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CEO CHARACTERISTICS AND EARNINGS MANAGEMENT: A STUDY OF MANAGER TENURE, AGE, GENDER, AND OVERCONFIDENCE

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Abstract:

Corporate scandals over the past few decades underline the importance of robust corporate governance mechanisms to monitor and control managerial behaviour. Earnings management, where accounting techniques are used to present a company's financial position more favourably than it actually is, can affect financial reporting quality and the company's financial reputation. Our study explores how CEO characteristics, such as tenure, gender, age and overconfidence, influence corporate earnings management. Using earnings and executive characteristics data for A-class companies listed in Shanghai and Shenzhen stock exchanges between 2016 and 2020, the research employs multiple regression analysis to empirically analyse the impact of manager characteristics on corporate earnings management. We find that CEOs with longer tenure, male and high self-confidence are more likely to participate in corporate earnings management. Additionally, firm size and asset-liability ratio are positively related to corporate earnings management behavior. While previous studies mainly use data from US companies, this research contributes to the literature by using data from non-US companies, addressing the call for more empirical studies to understand how top executives' demographic characteristics impact earnings management in different contexts.

Key words: *Enterprise earnings management; CEO characteristics, multiple regression analysis, China*

1. Introduction

Corporate scandals over the past few decades have underlined the importance of establishing robust corporate governance systems to monitor and control managerial behaviour. Earnings management (EM) involves using accounting techniques to present a company's financial position more favourably than it truly is to owners, shareholders and creditors. Earnings management has an effect on financial reporting quality, impacting on the company's financial performance and wider financial reputation.

The Upper Echelons Theory (UET) posits that top management's cognitions, values and perceptions significantly influence a firm's strategic choices and organisational outcomes (Hambrick & Mason, 1984; Hambrick, 2007; Kachelmeier, 2010). Evidence suggests that top executives may engage in earnings management to deceive shareholders and stakeholders (Roychowdhury, 2006), in order to boost corporate performance and achieve organisational and personal goals. Personal characteristics such as executive tenure (Ali and Zhang, 2015), personal background, experience, age, gender (Harris, Carl & Lawrence, 2019), and overconfidence (Hsieh, Bedard & Johnston, 2014; Hambrick, 2007) may have an effect on the level of corporate earnings management or have a certain degree of influence on its manipulation.

Despite previous research supporting this theory, it remains unclear whether the demographic characteristics of top management executives significantly influence the practice of earnings management (EM) or the accuracy of financial earnings report, as various publications investigating the impact of top executives on earnings management have reported mixed results (Simons et al. 1999; Carpenter and Fredrickson, 2001; Hambrick, 2007; Bamber et al. 2010; Dyreng et al. 2010; Ge et al. 2011). In addition, several prior studies investigating the interplay between top executive demographic profiles and earnings management use data from US companies (Qi et al. 2018). Consequently, there is a call for further empirical research, especially studies using non-US data to understand how top executives' demographic characteristics impact earnings management.

Our study responds to this call by examining whether top executives' characteristics influence EM in Chinese firms. It investigates the relationship between accrual-based EM and top executive characteristics, such as age, gender, tenure, and overconfidence. We draw data from A-class share companies listed on the Shanghai and Shenzhen stock exchanges, between 2016 to 2020 and conduct regression analysis to investigate this relationship. We find that CEOs with longer tenure, male and high self-confidence are more likely to participate in corporate earnings management, while our findings do not confirm a relationship between earnings management and CEO age. Our findings highlight the importance of establishing ethical management practices and robust monitoring and control mechanisms of management behaviour. They also highlight the importance of establishing sound information disclosure practices and systems in order for enterprises to disclose accurate, timely and comprehensive financial information.

2. Literature review

Earnings management (EM) is a subject of great interest since the 1980s. This great interest is confirmed by the fact that in the past 5 years alone, close to 400 studies have been published in leading accounting journals investigating this subject. EM refers to the manipulation of financial results to meet targets or expectations, in order to maximise organisational and personal interests (Schipper, 1989). This manipulation can involve various accounting techniques, such as accrual earnings management and real earnings management (Schipper, 1989; Healy, 1999; Roychowdhury, 2003; Garanina, et al., 2013; Einhorn, et al., 2017). Although companies use legitimate accounting techniques to manage earnings, the term usually has negative connotations and excessive earnings management can create information asymmetries, misrepresent the company's actual financial performance, and mislead investors (Christensen et al., 2022).

