Accounting Narratives and Impression Management

In *The Routledge Companion to Communication in Accounting*

Lisa Jack, Jane Davison and Russell Craig (eds.)

Routledge, London, Chapter 8, pp. 109-132.

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ABSTRACT

This chapter focuses on impression management in accounting communication. Impression management entails the construction of an impression by organisations with the intention to appeal to their audiences, including shareholders, stakeholders, the general public, and the media. If successful, it undermines the quality of financial reporting and capital misallocations may result. What is more, wider social and political consequences include unwarranted support by non-financial stakeholders or by society at large. Impression management is examined by reference to four perspectives: the economic, psychological, sociological, and critical. These variously conceptualise impression management as reporting bias, self-serving bias, symbolic management, and ideological bias.

"People like [Berni Madoff] become sort of like chameleons. They are very good at impression management...They manage the impression you receive of them. They know what people want, and they give it to them." (Cresswell and Thomas, 2009)

INTRODUCTION

Arthur Levitt (2000), former chairman of the US Securities and Exchange Commission, has

pointed to the gradual, but perceptible erosion in the quality of financial reporting. Arguably one

means by which this is achieved is impression management, as the quote above illustrates. Berni

Madoff was an establishment figure, a former non-executive chairman of NASDAQ, and

perpetrator of the biggest Ponzi fraud in history. Understanding impression management

communication choices is important in assisting readers of corporate reports in detecting the

potential deception inherent in such practices.

Financial information is frequently communicated through written narratives which are largely

qualitative in nature and which are sometimes referred to as 'soft' or unquantified information.

Accounting narratives can be found in annual reports, including financial statements, accounting

textbooks, official pronouncements by accounting bodies, and legal judgements concerning

accounting issues (Jones and Shoemaker, 1994). For example, Young (2003) analyses the

rhetorical devices in accounting standards used to persuade readers of their worth or to silence

alternative opinions and criticism. The function of accounting narratives in corporate reports is to

amplify quantified accounting information. Most accounting narratives in corporate reports are

not subject to external audit, which makes it easier for managers to manipulate the information

disclosed therein. For example, the scope of auditors' reports in company annual reports is

limited to the financial statements and the notes therein. At best, other narrative accounting

disclosures are merely monitored by external auditors for consistency with the financial

statements. The scope of this chapter is restricted to accounting narratives in corporate reports, excluding those in audited financial statements, such as the notes to the financial statements. Although audited financial statements contain accounting narratives, much prior research focuses on accounting narratives outside the audited accounts. In this chapter these are referred to as discretionary accounting narratives in order to distinguish them from accounting narratives supporting numerical information in audited financial statements.

This chapter discusses prior research by reference to four perspectives on impression management: economic, psychological, sociological, and critical. Seven communication choices in discretionary accounting narratives in corporate reports are also examined. These constitute the categories of analysis in research adopting the economic and psychological perspective on impression management. As the sociological and the critical perspectives adopt a more interpretive approach to text analysis, the analytical categories emerge inductively from the data (Merkl-Davies *et al.*, 2013). The effect of impression management on investors and other users of corporate reports is not addressed, other than in passing. The chapter concludes with some suggestions for future research and some implications for the practice of corporate reporting.

The concept of impression management originates in social psychology and is concerned with 'studying how individuals present themselves to others to be perceived favourably by others' (Hooghiemstra, 2000: 60). Using a dramaturgical metaphor, Goffman (1959) explains impression management as the performance of self *vis-à-vis* an audience. Impression management entails shaping an audience's impression of a person, an object, an event, or an idea (Schlenker, 1980) usually with the intention to appeal to appeal to audiences (Gioia *et al*., 2000).

The impression conveyed may correspond to an ostensible reality. Alternatively, it may entail enhancing desirable aspects of the organisation or obfuscating less desirable aspects, thus attempting to manipulate organisational audiences' perceptions (Gioia *et al.*, 2000).

