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EFFECTS OF CHIEF EXECUTIVE OFFICER'S NARSISMIC CHARACTERISTICS ON EARNINGS MANAGEMENT PRACTICES IN INDONESIA

BY

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Abstract
This research aims to explore the role of management personalities in corporate governance in the context of corporate accounting decisions. Specifically, the study examined the relationship between CEO narcissism and the extent of the company's earnings management practices. This research was conducted on non-financial companies listed on the Indonesia Stock Exchange (IDX) in 2022. In this study, the sampling technique used was purposive sampling so that samples were obtained as many as 250 non-financial companies. The results concluded that CEO Narcissism had no effect on a company's earnings management practices. This means that CEO narcissism (CEOs with high-self confidence) will not use accounting policies to practice earnings management or it can be conveyed that more narcissistic CEOs will not distort the financial information available to investors by managing income (earnings management practices).

Keywords: *CEO Narcissism; Earning Management; Upper Echelon Theory*

I. INTRODUCTION

Indonesia is a country that has rapid economic development, making competition in the business world increasingly tight. In conditions like this, it can encourage companies to compete and maintain their business. In Indonesia there are many sectors, one of which is the manufacturing sector which is divided into three parts, namely the basic and chemical industry sector, the miscellaneous industry sector, and the consumer goods industry sector. One of them is the manufacturing company in the property and real estate sector, namely companies that operate in the property sector. , real estate, and building construction. This field is generally long-term and will grow in line with economic growth and is also believed to be a promising investment and has large profits.

Many cases of earnings management practices have occurred both in Indonesia and internationally. Financial reports are the main parameters used to describe company performance. Because of their significant influence, several companies are known to have 'manipulated' the company's financial reports. These stunts are usually carried out to beautify performance so that it remains attractive in the eyes of shareholders and stakeholders, including investors, especially with the status of a public company whose annual financial report (LKT) can be seen transparently by the public. The issue of manipulation of issuers' financial reports has become popular again after the Indonesian Stock Exchange (BEI) was shocked by allegations of LKT manipulation in 2019 which hit one of the issuers in the services and trading sector in the information technology sector, PT Envy Technologies Indonesia Tbk (ENVY) and its subsidiaries. ENVY is suspected of manipulating the financial reports of its subsidiary, PT Ritel Global Solusi (RGS) in 2019. RGS is a subsidiary of ENVY with 70% ownership which operates in the online trading services sector through the "KO-IN" application. An interesting earnings management phenomenon recently is that one of the service companies, namely Garuda Indonesia, manipulated its 2018 financial reports. PPPK and OJK decided that there was something wrong in the presentation of GIAA's 2018 financial reports. The company was asked to re-present its financial reports and the company was hit. a fine of IDR 100 million along with the directors and commissioners signing the financial report. The Financial Services Authority (OJK) carried out an investigation into this case until finally in mid-June 2019, the OJK issued a warning to the KAP that carry out audits and impose fines on the directors of Garuda Indonesia.

Based on the case examples above, it can be concluded that the practice of earnings management is nothing new in the world economy. The rise in cases of earnings management has created a sense of distrust among investors towards the financial reports presented by the company. Earnings management can be described as the use of policy by

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managers to structure financial transactions and change accounting information to mislead users of financial reports (Dawar, 2014). Although earnings management can be positive, neutral, or harmful, its harmful effects have manifested in corporate accounting scandals at an alarming rate. In fact, behind every corporate accounting scandal, top executives such as the chief executive officer (CEO) and Chief Financial Officer (CFO) have been involved (Taleatu et al., 2020). Existing literature shows that the CEO is the driving force behind a company's involvement in accounting manipulation (Feng et al., 2011). The executive director is responsible for the company's organizational strategy, which is related to organizational performance. Existing empirical research provides evidence that Chief Executive Officers (CEOs) play a central role in top executive teams. CEOs can have disproportionate and sometimes domineering influence. The CEO's personal characteristics help determine the extent of the CEO's influence within the top executive team.

