The Impact of CEO Narcissism Behavior on Firm Performance through Earnings Management

Muhammad Rusydi 1*

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Abstract

The purpose of this study is to see if Narcissistic CEO behavior patterns lead to earnings management. This study looks at the signs of Narcissistic CEO management practices and how they relate to company performance in 19 Manufacturing Companies listed on the IDX from 2017 to 2019. There are 57 people in the sample. The method of research used in this study was quantitative research with a causal approach. The SPSS test tool for Windows 24.0 is used to test hypotheses by using Path analysis. The findings, CEO narcissism, impact earnings management behavior, but it also impacts company performance through earnings management practices or actions. The CEO is the custodian of data and has the power to make decisions, including policies. The accounting will make every effort to portray good performance through a positive image and profit achievement as expected by investors as an indicator of performance measurement; as a result, CEOs with high self-confidence will use accounting policies to practice earnings management by adding profit figures as needed and the investors' wishes or lowering the profit rate as necessary to achieve the desired results.

Keywords: CEO Narcissism; Firm Performance; Earnings Management

1. Introduction

Profit is one of the benchmarks used by financial statement users to evaluate company performance. The primary concern for assessing performance or management accountability is earnings information material. The hard work of top management in managing the company to achieve its primary goals can show whether the company is performing well or poorly. If the CEO (Chief Executive Officer) has exemplary achievements every year and can achieve common goals with the principal and agent, he is said to have a good performance. However, it does not rule out a CEO change if the current CEO is unable to meet the company's primary objectives, in which case a new CEO will be hired. To instill confidence, narcissistic CEOs frequently employ creative accounting strategies. If shareholders maneuver to record more optimal and healthier profits than the company's actual financial condition, this changes shareholders' decision patterns. On the other hand, Narcissistic CEOs believe that the financial statements' benefits will describe a good performance or achievement. The CEO will believe he has the power to maximize the company's profits and, as a result, bring good to the company's shareholders, giving him a social identity, praise, and recognition.

As the company's manager, the CEO tries to make policies that benefit him personally as much as possible. Still, every policy or decision he makes has an impact on the company and its partners. In terms of decision-making, every decision made by the CEO has far-reaching implications not only for the people who interact with them directly but also for a larger group of stakeholders (Chatterjee, & Hambrick, 2007). This explains why behavioral factors such as the CEO's personality can significantly impact the organization. It is also stated that CEOs with Narcissism are more aggressive and confident when making risky decisions (Li & Tang, 2010), such as acquisitions (Chatterjee & Hambrick, 2007), innovations (Gerstner, Konig, Enders, & Hambrick, 2013), or projections by maximizing the value of Resources and Development. This explanation demonstrates that Narcissism's CEO will strive to improve their performance and be publicly recognized to add value to companies such as Earning Per Share. As a result, even though some CEOs with Narcissism manipulate accrual-based financial reports, it is not uncommon for them to use operational data (Olsen, Dworkis & Young, 2014).

1* First Author and Corresponding Author. Department of Accounting, Faculty of Economics and Business, Universitas Muhammadiyah Makassar, Makassar City, 90221, South Sulawesi, Indonesia. [ Email: rusydi@unismuh.ac.id ]

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This is an Open Access article distributed under the terms of the Creative Commons Attribution 4.0 International License. Site Using OJS 3 PKP Optimized.
According to Reina, Zhang & Peterson (2014), CEOs who are always more aggressive are more likely to engage in earnings management practices. As the party to whom the principal has delegated authority and trust to manage its affairs, management is frequently pressed to meet performance goals such as revenue or profit growth (Hery, 2015). This has an impact on the way earnings are managed. A CEO's likelihood of being laid off in the coming year can be increased by aggressive earnings management (Guan, Wright, & Leikam, 2005). The CEO personality trait of Narcissism can be rated positively or negatively. When a narcissistic CEO's operational activities and activities can provide a fire that can burn enthusiasm and innovation, it can be rated positively.

On the other hand, CEOs can be judged negatively if their personalities lead them to compete unfairly (hostilely), be selfish, and file lawsuits (Zhang et al., 2017). The CEO of Narcissism tries his hardest to convince himself and others that he can run the company well and that every decision he makes will benefit the company, even if it is risky (Doho & Santoso, 2020). The CEO of Narcissism uses creative accounting to demonstrate the ability to manage earnings according to individual needs with strong self-confidence through power and flexibility as the highest policymaker (Arif, Aulia, & Herawati, 2014).