Impression management in a corporate reporting context

The concept of impression management is applied in a corporate reporting context to analyse attempts to influence audiences' perceptions of organizations, particularly financial performance (e.g., Clatworthy and Jones, 2001, 2003, 2006; Courtis, 2004a; Rutherford, 2003) and social environmental performance (e.g., Hooghiemstra, 2000). This entails 'vertical borrowing' (Highhouse *et al.*, 2009: 1483) in that social psychology research on individuals is applied to organizations. Depending on the theoretical position adopted, organizational audiences are defined either narrowly as consisting of shareholders and financial intermediaries, or more broadly as including stakeholders and society at large. The definition adopted affects the focus of analysis. A narrow agency theory based approach results in impression management conceptualized as managerial manipulation of shareholders' perceptions of financial performance (e.g., Clatworthy and Jones, 2001, 2003, 2006; Courtis, 2004a; Rutherford, 2003). By contrast, a wider systems-oriented theory based approach shifts the focus of analysis to managerial manipulation of stakeholders' impressions of social and environmental performance, organizational legitimacy (e.g., Hooghiemstra, 2000; Breton and Côté, 2006; Linsley and Kajüter, 2008) and organizational changes such as restructuring and reorganization, privatisation, demutualisation, mergers or acquisitions (Arndt and Bigelow, 2000; Odgen and Clarke, 2005).

If discretionary accounting narratives are used for impression management purposes, then financial reporting quality will be undermined and capital misallocations may result (if users are susceptible to impression management). Wider social and political consequences of impression management include unwarranted support of organizations and their activities by non-financial stakeholders or by society at large. Thus, impression management constitutes an important area of accounting research. To illustrate the persuasive power of impression management, Illustration 1 includes extracts from the annual report of Enron immediately prior to its collapse. Phrases presented in bold underline font are consistent with a positive bias introduced by Enron. We believe this is a reflection of opportunistic managerial behavior aimed at manipulating readers' perceptions of corporate achievements, rather than an attempt to provide investors with useful incremental information. Notwithstanding the hyperbolic claims, few quantitative amounts are included in the extracts. An exception is the reference to "record" net income of $1.3 billion. This amount does not appear in Enron's 2000 audited income statement. Rather, it relates to an unaudited amount of $1,266 million 'net income before items impacting comparability'. Enron appears to have managed impressions with words, when the underlying audited numbers told another story.

Impression management and disclosure media

Discretionary accounting narratives generally appear in the unregulated sections of corporate documents to support and expand upon the regulated accounting disclosures in the audited financial statements. We use the term 'corporate reports' / 'corporate documents' in a broad sense to include a wide variety of disclosure vehicles or media containing accounting narratives, including:

- Annual reports, particularly chairmen's statements (Smith and Taffler 1992a, 2000)

- CEO letters to shareholders (Amernic, Craig and Tourish 2007; Craig and Amernic 2008; Hooghiemstra 2010)

- Operating and financial reviews (Rutherford 2003; Sydserff and Weetman 1999, 2002) / management discussion and analyses (Feldman *et al.*, 2010)

- Initial public offering prospectuses (Lang and Lundholm 2000; Aerts and Cheng 2011)

- Takeover documents (Brennan *et al*., 2010)

- Press releases (Bowen *et al*., 2005; Henry 2006, 2008; Davis *et al*., 2012)

- Websites (Campbell and Beck 2004) and

- Conference calls (Matsumoto *et al*., 2011).

Davis and Tama-Sweet (2012) find the news content / tone varies depending on the disclosure vehicle. Disclosures in earnings press releases are less pessimistic than in management discussion and analysis documents.

Organizational reputation, image, and legitimacy

Impression management can play a role in restoring reputation, image, or legitimacy in times of crisis or change, such as during adverse financial performance (e.g., Abrahamson and Park, 1994; Courtis, 2004a), corporate scandals (e.g., Linsley and Kajüter, 2008), environmental disasters (e.g., Hooghiemstra, 2000) and major reorganization (e.g., Arndt and Bigelow, 2000; Odgen and Clarke, 2005). Impression management is used to persuade organizational audiences of the exceptional nature of the circumstances resulting in negative financial performance, to portray the financial scandal as an isolated incident, or to convince them of the validity, legitimacy or necessity of reorganization (Merkl-Davies and Koller, 2012). Impression management may be used reactively as a means of restoring reputation, image or legitimacy after a crisis or incident (e.g., Odgen and Clarke, 2005; Craig and Amernic, 2008; Linsley and Kajüter, 2008) or prospectively to shape perceptions of a controversial issue, such as a reorganization, demutualisation or merger (Arndt and Bigelow, 2000; Craig and Amernic, 2004a, 2008).

