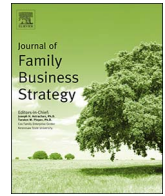




Contents lists available at ScienceDirect

Journal of Family Business Strategy

journal homepage: www.elsevier.com/locate/jfbs

The complex role of family involvement in earnings management

Silvia Ferramosca*, Marco Allegrini

Department of Economics and Management, University of Pisa, Via C. Ridolfi, 10 - 56124 Pisa, Italy

ARTICLE INFO

Keywords:

Family involvement
Earnings management
Socioemotional wealth
Upper echelons theory
Curvilinear relationship

ABSTRACT

Building on socioemotional wealth and upper echelons theory, this paper investigates family firms' behaviors in terms of their earnings management strategies. Our results indicate an inverted U-shaped relationship between discretionary accruals and family involvement in firm management and control (i.e., family members in C-suite positions). Furthermore, there are significant associations between the expertise and experience of C-suite managers and earnings management when the relationship is moderated by family involvement in firm management and control. As such, this study provides a unique contribution informing the accounting, family business, and corporate governance literatures. The study results indicate the types of firms that are more or less prone to earnings management behaviors, finding that accounting choices differ according to diverse characteristics, namely, the expertise and experience of C-suite managers and the level of family involvement in C-suite positions. These characteristics together affect firms' preferences for discretionary accruals and income-smoothing activities. The findings introduce several practical implications for regulators, family businesses, investors, lenders, and external auditors.

1. Introduction

This study combines three strands of research (family business, accounting, and corporate governance) by investigating whether family involvement and the characteristics of boards of directors and committees in terms of members' expertise and experience affect accounting choices. Our research is motivated by the expansion of the family business field, by the importance of earnings management studies in the financial accounting field, and by the growing number of corporate governance studies addressing the outcomes that certain board and committee characteristics generate regarding firm performance, firm value, and financial reporting quality, among other factors.

Family ownership is likely to be concentrated in the hands of families (La Porta, Lopez-de-Silanes, & Shleifer, 1999), reducing the traditional agency problem (type I agency conflicts) of ownership and control (Fama & Jensen, 1983; Jensen & Meckling, 1976). However, traditional principal-agent problems in family firms lead to principal-principal conflicts (type II agency conflicts) (Singla, Veliyath, & George, 2014), in which the dominant family owner can extract the firm's wealth to the detriment of minority shareholders (Miller & Le Breton-Miller, 2006; Morck & Yeung, 2003), manipulate earnings out of self-interest (Fan & Wong, 2002), or reap private benefits (Villalonga & Amit, 2006). Family firms' governance practices might face additional complications or barriers regarding the selection of adequate professionals, while ensuring the preferential treatment of next-generation

family members (Pérez-González, 2006). In this scenario, family members, long-tenured family accountants, and even close friends often constitute a majority on the board. Recruiting family-proximate professionals can lead to several distortions in the management and control of firms, giving rise to bargained skepticism because of excessively emotional bonds (Gomez-Mejia, Cruz, Berrone, & De Castro, 2011; Gomez-Mejia, Cruz, & Imperatore, 2014) with the firm and strong dependence on the firm's financial results. In contrast, outsiders bring the sets of skills and knowledge required to enforce financial reporting quality. Prior studies have shown that financial expertise and experience can foster monitoring activities (Kim, Mauldin, & Patro, 2014), resulting in lower earnings management (Krishnan & Visvanathan, 2008).

To date, only a niche area within the literature has explored earnings management in family business settings, and the results have been inconclusive since family firms have been associated with both reduced (Ali, Chen, & Radhakrishnan, 2007; Wang, 2006) and with greater (Chi, Hung, Cheng, & Tien Lieu, 2015; Razaque, Ali, & Mather, 2016) earnings management. Furthermore, the association between family firms and earnings management has been extensively explored with regard to public firms, while private firms have received relatively little attention (Kvaal, Langli, & Abdolmohammadi, 2012). Additionally, prior research into the intersection between the family business and earnings management fields has not considered the roles played by the characteristics of C-suite members. Finally, prior studies have primarily

* Corresponding author.