The relationship or contract between the principal and the agent is explained by agency theory. Principals hire agents to perform tasks in the principal’s best interests, such as delegating decision-making authority to the agent. Shareholders act as principals in companies with a share capital, and the CEO (Chief Executive Officer) acts as their agent. The shareholders hire the CEO to act in the best interests of the company. In this study, the term “agency theory” describes the contractual relationship between the agent and the principal. The agent is obligated to carry out tasks in the principal’s best interests. Each party in an agency relationship is motivated by different motivations based on their respective interests. Assume that each party in this relationship tries to achieve or maintain the desired level of prosperity. There could be a conflict of interest between management as an agent and the company owner as to principal in that case. The principal’s and agent's differing interests can lead to agency issues, in which each party prioritizes its interests. As rational humans, agents prioritize their interests (while disregarding the principal's interests), such as manipulating the income statement.

This study’s theory signaling explains why companies provide information to the capital market. Theoretically, companies should provide signals to users of financial statements, according to signal theory. This theory states that when a company’s financial situation is terrible, management uses earnings management to signal bad news to the market, demonstrating that they have integrity, act honestly, and are confident in their ability to solve the problems at hand. Earnings management is a false signal in signal theory because it causes investors to take on more risk. Management intervention in external financial reports that prioritizes personal interests is referred to as earnings management. Of course, management will benefit from this effort. Other parties who use the information in the financial statements, on the other hand, will be harmed because what is contained therein does not reflect the actual conditions.

Several previous studies have looked at CEO narcissism as a factor affecting CEO involvement in corporate decision-making from Upper Echelons Theory's perspective. According to Li et al., (2018), the CEO is one of the primary decision-makers who directly control the company’s operations. The effect of CEO narcissism on the disclosure of upbeat corporate earnings was investigated by Marquez, Zebedee, A., and Zhou (2019). The impact of CEO narcissism on internationalization decisions was investigated (Oesterle, Elsoge, & Elsoge, 2016). CEO narcissism has a positive impact on Environmental, Social, and Governance (ESG) disclosure, according to (Falah & Mita, 2020). According to the studies’ findings (Kim, Lee, & Kang, 2018) and (Falah & Mita, 2020), CEO narcissism has a positive and significant impact on earnings management. Because they see the company's reputation as their own, CEOs who are more narcissistic tend to release more positive company information to boost their self-image and reputation. As a result, a CEO with a narcissistic personality tries to make the best decisions for the company's long-term sustainability by increasing ESG disclosure.

H1: CEO narcissism has a positive and significant effect on earning management

Narcissism is characterized by a strong sense of self-assurance and excessive admiration for oneself (Kusuma, Setyanto, & Khasan, 2019). Narcissism is a positive attitude characterized by a strong belief in one's abilities and business results, as well as a desire for others to acknowledge one's superiority (Sakina, Wahyuni, & Mas'ud, 2014). Narcissism prefers to flaunt its superior abilities for its actions to garner attention and praise from others (Sakina, Zatrahadi, & Darmawati, 2019). CEO narcissism has its own set of values and consequences, though it is sometimes thought to be harmful in that it can harm a company if it is involved in a legal case due to its confidence in making risky decisions. On the other hand, CEO narcissism can be viewed as part of an individual's dynamism, which can motivate management to improve performance by channeling the CEO's passion and energy derived from his strong sense of self-confidence. The ultimate goal of implementing good corporate governance is that shareholders can know and obtain complete and reliable information so that the information obtained is equal to or comparable to the information owned by the manager (Njatrijani, Rahmanda, & Saputra, 2019). As top management, which is given the authority to take the highest policy, the CEO sometimes tries to practice earnings management because of the flexibility to apply creative accounting to increase or decrease its profits. The CEO's character, which is Narcissism, is a factor that can influence the amount of earnings management through the company's strategy to carry out earnings management to maximize individual profits, feel great, and want to get recognition, praise, and praise from others. Profitability is the ability of a company to generate profits (Amin, 2015). Performance measurement based on earnings motivates managers to give their best performance through creative accounting measures to show good
performance.