Impression management is used to establish, maintain, and restore image, reputation, and legitimacy. These concepts denote organisational audiences' perceptions and assessments of organizations (Deephouse and Carter, 2005: 329). Reputation refers to a temporally stable evaluative judgement of the desirability of organizations as a whole (Highhouse *et al*., 2009), often with respect to their peer group (Deephouse and Carter, 2005: 331). By contrast, image involves the dynamic perception of a specific area of distinction, such as market image, investment image, or corporate social responsibility image (Highhouse *et al*., 2009: 1489). Finally, legitimacy refers to a shared judgement about the normative appropriateness of organizations (Highhouse *et al*., 2009: 1487). Reputation and image are concerned with the evaluation of organizations, whereas legitimacy focuses on their acceptability with respect to social norms and rules (Deephouse and Suchman, 2008). Impression management thus entails constructing an impression of the quality or normative appropriateness of organisational structures, processes, practices, or outcomes. Table 1 provides an overview of the three concepts.

Table 1: Organizational reputation, image and legitimacy

Concepts	Key aspects	Time dimension	Definition
Organizational reputation	• Whole organization • Quality • Evaluation	• Short-term • Stable	A general, temporally stable, shared evaluative judgment about a firm
Organizational image	• Aspect of the organization (e.g., investment image) • Quality • Evaluation	• Short-term • Dynamic	A dynamic perception of a specific area of organizational distinction
Organizational legitimacy	• Whole organization or industry • Social norms and rules • Appropriateness	• Long-term • Stable	A shared general judgment about normative appropriateness

Adapted from Highhouse *et al.*, 2009: 1487, Table 1.

Adverse financial performance, pollution or product recalls can have a negative impact on the organizational image affected (i.e., investment image, environmental image, corporate social responsibility image or product image). These may affect organizational reputation. By contrast, corporate scandals involving a breach of law (e.g., tax evasion, corporate fraud) or a violation of social norms and rules (e.g., environmental disasters or human rights violations in Third World countries) can be regarded as damaging organizational legitimacy. Such legitimacy is particularly important for firms operating in socially contested industries, such as the nuclear industry, the oil and gas industry or the tobacco industry (e.g., Prasad and Mir, 2002). In these cases, an incident in a particular firm (e.g., BP's oil spill in the Mexican Gulf or the nuclear accident in Fukushima) not only threatens the legitimacy of the affected company, but of the whole industry (e.g., Beelitz and Merkl-Davies, 2012).
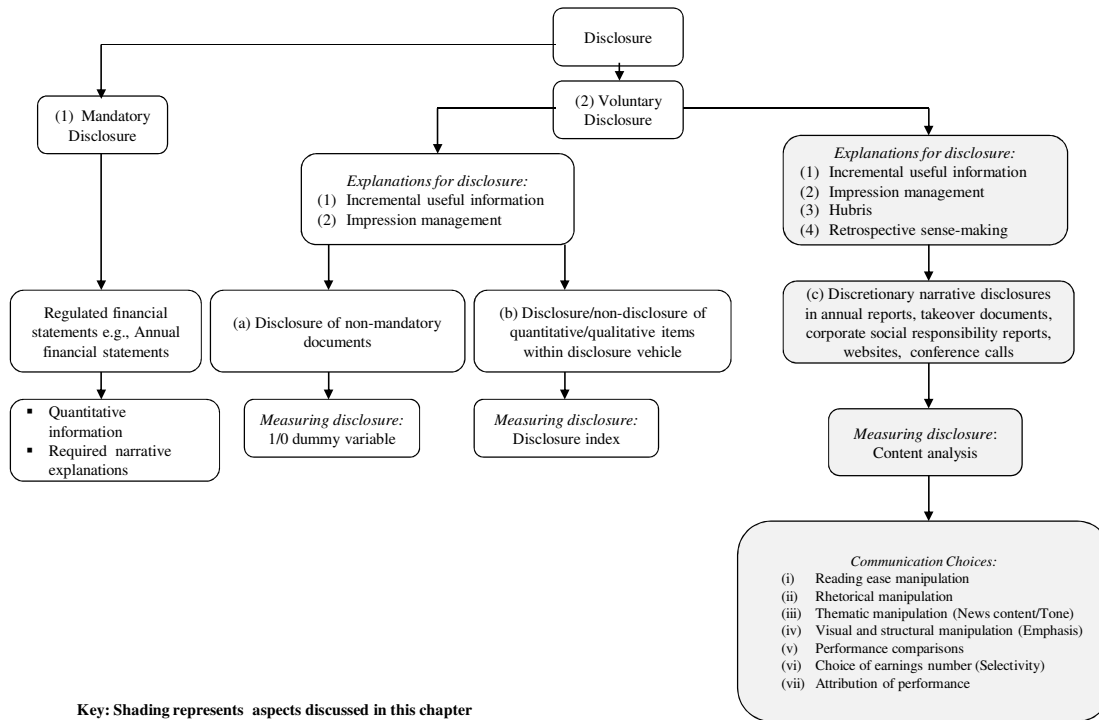
FOUR PERSPECTIVES ON IMPRESSION MANAGEMENT

