

Does CEO Reputation Matter to Financial Reporting Quality?

CEO 聲譽會影響財務報導品質嗎？

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Abstract

Financial reporting credibility is important because decision-useful information is greatly appreciated by all market participants. From a sample of 303 incumbent CEOs from Taiwanese listed electronics firms during the period from 2006-2008, the present study explores to what extent CEO reputation affects a firm's earnings quality. The efficient contracting hypothesis predicts reputed CEOs produce higher quality financial reports while the managerial opportunism hypothesis posits the opposite. Empirical findings indicate that the efficient contracting hypothesis dominates in explaining such relationships. Moreover, the positive CEO reputation effects persist in family firms because of their strong incentive to protect the longevity and reputation of the family, supporting the alignment of interest argument. Overall, our results provide additional evidence on variations in CEO reputation-earnings quality relationships using an international setting with distinctive features related to concentrated ownership and the abundance of family firms.

【Keywords】CEO reputation, earnings quality, family firm

摘要

資本市場參與者仰賴財務資訊進行重要決策，而高品質的財務報表提供可信及有用的資訊，更能反映企業的經濟實質。本文以 2006-2008 間 303 家台灣電子業之現任 CEO 為樣本，檢視 CEO 聲譽是否會影響企業之盈餘報導品質。效率契約假說預期 CEO 因聲譽考量會採取效率報導行為，故其盈餘品質較高；但管理投機行為假說則認為高聲譽 CEO 會因投機目的進行盈餘裁量，故其盈餘品質較低。實證結果顯示，CEO 聲譽效果確實會影響企業之財務報導決策，且當 CEO 聲譽愈高時，企業之盈餘品質愈佳，支持效率契約假說。此外，CEO 之聲譽效果在家族企業中仍然存在，支持利益一致之觀點。本研究以所有權高度集中及家族企業林立之國家為樣本，隱含 CEO 聲譽－盈餘品質之關係需考量機構背景不同而下定論。

【關鍵字】CEO 聲譽、盈餘品質、家族企業

1. Introduction

Firms are competing in the capital market to acquire resources. The quality of financial reporting is important to capital providers and other stakeholders because they rely on a firm's earnings information to make crucial decisions (IASB, 2008). Finance scholars argue that managerial characteristics may form corporate policies, including financial reporting decisions (Ali and Zhang, 2015; Francis, Huang, Rajgopal, and Zang, 2008; Graham, Harvey, and Rajgopal, 2005; Malmendier and Tate, 2009). It is therefore urgent to extend this line of research in accounting to study the effects of managerial traits on firm financial reporting quality.

Reputation research indicates that reputation concerns affect the behavior of business professionals (Fich and Shivdasani, 2007; Larcker and Richardson, 2004). A CEO occupies the highest position in a firm and is the human face of the organization. A firm's reputation is mostly based on the image of its CEO, and thus the CEO's reputation is one of the most important and intangible assets of a firm (Gaines-Ross, 2003). The CEO reputation effect on firms' reporting decisions is crucial since high-quality financial reporting is greatly appreciated by market participants (Watts and Zimmerman, 1986).

The generally accepted accounting principles grant great latitude for managers to exercise judgment in financial reporting. Two arguments in positive accounting research (Watts and Zimmerman, 1978) categorize managerial incentives related to exercising accounting discretion as either efficient or opportunistic motivation. The former argues that managers exercise accounting discretion in an efficient manner to protect shareholder value in the long run. The latter posits that self-opportunistic managers systematically exploit accounting discretion to increase their own wealth at the expense of shareholders.

Although limited in quantity, several studies have explored the relationship between CEO reputation and a firm's reporting credibility, but the results have been mixed. Some have predicted positive externalities from CEO reputation, supporting the efficient contract hypothesis. For instance, Ali and Zhang (2015) investigated how CEO tenure affects firm reporting quality. They asserted that CEOs build up their reputation as their durations extend, and thus earnings are of higher quality. Jian and Lee (2011) investigated how markets react to capital investment announcements. They demonstrated that stock markets respond more favorably on capital investment announced by reputable CEOs due to their reporting credibility. Hence, CEO reputation converts into the unseen wealth of a company. However, there are studies that have claimed that highly reputed CEOs engage in earnings management behavior for their self-interests, supporting the managerial

opportunism hypothesis. Francis et al. (2008) provided empirical evidence on how reputable CEOs use their discretionary power to manipulate earnings to improve labor and stock market perceptions. Hamilton and Zeckhauser (2004) also found that CEOs with superstar status are more likely to pursue fame at the expense of shareholder interests. They put more effort into activities outside the firm and thus are likely to inflate reported performance through earnings management in order to meet market expectations (Malmendier and Tate, 2009). These inconsistent findings indicate that CEO reputation effects may be circumstantially related to the issues under investigation thus leading to contestable conclusions.

The above mentioned literature mostly has examined firms with diffuse ownership structures, which is more popular in the U.S. However, family owned businesses are common in most locations outside of the U.S. and the U.K. (Claessens, Djankov, Fan, and Lang, 2002). Firms in East Asia, in particular, encounter agency problems between controlling and minority owners arising from ownership concentration. Claessens et al. (2002) reported that 80% of the management in Taiwanese listed companies is derived from controlling families. When controlling owners gain effective control of a firm, they also control the financial reporting decisions and the quality of the accounting information. Two lines of thinking explain the relation between family ownership and earnings quality. The alignment argument contends that the controlling family is concerned about the longevity and reputation of the family and is devoted to monitoring managers, thus there is a lower risk of earnings manipulation (Cascino, Pugliese, Mussolino, and Sansone, 2010; Sánchez-Ballesta and García-Meca, 2007; Wang, 2006). The entrenchment argument, on the other hand, reasons that the controlling family entrenches the wealth of other stakeholders by concealing the actual financial performance of the firm, resulting in a lower quality of accounting (Fan and Wong, 2002; Yang, 2010). There is evidence on nonlinear relationships showing that extreme levels of ownership concentration (either too high or too low) limit the quality of financial reporting (Sánchez-Ballesta and García-Meca, 2007). This literature mainly considers how family and ownership structures affect earnings quality of a firm, but ignores the potential effects of managerial reputation. Since this study focuses on the effect of the personal traits of CEOs on firm financial reporting quality, it is beneficial to examine if family ownership matters in the CEO reputation-earnings quality relationships. More research is warranted to disentangle how these intertwined relationships affect corporate financial reporting.

Several reasons motivate us to conduct this study using Taiwanese samples. First,

extant literature on the link between CEO reputation and financial reporting quality is mainly U.S. based. We acknowledge significant differences between Eastern and Western cultures with regard to individual self-concepts and their implications on business decision-making processes (Begley and Tan, 2001). CEO reputation-earnings quality relationships may vary in different cultural contexts. Second, Lafond (2008) proposed a study of CEO reputation-earnings quality relationships in international settings because such settings might yield more powerful tests for the distinctive features of concentrated ownership and large numbers of family firms. Indeed, family controlled businesses are common in Taiwan as opposed to the U.S. Thus, the extent to which reputation affects firm reporting behavior in family business contexts is an empirical question that has never been explored in the literature on this topic. Lastly, low transparency remains a major issue in the governance of public firms in East Asia (Fan and Wong, 2002). Differences in reporting regimes, governance, and the role of other stakeholders may yield different results regarding the relationship between CEO reputation and firm reporting quality (Lafond, 2008). The external reputation of top management could potentially affect how the public perceives the value and integrity of a firm. This is particularly important in assessing the quality of financial reporting in such an opaque reporting environment.

This study mainly explores the CEO reputation effect on firm financial reporting quality. We find a positive association between CEO reputation and the earnings quality of a firm, supporting the efficient contract hypothesis. In the family firm context, the positive CEO reputation effects persist. Reputation concerns from the family induce their commitment to convey quality information to outsiders, supporting the alignment of interest hypothesis. The results correspond to the public's perceptions that CEO reputation does matter to the financial reporting credibility of a firm.

This study makes incremental contributions to the relevant literature. First, reputation literature indicates that the CEO reputation effect on firm reporting quality is circumstantially related to the issues under investigation. The results of this study provide additional evidence through the use of different organizational settings, explaining the variations on the CEO reputation effects. Second, family related research usually focuses on how ownership structure affects the quality of financial reports. This study involves the CEO personal reputation factor to improve our understanding of the human capital dimension effect on earnings quality. Lastly, this study builds on previous research on CEO reputation-earnings quality relationships but extends them to family businesses, thus shedding light on the unexploited topic of a three-circle diagram composed of family,

managers, and owners.