CEO Narcissism will demonstrate good performance by increasing or decreasing company profits to project a positive image and maximize company profits. Their earnings management practices and creative accounting make their performance look good. This means that he will reduce his spending, including the large bath he took his first year in office. According to Natonis (2019), poor performance can be blamed on the previous CEO. A decrease in profit this year will increase the chances of a higher profit the following year. As the company's top executive, the CEO must demonstrate to stakeholders that he can lead a company to success. On the other hand, CEOs who receive positive performance reviews are more likely to be offered a better job when their current position expires. If the CEO's performance is poor and he cannot guide the company's development in a positive direction or is even harmful to the company, he may be replaced before his term is up (Putri & Ramantha, 2019).

The relationship or contract between the principal and the agent is explained by agency theory. Principals hire agents to perform tasks in the principal's best interests, such as delegating decision-making authority to the agent. Shareholders act as principals in companies with a share capital, and the CEO (Chief Executive Officer) acts as their agent. The shareholders hire the CEO to act in the best interests of the company. In this study, the term "agency theory" describes the contractual relationship between the agent and the principal. The agent is obligated to carry out tasks in the principal's best interests. Each party in an agency relationship is motivated by different motivations based on their respective interests. Assume that each party in this relationship tries to achieve or maintain the desired level of prosperity. There could be a conflict of interest between management as an agent and the company owner as to principal in that case. The principal's and agent's differing interests can lead to agency issues, in which each party prioritizes its interests. As rational humans, agents prioritize their interests (while disregarding the principal's interests), such as manipulating the income statement.

The concept of signaling explains why companies provide information to the capital market. Theoretically, companies should provide signals to users of financial statements. This theory states that when a company's financial situation is terrible, management uses earnings management to signal bad news to the market, demonstrating that they have integrity, act honestly, and are confident in their ability to solve the problems at hand. Earnings management is a false signal in signal theory because it causes investors to take on more risk. In general, the CEO of Narcissism has the authority to take and manage any available resources, including decisions to make acquisitions that may jeopardize the company's ability to achieve other objectives (Campbell, Bush, Brunell, & Shelton, 2005). Because they believe their decisions will be successful, narcissistic CEOs will often try to gain control of available resources, causing them to invest more aggressively in the company to achieve their goals (Nugraheni & Wahyuni, 2016). The study results (Sadia & Sukartha, 2014) discovered that the CEO's earnings management behavior appears when the period is replaced or when the new CEO replaces the old CEO in a company is interesting to study. According to (Phandeiro 2017), CEO duality has a significant impact on financial performance. CEO duality hurts financial performance. CEO duality causes a company's financial performance to decline when it occurs, and it causes a company's financial performance to increase when it does not. Earning management hurts financial performance, which means that its financial performance suffers when a company practices earnings management. When a company does not practice earnings management, the financial performance of the company suffers.

**H2: Narciss CEO will improve good company performance through earnings management practices**

This study was conducted at manufacturing companies in Indonesia, understanding that Indonesia is a developing country with a low level of transparency, resulting in poor governance and shaky investor protection. The Upper Echelon theory (Hambrick & Mason, 1984) emphasizes how top management has power and is the leading strategic decision-maker in companies and organizations. As a result, it emphasizes that top management has corporate governance and organization responsibilities and that their overall activities will influence its decisions. It is also explained that this theory is based on the idea that an aspect of personality behavior, in this case, the CEO's, influences how each policy is interpreted in light of the situations and conditions encountered in the decisions made.

