

Connecting Top Management Team (TMT) Characteristics to Earning Management: Sample Companies in Saudi Arabia

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Abstract: This study investigates whether specific characteristics of a firm's top management team (TMT) affect the company's earnings management (EM) in Saudi Arabia. The data was collected from 163 companies listed in Saudi Arabia from 2017 to 2021. The TMT characteristics were measured using two different criteria: the academic qualifications and the management expertise of the team. Two models were used to analyze the data: the modified Jones model (1995) was used to measure accrual management, and the Kothari model (2006) was used to estimate accrual discretionary. The research findings revealed that TMT characteristics do not significantly impact EM in Saudi Arabia. According to the Kothari model approach (2006), both the academic qualifications and the management expertise did not influence EM. However, when we followed the Jones model approach (1995), the results showed that management expertise significantly and positively impacts EM. On the other hand, the academic qualifications do not seem to significantly impact EM.

Keywords: Academic Qualifications, Management Experience, Earning Management, Companies, Saudi Arabia.

1. INTRODUCTION

Penrose's (1959) research primarily explored the impact of managerial skills on company growth. Business leaders invest in their human capital due to various qualities. Hambrick and Mason (1984) further explored the importance of human capital qualifications by explaining why firms tend to focus on the cognitive skills of their management team. They found that a company's strategic decisions are primarily influenced by the cognitive abilities of its management team. These decisions can be related to innovation, product diversification, financing of the company's investments, and more.

Hambrick and Mason (1984) noted that firm growth is influenced by cognitive dimensions such as managerial experience, age of team members, and socio-economic characteristics. Age, for instance, reflects the accumulation of tacit and explicit knowledge as a manager and experience in various functions, such as marketing and negotiation skills, which are developed over time within the company. Thus, sociodemographic factors play a crucial role in the development of a firm, and leaders must possess cognitive attributes that enable them to lead effectively. This is because experienced managers can make informed decisions in line with product and service market changes.

The ongoing debate over modern businesses' financial performance recognizes the critical role that managerial skills play. A manager who can think creatively, communicate effectively, and make innovative decisions can significantly contribute to creating new competitive advantages for the company (Uyar et al., 2020). According to Zehing et al. (2019), a manager's education level and years of experience can affect their ability to achieve performance goals. Psychological factors and a manager's value system that prioritizes creativity and ambition can also be catalytic in achieving peak performance (Penrose, 1959).

Our study aims to add to the existing body of research by examining how certain managerial traits affect companies' earning management and performance in Saudi Arabia over seven years. The traits we are interested in are related to academic qualifications and management experience. Firstly, we present a theoretical framework based on the literature, which explains the relationship between management, manager characteristics, and firm performance. Next, we describe our empirical approach and present our key findings.

2. LITERATURE REVIEW

2.1. Top Manager Characteristics and Earning Management.

It is widely recognized in management literature that human capital is a critical factor in a company's success and development. This capital is typically comprised of managers' knowledge, know-how, and self-interest, which they gain through experience or academic pursuit (Maiti et al., 2021). Furthermore, continuous education and training improve managers' human capital by enhancing cognitive skills (Gueguen, 2010). As a result, developing and maintaining human capital is critical for a company's growth and progress. Human capital plays a crucial role in an organisation's success.

According to Orser et al. (2000), the effectiveness of managers' skills in achieving a company's performance cannot be relied upon solely if they are not adequately acquired through the learning process and knowledge-sharing. The company's culture and values often influence this behaviour. Therefore, for a company to expand, its leaders must possess the necessary skills and knowledge to drive its growth.

The proximity, experience, and age of managers impact company performance. (Harjiono and Tjahjadi 2020). Amar and Nakaa (2016) studied 220 small Tunisian businesses and discovered that employee and managerial motivation and management and negotiation experience are critical for the company's growth. The study also found that motivating managers creates a more creative and cooperative work environment that encourages exchanging ideas. As a result, a company's success relies heavily on the motivation of its employees and managers.

