The Effect of CEO Personal Characteristics on CEO Overconfidence in Doing Earnings Management in Manufacturing Companies in Indonesia

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Abstract
This research aims to test Upper Echelons Theory by researching the relationship between CEO overconfidence and decisions in Earnings management. This research also identifies whether monitoring from external parties, especially institutional shareholdings, plays an important role in moderating Earnings management decisions concerning the behavior of overconfident CEOs. The author uses the CEO's characteristics based on age, education level, and work experience, while overconfidence is measured based on the CEO's portfolio decisions. The sample comprises 68 manufacturing companies listed on the Indonesia Stock Exchange from 2017-2019. The results showed that age and work experience did not affect CEO overconfidence, while education level had an effect. Furthermore, the CEO's characteristics (age, education level, and work experience), through overconfidence, do not affect Earnings management. Other results also show that overconfidence does not affect Earnings management. The moderating effect of institutional share ownership has no effect on CEO overconfidence in Earnings management. The results of this research can benefit users of financial information, namely internal parties (management), as a material consideration in selecting a CEO. As for external parties (government, investors/potential investors, and creditors/prospective creditors) can be used as a performance appraisal and a basis for decision-making.
Keywords: Personal Characteristics of CEO, CEO Overconfidence, Earnings Management

1. Introduction

Earnings management is a topic of concern to policymakers, investors, and academics because the credibility of financial information leads to the quality of company performance information (Akhigbe et al., 2013), which will affect the value of the company (Zimmerman, 2013), as well as reducing the cost of capital (Karjalainen, 2011). In other words, Earnings management hides the company's true performance from stakeholders (Orazalin & Akhmetzhanov, 2019). The results of previous research on Earnings management are always associated with agency theory (Jiraporn et al., 2008; Paiva et al., 2016; Prencipe & Bar-Yosef, 2011). According to Agency Theory, one of the parties involved in Earnings management decisions is the Chief Executive Officer (CEO). Generally, the CEO is seen as the most powerful person in a company (Bouaziz et al., 2020). CEO plays a role in company policy-making (Lestari & Faisal, 2019). They are responsible for the company's performance and exercise authority over company decisions (Chou & Chan, 2018).

Based on previous research, Zhang & Wiersema (2009) shows that the CEO's characteristics affect the quality of financial reports, thereby safeguarding the interests of shareholders. Huang et al. (2016) also stated that the personal characteristics of the CEO proved to have an impact on the company's decision-making. Personally, CEOs have different characteristics. CEOs' characteristics can be demonstrated by their high, medium, and low self-confidence.

The CEO's characteristics related to Earnings management decisions include belief in one's abilities that exceeds reality after this is referred to as overconfidence (Mellers et al., 2013). The theory that supports overconfidence as a cognitive deviation that encourages decision-makers to overestimate their ability to solve problems is the Upper Echelons Theory. (Sutrisno et al., 2019). Based on the Upper Echelons Theory, the characteristics of the CEO in the form of high trust (overconfidence) can influence the strategies and decisions taken to affect the company's performance.

Based on the Upper Echelons Theory, the measurement of CEO personal characteristics includes age, available tracks, work experience, education, socioeconomic roots, financial position, and group characteristics. In this research, the authors use the personal characteristics of the CEO as a factor forming CEO overconfidence, not as a measure of overconfidence, because the CEO's primary role in providing quality accounting information benefits CEOs in many areas, from strategic direction and decision making to different stakeholder orientations (Bouaziz et al., 2020).

In Indonesia, several studies on CEO overconfidence have been carried out. The results show that CEO overconfidence affects earnings management decisions (Harymawan et al., 2019; Lestari & Faisal, 2019; Yustisi & Putri, 2021). Meanwhile, Alqatamin et al. (2017) stated that most research on the relationship between CEO overconfidence and Earnings management practices is debatable. However, the results of research show this by Sutrisno et al. (2019), which does not support previous research, namely, CEO overconfidence does not affect Earnings management.

CEO overconfidence is positively related to the likelihood of financial statement fraud, and higher internal/external monitoring is expected to reduce this impact (Schrand & Zechman, 2012). In agency theory, it is explained that increasing the ownership structure can be an effective supervisory mechanism (Alzoubi, 2016). Based on data from the company's

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financial statements published on the Indonesia Stock Exchange, the largest share ownership structure in the manufacturing industry is held by institutions. Research result Alzoubi (2016) explained that institutional ownership hurts Earnings management. This research encourages researchers to examine whether CEO overconfidence can affect Earnings management practices if there is monitoring from external parties, especially institutional share ownership.