Upper Echelon Theory argues that organizational outcomes such as earnings quality are a reflection of the Chief Executive Officer's (CEO) decision making which is influenced by the CEO's characteristics (Hambrick & Mason, 1984). Specifically, observable CEO characteristics such as tenure, age, or gender as well as psychological characteristics such as values or personality influence their decision-making (Bromiley & Rau, 2016); (Carpenter et al.,2004). The narcissistic personality dimension is an important personal characteristic of CEOs because of their inherent ability to exercise power and manipulate others. There is wide variation among CEOs regarding their narcissistic tendencies. Narcissism is a necessary requirement for effective leadership and can have a productive influence, but it also constitutes a potential threat. More specifically, (Buchholz et al., 2020) theoretically proposed that CEO narcissism as a personality trait is related to the quality of corporate earnings.

Earnings management is carried out by executives not only by increasing profits but also by reducing revenues (Capalbo et al., 2018). These activities further demonstrate that narcissistic CEOs not only influence stakeholder perceptions of current performance but can also assess the CEO's potential to change perceptions of current and future earnings (Buchholz et al., 2020); (Capalbo et al., 2018); (F. Lin et al., 2020). Highly narcissistic CEOs' accounting choices are strongly driven by selfish behavior not to provide additional information to the market (Plöckinger et al., 2016). According to (Combs et al., 2007), the CEO has considerable power over company resources, this shows that the CEO can have greater influence in terms of increasing or reducing the level of earnings manipulation. Furthermore, (Chen, 2010) argues that the main causes of accounting scandals are largely attributed to unethical CEO leadership. This personality trait includes the CEO's good and bad judgments and decisions in the preparation and accuracy of financial reports.

Capalbo et al., 2018) examine the relationship between CEO narcissism and earnings management. This study measures CEO narcissism as the ratio of first-person singular pronoun usage to total first-person pronoun use—a non-intrusive measure that correlates with Narcissistic Personality Inventory (NPI) scores developed by Raskin and Terry (1988) and Raskin and Shaw (1988). By using a sample of companies that includes all securities listed on the NYSE other than companies in the financial services and insurance industries in 2007-2013, found that there is a positive relationship between CEO narcissism and earnings management. The results of this study provide evidence that companies with narcissistic CEOs engage in accrual management to manage profits positively. The findings of this study provide the first empirical support for (Amernic & Craig, 2010) who proposed that narcissistic CEOs use accounting choices to indulge their egos and increase their self-esteem. The results of this study find that more narcissistic CEOs distort the financial information available to investors by managing earnings positively, which is consistent with the view that narcissism lies at the heart of leadership and that CEOs in their leadership duties act on the discretion given to them in the application of accounting policies. to achieve their goals. Moreover, further analysis shows that the positive relationship between CEO narcissism and earnings management does not depend on CEO verbosity or CEO/Chair duality. The results of this study also show that information asymmetry caused by earnings management can be identified at an early stage based on the CEO's personality.

Research conducted by (Rispantyo, 2019) examined the relationship between CEO narcissism and earnings quality by observing 341 manufacturing companies listed on the IDX from 2015-2017, found that CEO narcissism was significantly positively related to earnings management. This shows that the higher the level of CEO narcissism leads to higher levels of earnings management carried out by the company. In other words, the results of this study show that CEO narcissism can reduce the quality of company profits. This research also provides evidence that CEO narcissism can direct the CEO into unethical behavior, one of which is earnings management.(F. Lin et al., 2020) tested whether Chief Executive Officers (CEOs) with narcissistic tendencies are more likely to engage in earnings management behavior due to pressure to meet profit thresholds. Data is sourced from the Taiwan Economic Journal database from 2015 to 2017 and the research combines CEOs who appear in photos in annual and corporate social responsibility (CSR) reports. Researchers suggest that CEOs whose photos appear in CSR reports may be more likely to consider themselves important, have a sense of belonging, display superior attitudes, and demand more attention and higher status. The research results reveal that CEOs who exhibit high narcissism are more likely to engage in earnings management to compensate for their performance. The findings of this study indicate that CEO narcissism directly influences financial decisions. Considering the earnings threshold, firms with more narcissistic CEOs experience regulatory effects on real earnings management behavior. Studies have shown that CEOs manipulate earnings to meet three key earnings thresholds: previous year's reported earnings, zero earnings, and analyst estimates. The empirical

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results of this study provide further evidence that CEOs engage in earnings management to meet positive earnings thresholds and analyst forecasts. This research concludes that CEOs use the abnormal production cost method as the underlying mechanism to increase reported profits.