The literature pertaining to the above issues is reviewed and hypotheses are developed for testing. The remainder of this paper is organized into six sections. Section 2 is a review of the relevant literature and provides an explanation of the development of the hypotheses. Section 3 describes the research methods. Section 4 presents the empirical results, followed by further analyses. Section 6 includes discussion and conclusions. The last section provides the limitations and suggestions for future study.

2. Literature Review and Hypotheses Development

2.1 Taiwanese Institutions Affecting CEOs' Incentives in Financial Reporting

This section discusses institutional factors in corporate ownership structure and culture that may potentially affect the CEO reputation-earnings quality relationship.

2.1.1 Corporate Ownership Structure

In East Asia, the ownership structure of listed companies is highly concentrated in the hands of large shareholders (Claessens et al., 2002; Fan and Wong, 2002). Controlling owners in these regions achieve concentrated control through complicated ownership arrangements such as stock pyramids and cross-shareholdings. In Taiwan, family controlled firms are common, and ownership is often concentrated within a controlling family (Tsai, Hung, Kuo, and Kuo, 2006; Yang, 2010).

The degree of ownership concentration affects the nature of contracting, thus creating different agency problems between managers and shareholders. For firms with diffuse ownership, as in the case of the U.S., agency costs arise from conflicts of interest between management and outside shareholders. Agency theory speculates that managers (especially CEOs) may indulge in opportunistic rent-seeking behavior at the expense of shareholders. In economies with concentrated ownership and an abundance of family firms, however, firms encounter different agency problems. Controlling families expropriate the interest of minority shareholders by covering their self-oriented behavior (Fan and Wong, 2002). Using Taiwanese samples, Yang (2010) confirmed that the larger the level of inside family ownership, the greater the extent of earnings management.

The literature on this topic also examines the role of CEOs on firm financial reporting quality. Using U.S. firms as samples, Francis et al. (2008) found that CEOs rely on earnings management to maintain their reputations, consistent with the viewpoint of agency theory. Does the same CEO reputation- earnings quality relationship hold for other countries? Family control is common for firms in East Asia. Business is considered to be

an extension of the family system, and business activities are designed to preserve and increase the wealth and status of the family (Zapalska and Edwards, 2001). In addition, the CEOs of family firms usually have close ties with the controlling family (Prencipe, Markarian, and Pozza, 2008). The decisions of CEOs in family firms may tend to be highly concerned about the longevity of the firms and thus place less emphasis on short-term financial results.

2.1.2 Cultural Influences

According to findings by Tan and Fock (2001), more than 50% of businesses in East Asia are family-controlled, and many of them are owned and operated by Chinese families. Chinese culture is influenced by Confucianism, which emphasizes values related to paternalism and collectivism. The centralization of decision-making is acceptable in such a cultural context, and a traditional respect for authority and hierarchy is important in forming a person's social prestige (Zapalska and Edwards, 2001). These traditional values are still vital despite modernization (Hofstede and Bond, 1988).

Cultural values also influence how business managers form their self-concept (Markus and Kitayama, 1991). Western culture is rooted in independent construal of the self, which suggests that individuals are inherently separate from others. The inner selves (preferences, tastes, abilities, personal values, etc.) are the most significant factors regulating behavior.

In contrast, the interdependent construal of the self, commonly found in Asian cultures, is based on the fundamental connectedness of human beings to each other. One's identity lies in one's familial, cultural, professional, and social relationships. Individuals with a highly interdependent construal of self will be more concerned about social roles and family relationships. Thus, social prestige and family reputation are important considerations in shaping management style. The influence of cultural values on CEOs in financial reporting quality is an issue of interest to many practitioners and academics.

2.2 CEO Reputation

Reputation affects how the market perceives a CEO's ability (Fama, 1980; Milbourn, 2003). Several reasons delineate why CEOs are concerned about their reputations. First, CEOs have reached the top of the leadership pyramid, and their ethics and values are set to those of the company. CEO reputation is important to a corporation for its linkage to the reputation of the company itself. Second, CEO reputation determines how employees, customers, potential customers, analysts, government regulators, and investors value and

ultimately respond to a company. Finally, and most importantly, reputation is associated with a CEO's personal benefits related to executive remuneration and dismissal/retention decisions. Loss of reputation may result in a decline in social prestige and disapproval from one's peers (Francis et al., 2008). In general, CEOs have a strong incentive to build and protect their reputations.

Reputation-related research suggests that reputation concerns affect the behaviors of business professionals. For example, analysts who are concerned about their reputation usually avoid overly optimistic forecasts (Jackson, 2005). Highly reputed analysts are more likely to maintain relatively accurate forecasting (Fang and Yasuda, 2014). In order to protect their reputation, prestigious underwriters apply more stringent standards for certification and intense monitoring to restrict firm incentives related to earnings management (Jo, Kim, and Park, 2007). Accounting studies consider reputation as the market's perception of a firm's financial reporting credibility (Farber, 2005; Desai, Hogan, and Wilkins, 2006; Srinivasan, 2005). Directors of companies found guilty of financial fraud experience reputation penalties (Fich and Shivdasani, 2007; Srinivasan, 2005). Reputable auditors are less likely to allow big clients to make abnormal accrual choices (Larcker and Richardson, 2004). Directors in firms that have undergone financial distress (Gilson, 1990), liquidation (Harford, 2003), poor performance (Yermack, 2005), and reduced dividends (Kaplan and Reishus, 1990) will experience a loss of reputation.

However, identifying of proxies for CEO reputation is difficult because of its multi-dimensional nature comprising of perceived competence at the task, credibility, charisma, integrity, and vision (Francis et al., 2008; Milbourn, 2003). There is no direct measure, but literature suggests indirect but observable measures by which to quantify it. Since a CEO's reputation is essentially the market's assessment of ability, assessment by parties external to the firm seems a feasible approach. Several studies have used an executive's prominence in the press to measure CEO reputation (e.g., Francis et al., 2008; Jian and Lee, 2011; Malmendier and Tate, 2009; Milbourn, 2003) because of its observability by the market. It therefore serves as a potentially reliable guide to the aggregate assessment of CEO ability (Milbourn, 2003).

2.3 CEO Reputation and Earnings Quality

The quality of financial reporting affects various economic entities. Specifically, capital providers and other stakeholders rely on a firm's earnings information to make investment, credit, and resource allocation decisions (IASB, 2008). High quality financial

statements provide users with reliable information (Watts and Zimmerman, 1986) and better reflect the underlying economic foundation of companies.

The latitude allowed by generally accepted accounting principles enables managers to exercise judgment in the process of preparing financial statements (Bowen, Rajgopal, and Venkatachalam, 2014). Earnings consist of two components: cash flow and accruals. The first component is more objective and hardly manageable through accounting policies, while the latter is more discretionary. Yen, Chang, and Wu (2016) indicate that agency problem and moral development will affect the behavioral intention on earnings management activities. Managers determine the level of accounting discretions before that of real activities manipulations (Hsieh and Wu, 2015). Preparers can use their discretion to manipulate earnings (via accruals) to alter financial reports and mislead stakeholders about underlying firm performance, thus achieving private benefits (Dechow and Dichev, 2002).

Although CFOs are the persons directly responsible for firm financial reporting quality, we choose CEOs in order to link their reputation to earnings quality for the following reasons: First, CEOs are responsible for setting the tone and defining company direction, and they naturally are capable of exerting a significant influence on corporate financial reporting decisions (Graham et al., 2005; Malmendier and Tate, 2009). A CFO reports to a CEO and normally will concur with the CEO's decisions. Second, users of financial statements consider the external reputation of top management to be a key factor in assessing the quality of financial reporting (Francis et al., 2008). Lastly, CFO reputation is less evident because most literature assesses CEO reputation for reporting quality (e.g., Ali and Zhang, 2015; Francis et al., 2008; Jian and Lee, 2011; Malmendier and Tate, 2009; Yang, 2010).

Manager's reputation significantly affects their financial reporting decisions (Ali and Zhang, 2015; Francis et al., 2008). Managers can purposefully intervene in the earnings determination process and exercise discretion either in an efficient or opportunistic manner (Watts and Zimmerman, 1978). Agency theory argues that the reputation effect induces behavior that is in the interest of the principal, even without a formal contract (Fama, 1980). Under the efficient contracting perspective, reputation concerns affect the behavior of professionals, such as financial analysts, investment bankers, auditors and directors, and cause them to focus on long-term benefits in lieu of short-term interests (Fich and Shivdasani, 2007; Larcker and Richardson, 2004). Managers who are concerned about their reputation will not indulge in opportunistic behavior. Thus, corporate

reputation is associated with higher financial reporting quality (Cao, Myers, and Omer, 2012). The stock market responses to announcements of capital investments are more favorable for firms with more reputable CEOs (Jian and Lee, 2011). Milbourn (2003) found a positive and economically meaningful relationship between stock-based compensation and CEO reputation. High quality reporting is beneficial for firms to lessen the cost of capital (Francis, LaFond, Olsson, and Schipper, 2004) and obtain higher market liquidity (Diamond and Verrecchia, 1991). Ali and Zhang (2015) posited that CEOs' tendency to build and protect reputation affects how aggressively earnings are reported. Any detection of aggressive reporting can make shareholders doubt the credibility of the CEO's previously reported performance and can substantially impair the CEO's reputation. As such, reputable CEOs are likely to refrain from aggressive financial reporting. Reputation concerns motivate reputable CEOs to maintain high financial reporting quality, leading to a positive association between CEO reputation and earnings quality. Hypothesis H1a states:

H1a: Under the premises of the efficient contracting hypothesis, CEO reputation positively affects the quality of earnings of a firm.