This research aims to test Upper Echelons Theory by researching the relationship between CEO overconfidence and decisions in Earnings management. In addition, this research also identifies whether monitoring from external parties, especially institutional share ownership, plays an important role in moderating Earningss management decisions regarding the behavior of overly confident CEOs.

This research uses the CEO's characteristics based on age, education level, and work experience, while overconfidence is measured based on the CEO's portfolio decisions. Furthermore, the measurement of Earnings management uses the latest approach proposed by Dechow (2011). The sample comprises 68 manufacturing companies listed on the Indonesia Stock Exchange from 2017-2019.

The authors hope these findings are useful for users of financial information and policymakers interested in improving the reliability of financial reporting. This paper is divided into several parts. Section 2 discusses the theoretical framework and literature review, leading to the development of hypotheses. Section 3 describes the research model. Section 4 provides details of the data and research methods. Finally, section 5 presents the findings, followed by conclusions.

Upper Echelons Theory supports overconfidence as a cognitive lapse, which encourages decision-makers to admit their excessive ability to solve problems (Sutrisno et al., 2019). Overconfidence is closely related to the courage to take risks, as overconfident CEOs tend to overestimate their ability to deal with problems; disparage other resources as strategic initiatives; underestimate the condition of their operational environment, and are suspicious of their knowledge and information (Li & Tang, 2010). Upper Echelons Theory recognizes that CEOs' different characteristics, such as age or career experience, influence their decisions on strategy and structure which directly affect the firm's strategic choices and organizational performance (Green et al., 2010). The Upper Echelons Theory states that personal characteristics such as age, available tracks, career experience, educational background, socioeconomic background, financial position, and group characteristics influence decision-making.

According to Upper Echelons Theory, CEO personal characteristics influence judgment and decision-making, and overconfidence among these characteristics. As a result, the excessive influence of CEOs on corporate decisions has received significant attention. For example, Ahmed & Duellman (2013) suggests that overconfident CEOs will be more optimistic about their company's future performance and overestimate their capacity to maximize future Earnings.

According to Shefrin (2001), managers' physiological and sociological characteristics can affect various management decisions. In addition, other studies have shown that CEO personal characteristics influence different decisions, for example, CEO age and investment decisions (Li & Tang, 2010; Serfling, 2012), CEO age and choice of voluntary financial disclosure (Bamber et al., 2010), excess CEO trust and company acquisitions (Brown & Sarma,

2007), CEO advantages and capital structure decisions (Tomak, 2013), and CEO advantages and Earnings forecasts (Schrand & Zechman, 2012).

Malmendier & Tate (2015) used the correlation between measures of CEO overconfidence and CEO decisions. Regarding acquisition decisions, Brown & Sarma's (2007) statement. Deshmukh (2013) suggests that the level of dividend payout is lower in companies managed by overconfident CEOs. In conclusion, overconfidence impacts company decision-making (Huang et al., 2016). Nevertheless, the relationship between a CEO's characteristics and Earnings Management practices remains ambiguous and controversial.

According (to Ben-David et al., 2007), In making corporate financing decisions, CEOs who are overconfident believe the company is more Earningsable and less risky, so they use debt financing more. Banks with overconfident CEOs tend to approve a lot of loans so that when a crisis occurs, they suffer a larger capital loss from bad loans, which causes a larger decrease in net worth. (Ho et al. 2016). High CEO confidence shows CEO optimism which can create bias when making decisions to perform Earnings management (Schrand & Zechman, 2012). Overconfident CEOs tend to carry out real Earnings management through sales manipulation activities and discretionary spending budget cuts rather than accrual income management to achieve certain revenue targets. (Kouaib & Jarboui, 2017).

Schrand & Zechman (2012) found a positive relationship between CEO overconfidence and financial reporting fraud, arguing that overconfident managers are more likely to engage in fraudulent practices. Hribar Henry et al. (2010) shows a positive relationship between overconfidence and the possibility of greater Earnings management. Chatterjee et al. (2019) show that overconfident CEOs lead to higher future optimism concerning firm performance and tend to engage in Earnings management to achieve expectations for certain revenue targets. Research conducted by Lin dan Hung (2013) explained that CEO overconfidence (managers who are too confident) increases Earnings management behavior in companies in Taiwan.

