Asian Journal of Management Entrepreneurship and Social Science
ISSN: 2808 7399
https://ajmesc.com/index.php/ajmesc Volume 04 Issue 02

The Role of Financial Performance in Mediating the Relationship of CEO Narcissism and Free Cash Flow on Earnings Management

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Abstract

Users of financial statements use earnings as one of the important benchmarks that attract external attention when assessing company performance. Some literature on corporate governance has focused on how CEO characteristics influence decisions, including those in earnings management. This study aims to test whether a narcissistic CEO and high free cash flow will motivate management to perform earnings management with financial performance as a mediating variable. This type of research is explanatory, using purposive sampling techniques in selecting samples. The samples in this study were 44 financial or banking service companies that have been listed on the Indonesia Stock Exchange for the period 2020–2022, for a total of 132 observations. The results showed that CEO narcissism can affect earnings management practices, while free cash flow does not affect earnings management. Furthermore, CEO narcissism affects financial performance, while free cash flow cannot affect financial performance. Then, financial performance has no effect on earnings management, and financial performance can mediate the relationship between CEO narcissism and earnings management but is unable to mediate the effect between free cash flow and earnings management.

Keywords: CEO Narcissism, Free Cash Flow, Earnings Management, Financial Performance

1. INTRODUCTION

Users of financial statements use earnings as one of the important benchmarks that attract external attention to assessing company performance. This is in line with the statement in Wandeca (2012) research that material earnings information is the main concern for assessing management performance or accountability. In Godkin & Allcorn (2011) research, the existence of management actions that report company earnings by not describing the actual condition of the company results in the quality of the resulting earnings being doubted as a decision-making medium.

The literature on corporate governance has focused on how CEO characteristics influence decisions including decisions in earnings management. Earnings management is a condition where management intervenes in the process of preparing financial statements for external parties to flatten, increase, and decrease earnings (Schipper, 1989). One of the traits studied is CEO narcissism, which refers to an excessive sense of self-importance, entitlement, and desire to be admired. These traits can greatly influence organizational decision-making. This can lead to behaviors such as aggressive risk-taking, opportunistic actions, and an emphasis on short-term gains over long-term sustainability.

A Chief Executive Officer (CEO) is someone who has a high position in a company. Narcissism is the attitude of avoiding bad images and forming good images that cannot be separated from individual narcissism. Narcissistic attitudes have a great desire for the assertiveness of others who are focused on the expertise they have (Ummah & Kelly, 2017). A CEO is certainly authorized by the company owner to manage the course of company activities and also make decisions.

Another phenomenon that is no less interesting to juxtapose with CEO narcissism is free cash flow. The concept of free cash flow is the net cash obtained by the company from operating activities after deducting fixed costs or asset replacement. This free cash flow is the amount of cash available to the company after paying all business operating costs and the need to keep it in operational form (Kemala Dewi et al., 2021). Managers believe that the more a company keeps a stock of free cash flow, the greater the opportunity to be able to invest in future projects that will be more profitable (Setiorini et al., 2022). Free cash flow is related to financial performance/profitability, which is what encourages company managers to seek more free cash on their balance sheets (Prasetyo et al., 2021).

As an intermediary between CEO narcissism and free cash flow, financial performance is one of the benchmarks of a company's success. Financial performance is a very fundamental thing and is considered for the assessment of a company. Financial analysis tools are used to analyze the financial state of a company, which then shows how good or bad it is. Financial performance is a representation of the company's work achievements over a certain period. The success of financial performance is measured by the earnings the company gets each year (Dewi, 2019).

Previous research shows mixed results regarding the relationship between CEO narcissism and free cash flow on earnings management with financial performance as mediation. Meiliya & Rahmawati (2022) and Rusydi (2021) research state that CEO narcissism affects earnings management, while Christian & Sulistiawan (2022) and Shinthia & Arisman (2023) research state that CEO narcissism does not affect earnings management. Research by Seri Murni (2018) and Dian et al. (2013) states that free cash flow can affect earnings management, while research by Kosasih & Paramitha (2021) and Sagala & Simbolon (2021) states that earnings management is not influenced by free cash flow. Youssef (2022) research states that CEO narcissism can affect financial performance, while research by Muttiarni et al. (2022) and Maduwu & Richard F. Simbolon (2023) shows CEO narcissism does not affect financial performance. Research by Rambe (2020) and Syamsudin et al. (2019) shows the effect of free cash flow on financial performance, while research by Eva (2020) and Ahira (2019) shows no effect between free cash flow and financial performance. Research by Sihombing (2020) and Indahsari & Prabowo (2021) shows that financial performance can affect earnings management, while research by Sulistyoningsih (2019) and Pramesti & Rahayu (2021) does not show the effect of financial performance on earnings management. Therefore, researchers are interested in re-examining the relationship between variables in this study.