(Buchholz et al., 2020) analyzed the influence of personality on decisions involving earnings quality by exploring whether CEOs manage earnings depending on their narcissism. Using a sample of 671 S&P 500 companies with 1126 CEOs over the period 1992 to 2012, the results of this study find that highly narcissistic CEOs engage in accrual-based earnings management (ABEM).

H1: CEO Narcissism influences Earnings Management.

II. RESEARCH METHOD

This research was conducted at the company non-financial companies listed on the Indonesia Stock Exchange (BEI) in 2022. Consistent with empirical studies by (Burgstahler et al., 2006) and (Stubben, 2009), this research excludes companies in the financial services and insurance industries, due to distortions in the relationship between revenues and accruals caused by regulatory compliance. Data can be accessed via the official website of the Indonesian Stock Exchange at the website address www.idx.co.id. The population in this study are non-financial companies that are registered and have carried out their financial reporting on the Indonesia Stock Exchange (BEI) in 2022, totaling 457 companies. In this research, the sampling technique used was purposive sampling with the following criteria:

1) Companies in the non-financial sector listed on the IDX for the 2022 period.
2) Companies that have published annual reports for the period ending December 31.
3) Companies that generate positive profits
4) Companies that have presented data relating to the variables that will be examined in this research.

Operational Definition of Variables

Profit management

The dependent variable in this research is earnings management. Earnings management itself is an action chosen by the management of a company to determine policies related to financial accounting and to achieve company goals (Scott, 2015). Earnings management is an activity of manipulating earnings information carried out by company management in accordance with management's wishes to maximize or minimize profits in financial reports (Dewi & Damayanti, 2020). Earnings management is used to smooth out earnings fluctuations to meet stock analysts' earnings projections (P. M. Dechow & Skinner, 2000). Company operations have large fluctuations in income and expenses, but the stability and growth of the company are preferred by investors. Therefore, a company's share price always rises or falls after an earnings announcement. Generally, earnings management is measured using discretionary accruals (see (P. M. Dechow et al., 1995), (P. Dechow et al., 2010)). Therefore, researchers use the Modified Jones accrual model to measure earnings management (P. M. Dechow et al., 1995); (Hashmi et al., 2018). Higher accruals from this model indicate high earnings management (Kontesa et al., 2021). Accrual values are taken from the following model:

TAit/Ait-1 = β0 + β1 (1/Ait-1) + β2 (ΔREVit - Δ RECit /Ait-1)+ β3(PPEit /Ait-1) + eit

For reasons of robustness, researchers use other proxies for earnings management, namely:Performance-Matched Discretionary Accrual Model (Kontesa et al., 2021). This model was popularized by (Kothari et al., 2005), where he introduced performance as one of the factors for accrual value. Researchers follow (Kothari et al., 2005), and (Hashmi et al., 2018) by using the following formula:

TAit/Ait-1 = β0 + β1 (1/Ait-1) + β2 (ΔREVit - ΔRECit /Ait-1) + β3(PPEit /Ait-1) + β4ROAit
+ eh

As is known, there are many other proxies for earnings management. However, there is no consensus on the best measure of earnings management. This research chooses modified Jones because it is the basic model for each earnings management proxy. Researchers ignore debates and arguments about the best earnings management for further research expansion (Kontesa et al., 2021).