![Figure 1. Conceptual Framework](image-url)
2. Research Design and Method

This research is qualitative research to examine CEO Narcissism's relationship or influence on Firm Performance through earning management. The population in this study were 150 manufacturing companies listed on the Stock Exchange in 2017-2019. The sample selection method used a purposive sampling method of 57 from 19 companies for three years.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earning management</td>
<td>Intervention or manipulation of company financial information (Dechow et al., 1995)</td>
<td>a. ( TA = \text{Net income} - \text{Cash flow from operation} )......... (1)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>b. ( \frac{\text{TA}}{\text{At-1}} = \alpha_1 (\frac{1}{\text{At-1}}) + \alpha_2 \frac{\Delta \text{REVt}}{\text{At-1}} + \alpha_3 \frac{\text{PPEt}}{\text{At-1}} + \epsilon )......... (2)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>c. ( \text{NDA} = \alpha_1 \frac{1}{\text{At-1}} + \alpha_2 \frac{\Delta \text{RECt}}{\text{At-1}} + \alpha_3 \frac{\text{PPEt}}{\text{At-1}} )......... (3)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>d. ( \text{DA} = \frac{\text{TA}}{\text{At-1}} - \frac{\text{NDA}}{\text{At-1}} )......... (4)</td>
</tr>
<tr>
<td>Firm Performance</td>
<td>The success of the company</td>
<td>ROA = \frac{\text{Operating profit}}{\text{Total Asset}}</td>
</tr>
<tr>
<td>CEO Narcissism</td>
<td>Overconfidence behavior, as seen from the size of the photos on the financial report</td>
<td>a. one point if there is no photo of the CEO;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>b. two points if the CEO is photographed with one or more fellow executives;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>c. three points if the photo is from the CEO only and is less than half a page;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>d. four points if the CEO's photo is a photo of himself that occupies more than half of the page</td>
</tr>
<tr>
<td></td>
<td></td>
<td>e. five points if the CEO's photo is a photo of himself that occupies the entire page</td>
</tr>
</tbody>
</table>


3. Results and Discussion

Result Analysis

This test is used to see if the data is normally distributed if there is no multicollinearity and no heteroscedasticity. The standardized residual histogram and the standardized residual PP plot were used to check for data normality. As shown by the standardized residual PP plot image, the data is usually distributed, which shows the points spread out in the diagonal line's direction.

![Figure 2. Normality Test Results](image-url)
The regression model needs to be tested to see an intercorrelation or collinearity between the independent variables. The multicollinearity test was tested by looking at the VIF value of each independent variable <10 and a tolerance value >0.05. The test results show that the VIF value of each independent variable is <10 and a tolerance value >0.01; So it can be concluded that there is no multicollinearity problem in the regression model. According to the processed data, each independent variable's VIF value is more significant than ten, as shown in Table 2.

Table 2. Multicollinearity test results

<table>
<thead>
<tr>
<th>Model</th>
<th>Collinearity Statistics</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Tolerance</td>
<td>VIF</td>
</tr>
<tr>
<td>(Constant)</td>
<td></td>
<td>0,990</td>
<td>1,010</td>
</tr>
<tr>
<td>Narcissme CEO</td>
<td></td>
<td>0,990</td>
<td>1,010</td>
</tr>
<tr>
<td>Firm Size</td>
<td></td>
<td>0,990</td>
<td>1,010</td>
</tr>
</tbody>
</table>

This test is used to see if the regression model's residual variance is unequal, as shown by the scatterplot graph (Ghozali, 2011). The Scatterplot graph shows the points spread randomly and scattered both above and below zero on the Y axis, indicating that the regression model has no heteroscedasticity and can be used to determine the study results.

Figure 3. Heteroscedasticity test results

Table 3. Hypothesis Testing Results (Model Test 1)

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-0,014</td>
<td>0,02</td>
<td>-0,728</td>
<td>0,47</td>
</tr>
<tr>
<td>Narcissism</td>
<td>0,005</td>
<td>0,005</td>
<td>0,148</td>
<td>1,044</td>
</tr>
</tbody>
</table>

Because the CEO Narcissism variable has a t-count value of 1.044 and a significant level > 0.05, it can be concluded that CEO Narcissism has no significant effect on earnings management, and H1 is accepted as a hypothesis. In the form of Equation 1, the following is written:

\[ Y = -0,014 + 0,005 \]

Table 4. Hypothesis Testing Results (Model Test 2)

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>-0,022</td>
<td>0,039</td>
<td>-0,577</td>
<td>0,567</td>
</tr>
<tr>
<td>Narcissism</td>
<td>0,025</td>
<td>0,01</td>
<td>0,331</td>
<td>2,478</td>
</tr>
<tr>
<td>Earning Management</td>
<td>0,391</td>
<td>0,277</td>
<td>0,188</td>
<td>1,410</td>
</tr>
</tbody>
</table>
The CEO Narcissism variable has a value of 2.478 and a significant level of 0.05, indicating that CEO Narcissism impacts firm performance via earnings management practices. As a result, H2 has been accepted. The following is written in the form of Equation 2:

\[ Y = 0.022 + 0.025 + 0.391 \]

