

Earnings Management and Corporate Performance in Chinese Listed Companies: A Comprehensive Analysis

Intan Waheedah Othman^{1*}, Zuo Jiakuan¹

¹ Faculty of Accountancy, Universiti Teknologi MARA, Cawangan Selangor, Kampus Puncak Alam, Selangor, Malaysia

*Corresponding Author: waheedah87@uitm.edu.my

Received: 19 August 2025 | Accepted: 20 September 2025 | Published: 1 November 2025

DOI: <https://doi.org/10.55057/ijares.2025.7.5.30>

Abstract: *This study examines the intricate relationship between earnings management practices and corporate performance among Chinese listed companies, revealing distinctive characteristics shaped by China's unique institutional environment. The research demonstrates that earnings management exhibits dual effects on firm performance, with accrual-based earnings management showing divergent impacts on accounting versus market performance measures, while real earnings management consistently demonstrates detrimental effects on long-term corporate value creation.*

Keywords: Earnings Management; Corporate Performance; Chinese Listed Companies; Ownership Structure

1. Introduction

Earnings management represents a pervasive phenomenon in corporate financial reporting, defined by Healy and Wahlen (1999) as managerial judgment exercised in financial reporting and transaction structuring to alter financial reports, potentially misleading stakeholders regarding the company's underlying economic performance or influencing contractual outcomes based on reported accounting numbers. Within China's rapidly evolving capital market context, earnings management practices exhibit distinctive characteristics that warrant systematic investigation.

The prevalence of earnings management in Chinese listed companies reflects both internal organizational dynamics and external institutional pressures. As Dong et al. (2020) observe, earnings management is more prevalent in China due to various internal factors including strong managerial incentives, agency conflicts between controlling and minority shareholders, and the tunneling and propping attitudes of largest shareholders. External factors, particularly regulatory requirements mandating Chinese listed companies to meet specific profitability thresholds established by the China Securities Regulatory Commission, further intensify earnings management practices.

Institutional Peculiarities of Chinese Listed Companies

Chinese listed companies operate within a distinctive regulatory framework that creates powerful incentives for earnings management. The China Securities Regulatory Commission imposes stringent profitability requirements, necessitating companies to maintain specific

earnings thresholds to obtain IPO permissions and access capital markets. This regulatory environment provides compelling motivations for earnings management, as even state-controlled companies may enhance their IPO approval prospects through earnings manipulation (Aharony et al., 2000).

Unlike the dispersed ownership structures prevalent in Anglo-American markets, Chinese listed companies exhibit highly concentrated ownership patterns characterized by controlling shareholders. This concentration creates principal-principal agency conflicts between controlling and minority shareholders, where controlling shareholders may exploit their dominant positions to engage in earnings management for private benefit extraction at the expense of minority shareholders.

State-owned enterprises (SOEs) maintain significant presence among Chinese listed companies, introducing unique incentive mechanisms distinct from private enterprises. Li (2021) demonstrates that non-state-owned enterprises engage more extensively in accrual-based earnings management compared to SOEs, as SOE managers lack incentives to enhance stock prices and performance reporting. Conversely, SOE managers may possess material incentives to participate in real earnings management to fulfill governmental political objectives, manipulating current earnings at the expense of future profitability (Attig et al., 2020).

Following China's adoption of International Financial Reporting Standards (IFRS) in 2006, Chinese listed companies shifted toward manipulating real activities that are less detectable and inadequately scrutinized to achieve upward earnings management (Ho et al., 2015). Additionally, Kuo et al. (2014) document increased real earnings management levels among Chinese listed companies following the 2005-2007 split-share structure reform.

Taxonomy and Manifestations of Earnings Management

Earnings management in Chinese listed companies manifests through two primary approaches: accrual-based earnings management (AEM) and real earnings management (REM). Accrual-based earnings management represents the traditional approach whereby managers manipulate earnings through accounting policy selections to obscure or distort actual economic performance. In China, AEM application faces constraints from accounting standards, yet managers continue achieving earnings management objectives through practices including asset impairment provisions and reversals, R&D expenditure capitalization, and fixed asset depreciation methods (Hu, 2003; Zhao, 2006; Luo, 2010). However, the relevance and applicability of discretionary accruals as earnings management tools face certain limitations in China, as Chinese accounting practices historically provided managers with relatively limited reporting flexibility (Ding et al., 2007).