In determining CEO overconfidence, each research looks at it from different aspects. Research (Ayres et al., 2007) uses the classification of entrepreneurs and non-entrepreneurs to measure overconfidence. Tomak's research (2013) uses the consumer confidence index issued by the University of Michigan to determine overconfidence. According to Ting et al. (2016) and Murhadi (2018), CEO overconfidence can be measured by the personal characteristics of the company's president and director. In contrast to previous studies, this research uses personal characteristics to influence decision-making, namely age, work experience, and educational background. Thus, the first set of hypotheses of this research is to predict whether the personal characteristics of the CEO are a factor of CEO overconfidence that affects Earnings management practices.

Prencipe & Bar-Yosef (2011) suggest that the presence of shareholders limits Earnings management. Furthermore, the research results by San Martin Reyna (2018) show a clear relationship between the increased participation of family and institutional investors and a decrease in Earnings management. On the other hand, it is also argued that the market relies on the majority shareholder to monitor management behavior and thus may not perceive Earnings management as risky (Prencipe & Bar-Yosef, 2011).

This research uses the SEM (Structural Equation Model) model to explain the relationship between CEO personal characteristics and CEO overconfidence in Earnings

management and determine the moderating effect of institutional share ownership. As illustrated in the chart below:
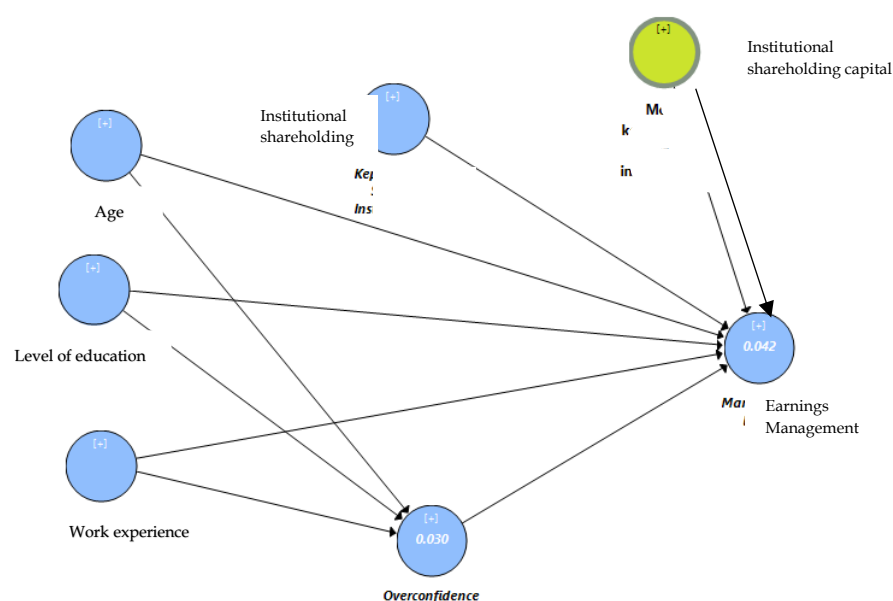

Figure 1. The complete model of research construct

2. Research methods

The type of data used in this research is quantitative data obtained from the Indonesia Stock Exchange website in the form of an annual financial report. In the financial statements, the data taken are data about the CEO's characteristics (age, work experience, and education) and financial data presented on the balance sheet. Data collection techniques are carried out with documentation, namely by collecting documents in the form of annual financial reports for the 2017-2019 ongoing public manufacturing companies listed on the Indonesia Stock Exchange.

Following previous research, the population of this research is manufacturing companies listed on the Indonesia Stock Exchange (IDX), which consists of 186 companies. This is done to avoid bias that might occur when using multiple sectors. Furthermore, the research sample was taken using a purposive sampling technique. Samples that meet the criteria and are used in this research are 58 companies.

The personal characteristics of the CEO used in this research are age, work experience, and CEO education. Age is measured by the difference between the CEO's birth date and the year of the research period (Serfling, 2014). Referring to the research of Ting et al. (2016), the measurement of CEO education level uses a scale ranging from 1-7. One point is awarded if the CEO does not graduate from high school. Two points are awarded for graduating from high school. Three points if you attend high school or university. Four points if you get a bachelor's degree or diploma. Five points if you attend post-graduate school. Six points if you get a master's degree. Seven points if you get a doctorate.