The extant literature also provides a different view. The managerial opportunism hypothesis articulates that reputed CEOs who overemphasize their personal interest in terms of career enhancement and future compensation will adopt aggressive reporting strategies (Francis et al., 2008), such as earnings management, to convey inside information to the market in order to satisfy selfish objectives (Schipper, 1989). To avoid missing forecast earnings, CEOs may lower the quality of accruals to meeting earnings targets. Two prior studies investigated the relationship between CEO reputation and earnings quality. Using samples from the U.S., Francis et al. (2008) documented a negative relationship between CEO reputation and earnings quality. Furthermore, they found that firms with poor earnings quality search for reputable CEOs for their talent to handle volatile operating environments. When CEOs over-emphasize their personal interests, they take actions that worsen the quality of discretionary earnings to meet both market and analysts' expectations. Consequently, CEOs are more inclined to use their status to extract rent from the firm. In addition, the perks of success may distract them from effectively running their companies. Repeatedly underperforming in regard to expectations is likely to undermine the CEO's status. Malmendier and Tate (2009) demonstrated that superstar CEOs manage earnings to report strong financial performance

to the stock market. Thus, the managerial opportunism hypothesis points to a negative association between CEO reputation and earnings quality. This study develops a competing hypothesis H1b as below.

H1b: Under the premises of the managerial opportunism hypothesis, CEO reputation negatively affects the quality of earnings of a firm.

Extant literature studying the reputation effect on a firm's reporting credibility generates contestable results and mostly uses U.S. samples (e.g., Ali and Zhang, 2015; Francis et al., 2008; Hamilton and Zeckhauser, 2004; Jian and Lee, 2011). More studies are warranted considering different cultures or distinctive ownership structures in order to provide more insightful knowledge on their relationships (Lafond, 2008).

2.4 Does Family Ownership Matter to CEO Reputation-Earnings Quality Relationships?

Ownership structure affects the quality of corporate financial reporting (Fan and Wong, 2002). Family owned businesses, in particular, have been the focus of much attention because of the presence of concentrated ownership in the hands of a controlling family and because of their symbolic exemplar for generalizations (Moore, 2009). Several studies have examined how family ownership structure affects the quality of earnings of a firm (e.g., Cascino et al., 2010; Jiraporn and Dadalt, 2009; Wang, 2006; Yang, 2010; Zhao and Millet-Reyes, 2007). However, these studies failed to consider the effects of the human capital component of executives, such as reputation, on the quality of financial reporting.

According to the entrenchment argument (Wang, 2006), high ownership concentrated in the hands of a small number of shareholders can result in entrenchment. Fan and Wong (2002) suggested that controlling families have a tendency to cover their self-oriented behavior by manipulating earnings information. Yang (2010) concurred by suggesting that earnings management increases with insider ownership in family firms. The practice of expropriation by controlling owners lowers the credibility of accounting earnings and the stock price informativeness of those earnings (Fan and Wong, 2002). Sánchez-Ballesta and García-Meca (2007) demonstrated that the relationship between ownership concentration and the quality of financial reporting is non-linear with a concave shape. In other words, the quality of financial reporting is the lowest when there are extremely low or high levels of ownership concentration. In the U.S. context, an increase in managerial

ownership has a positive effect on the informativeness of earnings (Warfield, Wild, and Wild, 1995). In Europe (Beuselinck and Manigart, 2007; Gabrielsen, Gramlich, and Plenborg, 2002), East Asia (Fan and Wong, 2002) and Australia (McKinnon and Dalimunthe, 1993), where ownership is highly concentrated, the quality of accounting information worsens with ownership concentration. In the family firm context, the alignment of interest argument predicts a positive relation between CEO reputation and earnings quality. This study forms H2a based on the above discussion.

H2a: In the family firm context, the entrenchment argument prevails and predicts a negative CEO reputation-earnings quality relationship.

However, there are studies that point in the opposite direction. According to the alignment of interest argument, higher ownership concentration is beneficial because it reduces agency conflicts between owners and managers (Jensen and Meckling, 1976). Family firms are generally characterized as long-term oriented. Founding families, representing a unique class of shareholders that hold poorly diversified portfolios, are long-term investors consisting of multiple generations (Anderson and Reeb, 2003). Family reputation concerns induce owner commitment towards maximizing firm value (Davis, Schoorman, and Donaldson, 1997). Wang (2006) contended that founding families report lower abnormal accruals, greater earnings informativeness, and less persistence of transitory loss components in earnings, mainly due to their reputation concerns. Founding families provide higher quality financial statements in order to enhance the communication between the insider and outsiders (Wang, 2006). In addition, the relationship between managers and owners can profoundly reduce the risk of rent-extraction by the top management team (Chen, Chen, and Cheng, 2008). Compensation literature also indicates that executive remuneration in family firms rarely relates to accounting information. Consequently, family firms face a lower risk of earnings manipulation (Ali, Chen, and Radhakrishnan, 2007). Moreover, family firms take risks for different reasons for the purpose of preserving family control of the firm (Gomez-Mejia, Nuñez-Nickel, and Gutierrez, 2001). Using Italian firms as samples, Cascino et al. (2010) concurred that family firms convey higher quality accounting and market based financial information compared to their non-family peers. This study proposes a competing hypothesis H2b.

H2b: In the family firm context, the alignment of interest argument prevails and predicts a positive CEO reputation-earnings quality relationship.

Extant studies exploring the relation between family ownership and earnings quality has generated mixed results. More studies are warranted to test the CEO reputation effect on earnings quality in the family firm context.

3. Research Method

3.1 Sample

A sample of CEOs in the Taiwanese electronic industries between 2006 and 2008 was selected for the purposes of this study. We focus on electronic industries for several reasons. First, this segment represents the most important segment in Taiwan inclusive of telecommunication, information technology, consumer electronics, semiconductor, according to the breakdown of eight industry codes by the Taiwan Stock Exchange. There are substantial numbers of publicly held firms providing a good object for the study of CEO personal traits on financial reporting decisions. Second, electronic businesses are high-tech oriented and highly cyclical thus attracting a great deal of attention from the public and the media, which potentially allows us to observe an array of managerial dispositions. Chatterjee and Hambrick (2007) argued that this segment is not highly regulated or otherwise constrained by the environment and thus is easier to use for observation of managerial behavior. Lastly, we gather CEO reputation proxies through extensive hand collection of data and individually read articles. Cost and time considerations require us to concentrate on a certain subset of firms in the population.

We consider general managers as CEOs since listed firms in Taiwan seldom use “CEO” as a job title. Reputation building is difficult (Reed and DeFillippi, 1990) and time consuming (Dierickx and Cool, 1989). A CEO is likely to develop his or her reputation over several years (Francis et al., 2008); measures of CEO reputation based on data in any individual year may be noisy measures of their true reputations. For this reason, we limit our sample to CEOs who have been on board for three consecutive years in order to observe the longer-term nature of CEO reputation, resulting in 303 firms (909 samples). Table 1 presents our sample selection results.

Table 1 Sample Selection

Year	2006	2007	2008
# of Electronics Firms	691	709	731
Exclude:			
CEO turnover and incomplete data	388	406	428
Final sample size	303	303	303

The financial data is from the Fiscal Databanks of the Taiwan Economic Press and company annual reports.