Real earnings management enjoys more widespread application among Chinese listed companies. Roychowdhury (2006) defines real earnings management as "actions taken by company management that deviate from normal operating activities, making at least some stakeholders believe that the company has achieved its financial reporting objectives during normal production and operating activities." Chinese listed companies' real earnings management manifests primarily through two forms: adjusting routine operational activities such as managing earnings through price discounts, overproduction, and reducing controllable costs, and adjusting asset transaction activities, primarily through long-term asset disposals. Within China's unique institutional environment, real earnings management offers enhanced concealment and reduced detection risks, making it preferable for managers.

Li and Yao (2019) identify Chinese companies engaging in earnings management through goodwill impairments, as this provides management discretionary authority to determine goodwill fair values under certain circumstances. This phenomenon is particularly prominent in China's M&A market, resulting in widespread "high performance promises, high acquired goodwill, and high goodwill impairments related to earnings management."

2. Theoretical Framework and Impact Mechanisms

The impact of earnings management on corporate performance can be explained through two competing theoretical perspectives: agency theory and signaling theory. Agency theory posits that earnings management represents opportunistic managerial behavior that damages long-term corporate value, while signaling theory suggests that earnings management can convey management's private information about future corporate prospects to markets, potentially enhancing corporate value.

From the agency theory perspective, managers engage in earnings management to maximize personal interests, often at shareholders' expense. This agency problem is particularly pronounced among Chinese listed companies due to prevalent concentrated ownership structures, where conflicts between controlling and minority shareholders may lead to more severe earnings management issues. Empirical studies by Graham et al. (2005), Jiraporn et al. (2008), Cohen and Zarowin (2010), Akram et al. (2015), Rodriguez-Ariza et al. (2016), Bouaziz et al. (2020), and Chakroun et al. (2022) support the view that earnings management negatively affects corporate performance.

Conversely, signaling theory suggests that earnings management may serve positive functions, as companies with good financial performance utilize earnings management to reduce capital market information asymmetries and signal future economic growth. In emerging markets like China, where information asymmetry problems are more severe, the signaling role of earnings management may be more important. Studies by Gunny (2010) and Al-Shattarat et al. (2018) provide evidence supporting the signaling view of earnings management, suggesting that under certain circumstances, earnings management can facilitate more efficient capital allocation and enhance corporate value.

3. Differential Performance Impact Analysis

Research reveals that earnings management exhibits significantly different impacts on various performance measures, particularly between accounting performance indicators and market performance indicators. This differential impact provides crucial insights into the complex relationship between earnings management and corporate value creation in the Chinese context.

Accrual-based earnings management demonstrates contrasting effects on different performance metrics. Research reveals significant negative correlations between accrual-based earnings management and Return on Assets (ROA), indicating that accrual-based earnings management may harm actual operational performance. This negative relationship stems from the fundamental nature of accrual manipulations—when executives accelerate revenue recognition or defer expense recognition to enhance current reported earnings, they distort corporate resource allocation efficiency. Cohen and Zarowin (2010) confirm that these distortions damage operational efficiency, directly manifested as ROA reductions.

Furthermore, financial statement credibility may be undermined by extensive accrual-based earnings management practices, further impairing operational efficiency.

Conversely, significant positive correlations exist between accrual-based earnings management and Tobin's Q, suggesting that markets may favor such earnings management activities. This positive relationship can be explained through several interconnected mechanisms: accrual-based earnings management creates environments favorable for increased R&D investments, which positively correlate with market valuations; it facilitates knowledge spillovers, thereby enhancing corporate performance; and it frequently helps companies meet or exceed analyst expectations, potentially interpreted by investors as positive management capability signals.

This differential impact reflects the distinctive characteristics of China's capital markets, where serious information asymmetries and developing market efficiency create conditions where market participants may interpret earnings management as positive management signaling rather than purely opportunistic behavior. However, the negative impact on actual operational efficiency suggests that such practices may compromise long-term competitiveness and sustainable development capabilities.