We concluded that demographic, cultural, relational, cognitive, and professional experiences drive a company's success. We also recognize that the impact of these factors can be limited if managers are unwilling to broaden their horizons. This could be due to personal or educational barriers that limit their ability to improve. In such a situation, it is challenging to differentiate between the managers' intentions and growth objectives. As a result, it would be more beneficial to concentrate on increasing desirability and optimizing managerial capacities.

Managers often prioritize their gain over the interests of their company and tend to focus on the income statement. This approach can benefit them if they need to utilize their skills and experience to generate profits for the company. Furthermore, managers may acquire more helpful information than their colleagues to gain a competitive edge and advance their interests (Dye, 1988). Research has shown that having a wealth of managerial experience in a team can promote socialization among managers before they become leaders or directors (Bauer & Cohen, 1981). Therefore, it is essential to understand the impact of a top manager's personal and professional knowledge on the company's success.

According to Diri (2017), some CEOs conceal information by failing to disclose their companies' financial position. This is known as opportunistic behaviour. It allows the CEO to increase their possible shares of the company's profits and manipulate certain information to reflect a better company image in the market. This strategy can attract new potential partners. Earning management is a practice that also falls under this category.

2.2. Firm Performance

Over time, different interpretations have been developed regarding the meaning of performance and how it can be measured. While financial criteria are usually used to evaluate performance, other aspects can also be considered. Additionally, the level of performance can be affected and justified by earning management practices (Kilduff et al., 2000).

Maximizing shareholder profits and market value is often seen as the ultimate goal of a company. However, focusing on financial metrics may lead to conflicts of interest between managers and shareholders. Charreaux (1991) discovered this issue in his research.

According to Charreaux (1991), no empirical convergence can be achieved between return on equity or economic profitability-based performance measures. Similarly, Fama (1978) classified the company's agents as shareholders and creditors. In a perfect financial market, we can rely on the optimal rule of maximizing the company's overall value from the point of view of economic profitability in the event of a conflict. However, Fama and Jensen (1983) showed that this rule is circumvented when securities are not tradable. Table 1 shows a literature review of Saudi Arabia from 2010 to 2023.

Table 1: Literature review on Saudi Arabia (2010 – 2023)

Author/year	Period	Variables employed	Methodology	Findings	
Altuwajiri & kalyanaraman (2020)	2010 to 2015	TMT pay (PAY), Firm size (SIZE), Firm risk (RISK), leverage (the ratio of long-term debt to total assets), and Firm performance, which is measured by both the return on assets (ROA) and the return on equity (ROE),	Data on 80 Saudi firms are extracted annually from each firm's report. Control variables are taken from CompStat global fundamentals by Wharton Research Data Services.	The study shows that TMT pay is significantly influenced by firm size and financial performance. Large firms and those with better financial performance tend to offer higher compensation to their TMTs.	
Baatour et al. (2016)	2010 to 2013	Accruals-based earnings management.	approach by Roychowdhury, the cross-sectional model by Jones (1991)	Multiple leaders are adopting earnings management practices.	
Habbash (2017)	2006 to 2009	auditor size, auditor specialization, auditor change	auditor industry opinion,	a cross-sectional variation of the Kothari model.	The study indicates that auditors have little ability to detect managerial opportunism.
Habbash (2019)	2014 to 2018	CSR items	Content analysis and OLS regression model	CSR is positively related to earning management in Saudi public firms	
Ghazali et al. (2015)	2010 to 2012	Monitoring opportunistic behaviours	mechanisms, pressure	Regression analysis	Managers may engage in earnings management when their firms are financially stable and profitable. However, such a practice may result in earnings manipulation, which can obscure the actual operating performance of the company and make the reported earnings information less reliable and accurate.
Setyoputri & Mardijuwono (2020)	2013-2017	managerial ownership, leverage and firm size	Multiple linear regression		According to the study, managerial ownership and leverage affect earnings management, not company size.