To understand the relationship between CEO narcissism, free cash flow, financial performance, and earnings management, there are several difficulties. One of them is accurately measuring CEO narcissism, which is difficult to do because it requires access to subjective personality characteristics. Some previous studies used the CEO photo size index as an indicator of measuring CEO narcissism. However, as a novelty in this study, researchers added proxies to the measurement of CEO narcissism into 3 indicators, namely CEO signature size, relative cash payout, and CEO photo size index.

Investors, regulators, and stakeholders urgently need an understanding of the impact of CEO narcissism on decision-making and financial performance given the increased scrutiny of corporate governance practices and the emphasis on transparency and accountability. In addition, when businesses have a lot of free money, issues such as earnings management become more pronounced. This research aims to study the mediating role of financial performance and how CEO narcissism and free cash flow affect a firm's earnings management. This helps us understand governance practices and strategic decision-making in today's business world.

2. LITERATURE REVIEW

2.1 Upper Echelons Theory

Hambrick & Mason (1984) were the first researchers to discuss the impact of certain individual characteristics on managers' strategic behavior. Upper echelons theory explains the concept of top management as a strategic decision-maker in a company. This study uses upper echelons theory to explain the effect of CEO narcissism on earnings management. The better the level of education and experience of top management, the more confident they are (narcissism) in deciding the company's strategic decisions (Sudana & Dwiputri, 2018). Therefore, narcissistic CEOs tend to make decisions that present the company's financial status as well as possible.

2.2 Agency Theory

The concept of agency theory addresses the main problems that arise when the principal (who has an interest) uses an agent (who acts on behalf of the principal) to perform certain actions. This theory is based on 3 assumptions, namely human nature assumptions, organizational assumptions, and information assumptions (Andriyani & Mudjianti, 2017). One form of agent responsibility is to provide information to the owner in the form of an annual financial report in which there are periodic financial reports (Meiliya & Rahmawati, 2022).

2.3 Signaling Theory

Signaling theory was first proposed by Spence (1973) which explains that the sender (owner of information) provides a signal or signal in the form of information that reflects the condition of a company that is beneficial to the party receiving it (investor). In terms of earnings management, signal theory is company information to provide good or bad information about the company's financial statements. If management signals are positive, they can increase the company's stock price, but if the signals are negative, they can decrease the stock price. Therefore, providing information on each financial report is very important for company management.

2.4 Earnings Management

Earnings management is management intervention in the process of preparing external financial statements to achieve a certain level of earnings with the aim of personal gain. One of the goals is to get bonuses, compensation, and so on. So it can be concluded that earnings management includes management's efforts to maximize or minimize earnings, including leveling earnings by management's wishes and objectives. Earnings management can occur because it is given the freedom to choose the accounting methods used in the company's financial information and there is high information asymmetry between management and stakeholders. According to Scott (2003), earnings management is the choice of accounting policies by managers to achieve certain goals.

2.5 CEO Narcissism

A CEO is someone responsible for the leadership and operational management of a company. The CEO's personality will influence the strategies, policies, and practices that occur in the company. Narcissistic CEOs are seen as creative, inspiring, and ready to face challenges (O'Reilly et al., 2014). A high-confidence CEO will try to convince himself and others that he can run the company well and can manage earnings. Thus, the decisions made will improve the company's performance despite the risks.

2.6 Free Cash Flow

Free Cash Flow is the remaining cash available after the company has spent the funds necessary to maintain or expand its assets. Companies with high free cash flow occur because top management does not optimally utilize available cash, or use it for self-interested investments. This has an impact on increasing earnings management practices to improve earnings reporting, so that the inefficiency in the use of cash flow can be covered (Bukit & T., 2009).

2.7 Financial Performance

Financial performance is the final result obtained by the company which is reflected in the financial statements. Financial performance reports are important to analyze, companies can plan management strategies that can predict future financial conditions. Decision-making by management that is carried out repeatedly within the company to achieve a goal efficiently and effectively is called financial performance (Munawir, 2010).

