OWNERSHIP CONTROL AND EARNINGS MANAGEMENT OF FIRMS IN CHINA: THE MODERATING ROLE OF ESG PERFORMANCE

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OWNERSHIP CONTROL AND EARNINGS MANAGEMENT OF FIRMS IN CHINA: THE MODERATING ROLE OF ESG PERFORMANCE

by

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TABLE OF CONTENTS

ACKNOWLEDGEMENT .... **ii**

TABLE OF CONTENTS .... **iii**

LIST OF TABLES .... **viii**

LIST OF FIGURES .... **ix**

LIST OF ABBREVIATIONS .... **x**

ABSTRAK .... **xii**

ABSTRACT .... **xiii**

CHAPTER 1 INTRODUCTION **1**

1.1 Introduction 1

1.2 Background of the Study 1

1.2.1 Earnings management in China 3

1.2.2 Ownership Control in China 10

1.2.2(a) Ownership Concentration in China 11

1.2.2(b) Family Ownership in China 12

1.2.3 ESG Performance in China 13

1.2.4 Institutional Background of China 14

1.3 Scope of the Study 16

1.4 Motivation of the Study 18

1.5 Problem Statement 19

1.6 Research Questions 26

1.7 Research Objectives 27

1.8 Significance of the Study 27

1.8.1 Theoretical Contribution 27

1.8.2 Practical Contribution 28

1.9 Definition of Key Terms 29

1.9.1 Earnings Management ... 29
1.9.2 Ownership Control ... 29
1.9.3 Ownership Concentration ... 30
1.9.4 Family Ownership ... 30
1.9.5 ESG Performance ... 30
1.10 Organization of Thesis ... 31
CHAPTER 2 LITERATURE REVIEW ... 32
2.1 Introduction ... 32
2.2 Earnings Management Practices ... 32
2.2.1 Accrual Earnings Management ... 32
2.2.2 Real Earnings Management ... 33
2.3 Underlying Theories of Earnings Management ... 35
2.3.1 Agency Theory ... 35
2.3.2 Stakeholder Theory ... 38
2.3.3 Stewardship Theory ... 40
2.3.4 Legitimacy Theory ... 43
2.4 Empirical Studies on the Earnings Management Determinants ... 45
2.4.1 Ownership Variables ... 45
2.4.1(a) Ownership Concentration ... 45
2.4.1(b) Family Ownership ... 47
2.4.2 ESG Performance ... 49
2.4.3 Firm Characteristics and Board Characteristics ... 53
2.4.3(a) Firm Age ... 54
2.4.3(b) Firm Size ... 55
2.4.3(c) Board Size ... 56
2.4.3(d) Board Independence ... 57
2.4.3(e) CEO Duality ... 58

2.4.3(f) Return on Assets 60

2.4.3(g) Firm Growth 61

2.4.3(h) Management Compensation 62

2.4.4 Literature Discussion 63

2.5 Theoretical Framework 68

2.6 Hypothesis Development 69

2.6.1 Ownership Concentration 70

2.6.2 Family Ownership 71

2.6.3 ESG Performance 72

2.7 Summary 73

CHAPTER 3 RESEARCH METHODOLOGY 75

3.1 Introduction 75

3.2 Research Paradigm 75

3.3 Research Design 77

3.3.1 Sample of the Study 78

3.3.2 Data Collection 79

3.4 Measurement of Variables 82

3.4.1 Dependent Variables 83

3.4.1(a) Real Earnings Management 83

3.4.2 Independent Variables 87

3.4.2(a) Ownership Concentration 87

3.4.2(b) Family Ownership 88

3.4.3 Moderator Variable 89

3.4.4 Control Variables 90

3.4.4(a) Firm Age 91

3.4.4(b) Firm Size 91

3.4.4(c) Board Size 91

3.4.4(d) Board Independence 91

3.4.4(e) CEO Duality 92

3.4.4(f) Return on Assets 92

3.4.4(g) Firm Growth 92

3.4.4(h) Management Compensation 92

3.5 Regression Models 95

3.5.1 Baseline Model 95

3.5.2 Moderator Model 95

3.6 Research Methods 96

3.6.1 Panel Data 97

3.6.2 Static Panel Estimation Methods 97

3.6.3 Selecting the Static Panel Data Model 99

3.6.4 Robust Estimations 101

3.6.5 Dynamic Panel Data Estimations 101

3.7 Summary 105

CHAPTER 4 RESULTS AND FINDINGS 106

4.1 Introduction 106

4.2 Descriptive Statistics 106

4.3 Multicollinearity Tests 113

4.3.1 Correlation 113

4.3.2 Variance Inflation Factor (VIF) Analysis 115

4.4 Regression Results 115

4.4.1 Regression Results for the Effect of Ownership Control on Real Earnings Management 116

4.4.2 Interaction Results on the Relationship between Ownership Control and Real Earnings Management 125

4.5 Robustness Check 130

4.5.1 Regression Results for the Effect of Ownership Control on

Accrual Earnings Management 130

4.5.2 Interaction Results on the Relationship between Ownership Control and Accrual Earnings Management 134

4.5.3 Regression Results Using Alternative Independent Variable of Ownership Control on Real Earnings Management 137

4.5.4 Interaction Results Using Alternative Moderating Variable 139

4.6 Discussions of Findings 141

4.7 Summary 144

CHAPTER 5 CONCLUSION 145

5.1 Introduction...145

5.2 Recapitulation 145

5.3 Implications of the Study 148

5.3.1 Theoretical Implications 148

5.3.2 Practical Implications... 149

5.4 Limitations of the Study..151

5.5 Suggestions for Future Studies 152

5.6 Conclusion 153

REFERENCES 156

LIST OF TABLES

Page

Table 3.1 Sample Selection and Distribution ... 81

Table 3.2 Summary of Variables Measurement ... 93

Table 4.1 Descriptive Statistics of the Continuous Variables ... 107

Table 4.2 Descriptive Statistics for the Dummy Variables ... 108

Table 4.3 Pearson Correlation Matrix ... 114

Table 4.4 Variance Inflation Factors ... 115

Table 4.5 Regression Results of the Static Panel on the Relationship between Ownership Control and REM (control variables only) ... 117

