of the financial fraud events were the company's management use of accounting policy to choose the flexibility of the space to manipulate the earnings, It damaged the authenticity and reliability of the financial report, which has a negative impact on the long-term development of the capital market at home and abroad. The focus of this paper is to summarize the research on the influence of manager characteristics on earnings management in recent years, hoping to provide some ideas for domestic scholars to further study manager characteristics and earnings management in the context of our special culture and system.

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MAIN RESEARCH CONTENTS

The relationship between executive gender and earnings management

Based on the gender perspective of earnings management research, according to whether the gender of the executive will affect the earnings management and the impact of different ways to divide, there are four main research contexts:

Srinidhi et al. (2011) found that with the increase in the proportion of female directors in board members, it was beneficial to improve the independence of the board, thereby reducing the company's earnings manipulation and enhancing the quality of the company's financial information [4]. Zhou Zejiang (2014) argue that, the deep-rooted cultural tradition in China that men are superior to women and a woman has no talent, the role of women in economic development has long been ignored. It leads women to participate in the company's top management and decision-making still faces significant obstacles, female executives join the company's senior team, as chairman and general manager and other key positions, especially in state-owned enterprises, can significantly adjust the gender and earnings management is a positive correlation [5]. Du Xingqiang et al. (2017) argue that when the proportion of female executives exceeds the threshold, the style of the company's leadership will be gradually transformed into a women-led democracy, so that female executives can better participate in the company's decision-making, To a certain extent, significantly reduce the company's earnings manipulation motivation, and when the proportion of female executives below the threshold, the company's style of leadership for the male-led dictatorship, female executives choose to cater to male dictatorship, making men Executives for the private interests of the company to manipulate the phenomenon of surplus will be more serious[6]. Zhang Huili et al. (2010) used earnings response coefficient, robustness, smoothness, and persistence as earnings quality indicators. The study found that female executives did not have a significant impact on earnings quality in these four areas [7].

In general, the results of different scholars studying the impact of executive gender on earnings management are different.

The relationship between managers’ audit background and earnings management

Audit background mainly includes two dimensions: one is the experience of audit, and the other is the association of firms. The study of the impact of managers’ audit background on earnings management that based on the different methods of measurement of managers’ audit background, there are two main lines of research:

Firstly, by setting a dummy variable to measure whether an executive has an audit experience and the association of firms. Zang (2012) argues that the manager's choice of earnings management approaches mainly considers the cost, benefits and ease of operation of real earnings management and accrual earnings management. The manager associated with the firm will choose to use both types of earnings management [8]. Liu Jihong and Zhang Lizhu (2014) found that the association of firms can improve the tolerance of CPA to the degree of earnings management of listed companies, it not only makes the company facing the audit regulation more relaxed, but also integrated the use of high-level accrued earnings management and low level of real earnings management [9].
Secondly, by setting continuous variables and dummy variables to measure the managers’ audit background. Liu Yulong (2016) argues that executives with audit background have a wealth of financial theory knowledge base, and a certain "anti-audit" ability, especially executives who have worked in accounting firms. As the cost of earnings management is small and the income is large, the manager with audit background has chosen to manipulate the earnings for Private interests, and the higher number of executives with audit background, the greater degree of earnings management of the listed company [10].

In general, domestic and foreign scholars have shown that there is a positive correlation between managers’ audit background and corporate earnings management behavior.

**The relationship between managers’ political connections and earnings management**

Whether the executive has ever or has been in the government department as a standard to define whether the manager has a political connection. The study of the impact of managers’ political connection on earnings management that based on the different methods of measurement of managers’ political connection, there are two main lines of research:

Firstly, by setting a dummy variable to measure whether an executive has political connection. Shen Hongbo et al. (2014) argue that the political connection prevalent in private listed companies will not only weaken their motives for the disclosure of high-quality accounting information, but also weaken the governance effect of securities regulatory agencies after administrative punishment [11]. Cai Jifu (2015) found that the disclosure of high-quality financial information by listed companies will increase the possibility that the transactions of corporate managers and relevant government officials are exposed. In order to prevent these transactions from being known to the world, companies often choose to use accounting policy to manipulate earnings and reduce the quality of accounting information. Since the acquisition and transfer of the benefits of the transaction has a certain time lag, to hide the unmoved trading gains from government officials, executives will choose negative earnings management, to fill the deficit after the transfer of transaction earnings, executives will choose positive earnings management [12].