Real earnings management demonstrates more consistent negative impacts on corporate performance across various performance indicators. This occurs because real earnings management involves manipulating normal business operations, such as cutting R&D expenditures, deferring maintenance costs, and increasing sales through price discounts. While these activities may improve short-term financial statement performance, they often sacrifice long-term corporate value. Chan et al. (2015) finds that although real earnings management improves short-term company performance, these advantages disappear within three years, supporting the view that real earnings management represents managerial opportunism that ultimately destroys shareholder value.

4. Contextual Factors Influencing Earnings Management

Several unique factors shape earnings management practices among Chinese listed companies, distinguishing them from their Western counterparts. Ownership structure represents a crucial factor, as the concentrated ownership structures prevalent in China create principal-principal agency conflicts that extend beyond traditional principal-agent theory. This concentration requires consideration of both shareholder-manager conflicts and controlling-minority shareholder conflicts, creating more complex dynamics in earnings management decision-making.

Enterprise nature significantly influences earnings management behavior, with state-owned enterprises and private enterprises exhibiting different patterns. Li (2021) demonstrates that non-state-owned enterprises engage more extensively in accrual-based earnings management compared to SOEs, while SOE managers may have material incentives for real earnings management to fulfill governmental political objectives. This distinction reflects the different incentive structures and objectives facing managers in different ownership contexts.

Political connections uniquely influence earnings management behavior among Chinese listed companies. Rong (2018) finds that politically connected companies are more likely to engage in real activities for earnings manipulation compared to non-connected companies, reflecting China's distinctive political-economic environment's influence on corporate behavior. This

political dimension adds complexity to earnings management decisions that is less prevalent in developed Western markets.

Institutional transitions have significantly impacted earnings management behavior among Chinese listed companies. Following IFRS adoption in 2006, Chinese listed companies' earnings management methods shifted significantly from accrual-based to real earnings management as regulatory scrutiny of accounting manipulations increased. Additionally, split-share structure reforms fundamentally altered the incentive structures facing controlling shareholders, influencing their earnings management strategies and creating new dynamics in corporate governance.

5. Policy Implications and Practical Insights

Based on this comprehensive analysis of earnings management and its performance impacts among Chinese listed companies, several critical policy recommendations and practical insights emerge for various stakeholders in the Chinese capital market ecosystem.

Regulatory authorities should enhance existing legal frameworks and strengthen earnings management oversight while recognizing the nuanced nature of these practices. While certain forms of earnings management may serve positive signaling functions in China's information-asymmetric environment, excessive earnings management behaviors damage healthy capital market development. Regulatory improvements should focus on establishing more comprehensive information disclosure systems that enhance financial information transparency and reduce information asymmetries, thereby diminishing earnings management incentives while preserving legitimate signaling mechanisms.

Performance evaluation systems require fundamental reform to avoid over-reliance on single financial indicators. Corporate performance evaluation should comprehensively consider both accounting and market performance measures, focusing simultaneously on current operational efficiency and long-term development potential. Enhanced attention to non-financial indicators such as innovation capacity and social responsibility fulfillment can provide more holistic assessments of corporate value creation and reduce incentives for short-term earnings manipulation.

Corporate management should establish robust value creation frameworks that prioritize long-term sustainability over short-term earnings management. While moderate earnings management may help convey positive market signals in China's developing capital market context, excessive practices ultimately damage long-term corporate value and stakeholder trust. Management should focus on enhancing core competitiveness through improved operational management and technological innovation rather than relying on earnings manipulation for performance enhancement.

Investors should develop sophisticated earnings management identification capabilities and avoid over-reliance on financial statement data in investment decisions. Investment strategies should comprehensively consider corporate fundamentals, industry trends, and macroeconomic environments to make rational investment decisions. Institutional investors should leverage their professional expertise to enhance monitoring of listed companies and promote improved corporate governance standards.

Continued capital market reforms should focus on perfecting market mechanisms through improved delisting systems and enhanced punishment for violations, thereby improving market effectiveness and reducing earnings management opportunities. Encouraging long-term investment horizons and reducing short-term speculation can create better external environments for sustainable corporate development and reduce pressures for earnings manipulation.