Table 4.6 Regression Results of the Static Panel on the Relationship between Ownership Control and REM ... 119

Table 4.7 Regression Results of the Dynamic Panel on the Relationship Between Ownership Control and REM ... 122

Table 4.8 Interaction Results on the Relationship between Ownership Control and REM ... 129

Table 4.9 Regression Results of the Dynamic Panel on the Relationship Between Ownership Control and AEM ... 134

Table 4.10 Interaction Results on the Relationship between Ownership Control and AEM ... 136

Table 4.11 Regression Results Using Alternative Independent Variable of Ownership Control on REM ... 138

Table 4.12 Interaction Results Using Alternative Moderating Variable ... 140

Table 5.1 Hypothesis and Result ... 147

LIST OF FIGURES

Page

Figure 1.1 Earnings Management in Various Countries 21

Figure 2.1 Type of Agency Problem 36

Figure 2.2 Theoretical Framework of Earnings Management 69

LIST OF ABBREVIATIONS

AEM	Accrual Earnings Management
AIIB	Asian Infrastructure Investment Bank
AMID	Administrative Measures on Information Disclosure
BIND	Board Independence
BRI	Belt and Road Initiative
BSIZE	Board Size
CSR	Corporate Social Responsibility
CSRC	China Securities Regulatory Commission
CSMAR	China Stock Market and Accounting Research
DA	Discretionary Accruals
ESG	Environmental, Social, and Governance
FAGE	Firm Age
FE	Fixed Effect
FO	Family Ownership
FSIZE	Firm Size
GAAP	Generally Accepted Accounting Principle
GMM	Generalized Method of Moments
GROWTH	Firm Growth
IFRS	International Financial Reporting Standards
IPOs	Initial Public Offerings
MCOM	Management Compensation
MSCI	Morgan Stanley Capital International
OC	Ownership Concentration
OLS	Ordinary Least Square
POLS	Pooled Ordinary Least Square
RE	Random Effect
REM	Real Earnings Management
ROA	Return on Assets
ROE	Return on Equity
SEC	United States Securities and Exchange Commission
SOEs	State-Owned Enterprises

SRI	Socially Responsible Investment
ST	Special Treatment
UNEP FI	United Nations Environment Programme Finance Initiative
VIF	Variance Inflation Factor

KAWALAN PEMILIKAN DAN PENGURUSAN PENDAPATAN FIRMA-FIRMA DI CHINA: PERANAN PENYEDERHANAAN PRESTASI ESG

ABSTRAK

Pertumbuhan ekonomi China yang pesat menekankan kepentingan tadbir urus korporat, namun pengurusan pendapatan masih berleluasa, terutamanya dalam firma-firma dengan kawalan pemilikan. Walaupun kajian-kajian terdahulu sebahagian besarnya mengkaji konflik agensi Jenis I antara pengurus dan pemilik, konflik Jenis II antara pemegang saham mengawal dan minoriti masih kurang diterokai. Kajian ini mengkaji bagaimana pemusatan pemilikan dan pemilikan keluarga mempengaruhi pengurusan pendapatan di firma-firma tersenarai di China dan meneroka peranan penyederhana prestasi Alam Sekitar, Sosial, dan Tadbir Urus (ESG). Dengan merujuk kepada teori agensi Jenis II untuk menjelaskan insentif bagi pengurusan pendapatan dan teori pihak berkepentingan untuk mentafsir peranan kekangan ESG, analisis ini menggunakan 26,449 pemerhatian firma-tahun daripada pangkalan data CSMAR dan Huazheng ESG (2012–2022). Penganggar Sistem GMM dua langkah digunakan untuk menangani kebimbangan endogeniti. Hasil kajian menunjukkan bahawa kedua-dua pemusatan pemilikan dan pemilikan keluarga mempunyai kaitan positif dengan tahap pengurusan pendapatan sebenar yang lebih tinggi, manakala prestasi ESG secara signifikan melemahkan hubungan ini. Dapatan ini mencadangkan bahawa prestasi ESG dapat mengurangkan risiko tadbir urus yang berkaitan dengan kawalan tertumpu. Kajian ini menawarkan implikasi kepada pengawal selia dalam mempromosikan ESG sebagai alat pelengkap tadbir urus, kepada pelabur dalam menilai risiko tadbir urus, dan kepada firma untuk mengukuhkan kepercayaan pihak berkepentingan.

OWNERSHIP CONTROL AND EARNINGS MANAGEMENT OF FIRMS IN CHINA: THE MODERATING ROLE OF ESG PERFORMANCE

ABSTRACT

China's rapid economic growth underscores the importance of corporate governance, yet earnings management remains prevalent, particularly in firms with ownership control. While prior studies have largely examined Type I agency conflicts between managers and owners, Type II conflicts between controlling and minority shareholders remain underexplored. This study examines how ownership concentration and family ownership affect earnings management of listed firms in China and explores the moderating role of Environmental, Social, and Governance (ESG) performance. Drawing on Type II agency theory to explain the incentives for earnings management and stakeholder theory to interpret ESG's constraining role, the analysis uses 26,449 firm-year observations from the CSMAR and Huazheng ESG databases (2012–2022). A two-step System GMM estimator is applied to address endogeneity concerns. Results show that both ownership concentration and family ownership are positively associated with higher levels of real earnings management, while ESG performance significantly weakens these relationships. These findings suggest that ESG performance can mitigate the governance risks associated with concentrated control. The study offers implications for regulators in promoting ESG as a complementary governance tool, for investors in assessing governance risks, and for firms to strengthen stakeholder trust.