3.2 Empirical Strategy

Francis et al. (2008) posited that firms match CEOs based on characteristics of the firm and documented an endogenous relation between earnings quality and CEO reputation. Reputable CEOs are engaged in activities intended to strengthen earnings quality. Meanwhile, firms with high quality earnings attract reputable CEOs if the efficient contract hypothesis prevails, or vice versa if the managerial opportunism hypothesis applies. A simultaneous equations system is a plausible means by which to consider the possibility of bi-directional causality. In this study a set of two models is used to test the proposed hypotheses using two-stage least square estimations. Similar to Francis et al. (2008), we use Model 1 to explore how CEO reputation impacts a firm's earning quality, controlling for innate factors on earnings quality. In Model 2, we incorporate earnings quality as an independent variable to predict CEO reputation, controlling for CEO and firm specific characteristics and the corporate governance variable.

$$EQ_{i,t} = \alpha_0 + \alpha_1 Rep_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 M/B_{i,t} + \alpha_4 \sigma(CFO)_{i,t} + \alpha_5 \sigma(Sales)_{i,t} + \alpha_6 NegEarnings_{i,t} + \alpha_7 RDInt_{i,t} + \alpha_8 Lev_{i,t} + Year\ Dummy + \epsilon_{it} \quad (1)$$

$$Rep_{i,t} = b_0 + b_1 EQ_{i,t} + b_2 Edu_{i,t} + b_3 CEO_{ten} + b_4 CEO_{own} + b_5 LagTobinQ_{i,t} + b_6 LagROA_{i,t} + b_7 Boardmeeting + b_8 CEO_{own} * Bmeeting + b_9 CEO_{own} * Edu + b_{10} CEO_{own} * CEO_{ten} + \epsilon_{it} \quad (2)$$

$$EQ_{i,t} \in AQ_{i,t}, DAC_{i,t}$$

3.3 Endogenous Variables

3.3.1 Measurement of Earnings Quality

A rich stream of literature in accounting focuses on the specific desired properties of earnings in accrual quality and defines this as earnings quality (Dechow and Dichev, 2002). The role of accruals is to adjust the recognition of cash flow over time. The more accruals reflect the stream of cash flow of a firm, the higher their quality (Francis et al., 2004). Dechow and Dichev (2002) proposed a measure of earnings quality that captures the mapping of current accruals into lagged, current, and future cash flows. The standard deviation of accruals estimation errors represents an inverse measure of accrual quality. Since Dechow and Dichev (2002), accrual quality has become synonymous with overall earnings quality (Francis et al., 2004). The accrual quality model is computed as follows:

$$\frac{TCA_{i,t}}{Assets_{i,t}} = \alpha_{0,i} + \alpha_{1,i} \frac{CFO_{i,t-1}}{Assets_{i,t}} + \alpha_{2,i} \frac{CFO_{i,t}}{Assets_{i,t}} + \alpha_{3,i} \frac{CFO_{i,t+1}}{Assets_{i,t}} + \varepsilon_{i,t} \quad (3)$$

$TCA_{i,t}$: firm i 's total current accruals in year $t = \Delta CA_{i,t} - \Delta CL_{i,t} - \Delta Cash_{i,t} + \Delta STD_{i,t}$;

$Assets_{i,t}$: firm i 's average total assets in year t and $t-1$;

$CFO_{i,t}$: firm i 's Cash flows from operations in year t ;

$\Delta CA_{i,t}$: Changes in current assets between year t and $t-1$ for firm i ;

$\Delta CL_{i,t}$: Changes in current liabilities between year t and $t-1$ for firm i ;

$\Delta Cash_{i,t}$: Changes cash equivalents and short investments between year t and $t-1$ for firm i ;

$\Delta STD_{i,t}$: Changes in current maturities of long-term debt between year t and $t-1$ for firm i .

For each firm-year, we estimate Model 1 by rolling the five-year window yielding five firm specific residuals each year. Accrual quality is the standard deviation of firm i 's estimated residuals. Large (small) values of the estimated residuals correspond to poor (good) accrual quality (earnings quality).

3.3.2 Discretionary Accruals (DAC)

For robustness, the present study uses another measure of earnings quality commonly seen in the literature: discretionary. We estimate an accrual model by Kothari, Leone, and Wasley (2005), similar to the modified Jones model by augmenting ROA. Total accruals are measured as net income minus cash flows from operations. Then discretionary

accruals, a proxy for earnings quality, are estimated by subtracting nondiscretionary accruals from total accruals, where all accrual variables are scaled by lagged total assets to control for potential scale bias. Normal levels of working capital accruals related to sales are controlled through changes in revenue adjusted for changes in accounts receivable. Normal levels of depreciation expense and related deferred tax accruals are controlled through property, plant and equipment. Lagged ROA is added as suggested by Kothari et al. (2005). Finally, the residual (ε) from the regression is the discretionary accruals. We use the absolute value of discretionary accruals as an additional measure of earnings quality because both large (small), negative and positive values indicate poorer (better) mapping of accruals to cash flow.

$$TAC_{i,t} = DAC + NDAC$$

$$TAC_{i,t} = (\Delta CA - \Delta CSAH - \Delta CL + \Delta STD - DEP_{i,t}) / ASSETS_{i,t-1}$$

$$NDAC_{i,t} = \beta_0 + \beta_1(1/ASSETS_{i,t-1}) + \beta_2(\Delta REV_{i,t} - \Delta REC_{i,t}) \times (1/ASSETS_{i,t-1}) + \beta_3PPE_{i,t} \times (1/ASSETS_{i,t-1}) + \beta_4ROA_{i,t-1}$$

$$DAC_{i,t} = TAC_{i,t} - NDAC_{i,t}$$

where

$TAC_{i,t}$ = total accruals for company i in year t , defined as above.

$NDAC_{i,t}$ = non-discretionary accruals for company i in year t .

$DAC_{i,t}$ = discretionary accruals for company i in year t .

$\Delta REV_{i,t}$ = change in revenue for company i in year t .

$\Delta REC_{i,t}$ = change in receivables for company i in year t .

$PPE_{i,t}$ = net property, plant and equipment for company i in year t .

$ROA_{i,t-1}$ = return on assets for company i in year $t-1$.

$ASSETS_{i,t-1}$ = total assets for company i in year $t-1$.

3.3.3 CEO Reputation

Following the procedures of previous studies (Milbourn, 2003; Francis et al., 2008), we use content analysis to determine the level of media portrayal for CEOs. The data collection involves searching for the company name in conjunction with the name of the CEO (general manager) as key words using an internet media database (Knowledge Management Winner) covering the two most prestigious daily and commercial newspapers published in Taiwan: The China Times and the Commercial Times, as well as

several magazines. We individually read through each article to obtain how external parties view the CEO as reflected in the number of articles containing the CEO's name and company affiliation. The focus of this study is to inspect how personality traits affect a firm's financial reporting decisions; thus, personally-related reporting is dropped. Articles simply describing a company action or simply quoting a CEO are also dropped. From this procedure, we establish a media database on these CEOs. We use the article count as proxy for CEO reputation. Similar to Francis et al. (2008), we classify CEOs with larger values of press coverage (articles) as more reputable than CEOs with smaller values for this variable. This study takes additional procedures to validate the CEO reputation variable in the robustness test section.

3.3.4 Control Variables for Model 1

In Model 1, we control the determinants of earnings quality using measures of firm size, cash flow variability, sales variability, incidence of negative earnings realizations and R&D intensity (Dechow and Dichev, 2002). Firm size (*Size*) is the log of the firm's average total assets. Cash flow variability, $\sigma(CFO)$, is the standard deviation of firm *i*'s cash flow from operations. Sales variability, $\sigma(Sales)$, is the standard deviation of firm *i*'s sales. Incidence of negative earnings realization, *NegEarn*, is the dummy, where firm *i* reported negative values of net income before extraordinary items in any year. In addition, we expect that growth and high leverage firms will have poorer earnings quality. RD intensity is the ratio of RD expenses to net sales, and leverage is the debt to asset ratio.

SIZE = the log of the firm's average total assets.

M/B = Market to book ratio of a firm;

$\sigma(CFO)$ = the standard deviation of firm *j*'s cash flow from operations scaled by total assets.

$\sigma(Sales)$ = the standard deviation of firm *j*'s cash flow from operations scaled by total assets.

NegEarn = 1 if the number of years (out of the past five) where firm *i* reported negative values of net income before extraordinary items is greater than one, 0 otherwise.

RDint = R&D intensity;

Lev = debt ratio;

3.3.5 Control Variables for Model 2

Model 2 controls for CEO and firm-specific characteristics. Edu is the years of education of the CEO. CEOten is the CEO's tenure with the firm, and CEOown is the percentage ownership of the CEO in the firm. As to firm-specific characteristics, we include a market based performance measure, LagTobinQ, and an accounting based performance measure, LagROA, because the previous performance of a firm can affect a CEO's reputation. Board monitoring is important to firm performance (Vafeas, 1999), and thus monitoring from directors may enhance or impede a CEO's reputation. Thus, we add Boardmeeting based on the frequency of board meetings in a year. Additional variables are in the model from interactions of CEOown and Edu, CEOten and Boardmeeting.

