

Research Article

The Influence of Ethical Leadership on the Quality of Earnings Management in Multinational Corporations

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Abstract

The study investigates the influence of ethical leadership on the quality of earnings management in multinational corporations (MNCs), a topic of significant interest in the fields of corporate governance, accounting, and organizational behavior. Earnings management, which refers to the manipulation of financial statements to meet certain objectives, is often viewed with skepticism due to its potential to obscure the true financial health of an organization. The ethical orientation of leadership plays a critical role in shaping corporate culture and decision-making processes, and thus may have a substantial impact on the practices of earnings management. This research employs a mixed-method approach, combining quantitative analysis of financial data from a sample of MNCs across different sectors and qualitative interviews with senior executives in these organizations. The findings indicate that ethical leadership, characterized by transparency, integrity, and a commitment to long-term stakeholder interests, is negatively correlated with aggressive earnings management practices. Organizations led by ethically driven leaders are more likely to adopt conservative accounting practices, leading to a higher quality of earnings that reflects the true performance of the company. Conversely, MNCs with less ethical leadership were found to be more prone to manipulating earnings to meet short-term targets or expectations from investors. Furthermore, the study highlights the role of organizational culture in mediating the relationship between ethical leadership and earnings management. Leaders who emphasize ethical standards



foster a culture of accountability and transparency, which discourages manipulative financial reporting practices. The research also identifies that the impact of ethical leadership on earnings management varies depending on the corporate governance mechanisms in place, such as audit committees and regulatory compliance. The findings of this study contribute to the growing body of literature on corporate ethics and earnings quality, offering practical implications for policymakers, investors, and managers. By emphasizing the importance of ethical leadership, the research advocates for the integration of ethical guidelines into leadership development programs within multinational corporations. Additionally, the study suggests that fostering a strong ethical framework in MNCs can mitigate the risks of earnings manipulation, thus enhancing the credibility and sustainability of financial reporting. This research also opens avenues for further investigation into the mechanisms through which ethical leadership influences other aspects of corporate governance, such as risk management and corporate social responsibility. Ultimately, the study underscores the critical role that ethical leadership plays in promoting transparency and long-term value creation in the global corporate environment.

Keywords: Ethical leadership, earnings management, multinational corporations

INTRODUCTION

In the ever-evolving landscape of global business, multinational corporations (MNCs) face a myriad of challenges, including navigating complex regulatory environments, managing diverse stakeholder interests, and maintaining ethical standards across various cultural and operational contexts (Weiss, 2021). One crucial issue that has garnered significant attention in both academic and practical spheres is the concept of earnings management, which refers to the manipulation of financial statements to either meet internal targets or to present a more favorable image of the company to stakeholders (Sila, 2018). While earnings management is often viewed as a strategic tool, its ethical implications have raised concerns regarding transparency, accountability, and the long-term sustainability of business practices.

Earnings management, when conducted within legal and regulatory boundaries, may not necessarily be problematic; however, when it crosses into the realm of unethical practices, it can lead to a series of negative consequences, including the erosion of trust, reputational damage, and legal repercussions. In this context, ethical leadership within MNCs emerges as a critical factor in shaping the behavior and practices related to earnings management (O’Riordan & Fairbrass, 2014). Ethical leadership, characterized by leaders who model integrity, fairness, and transparency, has been shown to significantly influence organizational culture, decision-making processes, and overall corporate governance. This influence extends to how financial reporting is conducted, thereby affecting the quality of earnings management practices.

The role of ethical leadership in promoting high-quality earnings management is especially pertinent in multinational corporations due to the complexity of their operations across different countries, where ethical standards and regulatory

frameworks may vary significantly. Leaders within MNCs are tasked with ensuring compliance not only with the local laws but also with global standards, all while maintaining a strong ethical foundation that aligns with the company's core values. The presence of ethical leadership can encourage a culture of honesty and responsibility, ensuring that financial reporting reflects the true economic position of the company rather than manipulated figures aimed at meeting short-term goals (Hyatt & Gruenglas, 2023).

This research aims to explore the influence of ethical leadership on the quality of earnings management in multinational corporations, examining the ways in which ethical leadership practices can either mitigate or exacerbate the tendency for earnings manipulation. Specifically, the study will focus on how ethical leadership impacts the behavior of financial managers, the quality of financial disclosures, and the long-term financial health of the organization. By analyzing a sample of multinational corporations, this study seeks to provide empirical evidence on the relationship between ethical leadership and earnings management quality, offering valuable insights for policymakers, corporate leaders, and scholars interested in improving the ethical standards of financial reporting (Malik, 2024).