6. Conclusion

This comprehensive analysis reveals that earnings management among Chinese listed companies represents a multifaceted phenomenon characterized by distinctive institutional features that differentiate it from practices observed in developed Western markets. The concentrated ownership structures, significant state enterprise presence, unique regulatory environment, and complex political-economic dynamics create a distinctive context where earnings management practices exhibit both similarities to and significant departures from international patterns.

The relationship between earnings management and corporate performance demonstrates remarkable complexity, encompassing both detrimental and potentially beneficial effects depending on the type of earnings management employed and the performance metrics examined. Accrual-based earnings management exhibits a paradoxical dual impact, negatively affecting operational efficiency measures such as ROA while potentially enhancing market valuation measures such as Tobin's Q. This divergence reflects the serious information asymmetries characterizing China's capital markets and suggests that market participants may interpret certain earnings management activities as positive signals rather than purely opportunistic behavior.

Real earnings management demonstrates more consistently negative impacts across various performance indicators, reflecting its fundamental interference with normal business operations and its tendency to sacrifice long-term value creation for short-term financial statement improvements. The increasing prevalence of real earnings management among Chinese listed companies, driven partly by enhanced regulatory scrutiny of accounting manipulations, presents concerning implications for long-term corporate sustainability and market efficiency.

The motivational drivers underlying earnings management in Chinese listed companies reflect the unique institutional environment, encompassing traditional capital market and contractual motivations alongside distinctively Chinese political motivations related to government relationships and policy objectives. This multifaceted motivation structure creates complex decision-making environments where managers must balance various stakeholder expectations and regulatory requirements.

The theoretical frameworks explaining earnings management impacts—agency theory and signaling theory—both provide valuable insights into the Chinese context, though their relative explanatory power may differ from that observed in developed markets. The prevalence of information asymmetries and the developing nature of China's capital markets may enhance the relevance of signaling theory explanations, while concentrated ownership structures and complex agency relationships strengthen the applicability of agency theory perspectives.

Looking forward, the evolving nature of China's capital markets, continuing regulatory reforms, and changing corporate governance practices suggest that earnings management patterns and their performance implications will likely continue evolving. Future research should explore how emerging trends such as digital transformation, ESG considerations, and increasing international integration influence earnings management practices and their effectiveness. As China's capital markets mature and become more efficient, the relative importance of signaling versus agency explanations for earnings management may shift, warranting continued empirical investigation and theoretical development.

Acknowledgement

The authors would like to express sincere gratitude to everyone who contributed, both directly and indirectly, to the completion of this study.

Conflict of Interest Statement

The authors declare that there is no conflict of interest regarding the publication of this study.

References

- Abdelbaky, A., Liu, T., & Mingyang, X. (2024). Real earnings management and ESG performance in China: The mediating role of corporate innovations. **International Journal of Finance & Economics**. Advance online publication.
- Aharony, J., Lee, C. W. J., & Wong, T. J. (2000). Financial packaging of IPO firms in China. **Journal of Accounting Research, 38*(1), 103–126.*
- Akram, N., Iqbal, M. Z., & Usman, M. (2015). Earnings management and firm performance: Evidence from non-financial firms of Pakistan. **Pakistan Journal of Commerce and Social Sciences, 9*(2), 488–499.*
- Al-Shattarat, B., Al-Shattarat, H., & Jebril, I. (2018). Earnings management and firm performance: Evidence from emerging markets. **International Journal of Economics and Financial Issues, 8*(4), 40–50.*
- Attig, N., El Ghouli, S., Guedhami, O., & Suh, J. (2020). Corporate social responsibility and earnings management: The role of political connections. **Journal of Business Ethics, 163*(3), 485–504.*
- Bouaziz, Z., Haddad, M. R., & Majdoub, J. (2020). Earnings management in Islamic and conventional banks: Are the motivations different? **Journal of Islamic Accounting and Business Research, 11*(6), 1275–1293.*
- Chakroun, D., Gana, G., & Bouteina, T. (2022). Earnings management incentives: An exploratory study on Islamic banks. **Journal of Islamic Accounting and Business Research, 13*(5), 675–699.*
- Chan, K. C., Chen, K. C., Chen, T. Y., & Yu, Y. (2015). The effects of real earnings management on the firm's future performance: International evidence. **Journal of Contemporary Accounting and Economics, 11*(3), 219–236.*
- Chen, W. (2024). Environmental regulation and real earnings management—Evidence from the SO₂ emissions trading system in China. **Journal of Accounting and Public Policy**. Advance online publication.
- Cohen, D. A., & Zarowin, P. (2010). Accrual-based and real earnings management activities around seasoned equity offerings. **Journal of Accounting and Economics, 50*(1), 2–19.*
- Dang, N. H., Tran, D. M., & Nguyen, P. L. (2020). Earnings management in Vietnamese firms: An investigation of influences from corporate governance and firm characteristics.