Accrual Earnings Management (AEM) involves manipulating accounting entries, particularly accruals, to alter reporting earnings (Healy et al., 1999; Schipper, 1989; Roychowdhury, 2003). Accruals are accounting entries used to record revenues and expenses that have been earned or incurred but not yet settled in cash, lowering future earnings in comparison to what they would have been without the manipulation (Christensen et al., 2022). Real Earnings Management (REM) refers to manipulating actual cash flows to alter reported earnings, directly impacting cash transactions and reported financial performance (Einhorn, et al., 2017; Roychowdhury, 2006).

Extensive literature looks at the underlying motivations driving earnings management, which are often rooted in a desire to achieve targets and meet market expectations (Roychowdhury, 2006; Purba et al., 2022), secure bonuses and compensation for executives (Healy, 1985), avoid breaching debt covenants (Kim et al. 2010), stabilise earnings and smooth income fluctuations, maintain stock price, minimize taxes, avoid regulators scrutiny (Beladi et al., 2020), access capital, respond to competitive pressures, and enhance management's reputation and job security (Khaled, 2007; Callao et al., 2021; Rahman et al., 2021).

The literature is inconclusive about the influence of CEO tenure on the likelihood of engaging in earnings management. Research provides evidence that junior CEOs may face more pressure to demonstrate immediate results and meet short-term financial goals, making them more aggressive and more likely to practice earnings management (Pourciau, 1993; Oyer, 2008; Axelson & Bond, 2009; Ali & Zhang, 2015; Qawashem & Azzam, 2020; Zhang, 2009). Contrary to this finding, other studies find that more senior CEOs have more control over resources and decisions and less time to make an impact on the company's performance, making them more likely to practice earnings management (Kalyta, 2009; Verkek, 2012; Di Meo, 2013). Ahmood et al. (2020) find that CEO tenure has no impact on earnings management, while Hu et al. (2015) find a U-shaped relationship between CEO tenure and earnings management.

Research findings are inconclusive about the influence of CEO age on the likelihood of practicing earnings management as well. Older CEOs are likely to be less risk-taking, prioritising stability and risk mitigation over short-term financial goals, resulting in a lower

likelihood of practicing earnings management (Huang, et al. 2012; Cornett et al. 2008, Qi et al. 2018; Le et al. 2020). On the other hand, Davidson et al. (2007), Isidro and Concalves (2011) and Dechow and Sloan (1991) find that older CEOs approaching their retirement age are associated with a higher probability of being involved in earnings management behaviour.

Looking at CEO gender, the literature argues that women are less inclined to take aggressive accounting measures to manipulate earnings, opting for more transparent financial reporting practices, in comparison to male CEOs who may exhibit more overconfidence and risk-taking behaviour (Krishnan & Parsons, 2006; Heminway, 2007; Baura et al. 2010; Peni & Vahamaa, 2010; Srinighi, et al., 2011; Abbot et al. 2012; Gavius et al., 2012, Liu et al. 2016; Kim, et al. 2017; Luo et al., 2017; Na & Hong, 2017; Gull et al. 2018). Still, Harris et al. (2019) find that the presence of female CEOs does not inherently decrease earnings management, while Du et al. (2016) find a non-linear relationship between female manager presence and earnings management, with the proportion of female CEOs driving the relationship between the two.

Finally, the literature suggests that CEO overconfidence can lead to increased likelihood of practicing earnings management, as overconfident CEOs may overestimate their abilities and judgements and believe that they may successfully manipulate financial results without detection or consideration of the consequences, leading to higher propensity for aggressive practices (Schrand & Zechman, 2012; Hsieh et al., 2014; Yu, 2014; Bouwman, 2014; Khligi & Zouari, 2021; Kouaib, 2023).

3. Research Methodology

Our sample comprises of class A-class share companies listed on the Shanghai and Shenzhen stock exchanges, excluding the financial industry, ST companies and companies with missing values in financial data, executive characteristics data and media report data, giving a total number of 3,501 companies included in our sample. We Collect data between the years of 2016 and 2020. The executive characteristic data and quarterly earnings forecast reports come from the CSMAR database, and the media report data comes from the CNRDS database. Stata is used for data processing and analysis.

