

Impact of Executive Changes on Goodwill Impairment

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Abstract

Based on the proxy theory, information asymmetry theory and signal transmission theory, this paper empirically tests the impact of executive changes on goodwill impairment. It uses the data of A-share listed companies in Shanghai and Shenzhen stock exchanges from 2010-2018 as samples. The research results show that: 1) Compared with companies that have not undergone executive changes, companies that have undergone executive changes have a greater degree of goodwill impairment; 2) The positive correlation between executive changes and goodwill impairment is only manifested in the companies audited by “non-Big Four”, which implies that high audit quality can effectively play an external monitoring role and curb the opportunistic behavior of senior management.

Keywords

Executive Change, Goodwill Impairment, Audit Quality, A-Shares

1. Introduction

The new accounting standards provide for an impairment test for subsequent measurement of goodwill, which is consistent with US and international accounting standards, and aims to increase the information content of goodwill. The substantial overestimation of the value of the acquired company causes the probability of impairment of the goodwill of the main and the company to increase year by year, so that the economic consequences of the impairment of goodwill are prominent.

The increasing risk of goodwill and subsequent goodwill impairment has aroused the concern of scholars. Due to the abstractness and difficulty of measurement of goodwill, research on goodwill has been controversial and has many

problems. Due to the recognition of goodwill and the subjective nature of impairment provisioning, is it true that huge goodwill can actually bring excess returns, or is it a blind overestimation of excess returns, or is it a means by which executives seek private gain? Thus whether or not it is really caused by the impairment of goodwill is a question worthy of discussion.

This paper uses the data of A-share listed companies in Shanghai and Shenzhen stock exchanges from 2010-2018 as samples. Based on the agency theory, information asymmetry theory, and signal transmission theory, this article is empirically testing the relationship between changes in executives and impairment of goodwill, focusing on the following empirical tests: 1) Whether a company with executive changes has a greater impairment of goodwill than a company without executive changes? 2) Whether the effect of changes in executive changes on accruals of goodwill impairment is different under different audit quality.

2. Research Hypotheses

2.1. Executive Changes and Goodwill Impairment

In the company's principal-agent relationship, there is a hidden danger of inconsistent interests between the owner and the operator. For the operator, it is hoped that the successor executives can increase their profits in a short time, do a good job of capital appreciation, and make the company have Long-term profitability; while executives first consider how much benefit they can get, so there are obvious inconsistencies in the goals that owners and operators place on the future development of the company.

Due to debt contract, compensation and reputation considerations, it will postpone the recognition of goodwill impairment to increase the current surplus (Ramanna & Watts, 2012). After researching 538 Spanish sample companies, it is pointed out that management has conducted earnings management activities of "Bigbath" and "Smooth" using goodwill impairment (Giner & Pardo, 2015). The financial experience of the company's financial director also affects the impairment of goodwill. Financial directors with financial experience are more likely to recognize small or multiple impairments of goodwill (Brochet & Welch, 2011). Goodwill impairment is an indicator of the company's future operating conditions. The disclosure of goodwill impairment information will cause investors to lower their forecasts of the company's future cash flow, which will have a negative impact on the stock market (Li et al., 2011). By comparing the goodwill amortization mechanism and the goodwill impairment mechanism before and after the new goodwill impairment standard, it is found that the negative correlation between goodwill impairment and the company's investment opportunities is more significant after the implementation of the impairment mechanism (Chalmers et al., 2014). For the consideration of debt covenants, compensation and reputation, the management postponed the recognition of goodwill impairment to enhance the current surplus (Ramanna & Watts, 2012).

As a result, in the case of executive changes, the succession executive will gain the trust of the board of directors and shareholders and obtain more benefits in subsequent terms. In order to reduce the starting point of performance and facilitate the later period of the company's operating profit, the company's profit will continue to rise and its own career will be better developed. Based on the above analysis, this paper proposes hypothesis H1:

H1: In the case of other conditions being unchanged, Companies with executive changes have a greater goodwill impairment than companies without executive changes.