In accounting research, four broad perspectives on impression management can be differentiated: (1) economic, (2) psychological, (3) sociological and (4) critical. Table 2 outlines differences between the four perspectives along five dimensions, namely underlying theories, assumptions about the managerial motivation to engage in impression management, the underlying concept of impression management, the focus of analysis and consequences of impression management. The economic and social psychology perspectives are primarily concerned with investment image and focus on managerial attempts to manage shareholders' and financial stakeholders' perceptions of financial performance. If successful, this results in short-term capital misallocations (Merkl-Davies and Brennan, 2007). By contrast, the sociological perspective is concerned with the corporate social and environmental responsibility image and legitimacy. This perspective focuses on impression management influencing organizational audiences' perceptions of social and environmental performance and on organizational compliance with social norms and rules. If organizational audiences are convinced by impression management attempts, it results in unwarranted support by stakeholders and the general public. Finally, the critical perspective is concerned with power and focuses on managerial attempts to influence organizational audiences' perceptions of corporate influence and control. If impression management is successful, it results in hegemony. In the context of corporate reporting, hegemony refers to the process of influencing the minds of organizational audiences in such a way that they are persuaded to support organizations out of their own free will.

Table 2: Differences between the four perspectives across five dimensions

Perspectives	*Underlying theories*	*Motivation to engage in impression management*	*Concept of impression management*	*Focus of Analysis*	*Consequences of impression management*
(1) Economic	• Agency theory	• Maximize compensation	• Reporting bias	• Obfuscation of negative organizational outcomes • Emphasis of positive organizational outcomes	• Capital misallocations
(2) Psychological	• Attribution theory	• Win social and material rewards and avoid sanctions	• Self-serving bias	• Performance attributions	• Capital misallocations
(3) Sociological	• Stakeholder theory • Legitimacy theory • Institutional theory	• Attract social and material resources and support	• Symbolic management • Decoupling	• Normalising accounts • Strategic restructuring	• Unwarranted support from stakeholders & society
(4) Critical	• Political economy • Critical theories	• Gain and maintain power	• Ideological bias	• Strategic use of rhetorical, semantic and grammatical features	• Hegemony

The perspective adopted affects the explanation for the motives underlying impression management, the manifestations of impression management in discretionary accounting narratives and the way impression management is conceptualized (i.e., reporting bias, self-serving bias, symbolic management/decoupling, ideological bias). The economic and psychological perspectives predominate. Impression management is viewed as falling into the broad category of voluntary disclosure research and is conceptualized as biased discretionary disclosures. A wide variety of impression management communication choices in discretionary accounting narratives have been studied, including the seven identified in Figure 1.

Figure 1: Locating impression management research in the voluntary disclosure literature: a taxonomy

Disclosure

(1) Mandatory Disclosure

(2) Voluntary Disclosure

Explanations for disclosure:
(1) Incremental useful information
(2) Impression management

Explanations for disclosure:
(1) Incremental useful information
(2) Impression management
(3) Hubris
(4) Retrospective sense-making

Regulated financial statements e.g., Annual financial statements

(a) Disclosure of non-mandatory documents

(b) Disclosure/non-disclosure of quantitative/qualitative items within disclosure vehicle

(c) Discretionary narrative disclosures in annual reports, takeover documents, corporate social responsibility reports, websites, conference calls

- Quantitative information
- Required narrative explanations

Measuring disclosure:
1/0 dummy variable

Measuring disclosure:
Disclosure index

Measuring disclosure:
Content analysis

Communication Choices:
(i) Reading ease manipulation
(ii) Rhetorical manipulation
(iii) Thematic manipulation (News content/Tone)
(iv) Visual and structural manipulation (Emphasis)
(v) Performance comparisons
(vi) Choice of earnings number (Selectivity)
(vii) Attribution of performance