We use the regression equation below:

$$EM_{i,t} = \alpha_0 + \beta CEOCharacteristics_{i,t-1} + \sum \alpha_k control_{i,t-1} + \gamma_i + \delta_t + e_{i,t} \quad (1)$$

where $EM_{i,t}$ represents the level of earnings management of the enterprise, $CEOCharacteristics_{i,t-1}$ represents the characteristics of the CEO, which are expressed in this study by age, tenure, gender and confidence level of the CEO; γ_i and $control_{i,t-1}$ represents the constant term and the set of control variables, respectively; δ_t represents the individual fixed effect, which is used to control the micro factors that do not change with time; and finally $e_{i,t-1}$ represents the residual term. We use the subscripts i and t to represent enterprise and year.

3.1 Measurement of variables

To estimate manipulative accruals, we employ the cross-sectional modified Jones model (Dechow et al. 1995). The annual non-manipulative accrual profit and manipulative accrual profit of listed companies are estimated according to the estimated parameters. According to the "Guidelines for Industry Classification of Listed Companies of the China Securities Supervision Commission" (CSRC, 2020), the data samples are classified by industry. Among them, the manufacturing industry adopts sub-categories, and other industries adopt first-level classification. If an industry's sample size for the given year is fewer than 15 firms, the sample of firms are combined with other firms in the same industry, and the cross-sectional modified Jones models is applied as follows:

$$NDA_t = a_1 * \frac{1}{A_{t-1}} + a_2 * \frac{\Delta S_t - \Delta R_t}{A_{t-1}} + a_3 * \frac{PPE_t}{A_{t-1}} \quad (2)$$

$$\frac{TA_t}{A_{t-1}} = a_1 * \frac{1}{A_{t-1}} + a_2 * \frac{\Delta S_t}{A_{t-1}} + a_3 * \frac{PPE_t}{A_{t-1}} + \varepsilon_t \quad (3)$$

$$DA_t = \frac{TA_t}{A_{t-1}} - NDA_t \quad (4)$$

Under the accrual accounting system, the total accruals represent the difference between net profit and net operating cash flow. These accruals can be further categorised into non-operational accrued profit and operational accrued profits. In the equations above, A_{t-1} denotes the total assets of company i at the beginning of year t ; PPE_t is the total amount of property, plant and equipment of the company i at the end of the t year; ΔS_t is the difference between the company i 's income in the t year and the income in $t-1$ year; and ΔR_t is the difference between the accounts receivable of the company i in the t year and the accounts receivable in $t-1$ year. The calculation involves the following steps. First, the model is estimated separately by year and industry to determine the parameters a_1 , a_2 and a_3 , then substitute the values of a_1 , a_2 and a_3 into the model, predict the non-manipulative accrued profit according to the regression model, and finally, use the model to calculate the manipulative accrued profit. Earnings management is quantified using the absolute value of the manipulative accrued profit, where a higher value indicates a greater degree of earnings management.

In addition, four core explanatory variables are selected in this paper, namely manager tenure, manager age, manager gender and manager self-confidence. Manager tenure is captured by the time between the manager's appointment and their departure, as disclosed by the company. Manager age is the age disclosed in the company records. Manager gender takes the value 1 when the manager is male and 0 when the manager is female. We use Hayward and Hambrick (1997) and adopt a compensation-based proxy for CEO overconfidence. More specifically, overconfidence is measured by the sum compensation of the top three executives divided by the sum compensation of all executives. The higher the salary of managers, the stronger the ability and the higher the status, the more likely to produce overconfidence.

Finally, the model includes the subsequent control variables: Enterprise size, measured by the natural logarithm of the company's total year-end assets; Asset-liability ratio, measured using the ratio of the company's total liabilities to total year-end assets;

Growth, measured using company revenue growth rates; Return on Assets (ROA), captured by the ratio of the company's net profit to the total year-end assets; Loss status, represented by 1 when the company's net profit is less than 0, and by 0 otherwise; Management shareholding ratio, measured by the number of year-end shares in management as a percentage of total shares; Enterprise age, measured by the natural logarithm of the company's establishment years; and Board size, measured using the natural logarithm of the total number of board members.

4. Findings

The descriptive statistics for the sample firms are presented on Table 1. The average value of earnings management level is 0.062854, demonstrating that the level of earnings management across companies is low. The maximum value is 6.2228, and the standard deviation is 0.101874, showing that although there is a gap in the level of earnings management of listed companies, this gap is small. Looking at CEO characteristics, the average term of office is 4.5 years, the standard deviation is 3.718, the maximum value is nearly 16 years, and the minimum value is only 0.083 years, which shows that the length of tenure of CEOs of listed companies in China is very different. Looking at gender, the average value is 0.883, indicating that the proportion of male CEOs in listed companies in China is about 88%, and the proportion of female CEOs is still relatively small. Looking at the overconfidence variables, the mean value is 0.566, the variance is 0.226, the maximum value is 1, and the minimum value is 0. These findings show that the proportion of overconfident CEOs in Chinese listed companies is about 56%, which accounts for a large proportion of the CEOs.