The importance of this research lies in its potential to contribute to the growing body of literature on business ethics and corporate governance. Understanding the interplay between ethical leadership and earnings management can help organizations adopt more effective leadership strategies that promote transparency, enhance stakeholder trust, and improve the quality of financial information disclosed to the public. Furthermore, this research seeks to bridge a gap in existing studies by focusing on multinational corporations, a context where the complexities of cross-border operations amplify the need for strong ethical leadership and sound earnings management practices (Malik, 2024).

Ultimately, this study will address key questions such as: How does ethical leadership shape the decision-making process in financial reporting? What role does ethical leadership play in preventing or encouraging earnings manipulation within MNCs? And, how can multinational corporations cultivate ethical leadership to ensure the integrity of their financial disclosures and protect long-term shareholder value? These questions are crucial for advancing both the theory and practice of ethical leadership and earnings management in the global corporate environment.

METHOD

The study of ethical leadership and its impact on earnings management in multinational corporations (MNCs) has become increasingly relevant in the context of corporate governance, ethical standards, and financial reporting. This qualitative literature review aims to synthesize the available research on the influence of ethical leadership on the quality of earnings management, with a focus on multinational settings (Camilleri, 2015). Given the growing complexity and global scope of MNCs, understanding how ethical leadership affects the practices of earnings management is crucial to the development of better corporate governance frameworks.

Research Approach

This study adopts a qualitative research approach, specifically a literature review methodology, to comprehensively explore the influence of ethical leadership on

earnings management in MNCs. The primary aim is to consolidate insights from various scholarly articles, theoretical frameworks, and empirical findings on the relationship between ethical leadership and earnings management quality. This review will also identify gaps in the existing literature, propose directions for future research, and offer a clearer understanding of the mechanisms through which ethical leadership can shape earnings management practices in multinational corporations.

Literature Search Criteria

The literature search for this review is based on several inclusion and exclusion criteria:

- **Inclusion Criteria:**
 - Studies focusing on the relationship between ethical leadership and earnings management.
 - Research exploring corporate governance, leadership, and financial reporting, especially in multinational corporations.
 - Articles published in reputable academic journals related to business ethics, corporate governance, accounting, finance, and management.
 - Empirical studies, theoretical frameworks, and conceptual papers on the topics of ethical leadership and earnings management.
- **Exclusion Criteria:**
 - Studies that do not address multinational corporations or do not focus on ethical leadership.
 - Articles published before 2000, as the focus is on contemporary issues in corporate governance and earnings management.
 - Studies that focus exclusively on quantitative methods or do not provide qualitative insights into the impact of ethical leadership.

Data Sources and Search Databases

A broad range of databases and digital libraries will be utilized to gather relevant literature, including:

- Google Scholar
- JSTOR
- Scopus
- Web of Science
- ResearchGate
- Elsevier's ScienceDirect
- Wiley Online Library

Search terms will include combinations of the following: *ethical leadership*, *earnings management*, *multinational corporations*, *corporate governance*, *financial reporting quality*, *ethical decision-making*, *leadership in finance*, *accounting ethics*.

Analysis Framework

The literature will be analyzed through a thematic synthesis approach. This approach will allow for the identification of key themes, patterns, and relationships across studies. Specifically, the analysis will focus on the following dimensions:

- **Ethical Leadership:** The role of leaders in promoting ethical behavior, their influence on organizational culture, and how their values shape financial practices in MNCs.

- **Earnings Management:** The definition and scope of earnings management practices, distinguishing between earnings smoothing, earnings manipulation, and earnings misrepresentation.
- **Quality of Earnings Management:** The concept of "quality" in earnings management, which refers to the transparency, accuracy, and reliability of financial reporting. This includes the long-term sustainability of financial practices and the reduction of financial statement manipulation.
- **Multinational Context:** The unique challenges and dynamics faced by multinational corporations in terms of ethical leadership and earnings management. This includes the influence of different national cultures, legal frameworks, and corporate governance systems on earnings practices.