E-mail addresses: silvia.ferramosca@ec.unipi.it (S. Ferramosca), marco.allegrini@unipi.it (M. Allegrini).<https://doi.org/10.1016/j.jfbs.2018.01.001>Received 2 July 2017; Received in revised form 2 January 2018; Accepted 9 January 2018
1877-8585/© 2018 Elsevier Ltd. All rights reserved.

focused on objective management characteristics, such as the board's or committee's size, independence, and meeting frequency. For these reasons, the recent literature has argued that there remains much to explore about financial reporting in family firms (Songini, Gnan, & Malmi, 2013; Prencipe & Bar-Yosef, 2011).

Considering the aforementioned gaps, our empirical research is performed using a sample of both private and public Italian firms in the period ranging from 2007 to 2015. Adopting an upper echelons perspective, we direct our attention toward the relationships of C-suite members' expertise and experience with earnings management in family firms. To the best of our knowledge, this study represents one of the first attempts to examine the associations between C-suite members' characteristics and earnings management through the effects of family members' involvement. Additionally, we add to the prior literature regarding the effects of executives beyond a pure focus on the CEO (Finkelstein, Hambrick, & Cannella, 2009). Finally, we respond to the call for research on the roles that individual managers play in financial reporting choices (Bamber, Jiang, & Wang, 2010).

The combination of socioemotional wealth considerations (Berrone, Cruz, & Gomez-Mejia, 2012; Gomez-Mejia et al., 2011) and upper echelons theory (Hambrick, 2007; Hambrick & Mason, 1984) makes it possible to better explain how leveraging the diversities of family businesses in terms of their members' involvement, expertise and experience can lead to more accurate decisions overall for all stakeholders who demand suitable corporate governance devices to constrain earnings management. Based on these frameworks, we find that family control exercised through a diverse level of involvement, as well as the experience and expertise of the board of directors and committee members, plays a key role in identifying the antecedents of accounting choices in family firms.

The remainder of this paper is structured as follows. Section 2 introduces the theoretical background of our study and develops hypotheses related to the relationships between family involvement and earnings management (2.1) and among the characteristics of C-suite members, family involvement, and earnings management (2.2). Section 3 outlines the research design with the sample selection process (3.1), variable definitions (3.2), and methodology used (3.3). Section 4 presents the descriptive statistics (4.1) and empirical results from the multivariate analysis (4.2). Section 5 briefly reviews the robustness analysis and additional tests. Section 6 concludes the paper with a discussion of the main findings and the contributions to theory (6.1), practical implications (6.2), and limitations and suggestions for future research (6.3).

2. Theoretical background and hypotheses development

A considerable body of literature has suggested that earnings management primarily derives from reporting incentives, e.g., big baths, income smoothing, CEO changes, leverage, and CEO bonuses (Burgstahler, Hail, & Leuz, 2006; Dechow, Ge, & Schrand, 2010; Feng, Ge, Luo, & Shevlin, 2011; Healy & Wahlen, 1999; Holthausen, Larcker, & Sloan, 1995). However, accounting choices in family firms can also be guided by reputational and socioemotional wealth preservation objectives (Gomez-Mejia et al., 2011: 657). Additionally, family influence can lead to less independent financial reporting because family members might have self-interested behaviors, expropriate wealth, and intensify the entrenchment effect (Anderson & Reeb, 2004; Morck & Yeung, 2003). These tensions in the literature have been reflected in varied empirical results (e.g., Hutton, 2007; Salvato & Moores, 2010).