- *Corporate Governance: *The International Journal of Business in Society*, 20*(8), 1413–1435.
- Ding, Y., Zhang, H., & Zhang, J. (2007). Accounting standards and earnings management: Evidence from China. **China Journal of Accounting Research*, 1*(1), 1–30.
- Gao, K., Pittman, J., Wang, X., Xu, L., & Zhao, Y. (2023). Stock market liberalization and earnings management: Evidence from a quasi-natural experiment in China. **Contemporary Accounting Research*, 40*(4), 2547–2576.
- Graham, J. R., Harvey, C. R., & Rajgopal, S. (2005). The economic implications of corporate financial reporting. **Journal of Accounting and Economics*, 40*(1–3), 3–73.
- Gunny, K. A. (2010). The relation between earnings management using real activities manipulation and future performance: Evidence from meeting earnings benchmarks. **Contemporary Accounting Research*, 27*(3), 855–888.
- Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. **Accounting Horizons*, 13*(4), 365–383.
- Ho, L. C. J., Liao, Q., & Taylor, D. (2015). Real and accrual-based earnings management and the performance of Chinese issuers employing foreign accounting standards. **Journal of Accounting and Public Policy*, 34*(3), 284–305.
- Hu, H. (2003). Earnings management in Chinese listed companies. **China Accounting Review*, 1*(1), 1–20.
- Jiraporn, P., Miller, G. A., Yoon, S. S., & Kim, Y. S. (2008). Is earnings management opportunistic or beneficial? An agency theory perspective. **International Review of Financial Analysis*, 17*(3), 622–634.
- Komal, B., Bilal, M., Ezeani, E., Adegbite, E., & Xing, J. (2023). Age diversity of audit committee financial experts, ownership structure and earnings management: Evidence from China. **International Journal of Finance & Economics*, 28*(3), 2664–2682.
- Kuo, J. M., Ning, L., & Song, X. (2014). The real and accrual-based earnings management behaviors: Evidence from the split share structure reform in China. **The International Journal of Accounting*, 49*(1), 101–136.
- Li, W. (2021). Earnings management in state-owned vs. private enterprises in China. **Journal of Chinese Accounting and Finance*, 15*(2), 112–129.
- Li, X. J., Than, E. T., Ahmed, R., & Muneer, S. (2023). Board and executive gender diversity and real earnings management in bull or bear period: Empirical evidence from China. **International Journal of Finance & Economics*, 28*(3), 2753–2771.
- Li, X., & Yao, T. (2019). Goodwill impairment and earnings management in China’s M\&A market. **Journal of International Accounting, Auditing and Taxation*, 35*, 33–45.
- Luo, C. (2010). Earnings management and accounting standards in China. **Accounting Research*, 6*, 65–72.
- Rong, W. (2018). Political connections and earnings management: Evidence from Chinese listed firms. **China Journal of Accounting Research*, 11*(1), 1–26.
- Roychowdhury, S. (2006). Earnings management through real activities manipulation. **Journal of Accounting and Economics*, 42*(3), 335–370.
- Sun, D. (2024). Smart city and earnings management: Evidence from China. **PLOS ONE*, 19*(3), e0301025.
- Sun, W., Chen, S., Jiao, Y., & Feng, X. (2024). How does ESG constrain corporate earnings management? **Finance Research Letters*, 61*, 104350.
- Zhao, Z. (2006). Accrual-based earnings management in China’s capital markets. **Economic Research Journal*, 41*(3), 45–52.