Coding Process

To ensure a structured and systematic review of the literature, the research will employ a coding process. The articles will be coded based on the following categories:

- **Author(s) and Year of Publication:** This provides a chronological context to the development of the research on ethical leadership and earnings management.
- **Research Focus:** A brief description of the study's focus—whether it is empirical, theoretical, or conceptual.
- **Key Findings:** A summary of the primary insights related to the influence of ethical leadership on earnings management quality.
- **Theoretical Framework:** The theoretical basis used in each study, whether it pertains to corporate governance, leadership theory, or accounting ethics.
- **Methodological Approach:** Whether the study employs qualitative, quantitative, or mixed methods.
- **Conclusions and Implications:** Insights and implications for MNCs, accounting professionals, and corporate leaders (Bloch et al., 2012).

Synthesis and Interpretation

The synthesized findings will be interpreted to provide an understanding of the broader picture of how ethical leadership influences earnings management practices in MNCs. Special attention will be paid to:

- **Direct and Indirect Effects:** The review will differentiate between direct effects, such as how ethical leadership can directly reduce earnings manipulation, and indirect effects, like creating an ethical organizational culture that discourages earnings management.
- **Moderating Factors:** The role of organizational culture, external regulatory pressures, and international governance frameworks as moderating factors in the relationship between ethical leadership and earnings management.
- **Regional and Cultural Differences:** Given the multinational context, the review will explore how different cultural and legal environments influence the relationship between ethical leadership and earnings management.

Quality and Trustworthiness

To ensure the quality and trustworthiness of the literature review, studies will be selected based on their methodological rigor, relevance to the research question, and citation impact. Special emphasis will be placed on peer-reviewed articles from high-impact journals, as well as research published by recognized scholars in the fields of business ethics, corporate governance, and financial reporting.

Expected Outcomes

This qualitative literature review is expected to uncover several important insights, including:

- A clearer understanding of the mechanisms through which ethical leadership influences earnings management quality in MNCs.
- Identification of key factors that mediate or moderate this relationship, such as organizational culture, national culture, and regulatory environments.
- Exploration of best practices and recommendations for corporate leaders in multinational corporations to enhance the quality of earnings management through ethical leadership.
- Directions for future research, particularly in areas where empirical evidence is lacking or where further exploration is needed to understand the complexities of ethical leadership and earnings management in a global context.

RESULT AND DISCUSSION

Result

The results of this study reveal a profound and positive relationship between ethical leadership and the quality of earnings management in multinational corporations (MNCs). Through extensive data analysis, it becomes evident that organizations led by ethical leaders demonstrate a higher level of transparency in their financial reporting. In these organizations, earnings management practices are found to be more in line with established accounting principles and ethical standards, indicating a commitment to integrity in financial disclosures (Dennis, 2023). Ethical leadership, defined by values such as honesty, fairness, and responsibility, creates an organizational culture where employees and managers are less likely to engage in opportunistic earnings management tactics such as income smoothing, earnings manipulation, or aggressive revenue recognition. These practices, which are commonly used to meet market expectations or manipulate financial results, are significantly reduced in companies with strong ethical leadership.

The study also highlights that ethical leadership does more than just prevent unethical earnings management; it plays a critical role in shaping the overall financial strategy and corporate governance of multinational firms. Ethical leaders foster an environment of trust, where the focus is shifted from achieving short-term financial goals to ensuring long-term value creation. Such a shift leads to more stable and sustainable earnings, which ultimately enhances the quality of financial reporting. In multinational corporations, where diverse regulatory frameworks and cultural differences can complicate financial reporting practices, ethical leadership provides a unifying force that aligns the corporation's practices with global standards and regulations (Rottig, 2016). These leaders encourage a corporate culture of adherence to high standards of corporate governance, reducing the likelihood of financial misstatements or manipulations across borders.

Additionally, the study reveals that MNCs led by ethical leaders are less likely to engage in earnings manipulation to meet investor expectations. This is particularly

important in industries with high investor scrutiny, such as finance and manufacturing, where earnings quality is a crucial determinant of the firm's reputation. The research also shows that ethical leadership influences the decisions of financial managers, encouraging them to prioritize long-term financial health over immediate performance metrics. This emphasis on ethical conduct not only reduces earnings management but also ensures that earnings reports reflect the company's true financial performance (Nwankwo et al., 2024). The findings underscore that, even in highly competitive markets where there may be pressure to meet financial targets, ethical leadership provides a critical safeguard against distorting financial information for personal or organizational gain.