CHAPTER 1

INTRODUCTION

1.1 Introduction

This chapter introduces the study and presents a detailed background, the scope, the motivation, the contributions, and the problem statement related to earnings management. This chapter also includes research questions and research objectives. This chapter begins by addressing some of the background for earnings management.

1.2 Background of the Study

The empirical study of earnings management emerged during the 1980s. Schipper (1989) postulates that earnings management is the strategic disclosure of financial information by corporate executives, tailored to procure personal gains. Scott (1997) explains that earnings management encompasses the economic consequences arising from a corporation's thoughtful selection of different accounting policies. Healy and Wahlen (1999) indicate that due to information asymmetry between a company's internal and external personnel, imperfect auditing systems, and differing accounting principles for accrued profits, management can manipulate earnings in financial reports for personal gain or transmit private information to related parties. This is known as earnings management (Haga et al., 2015).

According to Berle and Means (1932), publicly traded companies in the US have dispersed ownership structures with highly distinct ownership and control stakes. This creates an agency issue involving managers and external shareholders (Jensen & Meckling, 1976). In contrast to the U.S., the ownership of publicly listed companies in many other nations tends to be concentrated within families or government entities (Gao & Yang, 2021).

When family members control family enterprises, ownership and management roles are often not fully separated (Bin-Feng et al., 2022). Family companies are crucial to economic activity and have a significant impact on world economies (Chrisman et al., 2015). According to Flynn and Duesing (2020), family-owned or operated businesses account for 70–90% of all businesses worldwide and are crucial to the overall economic development of a nation.

Environmental, social, and corporate governance (ESG) serves as a crucial indicator of a company's commitment to sustainability, broadening the idea of socially responsible investment (SRI) (Nekhili et al., 2021). The United Nations Environment Programme Finance Initiative (UNEP FI) advocated in 1992 that companies should evaluate environmental, social, and governance aspects before making investment decisions. Since that time, the usage of ESG data in business investment choices has grown (Leins, 2020). Conversely, the rise of green initiatives has led to a growing number of companies accepting ESG evaluations from rating agencies (Tan & Zhu, 2022). Leading international rating agencies, such as MSCI, Bloomberg, and Standard & Poor's, have developed ESG rating systems to provide objective and scientific assessments of companies' ESG performance. (Yu et al., 2018).

ESG ratings are endorsed by trusted third-party agencies, as well as administrations and financial organizations that advocate for socially responsible investment (Aouadi & Marsat, 2018), and they also convey a positive message about a company's reputation to the capital market (Limkriangkrai et al., 2017). In addition to reducing budgetary limitations and reducing information asymmetries, ESG ratings can also communicate to external stakeholders the management's views on green investments (Tan & Zhu, 2022). A stakeholder is a group that incurs some level of risk as a result of investing various forms of capital, be it human or financial, in a business (Clarkson, 1995).

1.2.1 Earnings management in China

Earnings management is a global phenomenon, yet its prevalence, form, and underlying motivations vary significantly across different institutional and economic contexts. In developed markets, such as the United States and the United Kingdom, where ownership is typically dispersed, earnings management is often driven by Type I agency conflicts. Managers, motivated by capital market pressures to meet earnings forecasts and by performance-based compensation schemes, may engage in opportunistic reporting to maximize their personal utility at the expense of shareholders (Beyer et al., 2019). The robust regulatory frameworks and high litigation risk in these jurisdictions, however, act as significant deterrents.

In contrast, many emerging markets, much like China, are characterized by concentrated ownership structures, typically within families or institutional blockholders. In these settings, the primary driver of earnings management shifts to Type II agency conflicts, where controlling shareholders have both the incentive and the power to expropriate wealth from minority shareholders (Bao & Lewellyn, 2017). For instance, studies on Indian family firms have shown that controlling families may manipulate earnings to conceal related-party transactions or to maintain control (Bansal, 2021). Similarly, research in Brazil indicates a strong link between ownership concentration and the likelihood of earnings manipulation, exacerbated by weaker investor protection mechanisms (Sousa & Galdi, 2016).

The Chinese context, which is the focus of this study, presents a unique blend of these dynamics. It shares the characteristic of concentrated control with other emerging economies, making the Type II agency problem particularly acute (Guo & Ma, 2015). However, it is also distinguished by a unique institutional backdrop, including the significant influence of state ownership and a rapidly evolving, state-driven regulatory landscape.

As the world's largest emerging economy, China plays a significant role in the global market, it is also expanding quickly (Su et al., 2008). Geng and Tan (2021) indicate that, as of the end of 2018, the Wind database showed that 1,483 firms in China were listed overseas, while 3,626 companies in China were listed on the A-share market. However, China's market, like that of other emerging nations, is characterized by significant information asymmetry in the capital market, a corporate governance framework that is still developing, and inconsistent legislative enforcement (Jiang & Kim, 2024).

China's economic restructuring has led to the corporatization of enterprises and listing on stock exchanges, making the market the sixth largest globally, raising research questions about accounting numbers' usefulness (Lennox & Wu, 2022). According to Yu (2023), earnings management typically occurs in China before going public when confronted with the risk of delisting or before rights issues.

Earnings management is the practice of managers influencing other stakeholders by manipulating reported earnings that serve their own interests (Healy & Wahlen, 1999). The opportunistic earnings management at Enron and Worldcom led to some of the largest bankruptcies in American history, leading the public to believe that executives benefit themselves at the expense of shareholders (Jiraporn et al., 2008). Similarly, an increasing body of literature, including publications by Pan et al.

(2022), and Qiu and Zhang (2023), has produced empirical evidence indicating that earnings management is widespread in China's listed corporations.