Key: Shading represents aspects discussed in this chapter

Economic perspective

Regarded as part of the discretionary choice literature, most impression management studies are based on agency theory assumptions. Managers are assumed to exercise judgement in order to 'alter financial reports to … mislead some stakeholders about the underlying economic performance of the company' (Healy and Wahlen, 1999: 368). Thus, impression management constitutes opportunistic managerial behaviour arising from information asymmetries between managers and investors. Focusing on the valence (i.e., favourable or unfavourable) and tone (i.e., optimistic or pessimistic) of disclosures, impression management involves emphasizing positive organizational outcomes or obfuscating negative organizational outcomes. Negative organizational outcomes give rise to conflicts of interest between managers and shareholders. Managers are prompted to manipulate outsiders' perceptions of financial performance and

prospects in order to 'divert attention from financial distress' (Tennyson *et al*., 1990: 395-396). Corporate narrative documents are impression management vehicles used to present a self-interested view of corporate performance (Staw *et al*., 1983: 584; Abrahamson and Park, 1994: 1302; Clatworthy and Jones, 2006: 493). Managers introduce reporting bias to benefit from increased compensation, particularly via managerial stock options (Rutherford, 2003; Courtis, 2004a).

Reporting bias entails 'selecting the information to display and presenting that information in a manner that is intended to distort readers' perceptions of corporate achievements' (Godfrey *et al*., 2003: 96). This involves manipulating the presentation and disclosure of both verbal (e.g., reading ease manipulation, rhetorical manipulation, thematic manipulation, visual and structural manipulation, attribution of performance) and numerical information (e.g., visual and structural manipulation, performance comparisons, choice of earnings number).

Psychological perspective

Studies based on the social psychology perspective replace the economic view of managers, who make corporate reporting decisions solely on the basis of cost-benefit calculations, with a psychological view which takes the social relations inherent in the decision context into consideration. Managerial behaviour is regarded as embedded in and dependent on managers' relationships with organizational audiences and is thus inherently social in character. Impression management arises from 'the actual, imagined and implied presence' (Allport, 1954: 5) of organizational audiences to whom managers are accountable. Corporate reports, particularly annual reports, serve as an accountability mechanism to address the concerns of external parties.

Under conditions of accountability, managers engage in impression management in anticipation of an evaluation of their actions and decisions by (primarily) shareholders.

In the psychological perspective, managers use self-serving bias in anticipation of an evaluation of performance by shareholders and stakeholders with the aim of winning rewards and avoiding sanctions (Frink and Ferris, 1998). Self-serving bias is explained by reference to attribution theory which is concerned with people's explanations of events. People's attribution of actions and events is biased in that they take credit for success and deny responsibility for failure (Knee and Zuckerman, 1996). In a corporate reporting context, self-serving bias entails attributing positive organizational outcomes to internal factors (taking credit for good performance) and negative organizational outcomes to external circumstances (assigning blame for bad performance), to influence investors' perceptions of financial performance (Aerts, 1994, 2001; Clatworthy and Jones, 2003; Hooghiemstra, 2008; Aerts and Cheng 2011).

Seven impression management communication choices

As accounting standards generally do not prescribe the choice of wording in the accounting policies and explanatory notes to the audited financial statements, impression management may take place in required narrative disclosures. However, we treat these required disclosures as mandatory for the purpose of Figure 1. The majority of research conceptualises impression management in the form of discretionary disclosure strategies or communication choices. Merkl-Davies and Brennan (2007) identify seven categories of communication choices as shown in Figure 1: (i) Reading ease manipulation, (ii) Rhetorical manipulation, (iii) Thematic manipulation (News content/Tone), (iv) Visual and structural manipulation (Emphasis), (v)

Performance comparisons, (vi) Choice of earnings number (Selectivity) and (vii) Attribution of performance.

(i) Reading ease manipulation studies use readability scores to examine whether managers make accounting narratives more difficult to read with the objective of obfuscating bad news (e.g., Smith and Taffler, 1992b; Li, 2008). Readability is measured using readability formulae such as Flesch, Fog, Lix, Fry Graph, Dale-Chall and Kwolek which compare a calculated score with 'predetermined standards of written materials graded according to difficulty' (Courtis, 1995: 5), ranging from children's comics to scientific articles. One of the commonest, the Flesch Reading Ease score, is based on word and sentence length. It rates text on a 100-point scale. The higher the score, the easier it is to understand the text. A score of 60 to 70 is considered optimal for text comprehension. Illustration 2.1 contains short words and sentences, leading to a Flesch Reading Ease score of 69.16. Illustration 2.2 contains long words and sentences, with a much lower Flesch Reading Ease score of 18.39.