**Discussion**

The CEO of Narcissism has an impact on earning management practices. This is because Narcissism's aggressive behavior will make it believe it is superior, allowing it to enact policies that influence decision-making and project a positive image. Positive numbers can be derived from financial statement accounting figures. Narcissism is a personality trait that causes a person to assume a power position (power) and exert control over others. Narcissism, which is closely linked to self-esteem, also helps a person advance in their career. As a result, when someone has Narcissism, they try to project a positive image, which leads to optimism and strong confidence in the outcome. The CEO will choose an accounting method that will boost profits while also boosting compensation. It is used to evaluate the CEO's performance when the company profits increase. Agency theory explains the relationship or contract between the principal and the agent. Principals hire agents to perform tasks in their best interests, such as delegating decision-making authority to the agent. In companies with a share capital, shareholders act as principals, and the CEO (Chief Executive Officer) acts as their agent. The shareholders hire the CEO to act in the company's best interests. The term agency theory is used in this study to describe a contractual relationship between an agent and a principal. The agent is obligated to carry out tasks in the best interests of the principal. There may be a conflict of interest between management as the agent and the company owner as the principal when each party in an agency relationship is motivated by different interests and tries to achieve or maintain the desired level of prosperity. Differentiated interests between the principal and the agent can lead to agency issues, in which each party prioritizes its interests. As rational humans, agents prioritize their interests (while ignoring the principal's interests), as evidenced by income statement manipulation. Theory signaling is used to explain why companies provide information to the capital market in this study.

According to signal theory, companies should provide signals to users of financial statements. According to this theory, when a company's financial situation is dire, management uses earnings management to signal bad news to the market, demonstrating that they have integrity, act honestly, and are confident in their ability to solve the problems at hand. In signal theory, earnings management is a false signal because it raises investor risks. According to signal theory, companies should provide signals to users of financial statements. According to this theory, positive performance reviews at the end of a CEO's tenure are more likely to be offered a better job. If the CEO's performance is poor and unable to show expected to persuade stakeholders that correctly carried out and managed company activities can lead to financial report self-confidence, allowing managers to be considered successful in their duties (Sintyana & Artini, 2019).

Agency theory explains the principal-agent relationship. Principals hire agents to carry out tasks in their best interests, such as delegating decision-making authority to the agent. Shareholders act as principals, and the CEO (Chief Executive Officer) acts as their agent in companies with a share capital. The shareholders hire the CEO to serve the company's best interests. The term agency theory is used in this study to describe the contractual relationship between an agent and a principal. The agent is required to carry out tasks in the best interests of the principal. There may be a conflict of interest between management as the agent and the company owner as of the principal when each party in an agency relationship is motivated by different interests and attempts to achieve or maintain the desired level of prosperity. Differentiated interests between the principal and the agent can result in agency issues, in which each party prioritizes its interests. Agents prioritize their interests (while ignoring the principal's), as evidenced by income statement manipulation. Idea Signaling is a concept that explains why companies provide information to the capital market. According to signal theory, companies should theoretically provide signals to financial statement users. According to this theory, when a company's financial situation is dire, management uses earnings management to signal bad news to the market, demonstrating that they have integrity, act honestly, and are confident in their ability to solve the problems at hand.

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4. Conclusions

Based on the analysis and discussion findings, this study concludes that CEO narcissism impacts earnings management. This is because narcissistic CEOs will use creative accounts to increase or decrease profits to achieve their goals. CEO Narcissism affects firm performance through earning management. As a policyholder and decision-maker, he will project a positive image and sound performance through earning management, which is carried out by reporting optimal earnings to measure performance appraisal investors. According to this study, this CEO's personality should be investigated further because it significantly impacts company employees' actions, including work pressure and work environment. This will help you figure out if any other psychological factors point to the CEO's personality. Aside from that, the research object should be expanded to include different companies because pressure and the work environment can cause personality differences in the CEO.

References