In China, the problem of earnings management is fundamentally a problem of the market's institutional structure (Habib et al., 2022). It has been established that companies in China frequently manipulate their earnings statistics through non-operating transactions with related parties or tunneling, which refers to the transfer of assets and profits out of a firm for the benefit of its controlling shareholders, in addition to accrual procedures (Ding et al., 2007; Aharony et al., 2010). The strong supervision found in the U.K. and U.S. markets, as suggested by Ball and Shivakumar (2006), does not apply to the Chinese market, resulting in Chinese issuing corporations practicing earnings management. According to Yang et al. (2022), China's legislation and institutions are immature, with poor corporate governance processes, inefficient law enforcement due to a lack of an efficient court system, and problematic accounting systems. Piotroski and Wong (2012) claim that China's securities regulatory commission's weak enforcement, institutional investors and sell-side analysts' restricted engagement, and heavily regulated media and internet all contribute to China's reputational penalty for earnings management is rather small.

In 2004, the Chinese government revised company law and securities regulations to strengthen corporate governance and protect the rights of minority shareholders (Feinerman, 2007). These laws empower minority shareholders to initiate legal proceedings against dominant shareholders, prevent resource divergence, deter misconduct, and impose fines and punishments (Jiang et al., 2020). Consequently, when the rights of minority shareholders are violated, board members of listed companies, as well as the controlling shareholder and other significant owners, are frequently subject to financial penalties as well as public censure (Chen et al., 2005).

However, the regulatory landscape has undergone substantial transformation in the past decade, culminating in the landmark revision of the Securities Law in 2020. This new legislation significantly increased the penalties for financial fraud and strengthened disclosure requirements, signaling a new era of stricter oversight (Chan et al., 2021). The China Securities Regulatory Commission (CSRC) has intensified its enforcement actions, leading to a marked increase in the legal and financial costs of accounting misconduct (Pan et al., 2022). Despite these significant regulatory advancements, the underlying incentives for earnings management persist, driven by pressures to meet performance targets or secure financing (Qiu & Zhang, 2023).

Firms in China frequently engage in earnings management to meet regulatory requirements and accounting criteria for share issuance (Cui et al., 2021). Earnings management in China typically occurs when corporations do their initial public offerings (IPOs), and it also occurs during secondary issuances or rights offerings by listed companies (Yu, 2023). Many publicly traded companies secure authorization for rights offerings through earnings management, resulting in inferior performance compared to those that do not engage in these practices. This suggests that regulators might enhance the allocation of capital resources by scrutinizing earnings management; however, their limited resources prevent them from closely monitoring all applicants (Bhatti et al., 2022).

According to Chen et al. (2021), the magnitude of discretionary accruals (DA) in listed firms in China, as determined by the modified cross-sectional Jones model (Dechow et al., 1995), was fairly high between 2001 and 2016, with an average value of 0.041. This suggests that earnings management is significantly prevalent among firms in China. Because China's capital market is not yet mature, and there is a large degree of information asymmetry, the phenomena of earnings management have always existed (Yu, 2020). According to Ding et al. (2007) and Aharony et al. (2010), companies in China regularly inflate their earnings through the use of tunneling, non-operating transactions with related parties, and accrual procedures. Lin and Wu (2014) find that in emerging markets, managers within corporations have a heightened incentive to adjust earnings compared to those in developed markets.

Since obtaining a listing qualification in China is rather difficult, earnings management is quite common (Li et al., 2011). If losses continue, firms that have received "Special Treatment" (ST) —a designation imposed by Chinese stock exchanges on listed companies with financial abnormalities, most commonly triggered by two consecutive years of net losses— may have their listing qualification suspended or terminated (Li et al., 2020). Since current regulations focus on earnings, ST companies that are unable to rapidly enhance their operations but still want to remain listed are driven to manipulate their earnings significantly (Ding et al., 2007; Jiang & Wang, 2008; Du et al., 2018). According to Cui et al. (2021), in order to prevent a loss, listed companies in China frequently adopt the earnings management method. The empirical results of Qiu and Zhang (2023) indicate that firms that are protected from the risk of delisting engage in more stringent earnings management than companies that have faced delisting. On the other hand, the fraction of public firms in China that participate in big bath is significantly higher than in the US, with the vast majority of companies that generate losses using this strategy to prevent delisting, particularly those with the lowest accrued profits (Li et al., 2011).

Since accounting numbers serve as important performance indicators for reward contracts in China, managers have significant motivation to distort earnings (Jin et al., 2023). A large amount of the earnings management activities for listed companies in China can also be explained by agency conflicts between majority and minority shareholders (Yang et al., 2022). According to Aharony et al. (2010), the practices of tunneling and propping by the largest shareholder have a notable influence on corporate earnings in China. While tunnelling involves transferring resources out of the firm, propping is the opposite mechanism, where controlling shareholders inject resources into the firm, typically to support its financial performance and avoid violating regulatory thresholds.

Regulatory limitations in China also play a significant role in making earnings management more prevalent. The China Securities Regulatory Commission (CSRC) has amplified the relevance of profit management by requiring firms to fulfill particular standards, the previous year's return on equity (ROE) and ROE thresholds of 0%, 6%, and 10%, which companies must meet to obtain approval for an IPO or additional share issuance (Dong et al., 2020). As a result, many businesses declare ROEs that are marginally higher than the required levels. Enterprises governed by the state may also resort to manipulating earnings to boost their likelihood of approval for initial public offerings (IPO) (Yu, 2023). As the ultimate owners, the local governments may also offer subsidies to boost corporate earnings above specific legal criteria for financing (Lu et al., 2023).

Regarding real earnings management in China, Chen et al. (2008) provide evidence that the country routinely uses real activities to manage revenues. They underline that due to the stringent nature of rule-based accounting standards, earnings management through the choice of accounting methods and discretionary accruals is infrequent in China. According to Kuo et al. (2014), listed companies in China increased their real profits management activities in the wake of the share split reform conducted during the years 2005 to 2007. China switched to principle-based accounting rules in 2006 after IFRS was adopted there.

According to Liu et al. (2011), while AEM is typically easier to practice yet more susceptible to discovery, it has steadily been overshadowed by actual earnings management, which carries a lower risk of detection, among listed companies in China.