2.8 Relatıonshıp Between Varıables

a. CEO Narcissism and Earnings Management

The upper echelons theory reveals that the characteristics and values of top leadership, such as the level of narcissism, influence organizational decision-making. CEOs who have high levels of narcissism may tend to take higher risks and pursue selfish goals, including manipulation of financial statements to show better performance. In Meiliya & Rahmawati (2022) research states that CEO narcissism has a significant positive effect on earnings management. Then Rusydi (2021) research also states that CEO narcissism has a significant positive effect on earnings management.

Hypothesis 1: CEO narcissism has a positive effect on earnings management.

b. Free Cash Flow and Earnings Management

Free cash flow is an important indicator of a company's long-term financial health and its ability to generate sustainable earnings. Based on the upper echelons theory, it can be considered that leaders who have a short-term orientation and focus on immediate financial returns may tend to engage in earnings management practices, especially if free cash flow does not meet expectations or targets. Seri Murni (2018) research states that free cash flow has a significant negative effect on earnings management. Then in the research of Dian et al. (2013), the results also show that free cash flow has a negative effect on earnings management.

Hypothesis 2: Free Cash Flow has a negative effect on earnings management.

c. CEO Narcissism and Financial Performance

Agency theory highlights the relationship between CEOs as agents and shareholders as principals. CEOs who are more narcissistic are thought to be more likely to take actions that benefit themselves rather than the company and shareholders. They may be more likely to make decisions that enhance their reputation and rewards, even if it is not in line with the long-term interests of the company. The results of Youssef (2022) research state that CEO narcissism has a positive influence on financial performance which can improve company performance.

Hypothesis 3: CEO narcissism has a positive effect on financial performance

d. Free Cash Flow and Financial Performance

According to agency theory, there is a conflict of interest between company management (agent) and shareholders (principal). Free cash flow is important because it is a source of funds available for investment or distribution to shareholders. Good management will use free cash flow efficiently to increase company value and shareholder wealth. In Rambe (2020) research states that partially free cash flow has a positive and significant effect on financial performance. Then the research of Syamsudin et al. (2019) also states that free cash flow has a significant positive effect on financial performance.

Hypothesis 4: Free Cash Flow has a positive effect on Financial Performance.

e. Financial Performance and Earnings Management

Signaling theory argues that companies use financial statements to send signals to shareholders and the capital market about their performance and prospects. Managers may tend to perform earnings management to create positive signals about the company's performance, which in turn can affect stock prices and investor confidence. The results of Sihombing (2020) research state that financial performance has a positive influence on earnings management. Then Indahsari & Prabowo (2021) research also states that the company's financial performance has a significant positive effect on earnings management.

Hypothesis 5: Financial performance has a positive effect on earnings management.

f. The Role of Financial Performance in Mediating the Relationship between CEO Narcissism and Free Cash Flow to Earnings Management

According to signaling theory, a company's financial performance is an important signal to investors and shareholders about the health and prospects of the company. High CEO narcissism can lead to efforts to create impressive financial performance as part of their strategy to strengthen their self-image. Then, high free cash flow is considered positive, but if the financial performance is not in line with market expectations or there are indications of underlying problems, the company may face negative signals.

Hypothesis 6: There is a positive effect between CEO narcissism and earnings management mediated by financial performance.

Hypothesis 7: There is a negative effect between free cash flow and earnings management mediated by financial performance.

We sketch all the above hypotheses into a figure conceptual framework of research below

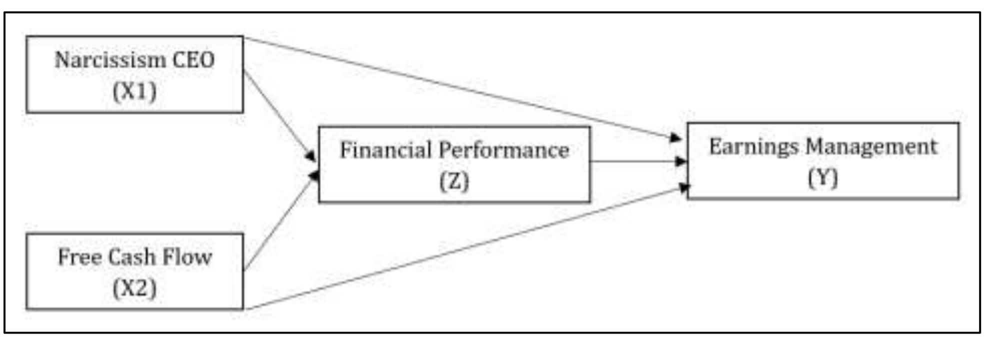

Figure 1 Framework of Thinking

2.9 Variable Measurement

The independent variables in this study are CEO narcissism and free cash flow, then the dependent variable is earnings management, and the mediating variable is financial performance.