Furthermore, in measuring CEO experience, this research refers to research from Yang et al. (2011) by using a measure of one if he served as an executive, such as finance director, operational director, or deputy director of a company in another company before joining the current company. If not coded zero.

Overconfidence is a management bias behavior that refers to an overestimation of the ability of individual management. This bias arises because of a generally accepted psychological phenomenon: each manager relatively overestimates their abilities compared to the average manager's ability (admitted ability above average). The overconfidence measurement is based on the CEO's portfolio decision developed by Ben-David et al. (2007). Companies with overconfident CEOs have a larger capital expenditure (CAPEX) budget than non-overconfident CEOs. Assessed 1 (Overconfidence) if CAPEX minus the value of the remaining assets in the current year is greater than CAPEX minus the value of the remaining assets in the middle of the previous year.

Earnings management is active management to increase or decrease reported Earnings. However, it has no relationship with the increase or decrease in the company's Earningsability in the long term. This research uses a new approach developed by Dechow (2011) as the main proxy for detecting Earnings management. The reason for choosing the Dechow (2011) model in measuring Earnings management is that few other alternative models are different from the Jones (1991) model, which other researchers most widely used. In addition, the Dechow model (2011) succeeded in perfecting the concept of discretionary accrual testing that existed in the previous methods. The measures developed by Dechow et al. (2011) are as follows:

Using non-cash working capital accruals (WC_ACC) as an accrual measurement with the formula:

$$WC\_ACC_{i,t} = (\Lambda CA_{i,t} - \Lambda CL_{i,t} - \Lambda Cash_{i,t} + \Lambda STD_{i,t}) / A_{i,t-1}$$

Where:
ΛCA = Changes in Current Assets
ΛCL = Changes in Current Liabilities
$\Lambda Cash$ = Changes to Cash
ΛSTD = Changes to Short-term debt
A = Total Assets

1)   Then, the results are substituted into the reversal period as follows:

$$WC\_ACC_{i,t} = \alpha + \beta PART_{i,t} + \Sigma_k f_k X_{k,i,t} + \varepsilon_{i,t}$$

Where:
WC_ACC = non-cash working capital accruals;
PART = dummy variable determined 1 in the period in which the hypothesized determinants of Earnings management are present and 0 otherwise;
Xk = Control for nondiscretionary accruals.

Institutional ownership is the ownership of shares of a company by institutions or institutions such as insurance companies, banks, investment companies, and other institutional owners. Institutional ownership is measured by the indicator of the percentage of share ownership owned by the institution from the total outstanding share capital.

Data Analysis Techniques on PLS with Smart PLS software version 3.0. Hypothesis testing is carried out based on the Inner Model (structural model) test, which includes r-square output, parameter coefficients, and t-statistics. To see whether a hypothesis can be accepted or rejected, among others, by paying attention to the significance value between constructs, t-statistics, and p-values. The hypothesis testing of this research was carried out with the help

of SmartPLS 3.0 software. These values can be seen from the bootstrapping results. The rules of thumb used in this research are t-statistics > 1.96 with a significance level of p-value 0.05 (5%) and a positive beta coefficient.

3. Result and Discussion

The characteristics of each variable are summarized using descriptive statistics.

Table 1. Descriptive analysis of data

Variable	Mean	Median	Min	Max
Age	55.88	55.00	30.00	82.00
Level of education	4.25	4.00	1.00	7.00
Work experience	0.91	1.00	0.00	1.00
Overconfidence	0.40	0.00	0.00	1.00
Earnings management	-0.04	-0.02	-1.17	0.40
Shareholding	57.04	76.13	0.00	100.70

Based on the results in table 1, the lowest CEO age is 30 years, and the highest is 82 years, with the highest average being 55 years. Furthermore, the lowest level of CEO education is not graduating from high school, and the highest is obtaining a doctorate, with the highest proportion being S1 graduates. Then, the CEO's work experience shows that the average CEO served as a director in another company before joining the company.