Szczesny et al. (2008) state enterprises in China that are in trouble of failing to meet a regulatory performance level involve themselves in considerably more genuine earnings management efforts. In 2006, according to Ho et al. (2015), listed companies in China began using less obvious and less scrutinized real activity manipulation to manage rising earnings. Similarly, Kuo et al. (2014) investigate the Chinese split share structure reform find that as the application of discretionary accruals is curtailed, companies begin to engage in less transparent and under-examine real activities manipulation.

Firms in China manipulate earnings through various expense categories. For example, they might capitalize interest costs, use buildings without depreciation, or alter depreciation techniques. This is possible because the Chinese Generally Accepted Accounting Principle (GAAP) permits adjustments for economic changes, even though tax law forbids them (Noronha et al., 2008). Chinese GAAP allows companies to manipulate depreciation methods to reflect economic conditions, while tax law prohibits such changes, allowing companies to manipulate reported earnings while maintaining tax expense and cash flow (Tang & Firth, 2012). Also, managers in China manipulate earnings by focusing on administrative expenses, reclassifying ledgers, and selling promotional and advertising expenses to lower tax and promotional costs (Rehman et al., 2024).

Based on the literature, the list of 11 techniques or accruals for companies in China includes adjusting accounts receivables, gains or losses from disposals, construction in progress, changing depreciation methods, adjusting other revenues and gains, adjusting investment operations, related party transactions, operating revenue, government subsidies, administrative expenses, promotional expenses, and advertising expenses (Noronha et al., 2008).

1.2.2 Ownership Control in China

The central independent variable in this thesis is ownership control, a concept that is pivotal to understanding corporate governance and its consequences, particularly in emerging markets like China. Unlike the broader term "ownership structure" which encompasses a wide array of shareholder types and their holdings, "ownership control" specifically refers to the concentration of power that enables certain shareholders to exert decisive influence over a firm's strategic decisions and operational policies. This control is the primary conduit for the Type II agency problem, where the interests of dominant, controlling shareholders may diverge from those of minority shareholders (Chen et al., 2014).

In the academic literature, ownership control is conceptualized and measured through several dimensions, such as ownership concentration, managerial ownership, family ownership, institutional ownership. Given the specific context of China, where the corporate landscape is characterized by highly concentrated shareholdings and the significant presence of family-run enterprises, this study deliberately focuses on two of the most direct and powerful mechanisms of ownership control: ownership concentration (OC) and family ownership (FO).

1.2.2(a) Ownership Concentration in China

Unlike in the United States, the ownership of publicly listed companies in many other countries is not widely distributed and is frequently concentrated in the hands of a family or the government (Gao & Yang, 2021). In terms of the impact of ownership control, listed enterprises in China have concentrated ownership (Dong et al., 2020). When ownership is concentrated, agency conflicts between large and small shareholders become a serious concern, as controlling shareholders may maximize their private benefits at the expense of minority shareholders (Nashier & Gupta, 2023).

The development of China’s ownership structure can be traced back to the early 1990s, when the Chinese government initiated the establishment of a stock market as part of a partial privatization strategy. The goal was to help state-owned enterprises (SOEs) obtain funding and improve performance (Wang et al., 2004). During this period, the government maintained significant control over listed SOEs, while allowing a portion of shares to be publicly traded. In the following years, especially with the rise of the private sector, more family-owned firms entered the capital market, and founders often retained large controlling stakes even after listing (Fan & Wong, 2002).

Despite the gradual evolution of market institutions, ownership concentration has remained a persistent feature of listed firms in China. From 2011 to 2021, the average shareholding ratio of the largest shareholder in listed enterprises in China was 37.60%, indicating that ownership control in China's listed companies is remarkably concentrated (Wang et al., 2025). Studies also reveal that in many firms, the largest shareholder or group may hold more than 60 percent of the total shares, reinforcing the dominance of controlling owners (Liu et al., 2016).

Although reforms such as the split-share structure reform have encouraged greater share liquidity, significant ownership control by single entities continues to affect corporate governance dynamics. Controlling shareholders often retain decision-making authority, which can have implications for agency conflicts and financial reporting practices (Jiang & Kim, 2015).

The ownership concentration greatly affects the capital structure and governance of these firms because it can influence fundamental agency incentives (Booth et al., 2001). Controlling shareholders often siphon off wealth from minority shareholders through self-dealing transactions. These include intercorporate loans, using company assets as collateral for loans to affiliated firms, and transferring assets to related entities at favorable prices (Berkman et al., 2009; Jiang & Kim, 2015). According to Jiang et al. (2010), such actions considerably worsen corporate performance and reduce valuation in China.

1.2.2(b) Family Ownership in China

According to Liu et al. (2015), family businesses in China have distinctive characteristics and institutional frameworks that differentiate them from state-owned firms. Since the start of opening-up policies, China has seen a significant rise in privately owned family businesses, with family companies accounting for 49% of privately owned companies that are listed on the Chinese capital market (Liu et al., 2015). Over 80% of companies in China, including 55.7% of those with A-share listings, are family enterprises, accounting for over 60% of China's total GDP (Zhao & Wu, 2022). Family enterprises have grown over the years, making substantial contributions to the country's economy. Until 2021, they accounted for 80-90% of all jobs in China (Bin-Feng et al., 2022).

According to Jiang et al. (2010), in practice, China's legal system is weak and gives minority shareholders fewer options for pursuing private enforcement actions against the misconduct of block holders, while public enforcement options such as fines and prison sentences for tunneling are limited by the weak authority of securities market regulators. All of these factors increase the risk of tunneling by controlling shareholders. Before the non-tradable share reform, this issue was exacerbated by prevalent excess control rights and the division of shares (Liu & Tian, 2012).