Illustration 2: Measuring readability using Flesch Reading Ease scores

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Illustration 2.1: The year to 30th June 2002 was the Barratt Group's most successful year to date. We delivered record profits of £220m, almost double our profits of 3 years ago, and ended the year with record forward sales. (Barratt Developments Chairman's Statement 2002) (2 sentences; 37 words; 52 syllables).

Flesch score
206.835 – (1.015 x no. words 37 /no. sentences 2) – (84.6 x no. syllables 52 / no. words 37) = 69.16

Illustration 2.2: The Group continued to invest in the expansion of its Precision components operations where prospects for further growth remain encouraging. The disappointing profit performance of the Copal gravity diecasting unit, while unconnected to the investment programme in high-pressure technology, led nevertheless to a moderate level of spend in the year. (Alumasc Group Chairman's Statement 2002) (2 sentences; 51 words; 98 syllables).

Flesch score
206.835 – (1.015 x no. words 51 /no. sentences 2) – (84.6 x no. syllables 98 / no. words 51) = 18.39

(Source: Table 3, Merkl-Davies et al., 2011b)

Studies focusing on (ii) rhetorical manipulation argue that companies may frame their results using rhetorical devices. In examining the rhetorical effects of discourse, Hyland (1998) includes 41 examples in her paper, of which a number are reproduced in Illustration 3. She argues that creating an ethos of the CEO as a competent, trustworthy, authoritative and honest person are essential elements in credible communication.

Illustration 3: Rhetorical analysis – Establishing credibility in corporate reporting

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Illustration 3.1: Use of emphatics
As our H.K. $31,400 million worth of aircraft and equipment orders <u>clearly show</u>, we remain very confident about the future of Hong Kong

Illustration 3.2: Use of personal pronouns
<u>I know</u> from my year as chairman of the Administration Board that budgeting has been a very delicate operation over the last two years.

Illustration 3.3: Use of hedges to portray modest, trustworthy cautious steward
<u>It is possible to envisage</u> a future when many banking services will be delivered direct to the home or business place via television screens.

(Source: Hyland, 1998: 236-237, Examples 13, 16, 20)

(iii) Thematic manipulation studies mainly examine whether corporate narratives overstate good news and understate bad news, for example by means of coding sentences in the chairman's statement/president's letter, (e.g., Staw *et al*., 1983; Clatworthy and Jones 2001, 2003; Smith and Taffler, 1995, 2000). Brennan *et al*. (2010) adapt this stream of research to defensive and attacking themes and rhetorical devices used in hostile takeover defence documents. Thematic manipulation has also been studied in the context of social and environmental reporting and intellectual capital reporting. In Illustration 4, keywords are used to analyse good news and bad news themes in discretionary accounting narratives. The illustration indicates the presence of two positive keywords and one negative keyword. In examining the readability of sections of chairman's statements, Clatworthy and Jones (2003) coded the text into eleven major themes, as shown in Illustration 5.

Illustration 4: Thematic analysis – Measuring good news / bad news themes

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Profit before tax up [Keyword+1] 7.4% to £43.5m; investment profit down [Keyword–1] 2.2% to £39.6m; total dividend 10.3p per share, an increase [Keyword+2] of 3.0%.

(Source: Example 1, Brennan *et al*., 2009: 806)

Illustration 5: Thematic analysis – Key themes in chairmen's statements

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Future and/or outlook
Results
Employees
Acquisitions and disposals
Outline of major events
Discussion of major events
Overview of the year
Board changes
Operations
Business segments
Finance/investment

(Source: Clatworthy and Jones, 2001: 317)

(iv) Visual emphasis and structural manipulation may be used to overemphasise good news, including positioning good news first in documents (Bowen *et al*. 2005), burying bad news in middle passages of text within documents (Courtis 1998), highlighting text (Brennan *et al*., 2009), use of colour (Courtis, 2004b) and repetition (Courtis 1996, Davison 2008). In Illustration 6, text in target company defence documents was categorized into three levels of visual emphasis – most-emphasized, next-most-emphasized and least-emphasized. Target company managers, battling against an unwelcome bidder, use every means to get their point of view across to target company shareholders, including visual emphasis. There is also some evidence of rhetorical manipulation in the form of repetition in Illustration 6 ('don't let', 'Do not let').

Illustration 6: Visual emphasis

Illustration 6.1: Most-emphasised

> **Don't let Nasdaq transform itself at your expense**

Illustration 6.2: Next-most-emphasised

> **Do not let Nasdaq undermine the value of your investment**

Illustration 6.3: Least-emphasised

> It does not even offer you the standalone value of your company.

