

The Impact of Earnings Management on Corporate Performance under the Empowerment of Digital Transformation

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Abstract: Driven by the global digital economy, the relationship between corporate earnings management and performance has taken on new dynamics. This study explores how digital transformation affects corporate performance by altering the motivations, methods, and outcomes of earnings management. The research finds that digitalization enhances information transparency, reduces information asymmetry, and encourages companies to shift from short-term financial goals to long-term value creation. Digital tools optimize internal control and decision-making processes, reducing the scope for accounting manipulation. Furthermore, digital technology improves corporate risk management, mitigating the risk of performance fluctuations caused by earnings management and promoting stable and sustainable financial performance. This paper provides strategic guidance for corporate financial management in the digital environment, revealing the key role of digital transformation in enhancing corporate performance.

Keywords: Accrual-Based Earnings Management, Real Earnings Management, Digital Transformation, Corporate Performance.

1. Introduction

According to the Global Digital Economy White Paper (2024), the global digital economy surpassed \$33 trillion in 2023, reflecting a year-on-year growth of over 8%. This highlights the central role of digital transformation in driving economic vitality and presents new opportunities for earnings management: companies can more effectively leverage data to make precise earnings adjustments. Proper earnings management helps businesses maintain financial stability while enhancing market competitiveness and investor confidence, directly impacting corporate performance.

Exploring the effects of earnings management on corporate performance in the context of digital transformation has academic value, as it expands and deepens existing financial management theories. Moreover, this study offers practical contributions by providing companies with strategic financial planning guidance in a rapidly changing digital environment, optimizing earnings management strategies to enhance market competitiveness and economic benefits, while ensuring transparency and compliance, thus promoting long-term sustainable development. In summary, this research not only

contributes insightful findings to academia but also offers strategic reference for corporate practice, helping businesses achieve more stable and efficient financial management in the digital age.

The innovation of this paper lies in systematically combining digital transformation with earnings management, expanding the research perspective on the relationship between earnings management and corporate performance. On one hand, it explores how digital transformation affects corporate performance by altering the motivations, methods, and outcomes of earnings management. On the other hand, it not only focuses on how digitalization reduces information asymmetry and mitigates the risks associated with earnings management but also reveals how digital transformation drives companies to shift from short-term financial optimization to long-term value creation.

2. Literature Review

2.1. Understanding of Earnings Management

Earnings management has garnered significant attention, and scholars have primarily focused on the methods and motivations behind it. Regarding the methods of earnings management, Jones suggested that accrual-based earnings management involves the manipulation of earnings through the discretionary choices allowed by accounting standards [1]. Sun Wei pointed out that accrual-based earnings management only changes corporate accounting policies, whereas real earnings management involves actual transactions, such as artificially inflating core earnings, to achieve earnings manipulation [2]. As for the motivations for earnings management, research indicates that it mainly arises from the demands of capital markets Lin Zhizhang and Huang Xingluan; Jiang Qiujun and Li Danmeng, executive compensation Wen Riguang and Wang Jianfeng, debt covenants Qin Xuan and Fang Junxiong, tax avoidance, and policy considerations Liang Xuan and Xu Lu; Chen Deqiu and Chen Yunsen [3-8].

2.2. Understanding of Corporate Performance in the Context of Digital Transformation

Digital transformation is one of the internal factors influencing corporate performance. Research suggests that digital transformation positively impacts corporate performance by improving operational efficiency, fostering innovation, and optimizing customer experience and supply chain management Bouwman et al.; Chi Renyong et al. [9, 10]. However, in the early stages of digital transformation, companies may face increased transformation costs, insufficient technological adaptability, and resistance from organizational culture, which could have short-term negative effects on corporate performance Bai Fuping et al. [11]. As companies gradually adapt to digital transformation, these initial negative effects will be overcome, and the transformation will drive continuous improvement in corporate performance by enhancing innovation capabilities and market competitiveness Cai Chunhua [12].

2.3. The Impact of Earnings Management on Corporate Performance

Existing research primarily focuses on the effects of accrual-based earnings management and real earnings management. Regarding accrual-based earnings management, Teoh, Welch, and Wong found that companies engage in upward earnings management before equity refinancing or stock offerings, as well as prior to IPOs, which subsequently leads to a decline in operating performance [13]. Qi Mingxia showed that accrual-based earnings management reduces investment efficiency and performance [14]. However, Wang Fusheng et al. argued that accrual-based earnings management can sometimes convey positive signals about future performance, while Cai Chun et al. noted that long-term performance is not significantly harmed by it [15, 16]. As for real earnings management, Bens et al. and Gu Mingrun et al. found that real earnings management typically leads to a decline in

company performance in subsequent years [17, 18]. Zhang Wei and Liu Xiaoyan pointed out that this type of management may impair the company's future profitability. In contrast, Taylor and Xu, as well as Gunny, found that real earnings management can have positive effects in certain situations [19-21].