2.2. Audit Quality, Executive Changes and Goodwill Impairment

As the improvement of audit quality will increase the cost of earnings management, managers will make different choices when making cost-benefit judgments. While demonstrating the motivation for goodwill impairment as earnings management, take the external audit unit as the "Big Four" as a moderating variable. Therefore, it is speculated that different auditing institutions have a certain influence on the earnings management of enterprises using the method of impairment of goodwill. Influential international auditing companies receive a high degree of attention, and their risk of helping clients with earnings management is also high. Therefore, it can be speculated that the international "Big Four" audits of clients are more stringent. Under strict auditing, the manipulation of goodwill impairment is more likely to be found by audit institutions, which takes a greater risk, and management tends to use its surplus to manipulate earnings is weaker; and under loose auditing, it is easier for management to accrual adjustments for goodwill impairment profits. Therefore, the impact of auditing on earnings management should be able to be reflected in the item of goodwill impairment, that is, strict audit institutions reduce the possibility of enterprises using goodwill impairment for adjusting profit. This leads to the hypothesis H2:

H2: In the case of other conditions being unchanged, executive changes have a positive relationship with the company's goodwill impairment among the companies whose audit institutions are "non-Big Four". There is no significant correlation between executive changes and goodwill impairment among the companies whose audit institutions are "Big Four".

3. Research Design

3.1. Research Samples and Data Sources

The listed companies in the A-share market from 2010 to 2018 are selected. This article studies the impairment of goodwill, so the sample that the balance of goodwill at the end of the period and the amount of impairment loss of goodwill are zero is excluded. The financial data and corporate governance data are from the CSMAR database. The CSMAR database is China's current large-scale, accurate and comprehensive data-based economic and financial research database.

It was developed by Guotai'an based on the professional standards of the internationally renowned databases such as CRSP and Compustat.

During the sample selection process, the following screenings were performed: 1) excluding financial companies; 2) excluding companies with missing data on major variables; 3) excluding outlier data, e.g.: the main business income is negative and the asset-liability ratio is greater than 1. After screening through the above criteria, 1568 sample observations were finally obtained. In order to eliminate the influence of outliers, this paper winsorizes the upper and lower quantiles of all continuous variables. This paper uses EXCEL2010 and STATA14.0 for data processing.

3.2. Definition of Variables

1) Dependent variable. The dependent variable of this article is the degree of goodwill impairment. Relative research has generally used relative values to measure the degree of goodwill impairment. Therefore, in order to make the data comparable, this article draws the use of goodwill impairment accounts for the total goodwill before accruing goodwill as the dependent variable.

2) Independent variable that measures executive change. The independent variable in this article is executive changes (Recover). This article defines the company's chairman and general manager as executives, because the above two are the ultimate decision makers in the company's leadership and play different roles, and other executives have relatively little influence on the company. The change of either the chairman or the general manager is a change of senior management, and the simultaneous change of the two is regarded as a change. When a change occurs, the value of Recover is 1, otherwise it is 0.

3) Grouping variable. In this paper, the samples are grouped and regressed from the aspect of audit quality, and audit quality (Big4) is selected as the grouping variable. For audits conducted by the "Big Four", the value of Big4 is 1; for audits conducted by the "non-Big Four", the value of Big4 is 0.

4) Control variables. This article adds a series of control variables that have an impact on goodwill, including the size of the company, the size of the goodwill, the return on equity (ROE), the growth rate of total operating income (Growth), and the concentration of equity (OWN), asset-liability ratio (Lev), book-to-market ratio (BTM), equity balance (Balance), board size (Num), etc. At the same time, in order to reduce the impact of years and industries on empirical results, annual and industry dummy variables are added to the model. The variable definition table is shown in **Table 1**.

3.3. Empirical Model

In order to test the research hypotheses of H1 and H2 in this paper, the following regression equations are constructed in this paper:

$$\text{SYD1} = \beta_0 + \beta_1 \text{Recover} + \beta_2 \text{Size} + \beta_3 \text{SYsize} + \beta_4 \text{ROA} + \beta_5 \text{Growth} + \beta_6 \text{OWN} \\ + \beta_7 \text{Lev} + \beta_8 \text{BTM} + \beta_9 \text{Balance} + \beta_{10} \text{Num} + \sum \text{Year} + \sum \text{Ind}$$

In addition, based on this model, this paper uses a group regression method to compare the impact of executive changes on the impairment of goodwill under different audit quality.