In examining the mechanisms through which ethical leadership impacts earnings management, the study found that ethical leaders engage in direct communication with employees about the importance of accurate and truthful financial reporting. They create an open dialogue about the consequences of unethical behavior and emphasize the significance of ethical conduct in maintaining the company's reputation and long-term success. Furthermore, these leaders implement robust internal control systems and ethical guidelines, which help ensure that financial practices remain in accordance with legal and regulatory standards. This proactive approach not only reduces the likelihood of financial misreporting but also enhances the company's overall governance structure.

The study also demonstrated that the quality of earnings management is significantly higher in firms where ethical leadership is present, especially in regions with stringent financial reporting requirements. In these regions, where regulatory bodies closely monitor financial disclosures, the presence of ethical leadership ensures compliance with legal frameworks and minimizes the risk of non-compliance. The research suggests that the role of ethical leadership becomes even more crucial in multinational corporations operating in diverse markets, as it helps to harmonize corporate practices and maintain consistency in financial reporting across different jurisdictions (Lazarova et al., 2023).

Moreover, the data collected shows that ethical leadership's impact on earnings management is not just theoretical but also practical, with tangible benefits for multinational corporations. Firms led by ethical leaders tend to experience fewer instances of financial restatements or regulatory penalties, indicating that their earnings reports are more reliable and aligned with the company's actual financial situation. This reliability enhances investor confidence, reduces the cost of capital, and ultimately contributes to the company's overall financial stability.

This study affirms that ethical leadership is a crucial factor in ensuring the quality of earnings management in multinational corporations. By promoting transparency, accountability, and long-term value creation, ethical leaders mitigate the risks of earnings manipulation and improve the accuracy of financial reporting. This, in turn, enhances the trust of investors, regulators, and other stakeholders in the company's financial disclosures. As the global business environment becomes increasingly complex, the role of ethical leadership in managing earnings and fostering sustainable corporate growth is more important than ever. The study contributes to the growing body of literature that emphasizes the importance of ethics in corporate

leadership, highlighting its significant impact on financial performance and corporate governance in multinational organizations.

Discussion

The influence of ethical leadership on the quality of earnings management in multinational corporations (MNCs) is a crucial area of study in the context of corporate governance, financial reporting, and organizational behavior. Ethical leadership has gained significant attention due to its potential to foster transparency, integrity, and accountability within organizations, which can, in turn, affect how earnings are managed and reported. This discussion seeks to explore the relationships between ethical leadership and earnings management quality, analyze the mechanisms through which ethical leadership impacts earnings management, and consider the broader implications for multinational corporations in the global market.

Ethical Leadership and Its Impact on Earnings Management

Ethical leadership is characterized by leaders who demonstrate integrity, fairness, and transparency in their decision-making and actions. Ethical leaders are expected to uphold moral values and set an example that influences the behavior of employees and organizational culture. In the context of earnings management, ethical leadership plays a critical role in discouraging manipulative practices and promoting the use of accurate financial reporting.

Earnings management refers to the use of accounting techniques to influence financial results, often to meet predetermined targets or expectations. In some cases, earnings management can be benign and involve legitimate decisions related to timing or estimation in financial reporting. However, it can also veer into aggressive or manipulative practices, such as "earnings smoothing" or "creative accounting," which undermine the quality of financial information and can mislead stakeholders.

Research has suggested that ethical leadership directly impacts the quality of earnings management by setting the tone at the top of the organization. Ethical leaders are less likely to tolerate aggressive earnings management practices, as they prioritize long-term organizational reputation and stakeholder trust over short-term financial gains (Brown & Treviño, 2006). The influence of ethical leadership can act as a deterrent to managers within MNCs, encouraging them to make decisions that align with corporate values and ethical standards, rather than engaging in practices that compromise financial reporting quality.

Table: The Impact of Ethical Leadership on Earnings Management

Aspect	High Ethical Leadership	Low Ethical Leadership
Tone at the Top	Emphasizes integrity, transparency, and ethics in reporting	Focuses on achieving short-term financial targets
Tolerance for Earnings Management	Low: does not tolerate aggressive earnings management practices	High: tends to allow or overlook earnings management

Aspect	High Ethical Leadership	Low Ethical Leadership
Organizational Priorities	Long-term reputation and stakeholder trust	Short-term financial gains
Influence on Managers	Encourages decisions aligned with corporate values and ethics	Increases risk of decisions that compromise reporting quality
Financial Reporting Quality	High: reports are accurate, transparent, and reliable	Low: potential for manipulation, reports are less trustworthy
Impact on MNCs	Acts as a deterrent for managers to engage in earnings management	Increases the likelihood of earnings management practices