1.2.3 ESG Performance in China

China has prioritized creating an eco-friendly economy after decades of rapid economic growth (Sun et al., 2023). As the world's biggest emerging economy, China’s rapid economic growth has resulted in significant environmental issues. A third of the world's greenhouse gases and 27% of its carbon dioxide are produced in China (Lewis, 2015). China is well aware of the environmental and social problems that are emerging as a result of its economic shift (Wang et al., 2018). According to Zheng et al. (2023), high ESG firms can compensate for socially responsible practices by gaining the trust of stakeholders through their reputation for honoring implicit contracts.

According to Tan and Zhu (2022), China has focused heavily on ESG ratings since 2015, viewing them as a manifestation of corporate-level sustainable development ideals. In September 2020, President Xi stated that China would achieve peak carbon emissions by 2030 and carbon neutrality before 2060 (Shu & Tan, 2023). China will need a significant resource shift and new technologies to cut emission levels, improve energy efficiency, and increase resource productivity in order to meet peak carbon emissions and achieve carbon neutrality goals (Sun et al., 2023).

Due to the differences in business philosophy and culture between China and Western developed nations, the existing global ESG rating system fails to effectively identify suitable criteria for companies in China (Tan & Zhu, 2022).

Since 2015, SynTao Green Finance has been a leading unbiased third-party institution and a prominent supplier of ESG data for companies in China. It is a credible green finance and social investing service that gives annual ESG ratings on the listed firms it chooses as targets (Qiang et al., 2023). It has evolved into a critical indicator for investors, assisting them in allocating capital and supporting a company's long-term development. It has covered all companies on the Shanghai and Shenzhen 300 Index since 2015 and all companies on the Smallcap 500 Index since 2018 (Wang et al., 2023). Furthermore, it functions as a reference for financial institutions to analyze the potential gains and market opportunities resulting from corporate green innovation in China (Tan & Zhu, 2022).

1.2.4 Institutional Background of China

Understanding the dynamics of ownership control, earnings management, and ESG performance in China requires an appreciation of its unique and rapidly evolving institutional environment. This section outlines the key developments in China's capital market, corporate governance regulations, the regulatory stance on financial irregularities, and the recent push for ESG integration.

China's modern capital market, established in the early 1990s, was initially designed to facilitate the fundraising and reform of State-Owned Enterprises (SOEs). This origin led to a market structure historically dominated by concentrated state ownership (Ji, 2022). A pivotal moment in corporate governance reform was the non-tradable share reform, completed around 2007, which aimed to align the interests of controlling and minority shareholders by making all shares tradable. Despite this and other reforms, concentrated ownership, whether by the state or by families in privatized firms, remains a defining characteristic of the landscape (Lennox & Wu, 2022).

The primary regulatory body overseeing the capital market is the China Securities Regulatory Commission (CSRC). The CSRC, along with the Shanghai and Shenzhen Stock Exchanges, sets the listing rules and corporate governance codes. A key milestone was the issuance of the Code of Corporate Governance for Listed Companies in 2001, which was subsequently revised in 2018 (Alshbili et al., 2019). These codes introduced requirements for board independence and the establishment of audit committees, yet de facto power often remains with controlling shareholders, which makes the Type II agency problem a persistent challenge (Jiang & Kim, 2015).

The CSRC has progressively tightened its stance on financial irregularities and earnings management. Historically, enforcement was considered less stringent compared to developed markets. However, the regulatory environment has shifted dramatically, particularly with the implementation of the revised Securities Law in 2020 (Zeng, 2022). This legislation introduced some of the world's harshest penalties for financial fraud, including significantly higher fines for both the company and responsible individuals, and strengthened the legal framework for investor lawsuits (Chan et al., 2021). This policy has increased the risks of blatant accrual-based earnings management, compelling firms to seek more subtle methods that are more difficult to detect, such as real activities earnings management (REM) (Dong et al., 2020).

The integration of ESG factors into China's corporate and investment landscape is a more recent but powerful development, driven by top-down policy initiatives. The push for ESG is a core component of China's national strategy to achieve high-quality, sustainable development, including its ambitious goals of peaking carbon emissions by 2030 and achieving carbon neutrality by 2060 (Zhang et al., 2024). The CSRC has played a crucial role in this process. In 2018, the commission revised its governance code to encourage, but not yet mandate, ESG information disclosure. Subsequently, stock exchanges have issued guidelines for specific industries to disclose ESG information (Li et al., 2024). Recently, the CSRC is actively working towards establishing a mandatory ESG disclosure framework for all listed companies, moving from a voluntary to a regulated system (Shu & Tan, 2023). This policy momentum has led to a rapid increase in the demand for and supply of ESG data and ratings from third-party providers like SynTao Green Finance and Huazheng, which are tailored to the Chinese context (Tan & Zhu, 2022). This evolving institutional pressure makes ESG performance an increasingly material factor for firms in China.

1.3 Scope of the Study

This research focuses on the interplay between ownership control and earnings management in China, motivated by three significant reasons. First, agency problems in emerging economies are exacerbated by weak legal protections and governance mechanisms. This is particularly true in China, where the legal environment lags behind that of the US and other developed nations, making the study of these dynamics crucial (Dong et al., 2020). This research focuses specifically on the concept of ownership control and its influence on earnings management in the Chinese context. The choice to examine ownership control, rather than the broader concept of ownership structure, is deliberate. It allows for a targeted investigation into the Type II agency problem, which arises from conflicts between controlling shareholders and minority shareholders. This type of conflict is particularly pronounced in China and many other emerging markets where corporate ownership is highly concentrated (Yang et al., 2022; Lennox & Wu, 2022).

Consequently, this study concentrates on ownership concentration (OC) and family ownership (FO) as they are the primary mechanisms through which ownership control is exercised. These two dimensions directly represent the power of dominant shareholders to exert significant influence over corporate policies, including financial reporting practices. Other forms of ownership, such as managerial or institutional ownership, are more frequently analyzed through the lens of Type I agency theory (Pei, et al., 2016; Kapoor & Goel, 2025), which addresses the separation of ownership and management. While important, the Type I agency problem is a different theoretical puzzle and thus falls outside the specific scope of this thesis, which is dedicated to understanding the principal-principal conflict inherent in concentrated control structures.