Table 1. Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
EM	17505	.062854	.0101874	0	6.2228
Term	11697	4.533	3.718	.083	15.583
EAge	11787	54.195	14.749	32	113
Gender	16258	.883	.322	0	1
Overconfidenc	17505	.566	.226	0	1
CAge	13635	10.46	7.43	1	26
Lev	13635	.419	.195	.065	.898
Size	13635	22.353	1.285	20.067	26.366
SO	12221	18.761	20.791	.0001	70.206
BS	15191	8.386	1.603	5	15
Numexe	15189	6.279	2.279	2	14
Q	14840	1.994	1.267	.846	8.6
top1	15084	21.22	17.08	.153	66.563
ROA	16067	.056	.186	-1.182	.381
Audit	15192	.046	.209	0	1

The results of the regression analysis for model (1) for the impact of CEO characteristics on corporate earnings are presented on Table 2. We can see that the regression coefficient of Term is 0.001, which is significant at the 5% level, indicating that CEOs with higher tenure are more likely to participate in earnings management. The regression coefficient of EAge is 0, which is not significant, indicating that there is no relationship between CEO age and earnings management participation. The regression coefficient for gender is 0.013, significant at the 5% level, indicating that male CEOs are more involved in earnings management than female CEOs. The regression coefficient of overconfidence in the fourth column of results was 0.023, which was significant at the 10% level, indicating that CEO overconfidence increases participation in earnings management. These findings are in line with Kalyta (2009), Verkek (2012) and Di Meo (2013) who also find that CEOs with longer tenure are more likely to practice earnings management. Also, our findings are in line with earlier findings suggesting that male CEOs are more likely to participate in earnings management (Krishnan & Parsons, 2006; Heminway, 2007; Baura et al. 2010; Peni & Vahamaa, 2010; Srinighi, et al., 2011; Abbot et al. 2012; Gaviious et al., 2012, Liu et al. 2016; Kim, et al. 2017; Luo et al., 2017; Na & Hong, 2017; Gull et al. 2018). Moreover, our findings support earlier research indicating that CEO overconfidence can lead to increased likelihood of practicing earnings management (Schrand & Zechman, 2012; Hsieh et al., 2014; Yu, 2014; Bouwman, 2014; Khligi & Zouari, 2021; Kouaib, 2023). Finally, our research does not confirm previous findings suggesting that older CEOs are associated with a lower likelihood of practicing earnings management (Huang, et al. 2012; Cornett et al. 2008, Qi et al. 2018; Le et al. 2020) or that older CEOs are associated with a higher probability of engaging in earnings management (Davidson et al., 2007; Isidro & Concalves, 2011; Dechow and Sloan, 1991).

Looking at the control variables, our findings show that there is a positive relationship between firm size and corporate earnings management behavior, which is consistent with the research conclusions of Watts and Zimmerman (1986). Moreover, our findings suggest that there is a positive and significant relationship between the Asset-liability ratio (Lev) and corporate earnings management behavior. This may be due to the pressure of corporate performance that leads executives to implement earnings management and then whitewash financial reports.

Table 2. Regression analysis

Variable	(1)	(2)	(3)	(4)
	EM	EM	EM	EM
Term	0.001** (2.35)			
EAge		0.000 (0.91)		

Gender			0.013** (2.32)	
CAgr	-0.019* (-1.70)	-0.015 (-1.44)	-0.012 (-1.44)	-0.013 (-1.49)
Lev	-0.015 (-0.84)	-0.013 (-0.75)	-0.029** (-2.01)	-0.029** (-2.04)
Size	0.021*** (3.79)	0.022*** (3.95)	0.014*** (3.13)	0.014*** (3.24)
SO	-0.000 (-0.06)	0.000 (0.06)	-0.000 (-0.47)	-0.000 (-0.38)
BS	0.003* (1.67)	0.003* (1.81)	0.002 (1.53)	0.002 (1.49)
Numexe	-0.001 (-1.27)	-0.001 (-1.29)	-0.001 (-0.62)	0.001 (0.58)
Q	-0.001 (-0.75)	-0.001 (-0.60)	0.000 (0.22)	0.000 (0.20)
top1	-0.000 (-0.30)	-0.000 (-0.26)	-0.000 (-1.00)	-0.000 (-1.01)
ROE	0.271*** (31.88)	0.270*** (31.92)	0.266*** (37.58)	0.265*** (37.47)
Audit	0.004 (0.43)	0.003 (0.35)	0.000 (0.02)	-0.000 (-0.07)
Constant	-0.332** (-2.07)	-0.386** (-2.46)	-0.237* (-1.83)	-0.240* (-1.86)
Observations	7,878	7,933	10,729	10,736
R-Squared	0.516	0.516	0.504	0.504
Control Variable	YES	YES	YES	YES
year FE	YES	YES	YES	YES
id FE	YES	YES	YES	YES
r2_a	0.344	0.345	0.347	0.347
F	135.7	135.5	188.3	188.2