4. EMPIRICAL RESULTS

4.1 Descriptive Statistics and Correlation Analysis

Table 2 presents the descriptive statistics. The mean value for accrual quality (AQ) and discretionary accrual (DAC) are 0.095 and 0.037, respectively, with standard deviations of 0.063 and at 0.030 respectively. The mean score for CEO reputation is 2.207, with a SD of 5.478. Average firm size is 9.560, with a standard deviation of 0.582; the average MTB is 1.657 with a standard deviation of 1.451. The average value of the standard deviation of cash flow from operations and sales revenues are 0.071 and 0.243, respectively. The average of negative earnings is 0.352 (SD 0.478). The ratio of R&D expenses to sales is 0.053 (SD 0.080). The average leverage ratio is 0.396.

The average year of education of CEOs is 16.255, and the average tenure is 13.178. The average CEO ownership in a firm is 0.053. The average market and accounting return of the previous year are 1.602 and 0.049, respectively. The average board meeting frequency is 8.704 times.

Table 2 Descriptive Statistics

Variables	Mean	Median	SD	Min	Max
AQ	0.095	0.080	0.063	0.01	0.504
DAC	0.037	0.029	0.030	0.002	0.306
Repu	2.207	0	5.478	0	37
SIZE	9.560	9.504	0.582	8.258	11.954
MTB	1.657	1.270	1.451	0.08	13.17
σ (CFO)	0.071	0.060	0.047	0.009	0.537
σ (SALES)	0.243	0.177	0.256	0.013	2.145
NegEarn	0.352	0	0.478	0	1
RDint	0.053	0.026	0.08	0	0.627
LEV	0.396	0.401	0.168	0.056	0.876
Edu	16.255	16.000	2.865	0	22
CEOten	13.178	10.417	7.465	0.750	39.917
CEOown	0.053	0.032	0.059	0	0.398
LagTobinQ	1.602	1.280	1.166	0	11.527
LagROA	0.049	0.051	0.098	-0.447	0.475
Boardmeeting	8.704	8.000	4.057	3	37
N	909				

Note: AQ: Accrual quality; DAC: Discretionary accrual; Repu: CEO reputation; SIZE: Firm size; MTB: Market to book ratio; σ (CFO): SD of cash flow from operations; σ (SALES): SD of sales; NegEarn: Negative earnings; RDint: R&D intensity; LEV: debt ratio; Edu: years of education; CEOten: years of CEO tenure in a firm; CEOown: % of ownership of a CEO; LagTobinQ: Ratio of equity at market value plus debt over asset at book value; LagROA: Return on assets of the previous year; Boardmeeting: Frequency of board meetings.

Table 3 presents the correlations for all variables. CEO reputation is significantly related to AQ, but insignificantly related to DAC, which provides partial support for H1. Firm size (SIZE) is negatively related to AQ and DAC, while MTB, σ (CFO), σ (SALES), and RDint are positively related to AQ and DAC.

As to the reputation model, Edu and CEO tenure are significantly and positively related to CEO reputation while CEO ownership exhibits a significant but negative relationship with CEO reputation. Board monitoring has a positive and significant impact on CEO reputation. More definitive tests require multiple regression analysis to consider compounding influences from other factors.

Table 3 Correlation Analysis

	AQ	DAC	Repu	SIZE	MTB	$\sigma(\text{CFO})$	$\sigma(\text{SALES})$	NegEarn
AQ	1							
DAC	.775**	1						
Repu	-.074*	-0.036	1					
SIZE	-.098**	-.135**	.521**	1				
MTB	.203**	.366**	.120**	-.089**	1			
$\sigma(\text{CFO})$.246**	.100**	-.145**	-.215**	-0.033	1		
$\sigma(\text{SALES})$.167**	.130**	-0.018	-0.037	0.021	.455**	1	
NegEarn	0.038	0.018	-0.056	-.099**	-.217**	.228**	.122**	1
RDint	.127**	.080*	-0.031	-.274**	.150**	.212**	-.078*	.110**
LEV	0.007	0.041	0.032	.234**	-.218**	-0.065	.169**	.207**
Edu	.122**	.076*	.091**	0.044	0.029	0.01	-0.002	.072*
CEOTen	-.206**	-.222**	.077*	0.054	-.151**	-.079*	-.167**	-0.014
CEOOwn	-0.056	-0.028	-.146**	-.200**	0.005	0.064	-.101**	0.021
LagTobinQ	.147**	.071*	.103**	0.006	.575**	0.002	-0.043	-.259**
LagROA	0.019	.088**	0.053	-0.008	.441**	-0.065	-0.06	-.459**
Boardmeeting	-0.055	0.04	.094**	.115**	0.06	-.115**	-.065*	-.069*

	RDint	LEV	Edu	CEO Ten	CEO Own	Lag TobinQ	Lag ROA	Board meeting
AQ								
DAC								
Repu								
SIZE								
MTB								
$\sigma(\text{CFO})$								
$\sigma(\text{SALES})$								
NegEarn								
RDint	1							
LEV	-.396**	1						
Edu	.161**	-.072*	1					
CEOTen	-.132**	0.015	-.207**	1				
CEOOwn	0.053	-0.041	-.192**	.239**	1			
LagTobinQ	.215**	-.372**	0.054	-0.056	0.022	1		
LagROA	-.113**	-.245**	-0.014	-0.031	0.012	.291**	1	
Boardmeeting	-0.049	-0.015	-0.048	0.014	-0.001	-0.021	.075*	1

Note: **. Significance at 0.01; *. Significance at 0.05; Variable definitions are same as Table 1.

4.2 CEO Reputation and Earnings Quality

4.2.1 For H1a and H1b

Table 4 is the results of the simultaneous equations modeling on the relation between CEO reputation and the earnings quality of a firm, indicating that reputed CEOs report significantly lower AQ (Coef = -0.005, $p = .03$). For robustness, we test the alternative measure of earnings quality in discretionary accrual (DAC) and report similar results (Coef = -.002, $p = .04$). This provides evidence that CEO reputation is associated with higher earnings quality in the mapping of accruals to cash flows and less extreme discretionary accruals. H1a is therefore supported.

In the AQ specification, control variable size, market to book ratio (MTB) and cash flow variability ($\sigma(\text{CFO})$) significantly affect AQ, meaning larger and growth firms, and firms with higher cash flow variability ($\sigma(\text{CFO})$) report higher accruals. As to the level of discretionary accrual, growth firms, firms with higher sales variability, negative earnings, and high level of debt report higher discretionary accruals.

Table 4 Results of Simultaneous Equations Modeling on the Relationships between CEO Reputation and Earnings Quality

	AQ				DAC			
	EQ Equation		CEO Reputation Equation		EQ Equation		CEO Reputation Equation	
	Coef.	p-value	Coef.	p-value	Coef.	p-value	Coef.	p-value
Repu	-0.005**	0.03			-0.002**	0.04		
EQ			-38.395***	0.00			-35.585**	0.04
SIZE	0.022**	0.05			0.004	0.39		
MTB	0.011***	0.00			0.009***	0.00		
σ (CFO)	0.269***	0.00			0.031	0.28		
σ (SALES)	0.015	0.11			0.008*	0.08		
NegEarn	0.004	0.47			0.004*	0.07		
RDint	0.047	0.17			0.001	0.94		
LEV	0.022	0.18			0.017**	0.02		
Year Dummy	Included				Included			
Edu			0.391***	0.00			0.348***	0.00
CEOten			0.062	0.17			0.103**	0.01
CEOown			57.369**	0.02			65.130***	0.01
LagTobinQ			0.650***	0.00			0.429**	0.01
LagROA			4.834***	0.03			5.774***	0.01
Boardmeeting			0.307***	0.00			0.338***	0.00
CEOown*Bmeeting			-2.784**	0.00			-2.794***	0.00
CEOown*Edu			-2.864**	0.02			-3.108***	0.01
CEOown*CEOten			-0.195	0.69			-0.415	0.369
Constant	-0.154	0.13	-4.383**	0.04	-0.027	0.55	-6.570***	0.00
First-stage Adj. R ²	15.77%		31.22%		31.22%		22.60%	
Second-stage Adj. R ²	6.60%		4.74%		11.74%		10.56%	

Note: Variable definitions are same as Table 1. ***, **Significance at 1%, **Significance at 5%, * Significance at 10%.

Additionally, the results also document a matching of firms with good earnings quality for reputable CEOs, which is consistent across AQ (Coef = -38.395, $p = .00$) and the alternative measure DAC (Coef = -35.585, $p = .00$). As to the control variables, we find education, CEO ownership and past accounting and market returns have significantly positive effects on CEO reputation in regard to both the AQ and DAC specifications. CEO tenure is only significant in the DAC specifications. As to board monitoring, board meeting frequency has a significant influence on CEO reputation, meaning close monitoring from the board enhances the building of a CEO's reputation.