3. DATA AND METHODOLOGY

Our study focuses exclusively on Saudi Arabian companies listed on the Saudi Stock Exchange (SSE) between 2017 and 2021. We have selected 42 non-financial companies on the SSE to conduct our analysis and gathered data from their annual reports and financial statements. We obtained this data from the SSE website and the Financial Market Council of Saudi Arabia (FMC). In our analysis, panel data is used to increase the number of observations and reduce collinearity between explanatory variables, especially when only a few years are available (Arouri & Rault, 2010).

In financial research, analyzing firm conditions using panel data techniques can result in unobserved fixed effects (Petersen et al., 2009). To solve problems of heteroscedasticity and autocorrelation, we utilize panel-corrected standard errors (PCSEs) to adjust standard errors. If no autocorrelation exists, OLS parameter estimates can be obtained through EAPC. We confirm that when autocorrelation is present, parameter estimates are dependent on the estimates of autocorrelation parameter(s) (Nguyen, 1973). Furthermore, to produce robust results, we will use Hsieh (2018) approach, an ordinary least squares method with clustered standard errors. This method is designed to distinguish between groups. The variable to be explained is earning management, measured by discretionary Accruals and estimated using Jones models (Dechow et al., 1995) and Kothari (2006). The model accounts for total Accruals are as follows.

$$\frac{TA_{i,t}}{A_{i,t-1}} = \alpha_{0t} + \alpha_{1t} \frac{1}{A_{i,t-1}} + \alpha_{2t} \frac{\Delta S_{i,t} - \Delta AR_{it}}{A_{i,t-1}} + \alpha_{3t} \frac{PPE_{i,t}}{Asset_{i,t-1}} + \epsilon_{i,t} \tag{1}$$

$$\frac{TA_{i,t}}{A_{i,t-1}} = \alpha_{0t} + \alpha_{1t} \frac{1}{A_{i,t-1}} + \alpha_{2t} \frac{\Delta S_{i,t} - \Delta AR_{it}}{A_{i,t-1}} + \alpha_{3t} \frac{PPE_{i,t}}{TA_{i,t-1}} + \beta_{3i} ROA_{i,t-1} + \epsilon_{i,t} \tag{2}$$

Where:

- $TA_{i,t}$: The total accruals of firm i in year t .
- $A_{i,t-1}$: The total assets of firm i in year $t - 1$.
- $\Delta S_{i,t}$: The change in net sales of firm i in year t .
- ΔAR_{it} : The change in accounts receivable of firm i in year t .
- PPE_{it} : The net property, plant, and equipment of firm i in year t .
- ROA_{it} : The return on assets of firm i in year t .
- ϵ_{it} : Residual from the period of the firm i on date t .

Jones (1995) divides total accruals into two categories: non-discretionary and discretionary. Non-discretionary accrued liabilities are believed to be influenced by economic factors, while discretionary accrued liabilities are determined by directors based on the reported results (Hsieh, 2018). The calculation of discretionary accruals (DA) can be done by using Equation 3.

$$DA_{it} = TA_{it} - ND_{it} = \epsilon_{it} \tag{3}$$

TA_{it} : The total accruals of firm i in year t .

DA_{it} : Discretionary accruals of firm i in year t . ND_{it} : Non-Discretionary accruals of firm i in year t .

The study aimed to evaluate the characteristics of top managers based on their academic qualifications and management expertise. The academic qualifications was classified into three categories: 1 for a bachelor's degree, 2 for a master's or graduate degree, and 3 for a doctorate or professional degree. Management expertise was measured as a binary variable, where 0 indicated no management experience and 1 indicated experience in management. In addition, the study took into account control variables such as company size, asset structure, growth opportunity, risk, and sector classification. Table 1 provides a summary of the variables used in this study.