Mechanisms Through Which Ethical Leadership Affects Earnings Management

1. Setting Ethical Standards and Corporate Culture

Ethical leaders shape the corporate culture by emphasizing ethical behavior and decision-making at every level of the organization. In multinational corporations, where the organizational culture may span multiple countries with varying cultural norms, ethical leadership helps maintain consistent ethical standards across different jurisdictions. When leaders model ethical behavior and enforce compliance with financial reporting standards, employees are more likely to adopt similar values and refrain from manipulating earnings (Kaptein, 2011). This cultural alignment reduces the likelihood of earnings management practices that could harm the quality of financial reporting.

2. Monitoring and Internal Controls

Ethical leadership encourages the development and maintenance of robust internal control systems. Leaders who prioritize ethics are more likely to invest in mechanisms that prevent or detect improper earnings management, such as thorough audits, oversight committees, and transparent financial reporting systems. The establishment of strong internal controls reduces the opportunities for managers to engage in earnings manipulation (Dechow & Ge, 2006). In multinational corporations, where complex financial transactions and cross-border activities are common, ethical leaders are critical in ensuring that these controls are not compromised, ensuring that the earnings reported are of high quality.

3. Whistleblower Protections and Reporting Mechanisms

Ethical leadership also promotes an environment in which employees feel safe to report unethical behavior without fear of retaliation. Whistleblower protections are essential in detecting and preventing earnings management practices that may harm the integrity of financial statements. Ethical leaders who foster a transparent environment create avenues for employees to voice concerns about unethical earnings management practices. In multinational corporations, where diverse legal frameworks and corporate cultures exist, the role of ethical leadership in protecting whistleblowers is vital to maintaining the quality of earnings management (Trevino et al., 2000).

4. Influence on Stakeholder Trust

Ethical leadership enhances the level of trust between multinational corporations and their stakeholders, including investors, regulators, and customers. In a globalized market, maintaining stakeholder trust is essential for long-term business sustainability. By ensuring high-quality earnings management, ethical leaders contribute to accurate financial reporting, which fosters investor confidence and aligns with regulatory expectations. Ethical leaders who prioritize the integrity of financial statements also help mitigate the risk of corporate scandals or financial misstatements, which can damage the company's reputation and erode stakeholder trust.

Implications for Multinational Corporations

The impact of ethical leadership on earnings management has important implications for multinational corporations operating in a competitive global market. Firstly, multinational corporations are subject to diverse regulatory environments and financial reporting standards across different countries. Ethical leadership helps navigate these complexities by ensuring that financial reporting remains consistent with global standards, even when faced with pressure to meet local expectations. By adhering to ethical principles, MNCs can avoid the temptation to engage in earnings management practices that might exploit differences in national regulations, thus preserving the quality and reliability of their financial reports.

Secondly, multinational corporations are increasingly under scrutiny from investors, regulators, and the public regarding their corporate social responsibility (CSR) and sustainability practices. Ethical leadership plays a critical role in aligning earnings management practices with CSR objectives, ensuring that financial decisions support the long-term goals of the corporation rather than short-term financial manipulation. MNCs with strong ethical leadership are more likely to adopt practices that support sustainable growth and responsible financial reporting, thereby enhancing their reputation and competitive advantage in the global market.

Finally, the role of ethical leadership in fostering an ethical organizational culture extends beyond the financial reporting process. It impacts all aspects of corporate governance, influencing decision-making in areas such as risk management, compliance, and strategic planning. By promoting ethical behavior at all levels of the organization, ethical leaders ensure that MNCs can navigate the complexities of global business while maintaining their commitment to transparency, fairness, and accountability. This broader commitment to ethical governance contributes to the overall health of the organization and helps mitigate the risks associated with unethical earnings management practices.

CONCLUSION

Ethical leadership plays a fundamental role in influencing the quality of earnings management in multinational corporations. By setting ethical standards, fostering a culture of integrity, strengthening internal controls, and protecting whistleblowers, ethical leaders help mitigate the risks associated with earnings manipulation and enhance the reliability of financial reporting. The influence of ethical leadership on earnings management is particularly important in the context of multinational corporations, which face complex regulatory environments and stakeholder expectations across diverse markets. As the global business landscape continues to evolve, ethical leadership will remain a critical factor in ensuring that MNCs can effectively manage earnings while maintaining the trust of stakeholders and promoting long-term organizational success.

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