Overall, the VIF indexes are between 1.223-1.651 in the regressions, which is less than 10, eliminating the possibility of multicollinearity. To test the possibility of serial correlation, we calculate the Durbin-Watson statistics. The DW = 1.998 for the AC specification, and the DW = 2.008 for the DAC specification. These values are greater than the upper limit critical value indicating no serial correlation at a 5% significance level. We also perform White tests for heteroskedasticity in the error distribution by regressing the squared residuals on all distinct regressors and on the squares of regressors. The test statistics generate a χ^2 of 66.8645, with Prob > $\chi^2 = .9531$, showing insignificant test results. There should be no concerns related to heteroskedasticity.

4.2.2 For H2a and H2b

Following previous literature, we define family firms as controlling families with a minimum control threshold of 20% of the control rights, being the largest shareholder or voteholders, and with two or more family directors (Villalonga and Amit, 2006; Sue, Lu, and Chin, 2009). Control rights, also called voting rights, are the direct control rights owned by a firm's controlling shareholdings and indirect control rights in the terminal of each chain of control by its controlling shareholdings (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 2002). Procedures are taken to ensure that we disentangle the effect of ownership concentration from the effect of family control. We first establish a list of firms with 20% or more concentrated ownership, and then screen them for family control coupled with two or more family directors on board. Firms simply with concentrated ownership but no family control or family management are dropped. In sum, 413 firms are classified as family firms (45.4%).

Results of the simultaneous equations modeling in Table 5 indicate that reputable CEOs report higher accrual quality AQ (Coef = -0.006, $p = .01$). We test the alternative

measure of earnings quality in discretionary accrual (DAC) and report similar results (Coef = -0.002, $p = .01$). The positive CEO reputation-earnings quality relationship persists in family firms, supporting the alignment of interest argument.

As to control variables, size, market to book ratio (MTB), cash flow variability ($\sigma(\text{CFO})$), and sales variability ($\sigma(\text{SALES})$) significantly affect AQ; meaning larger, growing and volatile firms report higher accruals in the AQ specification. As to the level of discretionary accruals, larger and growing firms, and firms with cash flow variability report higher discretionary accruals.

In the reputation model, we find some support of matching for AQ (Coef = -32.015, $p = .05$), but not DAC (Coef = -6.002, $p = .73$). In terms of control variables, education and CEO ownership significantly and positively affect CEO reputation in the AQ specifications. However, we find CEO tenure and board meeting frequency significantly influence CEO reputation in the DAC specification.

Table 5 Results of Simultaneous Equations Modeling on the Relationships between CEO Reputation and Earnings Quality for Family Firms

	AQ			DAC		
	EQ Equation		Coef.	EQ Equation		Coef.
	Coef.	p-value		Coef.	p-value	
Repu EQ	-0.006**	0.01	-32.015*	-0.002**	0.01	-6.002
SIZE	0.028**	0.01		0.008*	0.06	
MTB	0.004	0.12		0.002**	0.02	
σ (CFO)	0.274***	0.00		0.091***	0.01	
σ (SALES)	0.021*	0.08		0.006	0.20	
NegEarn	-0.002	0.78		0.000	0.90	
RDint	0.044	0.33		0.008	0.65	
LEV	0.019	0.33		0.011	0.16	
Year Dummy	Included			Included		
Edu			0.283*			0.214
CEOten			0.107*			0.156***
CEOown			25.003			22.826
LagTobinQ			0.349			0.255
LagROA			1.371			0.637
Boardmeeting			0.168			0.227**
CEOown*Bmeeting			-1.599			-1.769
CEOown*Edu			-0.973			-0.765
CEOown*CEOten			-0.389			-0.521
Constant	-0.209**	0.04	-2.677	-0.069*	0.07	-5.027
First-stage Adj. R ²	12.94%		28.46%	43.95%		28.46%
Second-stage Adj. R ²	5.11%		7.60%	37.59%		9.43%

Note: Variable definitions are same as Table 1. ***, Significance at 1%; **, Significance at 5%; *, Significance at 10%.

4.2.3 Robustness Test

4.2.3.1 For H1a and H1b

The present study takes several procedures to validate the reputation measure. First, we create another reputation measure, RepuTone, according to the tone of the mentions of CEOs in the media. In the previous procedure, we identified 2,005 articles in total after dropping personally-related articles or articles only describing a company action or quoting a CEO. We carefully read through each and define the tone of the article as positive, neutral or negative. We find the majority of the articles range from neutral to positive, and only 40 of them are strictly negative. Francis et al. (2008) identified 4,238 articles on CEOs. They randomly selected 500 articles and also found a high proportion (more than 94%) of these reports to be between neutral and positive. Similar to Francis et al. (2008), we rate reports ranging from positive to neutral as 1, negative as -1, and 0 if no report. Two firms receiving tremendous negative reporting due to extraordinary events are eliminated from the sample because these outliers may potentially distort the overall results. Descriptive statistics show the mean to be 2.106 with a SD of 5.134. Table 5 presents the outcomes of simultaneous equations modeling on the full sample. The results are similar to those of our main tests.

Table 6 Results of Simultaneous Equations Modeling on the Relationships between CEO Reputation and Earnings Quality

	AQ				DAC			
	EQ Equation		CEO Reputation Equation		EQ Equation		CEO Reputation Equation	
	Coef.	p-value	Coef.	p-value	Coef.	p-value	Coef.	p-value
RepuTone								
EQ	-0.006***	0.010			-0.002**	0.020		
SIZE			-34.642***	0.000			-27.402*	0.080
MTB	0.023**	0.040			0.005	0.360		
σ (CFO)	0.012***	0.000			0.009***	0.000		
σ (SALES)	0.262***	0.000			0.029	0.330		
NegEarn	0.016	0.100			0.008*	0.080		
RDint	0.004	0.460			0.004*	0.080		
LEV	0.046	0.180			0.000	0.980		
Year Dummy	0.022	0.170			0.018**	0.020		
	Included				Included			
Edu			0.360***	0.000			0.319***	0.000
CEOten			0.062	0.140			0.104**	0.010
CEOown			49.697**	0.030			56.896**	0.010
LagTobinQ			0.576***	0.000			0.375**	0.020
LagROA			4.663**	0.030			5.378**	0.010
Boardmeeting			0.264***	0.000			0.291***	0.000
CEOown*Bmeeting			-2.377**	0.010			-2.401***	0.000
CEOown*Edu			-2.629**	0.020			-2.849**	0.010
CEOown*CEOten			-0.132	0.770			-0.344	0.430
Constant	-0.169	0.100	-3.868*	0.050	-0.030	0.520	-6.006***	0.000
First-stage Adj. R ²	15.80%		30.30%		22.60%		30.30%	
Second-stage Adj. R ²	3.90%		4.40%		10.20%		10.40%	

Note: Repu Tone: Tone of media coverage, 1 if positive or neutral and -1 if negative. The rest of variable definitions are same as Table 1.

***.Significance at 1%, **.Significance at 5%, *.Significance at 10%.

Second, the skewness of the CEO reputation variable is a concern because many CEOs receive (or prefer) no media coverage. We take procedures to validate this measure. Specifically, we first rank CEO reputation in ascending order and then scale the ranks to obtain a percentile equivalent of a firm's rank (Lang and Lundholm, 1996; Lobo and Zhou, 2001). Similar to Francis et al. (2008), we replace CEO reputation measure by Repurank and rerun the simultaneous equations system. Table 6 presents the results for the full sample, indicating that Repurank significantly influences AQ (Repurank = -0.173, $p = .03$) and DAC (Repurank = -.076, $p = .03$), supporting the efficient contracting hypothesis. Test results for the rest of the variables are similar to those of the main test.

Table 7 Results of Simultaneous Equations Modeling on the Relationships between CEO Reputation and Earnings Quality

	AQ			DAC		
	EQ Equation	CEO Reputation Equation	EQ Equation	EQ Equation	CEO Reputation Equation	EQ Equation
	Coef.	p-value	Coef.	p-value	Coef.	p-value
Repurank	-0.173**	0.03				
EQ					-0.076**	0.03
SIZE	0.022*	0.07	-1.145***	0.00		
MTB	0.012***	0.00			0.005	0.35
σ (CFO)	0.268***	0.00			0.009***	0.00
σ (SALES)	0.015	0.13			0.029	0.33
NegEarn	0.003	0.51			0.008*	0.09
RDint	0.047	0.17			0.004*	0.09
LEV	0.022	0.18			0.002	0.91
Year Dummy	Included				0.017**	0.02
Edu			0.011***	0.00	Included	
CEOten			0.001	0.36		
CEOown			1.425*	0.05		
LagTobinQ			0.021***	0.00		
LagROA			0.155**	0.02		
Boardmeeting			0.009***	0.00		
CEOown*Bmeeting			-0.078***	0.00		
CEOown*Edu			-0.077**	0.04		
CEOown*CEOten			0.001	0.93		
Constant	-0.148	0.17	-0.066	0.29	-0.031	0.53
First-stage Adj. R ²	15.77%		31.61%		22.60%	
Second-stage Adj. R ²	5.89%		3.52%		10.08%	
					31.61%	
					10.50%	

Note: Repurank: rankings of Reputation. The rest of variable definitions are same as Table 1.