Table 1 Definition and Measurement of Variables

No	Variable	Definition	Measurement
1	Earnings Management	Earnings management is measured based on the modified Jones model developed by (Dechow et al., 1995).	DAit= Tait / Ait-1 - NDAit
2	CEO Narcissism	CEO narcissism is measured through 3 indicators based on the research of Ham et al. (2012) and Al-Shammari et al. (2019), namely the size of the CEO's signature, relative cash payout, and CEO photo size index.	Narsisme CEO= CEO Signature Size+ CEO Relative Cash Payout+ CEO Picture Size / 3
3	Free Cash Flow	Free cash flow is measured based on Murifal (2020) research by reducing operating cash flow with capital expenditures.	Free Cash Flow= NOPAT - CAPEX
4	Financial Performance	Financial performance uses Tobin's Q as a benchmark that uses the same measure as in (Chung & Pruitt, 1994).	Tobin's Q= MVE + Liabilities / Total Asset

3. RESEARCH METHOD

The type of research used is explanatory research. This study will examine the relationship between CEO narcissism and free cash flow on earnings management, and then will further examine the relationship between CEO narcissism and free cash flow on earnings management through financial performance. The population in this study are banking or financial services companies listed on the Indonesia Stock Exchange (IDX). This study used a purposive sampling technique with a total sample of 44 companies. The data source in this study uses secondary data in the form of annual reports for the 2020-2022 period.

The data analysis tool used is Eviews 10. The stages of data analysis in this study are descriptive statistics, model selection analysis, classical assumption test, and panel data regression analysis. The equation in panel data regression analysis used in testing this hypothesis is as follows:

$$Y = \beta 0 + \beta 1\ X1 + 2\ X2 \ldots (1)$$

$$Z = \beta 0 + \beta 1\ X1 + 2\ X2 \ldots (2)$$

$$Y = \beta 0 + \beta 1\ X1 + 2\ X2 + 3\ Z \ldots (3)$$

Description:

Y = Earnings Management
β0 = Constant
β1,2,3 = Coefficient that affects the variable
X1 = CEO Narcissism
X2 = Free Cash Flow
Z = Financial Performance

4. RESULT

4.1 Descriptive Statistics

In obtaining the model to be used for data analysis, researchers determine the data collection criteria. The data taken is sourced from the Indonesia Stock Exchange which is located at www.idx.co.id.

Table 2 Sample Selection Criteria

No	Description	Total
1	Financial services or banking sector companies listed on the Indonesia Stock Exchange (IDX).	44
2	Companies that do not publish annual financial reports for 3 years in the 2020-2022 period.	(0)
3	Companies that do not present data related to the variables to be studied in this study.	(0)
Total Sample		44
Total Observations (44 X 3)		132

Table 3 contains information about the statistical values of the research sample in the form of mean, median, maximum, minimum, and standard deviation.

Table 3 Descriptive Statistic

	CEO Narcissism	Free Cash Flow	Financial Performance	Earnings Management
Mean	2.924242	9.428249	0.424695	-0.852770
Median	3.000000	0.268530	0.436750	-0.320650
Maximum	3.000000	132.0630	0.844780	-0.022800
Minimum	2.000000	-29.52950	0.000440	-41.85600
Std. Dev.	0.265618	27.43706	0.190760	4.462980
Observations	132	132	132	132

The maximum and minimum values of earnings management are -41.85600 and -0.022800, and the mean value is -0.852770. This result can be interpreted as the data on the dependent variable does not vary or group. The CEO narcissism variable has a mean value of 2.924242, while free cash flow is 9.428249. Both of these results can be interpreted as the data on the independent variables do not vary or group.