t-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

5. Conclusions

With increasing stakeholder scrutiny of corporate performance, the role of executives on enterprise performance has gradually emerged as a critical area of focus. Stakeholders, including investors, regulators, and the public, demand higher transparency and accountability from corporate leaders. Consequently, if enterprises want to improve their capital structure and realize their strategic objectives, they should pay attention to the appropriateness of the characteristics of their executives. This research contributes to existing research on earnings management by providing additional empirical evidence on the impact of CEO characteristics on earnings management.

This study uses comprehensive data on companies listed in the Shanghai and Shenzhen stock exchanges from 2016 to 2020 to explore the impact of manager characteristics, such as CEO tenure, age, gender and overconfidence on CEO participation in corporate earnings management. We find that CEO characteristics significantly influence their participation in earnings management. Overall, CEO tenure, gender, and degree of overconfidence are significantly positively related to senior executives' participation in earnings management, while CEO age has no significant relationship with earnings management. Our findings highlight the nature of managerial influence on corporate practices and underscore the importance of a careful approach in executive selection and development.

Considering that earnings management is not by definition illegal or detrimental to stakeholders, it is important to emphasise on managers' professional and ethical responsibility to safeguard the quality of earnings reporting. This realisation calls for the importance of strengthening managers' awareness and understanding of ethical values, compliance requirements and professional ethical standards. This will help managers establish correct values and ethical standards and reduce the risk of participating in earnings management helping managers better deal with challenges and pressures and reduce the tendency to manipulate earnings. In addition, the empirical evidence suggesting that women CEOs are less likely to engage in earnings management, provides additional incentives for corporations to support female executives break the glass ceiling that prevents them from holding senior executive positions. If promoting female executives to these positions is going to improve the quality of earnings management reporting, then companies might consider the potential benefits of the effect for their long-term performance and stakeholders.

5.1 Limitations

Our study has some limitations. Our sample comprises of A-class share companies listed on the Shanghai and Shenzhen stock exchanges. Chinese A-class shares are shares of companies bases on the mainland of China. This creates some restrictions for the generalisability of our results. Still, we think that our study contributes empirical evidence to existing literature, which is mainly based on US-based companies. In addition, we acknowledge that we may be using different measures from previous studies to capture CEO characteristics. For example, we use Hambrick (1997) to measure the degree of overconfidence, captured by the ratio of the total compensation of the top three executives

to the total compensation of all executives as a proxy variable. Other studies (e.g. Hsieh, et al 2014) use different measures for CEO overconfidence. This means that findings may not be directly comparable. However, we believe that using a variety of measures reinforces existing findings, providing a more holistic view of the impact of certain top executive characteristics on earnings management.

5.1 Practical implications

Our findings highlight the nature of managerial influence on corporate practices and underscore the importance of a careful approach in executive selection and development. Earnings management is not by definition illegal or detrimental to stakeholders, however, it carries significant ethical implications. Consequently, it is important to emphasise on managers' professional and ethical responsibility to safeguard the quality of earnings reporting. This realisation highlights the importance of strengthening managers' awareness and understanding of ethical values, compliance requirements and professional ethical standards. This will help managers establish correct values and ethical standards and reduce the risk of participating in earnings management helping managers better deal with challenges and pressures and reduce the tendency to manipulate earnings.

In addition, the empirical evidence suggesting that female CEOs are associated with a lower probability of being involved in earnings management, provides additional incentives for corporations to support female executives break the glass ceiling that prevents them from holding senior executive positions. If promoting female executives to these positions is going to improve the quality of earnings management reporting, then companies might consider the potential benefits of the effect for their long-term performance and stakeholders.

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