***.Significance at 1%; **.Significance at 5%; *.Significance at 10%.

Lastly, there are also concerns about the observations if a CEO has favorable press in one year but receives bad press in subsequent years. We go through each firm by year and identify 11 firms with such instances, of which six firms received overwhelming negative reports in different years. We delete these unfavorable firms (a total of 18 firm years), resulting in 891 firm years. We use this sample for our simultaneous equations, and untabulated results show similar outcomes to those of our main tests.

4.2.3.2 H2a and H2b

Similarly, we use RepuTone and Repurank as measures for CEO reputation for family firms. Untabulated results indicate similar findings. Both RepuTone and Repurank significantly influence AQ and DAC, supporting the alignment of interest argument.

We define family firms as controlling families with a minimum of 20% control rights. Since control rights include indirect rights, the level of deviations between control rights and cash flow rights may potentially affect our results. As an additional test, we include the deviation between control rights and cash flow rights (VC) as a control variable. The results in Table 8 are similar to those of our main tests, where Repu significantly influences AQ (Coef.= -0.006, $p = .01$) and DAC (Coef. = -.002, $p = .01$), and VC is insignificant in both AQ (VC = -0.004, $p = .80$) and DAC (VC = -.000, $p = .87$) specifications.

Table 8 Results of Simultaneous Equations Modeling on the Relationships between CEO Reputation and Earnings Quality on Family Firms controlling for VC

	AQ				DAC			
	EQ Equation		CEO Reputation Equation		EQ Equation		CEO Reputation Equation	
	Coef.	p-value	Coef.	p-value	Coef.	p-value	Coef.	p-value
Repu	-0.006***	0.01			-0.002***	0.01		
EQ			-34.735**	0.04			-7.260	0.68
SIZE	0.029***	0.01			0.008**	0.05		
MTB	0.004	0.12			0.002***	0.02		
σ (CFO)	0.275***	0.00			0.091***	0.01		
σ (SALES)	0.022*	0.08			0.006	0.20		
NegEarn	-0.002	0.82			0.000	0.88		
RDint	0.044	0.32			0.008	0.65		
LEV	0.019	0.34			0.011	0.16		
Year Dummy	Included				Included			
VC	-0.004	0.80			0.000	0.87		
Edu			0.289**	0.05			0.215	0.12
CEOten			0.102*	0.08			0.155***	0.00
CEOown			25.180	0.40			22.807	0.44
LagTobinQ			0.356	0.25			0.253	0.40
LagROA			1.449	0.66			0.676	0.84
Boardmeeting			0.163	0.13			0.227	0.03
CEOown*Bmeeting			-1.584	0.14			-1.767*	0.09
CEOown*Edu			-0.989	0.52			-0.760	0.61
CEOown*CEOten			-0.377	0.52			-0.521	0.36
Constant	-0.218**	0.03	-2.457	0.42	-0.070*	0.06	-4.978*	0.07
First-stage Adj. R ²	12.95%		28.76%		43.88%		28.76%	
Second-stage Adj. R ²	4.85%		6.43%		37.63%		9.49%	

Note: VC: Deviation between control and cash flow right. The rest of variable definitions are same as Table 1.

***.Significance at 1%; **.Significance at 5%; *.Significance at 10%.

5. Further Analysis

5.1 Does Family Kinship Matter to the CEO Reputation-Earnings Quality Relationships?

Family firms have a higher tendency to appoint family members to the board, management team, and even reserve the CEO position for family members (Anderson and Reeb, 2003; Prencipe et al., 2008). Claessens et al. (2002) and Yang (2010) reported that more than 70% of the CEOs of Taiwanese family firms are family members. The incentives on the supply of quality financial reporting may vary depending on the CEO's family kinship.

The extant literature on the financial reporting quality by family member CEOs (FMCEOs) generates mix results. One view argues that FMCEOs face less turnover and higher job security (Cascino et al., 2010). FMCEOs possess unique expertise and intentions to pass on the business (Anderson and Reeb, 2003; Morck, Shleifer, and Vishny, 1988). Executive compensation is rarely related to accounting data (Ali et al., 2007), and thus the risk of earnings manipulation is low (Yang, 2010). FMCEOs are more concerned with the longevity of the firms and place more emphasis on long-term financial performance. Consequently, FMCEOs are more likely to report higher quality earnings information.

The opposite view argues that a family firm is a less efficient form of organization (Morck and Yeung, 2004). FMCEOs are drawn from a suboptimal labor pool that limits more talented professional executives from operating the firm (Anderson and Reeb, 2003). The close relationship among board members and the top management team limits the monitoring functions presumed by a board. The possibility for family members to withhold private information is higher, creating opportunities for FMCEOs to engage in rent extracting activities. If so, financial reporting on firms helmed by FMCEOs is of lower quality. Again, the above literature does not take CEO reputation effects into consideration.

We designate a CEO as an FMCEO if the CEO is a member of the controlling families ($n = 218$, 52.8%), and non-FMCEOs if otherwise ($n = 195$, 47.2%). Independent t test results in Table 9 (Panel A) show no significant difference in earnings quality between FMCEOs and non-FMCEOs. The results do not support our predictions. We conduct correlation analyses on CEOs with high reputation from the FMCEO group as well as the non-FMCEO group. Panel B to D report our results. The positive CEO reputation-earnings quality relationship persists regardless of family kinship.

Table 9 T Test Results of Differences in Means for FMCEOs and non-FMCEOs

Variables	T Test on Diff. in Means		Correlation Analysis	
	AQ	DAC	AQ	DAC
Panel A: Family Firms (n = 413)				
FMCEOs (n = 218)	0.093	0.037	-0.147**	-0.126*
non-FMCEOs (n = 195)	0.085	0.032	-0.173**	-0.128*
T test on Mean diff	.152	.117		
Panel B: FMCEOs (n = 218)				
High Repu (n = 41)	0.072	0.031	-0.273*	-0.320**
Low Repu (n = 177)	0.099	0.038		
T test on Mean diff	.022**	.172		
Panel C: FMCEOs (n = 218)				
Repu > 0 (n = 70)	0.083	0.034	-0.253**	-0.273**
Repu = 0 (n = 148)	0.098	0.036		
T test on Mean diff	.126	.335		
Panel D: non-FMCEOs (n = 195)				
High Repu (n = 44)	0.076	0.032	-0.158*	-0.111
Low Repu (n = 151)	0.088	0.033		
T test on Mean diff	.204	.796		
Panel E: non-FMCEOs (n = 195)				
Repu > 0 (n = 87)	0.088	0.033	-0.219**	-0.244**
Repu = 0 (n = 108)	0.082	0.032		
T test on Mean diff	0.425	0.776		

Note: * $p < 10\%$; ** $p < 5\%$; *** $p < 1\%$.

5.2 Does the Positive CEO Reputation-Earnings Quality Relation Persist in Non-family Businesses?

Results of the main tests confirm the positive relation between CEO reputation and earnings quality of a firm, which persists in family firms. It is natural to inquire if this relation endures in non-family firms. We conduct similar tests using 496 non-family firms as a sample. The results from simultaneous equations modeling (Table 10) indicate insignificant relations in regard to both AQ (0.002, $p = .55$) and DAC (0.000, $p = .51$) specifications. This difference leads us to predict that the positive CEO reputation-earnings relations is more pronounced in family firms than in non-family firms. We conduct analyses on the full sample by adding the interaction terms of dummy FB and CEO reputation to the EQ model of the simultaneous equations system. However, the results (untabulated) do not support our predictions.

We decompose non-family samples to search for possible explanations. First, we break down non-family firms into high (low) reputation firms by CEO reputation greater (smaller) than the mean. We find significant differences in means between these two subgroups (see Panel A, Table 11). Contrary to our expectations, we find that firms with higher CEO reputation report significantly lower earnings quality ($AQ = 0.119$; $DAC = 0.048$) as compared to firms with low CEO reputation ($AQ = 0.096$, $p = .001$; $DAC = 0.036$, $p = .000$). Alternatively, this study breaks down firms into two subgroups: firms with CEO reputation greater (smaller) than 0 to see if earnings quality differs for firms with and without CEO media exposure. We find similar patterns in Panel B suggesting that firms with CEO media exposure report significantly lower earnings quality ($AQ = 0.110$; $DAC = 0.043$) as compared to firms with no CEO media exposure ($AQ = 0.094$, $p = .001$; $DAC = 0.036$, $p = .000$).