Financial performance as measured by Tobin's Q ratio as a mediating variable has a mean value of 0.424695, this result can be interpreted that the data on the mediating variable does not vary or group. According to Prasetyorini (2013), a Tobin's Q value of less than 1 indicates that the company has a poor company value. Conversely, if Tobin's Q ratio is greater than 1, the company has a good company value.

4.2 Model Selection Analysis

a. Chow Test

Table 4 Chor Test Results Model 1

Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	2.607152	(43,86)	0.0001
Cross-section Chi-square	110.149080	43	0.0000

Table 5 Chow Test Model 2 Results

Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	25.715458	(43,86)	0.0000
Cross-section Chi-square	347.007295	43	0.0000

Table 6 Chow Test Results Model 3

Test cross-section fixed effects			
Effects Test	Statistic	d.f.	Prob.
Cross-section F	2.538729	(43,85)	0.0001
Cross-section Chi-square	109.039779	43	0.0000

The chow test results in Table 4, Table 5, and Table 6 are 0.0000, 0.0000, and 0.0000. The cross-section chi-square probability value of model 1, model 2, and model 3 is smaller than alpha (0.05), so it means that the chow test results accept the fixed effect as the best model.

b. Hausman Test

Table 7 Hausman Test Results Model 1

Test cross-section random effects				
Test Summary		Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random		18.111248	2	0.0001
	16.805873	3	0.0008	

Table 8 Hausman Test Results Model 2

Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Cross-section random	5.065455	2	0.0007

Table 9 Hausman Test Results Model 3

Test cross-section random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.

Cross-section random	16.805873	3	0.0008

The Hausman test results in Table 7, Table 8, and Table 9 are 0.0001, 0.0007, 0.0008. The cross-section random probability value of model 1, model 2, and model 3 is smaller than alpha (0.05), so it means that the fixed effect is the best model used in the study.

4.3 Classical Assumption Test

In this study, the classical assumption tests carried out were normality test, multicollinearity test, and heteroscedasticity test.