4. Empirical Analysis

4.1. Descriptive Analysis

According to the data of China's listed company samples, this paper conducts

Table 1. Definition of variables.

Variable name	Explanation
SYD1	Goodwill Impairment accounts for total goodwill before goodwill is accrued
Recover	Change of chairman or general manager takes 1, otherwise 0
Big4	The value of the four audits takes 1, otherwise 0
Size	Natural logarithm of total assets at the end of the year
SYsize	Natural logarithm of goodwill
ROE	Ratio of net profit to owners' equity at the end of the year
Growth	Company growth
OWN	The ratio of the number of shares held by the largest shareholder to the total number of shares
Lev	Ratio of total liabilities to total assets at the end of the year
BTM	Ratio of Book value of total assets to market value of total assets
Balance	Ratio of Shareholding of top ten shareholders minus shareholding of largest shareholder to the largest shareholder
Num	Natural logarithm of Total number of directors at the end of the year
Year	virtual variable
Ind	virtual variable

Table 2. Descriptive statistics of main variables.

Variables	N	Mean	Sd	Min	Max
SYD1	1568	0.276	0.365	9.57e-08	1
Recover	1568	0.261	0.440	0	1
Lev	1568	0.483	0.201	0.0587	0.887
ROE	1568	0.0661	0.126	-0.585	0.306
Growth	1568	0.244	0.574	-0.498	3.705
OWN	1568	32.92	15.52	2.197	87.46
Big4	1568	0.244	0.322	0	1
BTM	1568	0.643	0.249	0.129	1.118
Balance	1568	1.002	0.854	0.0498	4.197
Size	1568	22.81	1.433	19.98	26.25
SYsize	1568	18.35	2.359	10.89	22.20
Num	1568	2.244	0.184	1.609	2.944

preliminary descriptive statistics on the main variable indicators. The results are shown in **Table 2**.

As can be seen from **Table 2**, in the sample companies, the average value of goodwill impairment accounts for 27.6% of the total goodwill before the impairment is accrued. The proportion of companies with executive changes was 26.1%, and more than a quarter of the companies had executive changes. Among them, the Big Four audited companies accounted for 24.4%, indicating that most of the listed companies in the sample still chose the Big Four auditing.

The correlation coefficient matrix and the significance level between the main variables are shown in **Table 3**. As can be seen from **Table 3**, the correlation coefficients between the variables are less than 0.6. It can be preliminarily considered that the model does not have serious multicollinearity problems. The correlation coefficients between the executive change and goodwill impairment is 0.056 respectively ($P < 0.05$), showing a significant negative correlation, which preliminarily verified the hypothesis 1.

4.2. Regression Analysis

See **Table 4** for the regression results of model. All of the following regressions were cluster analyzed and Robust adjusted for standard error. As shown in **Table 4**, first

Table 3. Variable correlation coefficient matrix.

Variable	SYD1	Recover	Size	SY size	ROE
SYD1	1				
Recover	0.056**	1			
Size	-0.181***	0.0270	1		
SY size	0.194***	0.0230	0.418***	1	
ROE	-0.120***	-0.127***	0.170***	-0.0250	1
Growth	-0.048*	0.062**	0.069***	0.059**	0.182***
OWN	-0.077***	0.048*	0.261***	-0.0310	0.133***
Lev	-0.133***	0.0360	0.584***	0.118***	-0.062**
BTM	-0.102***	0.057**	0.542***	0.243***	-0.067***
Balance	0.062**	-0.0370	-0.057**	0.150***	-0.0180
Num	-0.091***	-0.0340	0.265***	0.0270	0.096***
Variable	Growth	OWN	Lev	BTM	Balance
Growth	1				
OWN	0.055**	1			
Lev	0.0230	0.145***	1		
BTM	-0.0160	0.164***	0.501***	1	
Balance	0.089***	-0.706***	-0.102***	-0.046*	1
Num	0.0100	0.00500	0.149***	0.191***	0.052**
Variable	Num				
Num	1				

Note. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

Table 4. Model regression results.