Table 1. shows that the Earnings management variable has a minimum value of -1.17 and a maximum value of 0.40, while the overall average value is -0.04. Based on these results, it can be concluded that the level of Earnings management in manufacturing companies is low. The negative average value indicates that Earnings management is carried out by reducing income (income decreasing). Furthermore, the Overconfidence value shows that forty companies have overconfident CEOs. Meanwhile, the average share ownership owned by institutions shows a yield of fifty-seven. The value of testing the hypothesis of this research can be shown in Table 2.

Table 2. Path coeffiencies – bootstrap

	Original Sample (O)	Sample Mean (M)	T Statistics (|O/STDEV|)	P Values
Age -> Overconfidence	0.043	0.105	1.250	0.596
Work experience _ -> Overconfidence	-0.034	-0.037	0.442	0.659
Education Level -> Overconfidence	0.181	0.182	2.250	0.025
Age -> Overconfidence -> Earnings management	-0.004	-0.004	0.391	0.696
Work experience -> Overconfidence -> Earnings management	0.003	0.003	0.320	0.749
Education Level -> Overconfidence -> Earnings management	-0.018	-0.018	0.955	0.340
Overconfidence -> Earnings management	-0.087	-0.092	1.072	0.284
Overconfidence -> Stock Ownership Mod -> Earnings management	-0.115	-0.119	1.655	0.099

The first hypothesis tests whether age has a direct effect on overconfidence. The test results show the age beta coefficient on overconfidence is 0.043, and the t-statistic is 1.250. From this result, it is stated that the t-statistic is not significant because it is <1.96 with a p-value >0.05, so the first hypothesis is rejected. This proves that age does not have a direct effect on overconfidence.

In the Upper Echelons Theory, Hambrick & Mason (1984) state that age affects overconfidence in making decisions. When CEOs are younger, they may gather less information when making decisions, overestimate their abilities and knowledge, and thus be more confident. (Wei et al., 2011). However, the maturity level of the CEO does not make the CEO more overconfident. It cannot be proven from the results of this research, so it can be concluded that age cannot be used as a measure in determining overconfidence.

The second hypothesis examines whether work experience has a direct effect on overconfidence. The test results show that the beta coefficient of work experience on overconfidence is -0.034, and the t-statistic is 0.442. From these results, it is stated that the t-statistic is not significant because it is <1.96 with a p-value >0.05, so the second hypothesis is rejected. These results provide evidence that work experience does not have a direct effect on overconfidence.

According to the upper-echelon theory, CEO experience is related to opportunities and problems. CEOs who have only worked for one company during their careers tend to have limited knowledge when faced with unprecedented problems. CEOs with little experience tend to be overconfident (Wei et al., 2011). The results of this research differ from that of Lestari & Faisal (2019). Previous research (Lestari & Faisal, 2019) uses work experience as a measure of overconfidence affecting financial decisions.

The third hypothesis examines whether the level of education has a direct effect on overconfidence. The test results show that the beta coefficient of the education level on overconfidence is 0.181, and the t-statistic is 2.250. From these results, it is stated that the t-statistic is significant because it is >1.96 with a p-value <0.05, so the third hypothesis is accepted. There is a positive direct relationship between education level and overconfidence of 0.188, with a p-value of 0.025 indicating that an increase in education level will increase overconfidence by 0.188.

These results support the Upper Echelons Theory, which shows that the level of education can affect a person's self-confidence. In line with that, this research also supports the results of J. Wei et al. (2011), which makes age a measure of overconfidence. The results of this research indicate that CEOs with low education can make them more overconfident.

The fourth hypothesis examines whether age indirectly, through overconfidence, affects Earnings management. The test results show the age beta coefficient on Earnings management is -0.004, and the t-statistic is 0.391. From these results, it is stated that the t-statistic is not significant because it is <1.96 with a p-value >0.05, so the fourth hypothesis is rejected. Therefore, this proves that age indirectly does not affect Earnings management.

The results of this research align with Alqatamin et al. (2017) and (Schrand & Zechman, 2012), which indicate no relationship between age and Earnings management. Thus, the age level of the CEO does not affect the CEO's decision-making. Therefore, about the first hypothesis, it can be concluded that age does not affect CEO overconfidence in Earnings management.

The fifth hypothesis examines whether work experience indirectly affects Earnings management. The test results show that the beta coefficient of work experience in Earnings management is 0.003, and the t-statistic is 0.320. From these results, it is stated that the t-statistic is not significant because it is <1.96 with a p-value >0.05, so the fifth hypothesis is

rejected. These results provide evidence that work experience does not indirectly affect Earnings management.