a. Normality Test

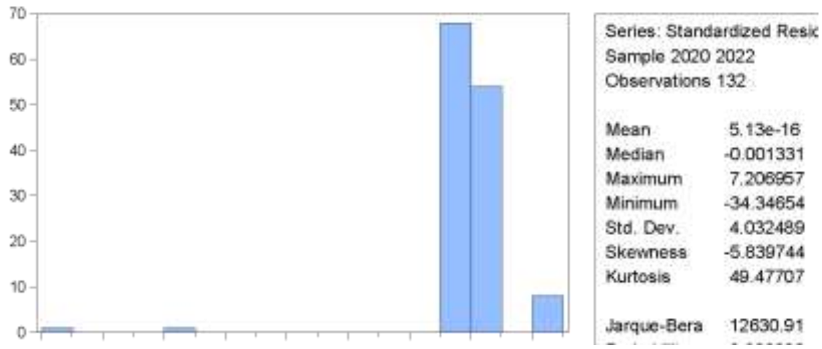

Figure 2 Normality Test Results Model 1

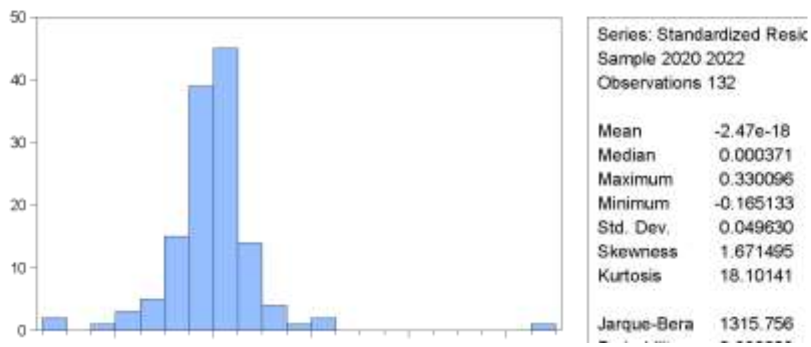

Figure 3 Normality Test Results Model 2

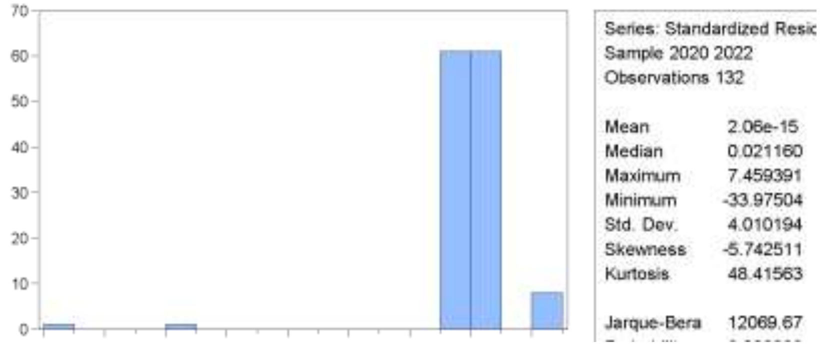

Figure 4 Normality Test Results Model 3

According to Ghozali (2016) if the Jarque-Bera probability value < significant value (0.05), it means that the data does not have a normal distribution. Based on the results of the residual normality test in Figure 2, it shows a Jarque Bera value of 12630.91 with a p-value of 0.0000, so the results in Model 1 show that the p-value is smaller than aplha or 0.0000 <0.05. Furthermore, the residual normality test results in Figure 3 show a Jarque Bera value of 1315.756 with a p-value of 0.000, so the results in model 2 show that the p-value is smaller than alpha or 0.0000 <0.05. Then, the residual normality test results in Figure 4 show a Jarque Bera value of 12069.67 with a p-value of 0.000, so the results in Model 3 show that the p-value is smaller than alpha or 0.0000 <0.05. The results of the normality test for model 1, model 2, and model 3 mean that the residual data is not normally distributed.

There is no need to worry if the normality test is not normally distributed, as long as it has the number of subjects for each variable (Azwar, 2001). In addition, Hadi (2015) research explains that whether or not data is normal in research does not affect the final results. Then, Nurudin et al. (2014) also stated that if the number of subjects is greater than or equal to 30, the data remains normally distributed regardless of the initial form of distribution. This study used research subjects from as many as 44 companies with a total sample of 132, so the data distribution in this study can be declared normal.

b. Multicollinearity Test

Table 10 Multicollinearity Test Results

	Narcissism CEO	Free Cash Flow	Financial Performance
Narcissism CEO	1.000000	0.100650	-0.081327
Free Cash Flow	0.100650	1.000000	-0.242310

Financial Performance	-0.081327	-0.242310	1.000000

Based on the multicollinearity test results in Table 10, shows the results of the correlation comparison for each variable that does not have a correlation value < 0.9, which means that there is no multicollinearity in the relationship between the independent variables.

c. Heteroscedasticity Test

Table 11 Heteroscedasticity Test Results Model 1

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.730129	5.265178	-0.138671	0.8900
Narcissism CEO	-0.036007	1.796080	-0.020048	0.9841
Free Cash Flow	-0.001840	0.022027	-0.083528	0.9336

Table 12 Heteroscedasticity Test Results Model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	20.47100	3.388052	6.042116	0.0000
Narcissism CEO	-6.728399	1.146080	-5.870793	0.0942
Free Cash Flow	-0.000204	0.013745	-0.014865	0.9882
Financial Performance	0.939163	3.602102	0.260726	0.7949

The results of the heteroscedasticity test in Table 11 and Table 12 show that the probability value of each variable is more than alpha (0.05), so it can be interpreted that there are no symptoms of heteroscedasticity in this research model.

4.4 Panel Data Regression Analysis

a. Partial Test (t-Test)

Table 13 Partial Test Results (t-Test) Model 1

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-21.87577	3.934158	-5.560470	0.0000
Narcissism CEO	7.185027	1.343483	5.348061	0.0000

Free Cash Flow	0.001298	0.013006	0.099808	0.9207

Table 14 Partial Test Results (t-Test) Model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.229752	0.098353	2.336003	0.0218
Narcissism CEO	0.066540	0.033550	1.983270	0.0050
Free Cash Flow	3.87E-05	0.000411	0.094144	0.9252

Table 15 Partial Test Results (t-Test) Model 3

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-20.58996	4.072459	-5.055902	0.0000
Narcissism CEO	7.090344	1.343603	5.277112	0.0000
Free Cash Flow	-0.002471	0.013363	-0.184916	0.8536
Financial Performance	-2.292004	1.918535	-1.194664	0.2344

The results in Table 13, it can be seen that the CEO narcissism variable has a probability value smaller than alpha or 0.0000 <0.05, with a positive coefficient value of 7.185027, it can be concluded that H0 is rejected and H1 is accepted. Then, the free cash flow variable has a probability value greater than alpha or 0.9207> 0.05, with a positive coefficient value of 0.001298, it can be concluded that H0 is accepted and H1 is rejected.