Table 1: Variables study

Variable	Abbreviation	Measure
Accruals discretionary	DA	Net income – free cash flow
Academic qualifications	S	Bachelor's degree = 1 Master's degree = 2 Doctorate degree = 3
Management Expertise	E	0: The CEO has no management experience 1: The CEO has experience in management
Firm size	F	Ln (Total assets)
Growth rate	G	It is the variation in a company's turnover from one year to another
Leverage	L	Total/total debt assets
Asset structure	A	Gross tangible asset/total assets

Growth Opportunity	O	Market capitalization + total debt) / Total assets
Risque	R	Standard deviation (ROA)
Sectoral classification	D	Telecommunications Consumer Services Health Consumer Goods Sector Industries Basic materials Oil & Gas

Global model is presented in equation (4):

$$DA_{i,t} = \alpha_i + \beta_{1i}S_{i,t} + \beta_{2i}E_{i,t} + \beta_{3i}F_{i,t} + \beta_{4i}G_{i,t} + \beta_{5i}L_{i,t} + \beta_{6i}A_{i,t} + \beta_{7i}O_{i,t} + \beta_{8i}R_{i,t} + \beta_{9i}D_{i,t} + \varepsilon_{i,t} \quad (4)$$

Where :

- $DA_{i,t}$: Each of DA Jones (DAJ) and DA Kothari (DAK) accruals
- $S_{i,t}$: Dichotomous variable takes the values 1, 2, 3 respectively.
- $E_{i,t}$: Binary variable takes 0 and 1.
- $F_{i,t}$: Size of enterprise i on date t .
- $G_{i,t}$: Growth rate of enterprise i at date t .
- $L_{i,t}$: the leverage effect of the company i on date t .
- $A_{i,t}$: structure of the assets of the enterprise i on date t .
- $O_{i,t}$: the growth opportunity of the company i on date t .
- $R_{i,t}$: risk related to the assets of the company i on date t .
- $D_{i,t}$: variable dummy represents sector of activity of the enterprise i on date t
- $\varepsilon_{i,t}$: the error term that represents discretionary accruals (according to the model of Jones modify1995 and kothari 2005).

4. EMPIRICAL RESULTS

Descriptive statistics for the entire sample are presented in Table 2. Based on our sample of companies from 2017-2021, the balance sheets using discretionary provisions (DAJ and DAK) range from 0.490 to 0.581 and from -0.210 to 0.201, with an average of zero. Regarding TMT knowledge variables, only about 1.87% of TMT members hold a master's degree; on average, CEO work experience in management is 0.355 years. This data suggests that work experience in management is not crucial for TMT knowledge, and vice versa.

Table 2 : Summary statistics, 2017–2021

Variable	Ob.	Mean	SD	Min.	Max.
DAJ	142	0.000	0.230	-0.490	0.581
DAK	142	0.000	0.045	-0.210	0.201
S	142	20.902	1.111	18.429	24.222
G	142	12.250	67.230	-63.102	88.320
L	142	0.360	0.455	0.000	0.223
SA	142	0.630	0.321	0.013	3.333
OC	142	0.788	1.718	0.344	16.988
R	163	0.324	0.444	0.000	1.000
D	163	5.924	1.560	1.000	9.000
S	163	1.877	0.466	1.000	2.000
E	163	0.355	0.310	0.000	1.000

The size of enterprises (S) ranges from 18.429 to 24.222, with an average value of 16.988. The growth rate (G) ranges from -63.102 to 88.320, with an average value of 10.938. The average leverage ratio (LEV) is 0.252, with a minimum value of zero and a maximum of 524561 years. The asset structure ranges from 0.013 to 3.333, with an average value of 0.654. The Q Tobin (OC) ranges from 0.344 to 16.988, with an average value of 0.708. The maximum growth rate of 288.044 is higher than the other control variables D presents the sectoral classification of enterprises according to activity, which varies from 1 to 7, with an average of 3.967. The average for CEOs with management experience is 0.422, which varies between 0 and 1.