A CEO with work experience as a director in a previous company does not guarantee that the CEO will carry out Earnings management at the current company. The results of this research reject previous studies that showed a negative relationship between CEO experience and Earnings management (Baatwah, S.R., Salleh, Z., 2015; Chou & Chan, 2018; Zouari et al., 2012). Previous research (Baatwah, S.R., Salleh, Z., 2015; Zouari et al., 2012) used a sample of all non-financial companies in countries with economic levels that are still developing while the research by Chou & Chan (2018) used the banking industry as a research sample. This can cause differences in results with this research which only uses the manufacturing industry as the research sample.

The sixth hypothesis examines whether the level of education indirectly affects Earnings management. The test results show the value of the educational level beta coefficient on Earnings management is -0.018, and the t-statistic is 0.955. From these results, it is stated that the t-statistic is not significant because it is <1.96 with a p-value >0.05, so the sixth hypothesis is rejected. These results provide evidence that the level of education does not indirectly affect Earnings management. The results of this research reject the research of Ting et al.(2016), which states that the education level of the presidential director affects the leverage decisions of non-financial companies in Malaysia.

The seventh hypothesis tests whether overconfidence affects Earnings management. Based on the test results, the beta overconfidence coefficient on Earnings management is -0.087, and the t-statistic is 1.072. From these results, it is stated that the t-statistic is not significant because it is <1.96 with a p-value >0.05, so the seventh hypothesis is rejected. These results provide evidence that overconfidence does not affect Earnings management.

The negative coefficient value of Earnings management shows that management uses a pattern of income decreasing, which is reporting lower Earnings in the current period to get bigger Earnings in future periods. Management will be careful about the decision to do the income-decreasing method. The possibility that this can occur due to lower Earnings reporting, namely, management performance will be considered less good in managing the company because the reported Earnings are not on target.

The results of this research reject the previous literature, which states that CEO overconfidence affects Earnings management (Alqatamin et al., 2017; Schrand & Zechman, 2012; Yustisi & Putri, 2021). Furthermore, the results of this research complement the research conducted by Sutrisno et al. (2019) and Ting et al. (2016), who found that CEO overconfidence did not affect Earnings management decisions.

The eighth hypothesis examines whether institutional stock ownership can moderate the relationship between CEO overconfidence and Earnings management. Based on the test results, the beta coefficient value is -0.115, and the t-statistic is 1.655. From this result, it is stated that the t-statistic is not significant because it is <1.96 with a p-value >0.05, so the eighth hypothesis is rejected. These results prove that institutional share ownership does not moderate the overconfidence relationship with Earnings management.

In this research, it is hoped that there will be a moderating effect of institutional share ownership in influencing the overconfidence relationship with Earnings management developed in the eighth hypothesis. However, the results of hypothesis testing prove that

there is no moderating effect of institutional share ownership. Therefore, it can be concluded that institutional share ownership cannot control CEO overconfidence in Earnings management. Furthermore, this research results contradict previous research, which states that the presence of shareholders limits Earnings management (Prencipe & Bar-Yosef, 2011). In addition, the results of this research also reject the statement of San Martin Reyna (2018) that there is a clear relationship between increased participation of family and institutional investors and a decrease in Earnings management.

4. Conclusion

This research contributes to the literature by examining the impact of CEO personal characteristics on CEO overconfidence in Earnings management. This research also examines the moderating effect of institutional share ownership in influencing CEO overconfidence to perform Earnings management. The findings of this research indicate that age and work experience do not directly influence overconfidence. Meanwhile, the level of education has a direct influence on overconfidence. Furthermore, personal characteristics (age, work experience, education level) have no effect on CEO overconfidence in Earnings management. Testing CEO overconfidence on Earnings management shows that CEO overconfidence does not affect Earnings management. The findings of this research also show that there is no moderating effect of institutional stock ownership on CEO overconfidence in Earnings management.

This research has limitations because the measurement of CEO overconfidence only uses one measurement, namely the CEO's personal portfolio decision. Further research still needs to be done to find the right size to describe the presence of an overconfident CEO. Measurements of CEO overconfidence can be used in other forms or combined with several measures to measure CEO overconfidence more accurately. However, the findings of this research can provide an overview for companies in choosing CEOs by looking at their educational background because, based on the results of this research, the level of education indicates an overconfident CEO.

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