The results in Table 14, it can be seen that the CEO narcissism variable has a probability value smaller than alpha or 0.0050 < 0.05, with a positive coefficient value of 0.066540, it can be concluded that H0 is rejected and H1 is accepted. Then, the free cash flow variable has a probability value greater than alpha or 0.9252> 0.05, with a positive coefficient value of 3.87E-05, it can be concluded that H0 is accepted and H1 is rejected.

The results in Table 15, it can be seen that the financial performance variable has a probability value greater than alpha or 0.2344> 0.05, with a negative coefficient value of -2.292004, it can be concluded that H0 is accepted and H1 is rejected. Furthermore, the CEO narcissism variable mediated by financial performance has a probability value smaller than alpha or 0.0000 <0.05, with a positive coefficient value of 7.090344, it can be concluded that H0 is rejected and H1 is accepted. Meanwhile, the free cash flow variable mediated by financial performance has a probability value greater than alpha or 0.8536 <0.05, with a negative coefficient value of -0.002471, it can be concluded that H1 is rejected and H0 is accepted.

Table 16 Simultaneous Test Results (F-Test) and R^2 Model 1

R-squared	0.183612	Mean dependent var		-0.852770
Adjusted R-squared	0.170955	S.D. dependent var		4.462980
S.E. of regression	4.063629	Akaike info criterion		5.664495
Sum squared resid	2130.187	Schwarz criterion		5.730013
Log likelihood	-370.8567	Hannan-Quinn criter.		5.691118
F-statistic	14.50654	Durbin-Watson stat		0.909358
Prob(F-statistic)	0.000002			

Table 17 Simultaneous Test Results (F-Test) and R2 Model 2

R-squared	0.192614	Mean dependent var		-0.852770
Adjusted R-squared	0.173691	S.D. dependent var		4.462980
S.E. of regression	4.056917	Akaike info criterion		5.668558
Sum squared resid	2106.697	Schwarz criterion		5.755916
Log likelihood	-370.1248	Hannan-Quinn criter.		5.704056
F-statistic	10.17879	Durbin-Watson stat		0.909091
Prob(F-statistic)	0.000005			

b. Simultaneous Test (F Test)

The results in Table 16 show that the probability value of the F-statistic is 0.000002. This can be interpreted that the profitability in model 1 is less than alpha (0.05). So it can be concluded that the variables of CEO narcissism and free cash flow together (simultaneously) affect earnings management in financial sector companies listed on the Indonesia Stock Exchange (IDX).

The results in Table 17 show that the probability value of the F-statistic is 0.000005. This can be interpreted that the profitability in model 2 is less than alpha (0.05), so H0 is rejected and H1 is accepted. So it can be concluded that the variables of CEO narcissism and free cash flow mediated by financial performance together (simultaneously) affect earnings management in financial sector companies listed on the Indonesia Stock Exchange (IDX).

c. Test Coefficient of Determination (R^2)

The results in Table 16, the Adjusted R-squared value of model 1 is 0.170955 or 17.09%. This means that the independent variables which include CEO narcissism and free cash flow can explain the dependent variable, namely earnings management, by 17.09%. While the remaining 82.91% is influenced by other variables not included in this study.

The results in Table 17, the Adjusted R-squared value of model 2 is 0.173691 or 17.36%. This means that the independent variables which include CEO narcissism and free cash flow mediated by earnings management can explain the dependent variable, namely earnings management, by 17.36%. While the remaining 82.64% is influenced by other variables not included in this study.

5. DISCUSSION

5.1 The Relationship of CEO Narcissism to Earnings Management

The results showed that CEO narcissism has a positive effect on earnings management. Based on the perspective of upper echelons theory, it highlights the important role of individual characteristics at the top of the organization in shaping corporate strategic decisions and accounting practices. This shows that individual psychological factors, such as the level of narcissism, can be one of the relevant variables in understanding managerial behavior and company performance. These results are in line with research conducted by Rusydi (2021) and Meiliya & Rahmawati (2022) which state that CEO narcissism has a significant positive effect on earnings management. However, it is not in line with the research of Christian & Sulistiawan (2022) and Shinthia & Arisman (2023) which state that narcissism is unable to explain earnings management.