Before conducting the regression analysis, we first perform a correlation analysis to examine the relationship between the variables in our model. Based on the correlation matrix presented in Table 4, we find no significant correlation between the independent variables. This is a good sign, as it helps to minimize the risk of multicollinearity in the regressions we use to validate our research hypotheses. The VIF test (Variance Inflation Factor) also confirms this result, as all values are less than 2.

Table 3: The correlation matrix of the different model variables

Variable	DAJ	DAK	S	G	L	A	OC	R	D	S	E
DAJ	1										
DAK	0.430	1									
S	0.023	0.055	1								
G	-0.044	-0.019	0.016	1							
L	-0.433	-0.033	0.620	0.087	1						
A	-0.044	0.011	-0.215	-0.211	0.406	1					
OC	0.355	-0.018	-0.078	0.022	-0.255	0.433	1				
R	0.015	0.029	0.120	0.255	-0.019	-0.620	-0.066	1			
D	-0.027	-0.182	-0.233	0.105	0.100	0.410	-0.067	-0.017	1		
S	-0.063	0.210	-0.455	-0.005	-0.322	0.315	-0.098	-0.198	0.095	1	
E	0.120	0.083	0.277	-0.044	0.099	0.540	0.043	-0.117	0.223	-0.388	1

Petersen (2009) found that all characteristic managers are still negatively related to profit management, as represented by DAJ and DAK (available on request). In addition, we observed a weak positive correlation between the dependent variables representing DAJ and DAK. Manager knowledge refers to academic qualifications and experience in management. To confirm the choice of estimation method, the results of various tests are provided in Table 4.

Table 4: Statistic Test

Statistic Test	Jones 1995	Kothari 2005
Test Fisher F	1.455 (0.082)	3.105 (0.088)
Haussmann	17.220 (0.009)	5.677 (0.615)
Heteroscedasticity Test	1.566 (0.403)	10.430 (0.004)
Autocorrelation Test of Woodbridge	0.231 (0.877)	0.012 (0.766)

Table 4 reveals that the Fisher test is significant. The data has a unique character and issues related to heteroscedasticity and autocorrelation. Therefore, using the standard right panels Error (PCSEs) estimation method for both models was appropriate, as shown in Table 5.

Based on Table 5, it can be observed that academic qualifications and experience in management, which are the explanatory variables, have a positive coefficient of 0.011 and 0.035, respectively. The respective P-values are 0.073 and 0.000. These findings indicate that there is a relationship between the management of results, which is the variable to be explained, and the characteristics of top managers, which are the explanatory variables. The results demonstrate that having tacit and explicit knowledge, such as academic qualifications and experience in management, has a positive impact on results management.

After conducting an analysis, we have discovered that there are two control variables, namely financial leverage level and sectorial classification, that have a negative impact on DA Kothari. The values of these variables are -0.034 and -0.021 respectively. It is important to note, however, that our findings do not suggest that these variables have any influence on earning management.

Table 5: Results estimation with panels corrected standard errors (PCSEs)

Variable	DAJ			DAK		
	Coeff.	Prob.	Information	Coeff.	Prob.	Information
S	0.023***	0.001	Significant effect (Positive direction)	0.000	0.777	No effect
G	0.000	0.000	No effect	0.000	0.768	No effect
L	-0.210***	0.000	Significant effect (Negative direction)	-0.034*	0.064	Significant effect (Negative direction)
A	-0.045	0.324	No significant effect	0.003	0.356	No significant effect
OC	0.024	0.568	No significant effect	-0.007	0.668	No significant effect
R	0.015	0.910	No significant effect	0.069	0.340	No significant effect
D	0.001	0.687	No significant effect	-0.021**	0.078	Significant effect (Negative direction)
S	-0.001	0.324	No significant effect	0.017*	0.073	Significant effect (Positive direction)
E	0.056***	0.000	Significant effect (Positive direction)	0.035***	0.000	Significant effect (Positive direction)
Intercept	-0.578	0.011		0.033	0.120	
R ²				0.4310		0.2376
Wald-Chi2				200.50		730.56
Prob.				0.0000		0.000