Positive discretionary accruals indicate upward earnings manipulation, while negative discretionary accruals indicate downward earnings manipulation. (Yu, 2008) reported negative manipulation was used to manage expectations. In good years, negative earnings manipulation is used to hide earnings for future reporting periods. In bad years, companies employ a take-a-bath method to create feasible future earnings targets. Consistent with (Amernic & Craig, 2010) the results of this study expect more narcissistic CEOs to exhibit positive bias behavior and manipulate earnings upwards.

CEO narcissism

The independent variable in this research is CEO narcissism. Narcissism is a characteristic related to personality traits such as excessive self-love, a sense of self-importance, a sense of unlimited success, power, curiosity to excessive admiration (Emmons, 1981). Narcissism as a personality trait can be measured using the Narcissistic Personality Inventory (NPI) ((Reilly et al., 2014); (Petrenko et al., 2015); (Raskin & Terry, 1988)). However, it is not easy to conduct a survey using the NPI, let alone a survey of CEOs ((Capalbo et al., 2018); (Reilly et al., 2014); (Olsen & Stekelberg, 2016)). Top executives of large corporations are very reluctant to participate in survey research questions about traits such as highly sensitive narcissism resulting in very low response rates (Cycyota & Harrison, 2006). Considering the difficulty and sensitivity of measuring narcissism using the NPI, researchers use other methods that are more effective and efficient in identifying the nature, behavior, and characteristics of narcissism (non-participant observation). (Chatterjee & Hambrick, 2007), (Olsen et al., 2013), (Reilly et al., 2014) developed and validated a measure of narcissism

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using CEO photo measures. The photos were measured using the size and prominence of the CEO's photo in the company's annual report. Specifically, referring to research (Kontesa et al., 2021), researchers rated each CEO photo on a scale from one (1) to five (5) as follows:

The research sample was taken using purposive sampling and obtained 250 non-financial companies. The main objective of this research is to determine the relationship between CEO narcissism and earnings management in non-financial companies listed on the Indonesia Stock Exchange for the period 2022. The relationship between CEO narcissism and company earnings management is tested using the multiple regression analysis method. Therefore, the complete estimation model in this study is as follows:

EM = β0 + β1CEO Narcissism + β2SIZE+ β3LEVERAGE + β4GROWTH+ β5BIG4 + β6AUDIT + β7PROFITABILITY + β8CFO + e

III. RESULTS AND DISCUSSIONS

Tabel 1 Narcisism Proportion

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1	5	1,9	1,9	1,9
	2	21	8,1	8,1	10,0
	3	52	20,1	20,1	30,1
	4	92	35,5	35,5	65,6
	5	89	34,4	34,4	100,0
	Total	259	100,0	100,0	

Source: 2022

The narcissism variable has a range from 1 to 5. The highest narcissism score for each CEO is 4 and 5, this shows that there are many CEOs with high narcissism in Indonesia. This is different from the character of CEOs in Malaysia based on research results (Kontesa et al., 2021) which show that the narcissism variable has a range from 1 to 5. The narcissism scores are 1 and 3 respectively, indicating that there are differences in terms of narcissism among CEOs in Malaysia. There are many CEOs with low narcissism, but there are also many CEOs with high narcissism

The results of this research have fulfilled all the elements of classical assumptions, namely normality assumptions, multicollinearity assumptions, and heteroscedasticity assumptions. To meet the assumption of normality, this study removed

several weaknesses that make the data results abnormal (Mehta & Patel, 2013). Therefore, apart from using asymptotic equations, one can use Monte Carlo. One of the criteria in the Kolmogorov-Smirnov test to determine the results is to see the significant value of Monte Carlo (2-tailed). If the resulting Monte Carlo Sig(2-tailed) value is greater than 0.05 then the residual is normally distributed (sig > 0.05) and vice versa, if the resulting Monte Carlo Sig(2-tailed) value is less than 0.05, it can be said that the residual is not normally distributed (sig < 0.05). The test results with the Kolmogorov-Smirnov test are presented in the following table.