Variable	(1)	(2)	(3)
		“non-Big Four”	“Big Four”
Recover	0.0646*** (0.0240)	0.0883*** (0.0279)	-0.0626 (0.0432)
Size	-0.0379 (0.0343)	-0.0423 (0.0376)	0.0966 (0.104)
SY size	-0.0569*** (0.00873)	-0.0643*** (0.00944)	-0.0252 (0.0267)
ROE	0.219** (0.0963)	0.222** (0.102)	0.740* (0.402)
Growth	-0.0250 (0.0204)	-0.0324 (0.0228)	-0.00982 (0.0499)
OWN	-0.000177 (0.00213)	0.000325 (0.00248)	-0.0116** (0.00551)
Num	0.354*** (0.123)	0.372*** (0.139)	0.380 (0.237)
Lev	-0.0345 (0.119)	-0.00591 (0.128)	-0.369 (0.453)
BTM	0.0521 (0.0944)	0.0248 (0.106)	-0.00553 (0.232)
Balance	-0.0182 (0.0303)	-0.000924 (0.0323)	-0.396*** (0.130)
Constant	1.330 (0.809)	2.078** (0.861)	-1.561 (2.190)
Observations	1568	1184	384
R-squared	0.155	0.183	0.325
Industry FE	YES	YES	YES
Year FE	YES	YES	YES

Note. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

column (1) regression results show that under the premise of controlling the annual and industry dummy variables, the change in executive management has a positive correlation with the degree of impairment of goodwill of listed companies. The coefficient of Recover is 0.0646, which is significant at the 1% level. Therefore, based on the above regression results, it is shown that companies with executive changes have a greater goodwill impairment than companies without executive changes, which supports the H1.

Second and third columns show that impact of executive changes on goodwill impairment under different audit quality. In the second column, the coefficient of Recover is 0.0883, which is significant at the 1% level. In the third column, the coefficient of Recover is -0.0626, which is no significant. The executive change has no impact on goodwill impairment. Comparing the regression results of (2) and (3), it can be concluded that executive changes have a positive relationship with the company's goodwill impairment among the companies whose audit institutions are “non-Big Four”. There is no significant correlation between executive changes and goodwill impairment among the companies whose audit institutions are “Big Four”, which supports the H2.

5. Conclusion

This paper uses the data of A-share listed companies in Shanghai and Shenzhen stock exchanges from 2010-2018 as samples. Based on the agency theory, information asymmetry theory, and signal transmission theory, this paper empirically tests the impact of executive changes on the goodwill impairment of listed com-

panies. From the aspect of audit quality, we discussed the difference in the impact of executive changes on the goodwill impairment under different audit quality.

This article concludes as follows:

1) Companies with executive changes have a greater degree of goodwill impairment than companies without executive changes. This is because in the case of executive changes, the succession management in order to gain the trust of the board of directors and shareholders, and obtain more benefits in subsequent terms. The succession management has an incentive to achieve goodwill impairment and reduce the operating profit of the year.

2) In terms of audit quality, in companies with lower audit quality, there is a significant positive correlation between executive change and goodwill impairment, while in companies with higher audit quality, the correlation between executive changes and goodwill impairment is not significant. The reason is that under the strict auditing, the manipulation of goodwill impairment is more likely to be found by audit institutions, which has a greater risk, and the management's tendency to use it to manipulate profits is weak, so executives are more inclined to disclose real goodwill impairment information.

In terms of theory, this article explores its impact on goodwill impairment from the perspective of executive change, which enriches the research on the path of executive management's effect on earnings management, and is conducive to understanding the determinants of goodwill impairment. In reality, the research in this paper has important guiding significance for improving the quality of internal governance of listed companies. First, the capital market must strengthen the supervision of information disclosure of listed companies and strive to protect the interests of shareholders and external investors. Second, listed companies must improve their internal governance structure to prevent management opportunistic behavior and eliminate management's manipulation of goodwill.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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