It is clear from the results that management expertise has a positive impact on result management and is statistically significant at the 1% threshold., if the CEO has relevant experience in management, it encourages better result management. They can negotiate effectively with their partners while focusing on accessing new markets. According to Neophyhou (2009), rooting is a source of inefficiency in shareholders' wealth. It can be assumed that the CEO mainatin power and participative management style to lead their firms. Managers struggle to access reliable company information while closing contracts..This result contradicts the findings of Jones (1995), CEOs possessing better knowledge of their customers and macroeconomic conditions can accurately estimate accrued responsibilities.

In the second part of the table, we can detect a positive correlation between size and DAJ. The estimated coefficient is 0.019 with a probability of 0.001, which is significant at the 1% threshold. Furthermore, we observe a negative association between financial leverage (L) and earning management. This correlation is significant at the 1% threshold. We did not find any significant correlation between other variables such as risk, sectorial classification, growth rate, and asset structure with the DAJ variable. However, we did find a negative but non-significant correlation (probability > 10%) with the DAJ variable for these variables.

The analysis confirms previous results obtained through PCSE and emphasizes the significance of CEO management experience (with a 5% and 10% significance level). This suggests that managers with more management experience are less likely to engage in opportunistic reporting. Similarly, Li (2019) argues that CEOs are highly concerned with how the market perceives their capacity, as it is linked to long-term benefits such as better future performance, abilities of team work, rewards, rollovers, and resource capabilities.. We found evidence that supports our second hypothesis (H2): CEO management experience is negatively correlated with discretionary cumulations when the incentive reduction effect outweighs the rooting improvement effect.

The results indicate that academic qualifications negatively impact result management, but are not significant (P-value > 10%). It is more challenging for a manager without a higher education, especially a post-baccalaureate degree, to showcase their managerial skills in the job market. As a result, it becomes imperative for such leaders to establish a network of relationships both inside and outside the company. On the other hand, Managers' cognitive abilities encourages CEOs to improve their reinforcement of rootedness. Thus, if CEO maintain an extended academic education, the coefficient decreases, and the p-values increase by more than 10%. According to Combs & Main (2004), In order to protect their own interests, managers may become overly controlling as they gain more power. He may demand respect and obedience from their subordinates in order to establish their authority. Manager adopt this behavior seeking for legitimate and neutral position, but it can also lead to increased profits for the company. Through the formation of networks and informal contracts, the manager aims to increase the complementarity of the firm's assets with their know-how and specialized knowledge during this phase.

CONCLUSION

The aim of this study was to examine how manager characteristics affect income management in 42 SSE-listed companies from 2017 to 2021. Our findings support H1, that links CEO traits with accruals when income motive is high. Contrary to the literature to those of Arouri and Renault (2010) and Kilduff et al. (2000) suggests that experienced managers are less likely to manipulate profits due to their better understanding of financial reporting standards. Our research indicates that there is no ideal level of rootedness for directors of Saudian companies. Instead, the level of rootedness depends negatively on the director's tenure as CEO and the existence of relational networks. Furthermore, the lack of these networks indirectly contributes to a higher level of rootedness, making it more difficult for managers who lack these connections to keep their positions.

A CEO's position as leader becomes more secure when he or she has a long history with the company and has performed well in previous roles. In contrast, our results contradict the findings of other researchers, such as François et al. (2008), Malmendier and Tate (2009), Managers with greater control are more likely to root and increase profits.

Our research has made significant contributions in two important areas. Firstly, we have gained insights into how cognitive issues related to managers, company size, leverage, and asset structure impact results management in the context of non-financial companies listed on the Saudi stock exchange. Secondly, we have highlighted areas for further research, such as expanding the sample size beyond listed Saudi non-financial companies and including other leadership characteristics like gender, age, and social origin to understand how they impact outcomes management. In conclusion, this study aims to clarify the relationship between asset management and top management team (TMT) characteristics, such as their network and management experience.

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