Table 2 . Normality test

			Unstandardized Residual
N			259
Normal Parameters[a,b]	Mean		,0000000
	Std. Deviation		,08933285
Most Extreme Differences	Absolute		,070
	Positive		,070
	Negative		-,042
Test Statistic			,070
Asymp. Sig. (2-tailed)			,003[c]
Monte Carlo Sig. (2-tailed)	Sig.		,143[d]
	99% Confidence Interval	Lower Bound	,134
		Upper Bound	,152

Sources: 2022

The aim of this study is to test whether narcissistic CEOs are more likely to use EM to achieve company performance targets. Because the CEO Narcissism variable has a significant level of > 0.05 or 0.178, it can be concluded that CEO Narcissism has no significant effect on earnings management, and the research hypothesis is not supported. Possible explanation for the unsupported hypothesis research, namely the concentration of power in the hands of the CEO (CEO narcissism) in this study, does not necessarily allow the CEO to practice earnings management, either in the form of increasing income or decreasing income. This shows that the higher level of CEO narcissism does not lead to higher earnings management practices in the company concerned. In other words, the results of this study show that CEO narcissism does not reduce the quality of company profits. This research also provides evidence that CEO narcissism does not lead CEOs into unethical behavior, one of which is earnings management. Narcissistic CEOs apparently do not have the tendency to manage company profits in order to fulfill their egos, so the results of this research do not bring a new perspective to agency theory as research results (Kontesa et al., 2021).

Additionally, studies in the accounting field have documented that narcissistic CEOs prefer real earnings management to accrual-based earnings management (Olsen et al., 2013). In this research, earnings management is measured using accrual-based earnings management, so the research results do not support the hypothesis proposed in this research. The results of this study are not in line with the results of research (Kontesa et al., 2021) which states that there is a positive and significant relationship between CEO narcissism and earnings management which is consistent with the results of research (Rijsenbilt & Commandeur, 2013). The results of this research are able to provide implications for upper-echelon theory. The research findings suggest that narcissism in CEO psychology maintains pride and ego, and the same traits compel CEOs to manage company earnings. The results of this research also show that CEOs place their personal reputation above the company's wealth by carrying out earnings management; confirmation of agency theory.

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Table 3 hypothesis Test

Model		Unstandardized Coefficients B	Unstandardized Coefficients Std. Error	Standardized Coefficients Beta	t	Sig.
1	(Constant)	-,088	,102		-,865	,388
	Narsisme CEO	,008	,006	,083	1,352	,178
	SIZE	,003	,004	,055	,770	,442
	Leverage	-,059	,029	-,132	-2,061	,040
	Growth	,005	,003	,090	1,492	,137
	BIG4	-,059	,014	-,290	-4,280	,000
	AUDIT	,018	,014	,076	1,231	,220
	PROFITABILITY	-,275	,104	-,166	-2,647	,009

Sources: 2022

IV. CONCLUSIONS

The results of this test do not support H1 that CEO narcissism influences company earnings management practices. This means that the narcissism of company CEOs in Indonesia does not reduce the quality of company profits. CEO narcissism in Indonesia does not direct CEO behavior non-ethical, namely in earnings management practices. Researchers are aware of several limitations in this research, including that this research only uses accrual earnings management measurements. Thus, it is hoped that future research can use other earnings management measurement approaches so that it will obtain more comprehensive findings. Future research should be able to test and compare this test in the financial industry. The narcissistic behavior of CEOs in the financial industry may be different due to stricter regulations and supervision. Accounting and financial innovations in the financial industry may also be relatively more complex, which can trigger CEOs to practice earnings management. This study used an indirect measure of narcissism. The proxies used in this study have been widely used and validated in other studies, but the measurement of personality instruments is quite well known, such as the Narcissistic Personality Inventory ((Reilly et al., 2014); (Petrenko et al., 2015); (Raskin & Terry, 1988)), perhaps could provide a more direct measurement of narcissism, so that it would influence the research findings. Future research can carry out further testing regarding top management characteristics regarding various company strategic decisions or company performance.

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