(Source: Example 2, Brennan *et al*., 2010: 260)

(v) Performance comparison involves choosing benchmarks (prior year and others) as comparators to portray firm performance in the best possible light (Lewellen *et al*., 1996; Schrand and Walther, 2000, Short and Palmer, 2003). (vi) Earnings choice or selectivity has been studied by Johnson and Schwartz (2005). This involves the judicious choice or selection of a favourable earnings number to disclose in accounting narratives, such as *pro forma* earnings. Illustration 7 exemplifies both performance comparison and choice of earnings number/selectivity. In a study of discretionary accounting narratives in annual results press releases, the profit figure of £373.2m selected by this company for inclusion in its press release is the second largest amount (in absolute terms) of the ten profit figures available in the audited profit and loss account. Illustration 7 also includes a performance comparison in the form of percentage increase in profit over the prior year. The selected profit number shows an increase of 19.2% over the prior year performance comparison. Had the largest absolute profit amount been selected, this would only have shown an increase of 16.8% over the prior year performance

comparison. The performance comparison possibly accounts for the selection of the second highest rather than the highest profit amount.

Illustration 7: Performance comparison <u>and</u> earnings choice/selectivity

<u>Profit figures</u>
Group trading profit up £60 million (19.2%) to £373.2 million

(Source: Example 6, Brennan *et al*., 2009: 808)

(vii) Attribution analysis examines, for example, whether a company takes credit for positive outcomes and blames external factors for negative outcomes. Baginski et al. (2000) classify causal attributions in management earnings forecasts, as shown in Illustration 8.

<table>
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Illustration 8: Attribution

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External causes
General economic/environmental issues: recession/inflation, dollar weakness/strength, foreign currency fluctuation, input cost changes – increasing/decreasing costs, change in market for product, general loss/gain of customers, weather/catastrophe, order backlogs

Government / third party issues: tax law/other law changes, SEC actions/regulatory actions, expropriation by foreign governments, lawsuits/legal actions, competition action/issues, involuntary accounting changes

Internal causes
Product/services issues/actions: changes in product prices, changes in product mix, advertising/marketing, new products/processes/production

Organizational issues/actions: Management techniques/strategies/plans/ repositioning, changes in management personnel, cost cutting/savings, asset write downs, going public, selling/buying stocks, merger/acquisition/disposal of a business segment, investment in plant assets, voluntary accounting changes

 (Source: Table 2, Baginski *et al.*, 2000: 377).

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<u>Alternative explanations for communication choices in discretionary accounting narratives</u>

As shown in Figure 1, three explanations other than impression management have been suggested for the seven communication choices in discretionary accounting narratives outlined above: (1) incremental useful information, (2) hubris and (3) retrospective sense-making (Merkl-Davies and Brennan, 2011). The impression management explanation assumes that managers opportunistically exploit information asymmetries between them and organizational audiences by means of biased reporting. By contrast, the incremental information explanation assumes that managers provide discretionary accounting narratives to facilitate better decision making by investors and other corporate report users. A number of studies reviewed in Merkl-Davies and Brennan (2007) test both the incremental information and the impression management

hypotheses. These favour an impression management explanation for discretionary accounting narratives.

However, biased reporting can also be due to managerial hubris. Whereas impression management constitutes opportunistic managerial behaviour, hubris constitutes self-deception or egocentric bias. Egocentric bias results in managers being biased towards their own performance. Finally, in an accountability context, particularly in annual reports, biased reporting, particularly in the form of performance attributions, may also be the result of managerial retrospective sense-making. This entails managers providing an account of organizational actions and events by retrospectively assigning causes to them (Aerts, 2005).

The predominant economic and psychological perspectives are based on a narrow view of impression management, as they are primarily concerned with the relationship between managers and financial stakeholders (e.g., investors, lenders and financial intermediaries). They focus on reporting bias or self-serving bias with respect to the financial performance of the firm. The role of corporate reporting in mediating the relationship between organizations and their non-financial stakeholders, and biased reporting of social and environmental performance, are ignored. The relationship between organizations and their audiences is regarded solely in terms of market exchange (Mouck, 1995). By contrast, the sociological and the critical perspectives take into account the wider socio-political context in which corporate reporting takes place. This shifts the focus of analysis to the managerial manipulation of organizational audiences' perceptions of social and environmental performance, organizational (non)compliance with social rules and norms and power relations between organizations and their constituents. The focus of analysis is not on narrow predetermined communication choices, but on wider