2.4. Literature Review

Upon a comprehensive examination of existing literature, it becomes clear that the impact of earnings management behavior on corporate performance under the emerging context of digital transformation has not yet been thoroughly explored. Therefore, this study aims to fill this gap by providing a multidimensional perspective to investigate the effects of earnings management on corporate performance in the digital transformation era. The goal is to offer strategic guidance for corporate financial planning, promoting sustainable development for companies in the digital age.

3. The Impact of Earnings Management on Corporate Performance: Path Analysis

3.1. The Impact of Earnings Management on Short-Term Financial Performance

Accrual-based earnings management manipulates financial statements by adjusting accounting estimates and policies, enabling companies to present an ideal level of profitability in the short term. This approach does not involve changes in actual business activities, but its unsustainability can lead to performance declines in the future due to earnings reversals, particularly evident after equity refinancing or IPOs. The conflict between management's short-term incentives and long-term shareholder value exacerbates the negative impact of accrual-based earnings management on corporate performance.

3.2. The Erosion of Long-Term Financial Performance by Earnings Management

Real earnings management alters financial performance through adjustments in actual business activities, directly affecting resource allocation and operational efficiency. Managers might engage in real earnings management to boost short-term profits, enhancing personal compensation and reputation. However, this pursuit of short-term gains may come at the expense of the company's long-term competitiveness. Reducing R&D investments can weaken the company's innovation capabilities, while cutting marketing expenses might diminish market share and brand influence. In the long run, this behavior significantly erodes corporate performance.

3.3. The Impact of Earnings Management on Investment Performance

Although accrual-based earnings management is primarily achieved through accounting practices, it can improve performance in the short term, potentially misleading management and investors into making irrational investment decisions. For example, to meet short-term earnings targets, companies might forgo or delay high-risk, high-reward investment projects, which not only reduces investment efficiency but also limits long-term growth and innovation potential. Real earnings management, by directly cutting long-term investment expenditures such as R&D and capital investments, impacts the company's long-term development potential.

3.4. The Suppression of Innovation Performance by Earnings Management

Real earnings management suppresses a company's innovation capabilities and technological advancement by reducing investments related to innovation. Driven by tax avoidance motives, some companies might cut R&D expenditures to decrease taxable profits and, consequently, tax liabilities.

In highly competitive industries, insufficient investment in innovation can shorten product lifecycles and reduce market share. The conflict between short-term profit pursuits and long-term innovation development, if not properly balanced, poses a serious threat to the company's long-term development and competitiveness.

3.5. The Impact of Earnings Management on Long-Term Sustainable Performance

Earnings management also has a profound impact on a company's long-term sustainable performance. Driven by debt covenant motives, companies may engage in earnings management to present a favorable financial condition, thereby reducing default risks and financing costs. However, such earnings management can lead to a crisis of trust if exposed, increasing reputational and legal risks for the company. Additionally, excessive reliance on earnings management can cause companies to neglect fundamental operations and strategic development, potentially leading to instability in long-term performance. Once earnings management practices are identified by the market or regulatory bodies, a company's stock price may experience significant fluctuations, affecting its financing ability and cost of capital, and thereby undermining its long-term sustainable development.

4. The Impact of Earnings Management on Corporate Performance in the Context of Digital Transformation

4.1. Changes in Motivations for Earnings Management

Digital transformation enhances information transparency and management control capabilities, driving companies to shift from a focus on short-term financial metrics to long-term value creation. As digital transformation improves information integration and transparency, reducing the degree of information asymmetry, motivations driven by short-term performance are suppressed. Management is more inclined to enhance corporate competitiveness and market recognition through long-term value enhancement. Increased transparency reduces the benefits of earnings management, while increasing the costs and risks associated with it, leading management to focus more on improving actual performance to achieve long-term value.

4.2. Upgrading of Earnings Management Methods

With the reliance on digital tools, earnings management methods have become more refined and intelligent. Traditional earnings management methods are no longer predominant. Digital tools enable companies to monitor and analyze data in real-time, allowing for timely adjustments in business activities, such as inventory management, to meet earnings targets. Data-driven management approaches enhance the effectiveness of real earnings management and reduce the need for accounting adjustments to manipulate financial statements, thereby improving the credibility of financial data.

4.3. Optimization of Earnings Management Effects

Digital transformation enhances a company's risk management capabilities, thereby optimizing the effects of earnings management. In traditional environments, earnings management practices may lead to future performance volatility. The introduction of digital tools enables companies to better monitor financial conditions, identify risks, and respond promptly, mitigating the negative impacts of earnings management. The application of digital technology allows companies to achieve robust financial performance by improving operational efficiency and resource allocation, thereby reducing the necessity and risks associated with earnings management.

5. Conclusion

Digital transformation has redefined the relationship between earnings management and corporate performance, achieving overall performance improvements through three key dimensions: motivation, methods, and effects. Digital transformation encourages companies to reduce their reliance on short-term financial metrics and instead focus on optimizing management processes and enhancing operational efficiency to achieve long-term value creation. Additionally, digital transformation has increased the reliability of financial reporting, enhancing the company's market image and investor trust. Thus, digital transformation not only boosts management efficiency but also provides a solid foundation for achieving sustainable performance.

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