However, arising from the neoclassical assumptions of behavioral agency theory, socioemotional considerations suggest that any manager, when confronting determined events, responds by following the same "rational pattern"; in other words, managers are conceived as perfect substitutes for one another (Bertrand & Schoar, 2003). In this context, contractual incentives lead managers to make similar decisions (McVay, Nagar, & Tang, 2006; Bamber et al., 2010). In contrast, upper

echelons theory considers the characteristics specific to top management, which can have impacts on accounting choices (Ge, Matsumoto, & Zhang, 2011). Hence, a great deal of the literature has explored the roles of CEOs', CFOs', committees', senior management's and board members' characteristics in shaping accounting decisions (e.g., Bédard, Chtourou, & Courteau, 2004; Aier, Comprix, Gunlock, & Lee, 2005; Krishnan, Raman, Yang, & Yu, 2011). In their touchstone work, Hambrick and Mason (1984: 193) argued that the characteristics of the "upper echelon" of an organization affect its decision-making processes because the top management decisions are likely to be influenced by the top managers' cognitive bases. The common upper echelons characteristics include powerful actors' educations, ages, and experiences (Hiebl, 2014), and in family firms, these characteristics can complement the motives underlying socioemotional wealth considerations for earnings management.

To develop our hypotheses, we mainly draw on these theoretical backgrounds and on the literature related to top management teams, CEOs, CFOs, and other high-level members. This literature is extendable to C-suite members, essentially consisting of CEOs, CFOs, and, more generally, all of the highest-level managers. In this sense, Menz (2012: 3) suggested that, even if the functional top management team members are diverse, "they all share characteristics, which allows scholars to integrate related studies' findings and to define them collectively as senior executives" or C-suite members in our case. Furthermore, all C-suite managers in typical organizational structures report directly to the CEO (Guadalupe, Li, & Wulf, 2014); hence, it is predictable that the CEO can influence their behaviors. Nonetheless, the CEO cannot disregard suggestions, analyses, and recommendations from other top-level members (Groysberg, Kelly, & MacDonald, 2011). Altogether, these considerations lead to interpretation of all of these apex positions as functionally interdependent, sharing the CEOs' and other top-level managers' decision power (Finkelstein, 1992).

2.1. Family involvement and earnings management

Consistent with family firms' long-term investment horizons, several studies have found that family firms produce better financial reporting by resorting to lower abnormal accruals (Cascino, Pugliese, Mussolino, & Sansone, 2010), higher earnings informativeness and the ability to anticipate future cash flows, as well as higher earnings response coefficients (Ali et al., 2007), less persistence of lost transitory components (Wang, 2006), fewer restatements (Tong, 2008), a greater likelihood of disclosing earnings warnings (Chen, Chen, & Cheng, 2008), and lower discretionary accruals (Jiraporn & DaDalt, 2009). In agreement with the alignment hypothesis, Greco, Ferramosca and Allegrini (2015) provided evidence that family firms are less likely to use long-lived asset write-offs for earnings management purposes. In this regard, Siregar and Utama (2008) suggested that family firms are more likely to adopt efficient earnings management practices to convey private information, rather than opportunistic earnings management practices for managerial reporting incentives. However, another trend in the literature has argued that family firms are negatively associated with financial reporting quality, measured in terms of lower earnings informativeness (Ding, Qu, & Zhuang, 2011), higher use of discretionary accruals (Chi et al., 2015; Jara-Bertin, López-Iturriaga, & López-de-Foronda, 2008) and real earnings management activities (Razzaque et al., 2016). Finally, a few recent studies have not provided evidence that public family firms differ significantly from their non-family counterparts (Sáenz González & García-Meca, 2013; Vieira, 2016).

A sizable body of the literature on family businesses has found a curvilinear relationship between family ownership or involvement and particular firm characteristics, such as the cost of debt (Anderson, Mansi, & Reeb, 2003; Mazzola, Sciascia, & Kellermanns, 2013), firm performance (Minichilli, Corbetta, & MacMillan, 2010; Sciascia & Mazzola, 2008), firm value (Lins, 2003; McConnell & Servaes, 1990; Stulz, 1988), export intensity (Sciascia, Mazzola, Astrachan, & Pieper,

Download English Version:

<https://daneshyari.com/en/article/7426244>

Download Persian Version:

<https://daneshyari.com/article/7426244>

[Daneshyari.com](https://daneshyari.com)