As a comparison, we tabulate similar statistics for family firms. Panel C indicates the opposite results. High CEO reputation firms report significantly higher earnings quality ($AQ = 0.073$; $DAC = 0.030$) as compared to low CEO reputation firms ($AQ = 0.093$, $p = .001$; $DAC = 0.036$, $p = .070$). A similar analysis is performed by breaking down family firms into two subgroups: firms with CEO reputation greater (smaller) than 0. The results are presented in Panel D although we do not detect significant differences in AQ and DAC between these two groups.

The above analyses perhaps partially explain our insignificant CEO reputation-earnings quality relations in non-family firms. To support a positive CEO reputation-earnings quality relationship, there should be consistent relationships between CEO reputation and earnings quality regardless of whether CEO reputation is high or low. We evidence this consistent positive pattern in family firms, but not in non-family firms.

We conduct correlation analysis on CEOs with high reputation from the non-family firms and find a significant negative association between CEO reputation and the two earnings quality measures (see columns 4 and 5 in Panel A, $AQ = -0.267$, $p = .000$; $DAC = -0.192$, $p = .000$). For non-family firms, CEOs with high media exposure report higher earnings quality. That means the positive CEO reputation spillover does exist for this group of CEOs. This may explain to some extent why the interaction term of dummy FB and CEO reputation is not significant.

Table 10 Results of Simultaneous Equations Modeling on the Relationships between CEO Reputation and Earnings Quality for Non-family Firms

	AQ			DAC		
	EQ Equation		CEO Reputation Equation	EQ Equation		CEO Reputation Equation
	Coef.	p-value	Coef.	p-value	Coef.	p-value
Repu EQ	-0.002	0.55	-32.744***	0.01	0.000	0.97
SIZE	0.000	0.99			-0.007	0.29
MTB	0.012***	0.00			0.008***	0.00
σ (CFO)	0.306***	0.00			0.020	0.60
σ (SALES)	0.005	0.71			0.009	0.16
NegEarn	0.007	0.35			0.005	0.13
RDint	0.042	0.40			0.002	0.92
LEV	0.041	0.09			0.022**	0.04
Year Dummy	Included				Included	
Edu			0.483***	0.00		0.453***
CEOten			0.087**	0.18		0.141**
CEOown			113.970**	0.01		130.732***
LagTobinQ			0.678**	0.01		0.464**
LagROA			6.497**	0.03		7.315**
Boardmeeting			0.382***	0.00		0.395***
CEOown*Bmeeting			-4.582**	0.02		-4.860**
CEOown*Edu			-5.546**	0.01		-6.116***
CEOown*CEOten			-0.702	0.38		-0.960
Constant	0.039	0.78	-6.899**	0.02	0.080	0.22
First-stage Adj. R ²	15.88%		34.51%		23.40%	
Second-stage Adj. R ²	15.17%		10.56%		20.79%	

Note: Variable definitions are same as Table 1. **Significance at 1%, ***Significance at 5%, * Significance at 10%.

Table 11 T Test Results of Differences in Means for High and Low Reputation CEOs in Non-family Firms

Variables	T Test on Diff. in Means		Correlation Analysis	
	AQ	DAC	AQ	DAC
Panel A: Non-family Firms (n = 496)				
HighRepu (n = 114)	0.119	0.048	-0.267***	-0.192***
Low Repu (n = 382)	0.096	0.036		
T test on Mean diff	.001***	.000***		
Panel B: Non-family Firms (n = 496)				
Repu > 0 (n = 225)	0.11	0.043	-0.12*	-0.053
Repu = 0 (n = 271)	0.094	0.036		
T test on Mean diff	.001***	.000***		
Panel C: Family Firms (n = 413)				
HighRepu(n = 71)	0.073	0.03	-0.368***	-0.342***
Low Repu(n = 342)	0.093	0.036		
T test on Mean diff	.001**	.070*		
Panel D: Family Firms (n = 413)				
Repu > 0 (n = 156)	0.086	0.033	-0.300***	-0.236***
Repu = 0 (n = 257)	0.091	0.035		
T test on Mean diff	0.354	0.408		

Note: * $p < 10\%$; ** $p < 5\%$; *** $p < 1\%$.

6. Discussion and Conclusions

Upper echelons theory argues that executive attributes affect management actions (Carpenter, Geletkanycz, and Sander, 2004), and managerial characteristics form corporate financial reporting decisions (Ali and Zhang, 2015; Francis et al., 2008; Graham et al., 2005; Malmendier and Tate, 2009). By a sample of 303 incumbent CEOs from Taiwanese electronics firms for the period of 2006-2008, this study extends this line of research by exploring the CEO reputation effect on a firm's reporting quality using an international setting. Several important findings emerge.

First, empirical results from simultaneous equation modeling reveal a positive CEO reputation effect on the earnings quality of a firm, similar to Ali and Zhang (2015) and Jian and Lee (2011). The efficient contract hypothesis dominates the rent extraction hypothesis in explaining executive reporting motivations. The higher the CEO reputation, the more they are concerned with the market's perceptions of the reporting credibility of a firm. The results are robust, and use two alternative measures of earnings quality: one reflects the mapping of accruals to cash flows, and the other focuses on taking less

extreme discretionary accruals.

Second, the traditional perspective censures family firms for poor reporting quality because concentrated ownership creates incentives for controlling shareholders to expropriate wealth at the expense of other shareholders (Fama and Jensen, 1983; Shleifer and Vishny, 2012). Empirical results of this study point to the opposite. The positive CEO reputation effects on earnings quality persist in family firms, supporting the alignment of interest argument. In a family firm context, reputable CEOs provide higher quality accounting earnings information (Ali et al., 2007; Wang, 2006).

Using U.S. samples with relatively diverse ownership, Francis et al. (2008) provided evidence of managerial opportunistic behavior, and earnings quality was found to be significantly lower for firms helmed by reputable CEOs. They claim that matching explains this unintuitive finding. In other words, firms with poor earnings quality require the talents of reputable CEOs to manage earnings (Francis et al., 2008).

Using Taiwanese samples, our findings are quite contrary to the results of Francis et al. (2008). Lafond (2008) argued that the CEO reputation-earnings quality relationships in international settings may differ from those in the U.S. Differences in corporate ownership structure and cultural influences may be able to explain the difference in such findings. Indeed, about 45% of our samples are family firms with concentrated ownership. High ownership in the hands of controlling families reduces agency conflicts between owners and managers. Family firms are usually long-term oriented. They take actions to preserve control and protect family reputation. Controlling families are more devoted to monitoring their top management team, and such close monitoring can effectively reduce the risk of managerial expropriation. Moreover, CEOs of family firms usually have close ties with the family. They may be more concerned about the reputation of the firm, and in turn may lower their incentive to manage earnings. The difference in cultural values could be another factor contributing to the differences in findings. In Eastern culture, traditional respect for authority and hierarchy are essential in forming a person's social prestige. Asian culture is rooted with the interdependent construal of self, which regards one's identity to lie with familial and social relationships. CEOs with highly interdependent self-identities will be more concerned about social prestige and family longevity, and will in turn minimize aggressive earnings management.

The quality of financial reporting is important for all market participants because it serves to reduce information asymmetries and increases overall transparency (Cascino et al., 2010). Accounting literature considers reputation to be the market's perceptions of the

reporting quality of a firm. Our findings provide evidence that the public can perceive a CEO's reputation as the reporting credibility of a firm.

7. Managerial Implications, Limitations and Future Study

Our results have important implications for theory and practice. Reputation research posits that reputation concerns affect the behavior of business professionals. Our study informs that CEO reputation is an important consideration in determining the reporting behavior of a firm and suggests that reputable CEOs are devoted to the quality of financial reporting. The traditional view censures family firms for poor financial reporting credibility due to the entrenchment of controlling families. The present study clarifies the current debate on the influence of family ownership on earnings quality by involving the CEO reputation factor, and to some extent disentangles the puzzling relationships among family, managers and owners, and their roles in corporate financial reporting.

This study is subject to several limitations. First, quantifying CEO reputation is a difficult task, indicating that our conclusions are contingent upon the ability of our proxies to capture these characteristics. Second, we chose a sample which requires the incumbent CEOs to have had three-year tenure in their firms to observe their reputations. This may lead to potential selection bias. Lastly, this study uses a sample from a certain industry in an emerging economy; thus, the results should be generalized with caution. Future studies can examine CEO reputation effects on financing and other corporate strategic decisions.

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