5.2 Relationship between Free Cash Flow and Earnings Management

The results showed that free cash flow did not have a positive effect on earnings management. This means that managers may not take advantage of free cash flow significantly to carry out earnings management or that other factors in the organization have a stronger influence in determining earnings management practices. The results of this study are in line with the research of Kosasih & Paramitha (2021) and Sagala & Simbolon (2021) which show that free cash flow does not affect earnings management. However, contrary to research conducted by Seri Murni (2018) and Dian et al. (2013) which shows that free cash flow has a significant effect on earnings management.

5.3 The Relationship of CEO Narcissism to Financial Performance

The results showed that CEO narcissism has a positive effect on financial performance. Agency theory considers the CEO as the main representative of the company responsible for managing day-to-day operations. In this case, CEO narcissism can encourage the CEO to take risks and make short-term profit-oriented decisions that may have a positive impact on financial performance. The results of this study are in line with Youssef (2022) research which states that CEO narcissism has a positive influence on financial performance. However, it is different from the research of Muttiarni et al. (2022) and Maduwu & Richard F. Simbolon (2023) which show that CEO narcissism cannot affect financial performance.

5.4 Relationship between Free Cash Flow and Financial Performance

The results showed that free cash flow did not have a positive effect on financial performance. Free cash flow is the money that remains after the company has made all the necessary capital investments. Therefore, the findings indicate that the company is unable to allocate free cash flow efficiently to improve financial performance, and there are agency problems in the company that require further attention from company stakeholders. The results of this study are in line with the research of Eva (2020) and Ahira (2019) which state that there is no influence between free cash flow and financial performance. However, it is different from Research by Rambe (2020) and Syamsudin et al. (2019) which shows the influence of free cash flow on financial performance.

5.5 Relationship between Financial Performance and Earnings Management

The results showed that financial performance has no negative effect on earnings management. Strong financial performance can be considered as a positive signal that the company is operating well and has good prospects in the future. The research findings can be interpreted as an indication that companies tend to rely on strong financial performance as a positive signal to the market, and therefore no potentially harmful earnings management actions are required. This result is in line with the research of Sulistyoningsih (2019) and Pramesti & Rahayu (2021) which state that financial performance does not affect earnings management. However, it is not in line with Sihombing (2020) and Indahsari & Prabowo (2021) research which shows that financial performance can affect earnings management.

5.6 The Role of Financial Performance in Mediating the Relationship between CEO Narcissism and Free Cash Flow on Earnings Management

The results showed that CEO narcissism mediated by financial performance has a positive effect on earnings management. Meanwhile, free cash flow mediated by financial performance has no negative effect on earnings management. Analysis of the financial performance variable that can mediate the relationship between CEO narcissism and earnings management is stated as a partial mediation variable because after including the mediation variable, the effect of variable X1 on Y which was previously significant remains significant. This result agrees with the research of Olsen et al. (2014) which concluded that narcissistic CEOs prefer to influence company performance through real management decisions rather than taking earnings management actions.

6. CONCLUSION

Earnings management is one of the various efforts that companies can make in engineering the numbers in the financial statements so that the company's financial statements can look in good condition for stakeholders.

The purpose of this study is to examine whether a narcissistic CEO and high free cash flow will motivate management to engage in earnings management practices to achieve corporate performance targets. This study contributes to the literature by showing which management practices are affected by CEO narcissism and free cash flow. Then, management decisions are influenced by CEO narcissism and free cash flow mediated by financial performance. This study uses data from 44 financial services or banking companies from 2020-2022 that have been listed on the Indonesia Stock Exchange (IDX). The data analysis technique used in this study is the panel data regression analysis method.

This study seeks to clarify the relationship between upper echelons theory, agency theory, and signaling theory with management behavior that can influence stakeholder decisions. Empirical results on the tested data show that (1) CEO narcissism can affect earnings management practices. (2) Free cash flow does not affect earnings management. (3) CEO narcissism affects financial performance. (4) Free cash flow cannot affect financial performance. (5) Financial performance does not affect earnings management. (6) Financial performance can mediate the relationship between CEO narcissism on earnings management. (7) Financial performance is unable to mediate the relationship between free cash flow on earnings management.

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