Second, significant evidence demonstrates that earnings management is prevalent in firms operating in China (Li et al., 2023; Qiu & Zhang, 2023; Ma & Ma, 2024), scarce empirical evidence exists on the relationship between ownership control and earnings management in China.

Finally, China has made significant economic progress over four decades since the late 1970s, with technology-intensive and innovative companies playing a crucial role in industrialization and maintaining its global economic competitiveness, highlighting its significant growth potential (Shah & Wan, 2024). Furthermore, the establishment of the Asian Infrastructure Investment Bank (AIIB) and the Belt and Road Initiative (BRI) has attracted foreign investors, financial institutions, and multinational businesses (Man, 2021).

The scope of this study is confined to listed companies in China, and the analysis is framed by the Type II agency problem. This thesis evaluates how ownership concentration and family ownership influence earnings management. Additionally, this thesis looks into the moderating effect of ESG performance on the relationship between ownership control and earnings management.

The sample period for this thesis is 2012-2022. This period was chosen to ensure data consistency under the new accounting standards adopted in 2007 (Li et al., 2020). The ownership and financial data utilized in this study are sourced from the China Stock Market and Accounting Research (CSMAR) database. The ESG ratings used in this analysis come from Huazheng, which is the largest ESG rating database for listed firms in China (Mu et al., 2023). The final sample consists of 26,449 firm-year observations.

1.4 Motivation of the Study

A significant body of literature on earnings management addresses agency conflicts (Franzoi et al., 2021). Agency conflicts between majority and minority shareholders account for a substantial amount of earnings management among listed corporations in China (Gu et al., 2024). The tunneling activities and propping activities of the biggest shareholder in China have a significant impact on company earnings (Bian et al., 2023).

The ESG framework, on the other hand, is based on early CSR research that developed from stakeholder theory (Saygili et al., 2022). While CSR emphasizes voluntary corporate responsibility, ESG provides a measurable and investor-oriented framework that captures a firm's environmental, social, and governance practices (Zheng & Bu, 2024). Zhang et al. (2021) suggest that CSR activities constrain earnings management: socially responsible companies tend to have stronger financial reporting, use fewer atypical discretionary accruals, and engage in less real activity manipulation.

Building on previous research, this study explores how ownership control may affect earnings management in China, specifically focusing on both ownership concentration and family ownership. Additionally, the role of ESG performance in reducing corporate earnings management behaviors has been investigated. ESG performance refers to a firm's practices and outcomes in the areas of environmental responsibility, social impact, and corporate governance, and has become a key indicator of sustainable and ethical business conduct (Mingqiang et al., 2024). However, whether ESG performance can moderate this relationship remains underexplored in the existing literature. Therefore, the primary goal of this study is to assess whether ESG performance can moderate the relationship between ownership concentration, family ownership, and earnings management in publicly listed companies in China.

1.5 Problem Statement

Earnings management is a short-sighted activity because it prioritizes short-term financial outcomes over long-term sustainability. Managers may manipulate earnings to meet market expectations or performance targets, even if such practices compromise the firm’s future financial health, transparency, or stakeholder trust (Eloff & Steenkamp, 2022). A significant body of research has emerged in the field of earnings management, with one area concentrating on its outcomes (Brennan, 2021; Ning & Lin, 2023). Financial reporting is an important instrument for representing a company's financial health and providing information that influences investor decisions (Alawadi & Rashid, 2023). In contrast, earnings management significantly compromises the integrity of financial statements, harms the interests of minority shareholders, obstructs the effective allocation of resources in the securities market, and can even erode investor confidence in the Chinese stock market (Fushun, 2018). Disclosing figures that misrepresent a company's actual financial situation can undermine trust in managers' honesty and undermine trust in markets and institutions, all of which can have far-reaching effects on society worldwide (Demaline, 2023).

There are numerous instances of earnings management in China. This practice seriously undermines the validity and reliability of financial statements, harms corporate reputations, and causes investors to lose confidence in the company, which has an impact on the company's future growth (Yu, 2020). Earnings management significantly reduces the trustworthiness of listed companies in China (Ning & Lin, 2023). According to Tsai (2012), earnings management operations are also common in corporations in China where managers manipulate earnings to match regulatory benchmarks and accounting criteria in order to be granted a license to issue shares. Several firms, including Letv, Geeya Technology, and Zoneco Group, have been exposed for engaging in such practices, resulting in severe consequences for investors (Fushun, 2018; Mo, 2020; Zeng et al., 2021). A prominent example is the Letv scandal, where the company inflated revenues and profits from 2007 to 2016 to meet IPO requirements and attract further financing. Regulatory investigations revealed systematic earnings manipulation and fraudulent reporting. The company was eventually delisted, its founder was fined, and investors faced substantial losses (Fushun, 2018).

To contextualize the severity of earnings management in China from an international perspective, this study compiles a comparative figure based on the comprehensive analysis conducted by He et al. (2017). In their research, they investigated the degree of earnings management across 27 countries by measuring the absolute values of abnormal accruals, using a substantial dataset spanning the period from 1990 to 2010. Figure 1.1 visually represents these findings to highlight the relative position of China among its global peers.