Secondly, due to the different levels of administrative staff, leading to their political influence is different, so some scholars have adopted a score method of different political levels of corporate executives given a different score. Jiang Weiping (2014) found that the political connection between a listed company and government officials was regarded as an informal mechanism with an alternative role beyond the legal and formal system that could become the "Anti-umbrella" of enterprises in some ways, significantly reducing the quality of accounting information of listed companies. The listed companies associated with the deputies are more focused on corporate image and unwilling to manipulate earnings to damage the company's financial information quality; other background political connections have little impact on the quality of corporate financial information [13].

To sum up, scholars have shown that there is a positive correlation between executive government background and corporate earnings management behavior.
The relationship between managerial overconfidence and earnings management

The study of the impact of managerial overconfidence on earnings management, according to the study of whether the sample is excluded from the financial listed companies, there are two main research contexts:

Firstly, the study sample excluded financial listed companies. He Weifeng et al. (2011) based on the behavioral finance theory and argue that people, including executives, are not fully rational, executives will take into account the risks and benefits of the project, the characteristics of executives' irrational rationality often lead to the inevitable mistakes of executives in decision-making. The specific performance is overestimating the future income of the project, underestimating the financial risk of the project and the simple and crude information processing. To make up for and correct these mistakes, they are more motivated to manage earnings [14]. Habib et al. (2013) studied the impact of CEO's overconfidence on the choice of earnings management during the global financial crisis, and found that the CEO's overconfidence made him more inclined to operate in a hidden, risky and costly real earnings management, rather than accrual earnings management [15].

Secondly, the financial listed companies as research samples. Based on the theory of behavioral finance and overconfidence, Xia Zhe and Wei Yi (2015) studied the financial enterprise earnings management from the perspective of managers' irrationality from the financial listed companies in China. Research shows that overconfidence is a common behavioral feature of each industry manager, but the degree of overconfidence of managers in different backgrounds is different. China's financial listed companies generally exist in the phenomenon of earnings management, but the degree of earnings management and direction is different. Due to the particularity of financial enterprises and the high degree of social concern, compared with the general public companies, the irrational characteristics of overconfidence among executives of financial listed companies have little impact on earnings management [16].

In general, domestic and foreign scholars have shown that there is a positive correlation between managerial overconfidence and corporate earnings management behavior.

The relationship between risk preference and earnings management

Based on the study of earnings management from the perspective of managers' risk preference, according to the measurement method of manager's risk preference, there are two main research lines:

Firstly, the financial indicators act. Due to the impact of risk preference, risky managers tend to choose to smooth up their accounting profits by raising or lowering their earnings (Grant J et al., 2009) [17]. Zhang Tiezhu (2010) indirectly evaluates managers' risk preference with capital indicators, such as capital indicators, defense distance indicators, and self-financing satisfaction ratios. He believes that managers' risk preference will have an impact on the choice of accounting policy. If managers become risk-seeking, their choice of accounting policies will be more aggressive, which will seriously damage the quality of accounting information of listed companies [18]. Wang Sulian (2016) measures entrepreneurs’ risk preference with the proportion of risky assets to total assets, and think that the risks and benefits are often relative.
Compared to state-controlled companies, non-state-controlled companies are more likely to make earnings management to make up for decision-making mistakes [19].

Secondly, build the evaluation model. Sun Wenzhang (2016) based on two dimensions of manager risk preference utility index and characteristic index, building the manager risk preference evaluation model. They think that the smaller the risk preference index and the smaller the characteristic index, the more risk the manager is, managers are likely to maximize their wealth (floating pay and equity values) by manipulating earnings [20].

To sum up, domestic and foreign scholars have shown that executive risk preference is positively correlated with the company's earnings management behavior.

**SUMMARY**

It can be found from the literature review that the research on the influence of manager characteristics on earnings management has become a hot topic for domestic and foreign scholars. However, there are differences in the research conclusions on the relationship between manager characteristics and earnings management, and the reasons for these differences need to be further explored. Future research can be expanded from the following aspects: (1) Define and measure the managers' audit background, political connections, overconfidence and risk preference and other characteristics clearly. (2) Based on the foreign earnings management measurement model, the scholars will put forward the earnings management measurement model that accords with the situation in China. (3) With China's special cultural and institutional background to study the relationship between manager characteristics and earnings management. (4) Currently, most of the scholars' research samples are limited to all listed companies in Shanghai and Shenzhen A shares, should consider the sample size to a certain industry or other sections of the stock market.

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