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Ordering collective performance manipulation practices: How do leaders manipulate financial reporting figures in conglomerates?

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ABSTRACT

This article explores some of the resources, tactics and skills used by managers involved in the manipulation of performance reporting by looking at management accounting practices in a conglomerate. Prior research on reporting manipulation in large corporations has focused on *why* executives manipulate figures. The present paper documents *how* BU leaders compensate for the uncertainties impacting the performance of their activities. Empirical evidence comes from a field study of a diversified French conglomerate. Performance reporting practices within and between a parent company and two subsidiaries are analyzed. The article shows that the conglomerate constitutes a strategic action field (Fligstein and McAdam, 2011) where skillful group leaders use the resources granted by their power position to frame other actors' interests and identities to initiate stable cooperation around manipulation practices. This study clarifies the collective and collaborative dimensions of practices granting greater control over reporting figures.

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1. Introduction

This article deals with performance manipulation practices within conglomerates. It contributes to existing literature on "profit manipulation" defined as "when managers of business components make self-beneficial choices of accounting methods or take action to influence economic events which impact reported profits" (Macintosh, 1995, p. 289). Prior studies have explored the antecedents of manipulation practices. Extant research tends to see performance manipulation practices as a way for opportunistic managers to gain personal benefits (e.g. Lambert, 1984; Moses, 1987) or as a resistance strategy

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against unreasonable financial expectations imposed by shareholders (e.g. Lambert and Sponem, 2005; Macintosh, 1995). Few studies have focused on *how* managers' control over performance indicators is enacted in practice. A better understanding of the resources, tactics, and skills involved in manipulation practices is needed to clarify the material and social conditions surrounding such controversial techniques. The present article's aim is to shed light on how actors in conglomerates orchestrate performance reporting manipulation practices. By focusing on *how* the manipulation is carried out, the article provides additional knowledge about the ways in which conglomerate executives exert control over performance indicators regarding their activities. Such an inquiry is important because it complements academic research on figure manipulation that is relevant to managers, investors, and regulators alike (Healy and Wahlen, 2000).

The study uses Fligstein's theoretical framework on strategic action fields (SAFs) to demonstrate how subsidiary executives mobilize and combine a large variety of resources (e.g. their knowledge of business specificities, their understanding of other collaborators' interests, their control over local accounting calculations and procedures, etc.) to initiate cooperation within and between groups of individuals engaged in reporting figures manipulation. The article's contribution to the literature on performance manipulation is twofold. First, it demonstrates the institutional dimension of performance manipulation processes, emphasizing the group leaders' ability to implement stable rules and procedures framing other actors' attitudes regarding reporting enhancement practices. More precisely, it shows that manipulation techniques are implemented through collective and interactive processes initiated by a few actors occupying power positions and are gradually taken for granted by participants. Second, this study documents skills, resources, and tactics not usually associated with performance manipulation. It notably sheds light on the efforts by many group leaders to organize arenas for face-to-face discussions to maintain an intimate understanding of their stakeholders' identities and interests. Leaders can thus anticipate individuals' reactions and secure their long-term cooperation in reporting manipulation practices.

The empirical material in support of the argument consists of semi-structured interviews conducted in a French conglomerate. Performance reporting practices between a parent company and two of its subsidiaries are analyzed using data collected during meetings held with all organizational actors involved in management accounting at the interface between the sub-units.

The next section provides an overview of current literature on performance manipulation suggesting that such practices contribute to the institutionalization of the field of reporting in large corporations. Section 3 introduces Fligstein's theoretical framework on "strategic action fields" (Fligstein, 1997, 2001; Fligstein and McAdam, 2011) and its contribution to a better understanding of the complex systems of relations in which performance manipulation takes place. Section 4 provides a description of the research method and collected material. In Section 5, the general context of the case study is introduced, along with a brief description of the sub-units' activity sectors and governance peculiarities. Section 6 presents a selection of events and situations that address the research question. Section 7 discusses the major results grounded in the interpretation of empirical material, and presents the implications of the findings. The main arguments and limitations are summarized in the conclusion (Section 8).

2. Exploring the role of manipulation practices in the institutionalization of the field of reporting

For several decades, manipulation practices have constituted an important topic for research (e.g. Beidleman, 1973). Extant results focus on why manipulation happens. They specify the role of financial markets' expectations and incentive policies as important elements encouraging managers to control their performance outputs. Few studies have focused on actual manipulation practices. This section argues that extant research suggests that manipulation practices are structured in interactions that resemble processes of institutionalization. It calls for additional research with a holistic approach to processes ordering manipulation practices.

2.1. Hints of the institutionalization of performance reporting manipulation practices

It is well documented that most managers deliberately distort their financial reporting (DeFond and Park, 1997; Watts and Zimmerman, 1986). Since Beidleman's seminal study on earnings smoothing, it is commonly agreed that tampering with figures should only be done for the benefit of investors, in an attempt to reduce the "abnormal" variations in earnings and "to the extent allowed by sound accounting and management principles" (1973, p. 653). Under such conditions, manipulations benefit the functioning of financial markets by improving earnings informativeness (Tucker and Zarowin, 2006) and by allowing investors to infer the level of permanent future cash flows (Kirschenheiter and Melumad, 2002). Blameless corrections that compensate for the effects of ill-timed and irrelevant events without immediate benefits for the managers are commonly referred to as earnings or profit "management."

Smoother streams of reported earnings are usually associated with stock price benefits (Goel and Thakor, 2003). Not surprisingly, numerous managers of large corporations seek the benefits of reduced reporting volatility. A survey of 400 CFOs working in the USA shows that more than 95% of them prefer to communicate a smooth earnings path (Graham et al., 2005). The same study also shows that 78% of CFOs admit to sacrificing long-term performance to maintain predictability. The managers' primary objective, then, is to reduce earnings volatility whenever activities lead to discrepancies between actual earnings and expectations (Barton, 2001). Reporting manipulation is thus the work of opportunistic managers interested in securing their jobs (Fundenberg and Tirole, 1995), meeting the bonus targets (Dye, 1988; Healy, 1985), or reducing the perception of their business risk (Gul et al., 2003). Cosmetic interventions appear to be an unanticipated side-effect of the pressure to answer calls by the hierarchy and investors (Aglietta and Reberioux, 2005). Financial markets' expectations push everyone in listed

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