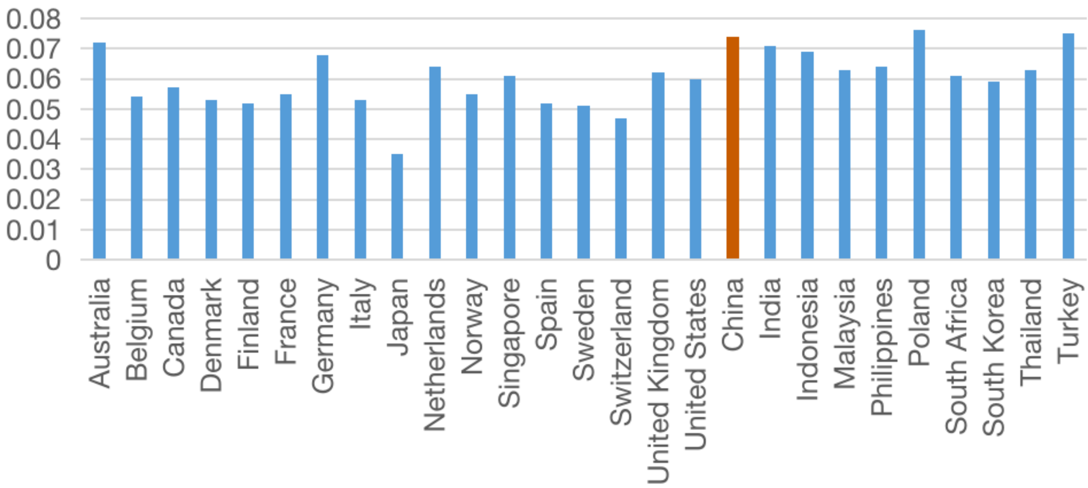

Figure 1.1 Earnings Management in Various Countries

As illustrated in Figure 1.1, among all 27 countries included in the sample, the situation of earnings management in China is particularly significant. The metrics indicate that its severity is worse than in most other nations, ranking only after Turkey and Poland in this analysis. While the data from He et al. (2017) provides a crucial historical baseline, this issue remains highly relevant. More recent studies, such as

Wang et al. (2022), continue to point out that earnings management is prevalent in China, contributing to financial fraud and impeding sustainable economic growth. This underscores the enduring nature of the problem that this thesis seeks to address.

According to the research of the 21st Century Business Herald, when faced with a deterioration in corporate performance, over 80% of publicly traded enterprises in China are accused of engaging in certain types of earnings control activities (Li et al., 2021). Accounting earnings are used by investors to evaluate a company's performance, and the accounting environment in China is notoriously opaque at best. Consequently, publicly listed companies in China have strong motivations to manipulate earnings to secure funding and retain their listing status (Wang et al., 2023; Qiu & Zhang, 2023).

To raise the standard of disclosures among listed companies, the Chinese government has introduced various accounting regulations (Chan et al., 2021). The adoption of International Financial Reporting Standards (IFRS) in China has had significant economic implications. This shift was prompted by the Ministry of Finance's issuance of new accounting standards in 2006, which have since largely converged with IFRS, highlighting the importance of accounting research in this area (Ho et al., 2015). According to Wang and Wu (2011), China's 2006 new accounting standards, which introduced fair value measurement and revised the reporting of minority interests by classifying them as part of shareholders’ equity and including their profit and loss in the consolidated income statement, have improved earnings transparency. In 2007, the China Securities Regulatory Commission (CSRC) issued Administrative Measures on Information Disclosure (hereafter, AMID) by listed companies. According to Gong and Marsden (2014), following the post-2007 AMID reforms, non-periodic price-sensitive announcements by listed companies in China...

increased, suggesting increased information disclosure for market fairness and reducing information asymmetry.

As Hou et al. (2015) point out, firms in China that engage in earnings management to achieve targets may show reduced performance later on, potentially leading to losses for minority shareholders. Managers are rarely significant stockholders in publicly traded companies in China (Jiang & Kim, 2015), indicating serious principal-agent agency problems. In listed firms in China, management often prioritizes the benefit of the largest shareholders, but outside investors often suffer when managers engage in earnings management (Liu & Lu, 2007).

However, earnings management affects not only a company's owners but also its stakeholders (Prior et al., 2008). Earnings management can severely affect a company's financial stability, potentially causing losses, instability, and loss of trust, which in turn impacts stakeholders and the wider economy, ultimately distorting its true financial position (Milojičić et al., 2019). In China, stakeholders also require an accurate assessment of corporations' value, while earnings management, the judgment of managers in financial reporting, can potentially deceive them about reported accounting numbers (Wang et al., 2015).

Gao et al. (2017) indicate that earnings management has a negative influence on long-term firm value in China. According to Sial et al. (2018), managers in China often employ earnings management strategies to circumvent stakeholder control in corporate governance, thereby negatively impacting firm performance. Yang and Wu (2020) indicate that earnings management leads to a decline in both the firm’s operating performance and innovation in the subsequent year.

Earnings management is significantly and positively associated with stock price crash risk in China (Haider et al., 2022). Managers' activities, such as temporarily boosting the stock price or utilizing earnings management to safeguard it, are unreasonable and can result in stock price collapses when the facts are known (Jin & Myers, 2006). Manipulated financial statements cause financial distress for managers and investors, leading to stock price crash risk and severe consequences for shareholder wealth (Habib et al., 2018).

According to Shen et al. (2015), earnings management has a positive effect on overinvestment in China, implying a negative relationship between earnings management and investment efficiency. Chen et al. (2010) indicate that the quality of financial reporting influences investment efficiency in China. Earnings management by firms can have an impact on internal decision making, leading to suboptimal or inefficient investment decisions (McNichols & Stubben, 2008).

Ehsan et al. (2022) find earnings management can impair a firm's long-term viability by weakening the credibility of financial reports, provoking stakeholder activism, and decreasing support. In China, managers may use earnings management to assess the value of competing companies, but this may not accurately reflect the company's true performance (Wang et al., 2015).

Nevertheless, despite the implementation of IFRS and other disclosure regulations, the effectiveness of these reforms in curbing earnings management remains limited. Managers use less current asset write-downs and more reversals post-IFRS, not influenced by incentives to avoid losses or "big bath" earnings management purposes (Zhou & Habib, 2013). Welker et al. (2017) show in a related study that mandatory dividend regulation in China may drive enterprises to engage in earnings