strategies, including symbolic management or decoupling and the strategic use of rhetorical, grammatical and semantic features used in order to appear to comply with social norms and rules or to gain and maintain power. For example, Davison (2002) examines the rhetorical device of antithesis used not only to embellish, but also to induce patterns of reading and thinking in users of annual reports. Walters-York (1996) and Walters (2004) advocate analysis of the use of metaphor in accounting discourse to open up new ways of 'seeing' impression management in a corporate reporting context resulting in new modes of investigation and raising new issues and concerns (Walters, 2004: 171). Rhetorical devices may be used such as silence (Young, 2003), antithesis (Davison, 2002), metaphor (Walters-York, 1996) or repetition (Davison, 2008). Milne *et al.* (2006) examine the use of journey metaphor in sustainability reporting. Portraying sustainability as a journey evokes images of organizational adaptation, learning, progress and a movement away from business-as-usual practices as exemplified in Illustration 9.

Illustration 9: Sociological perspective – analysis of metaphor in sustainability reporting

Illustration 9.1: It is my belief that radical targets are also required if we are to stimulate the innovation and thinking "out of the square" necessary to make significant progress along the road towards sustainable development. (Landcare Research New Zealand annual report 2000 (p. 4)

Illustration 9.2: Creating a sustainable world will be a daunting challenge—a tough journey of continual learning (Shell *There is No Alternative*)

(Source: Milne *et al.* , 2006: 816)

Repetition is exemplified in Illustration 10, where repeating short key phrases at the beginning of successive sentences (anaphora) is used to emphasize business intangibles and future growth.

Illustration 10: Sociological perspective – analysis of rhetoric in the form of repetition
It's about the liberation It's about the creation [. . .] [note also the repetitive rhyme of "ion"] And it's about growth [. . .] The first phrase continues thus: It's about the liberation of our people and our assets – these new businesses will be free to innovate and free to operate at speed. (Source: Davison , 2008: 803)

Sociological perspective

Studies adopting the sociological perspective regard impression management as resulting from structural constraints exerted either by different stakeholder groups or by society at large. Impression management is seen either as a response to concerns of various stakeholder groups or as a response to public pressure and media attention relating to a controversial issue or event (stakeholder theory) or as arising from inconsistencies between organizational and societal norms and values (legitimacy theory). In the latter case, it constitutes an attempt on the part of managers to gain or restore organizational legitimacy by seemingly aligning firms' norms and values with those of society, particularly in situations where firms face legitimacy threats, such as corporate scandals, product safety issues or environmental disasters.

Although it is not always explicitly stated, legitimacy is a social construct in the sense that it refers to 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions' (Suchman, 1995: 574). Legitimacy is conceptualized from either a strategic or an institutional perspective. Adopting an agency focus, the strategic perspective regards legitimacy

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as an operational resource to be employed in the pursuit of organizational goals (Suchman, 1995). Adopting a structure focus, the institutional perspective views legitimacy as the collective awareness and recognition of an organization's practices as acceptable, appropriate and desirable (Suchman, 1995). From the institutional perspective, legitimacy 'resides in people's minds' (Breton and Côté, 2006: 512) and is granted by organizational audiences when they perceive organizational practices to be congruent with social rules, norms and values. The strategic perspective is predominant, as it provides a better fit with the agency-based concept of impression management put forward by social psychology.

Prior research has identified a variety of impression management communication choices used by managers to (re)establish legitimacy. These can be classified according to the underlying concept of legitimacy, i.e. either strategic or institutional. From a strategic perspective, impression management is conceptualized as symbolic management (Ashforth and Gibbs, 1990). Symbolic management entails adopting communication choices which make organizations *appear* to respond to stakeholder concerns or *appear* to be congruent with society's norms and expectations. Firms facing a major legitimacy threat engage in symbolic management by separating negative events (e.g., fraud, scandal, product safety issue) from organizations as a whole (1) by providing normalising accounts (e.g., by means of excuses, apologies, or justifications) and (2) engaging in strategic restructuring (e.g., executive replacement, establishment of monitors or watchdogs). The purpose of normalising accounts and strategic restructuring is to construct a 'firewall' between audience assessments of legitimacy-threatening events and organizations as a whole. Normalising accounts entail the use of verbal remedial strategies to repair organizational legitimacy. This involves the use of a wide variety of mainly

defensive tactics identified by social psychology research. Defensive tactics, such as justifications and excuses, are deployed in situations where organizations expect to be met by disapproval, for example during events threatening organizational image, reputation, or legitimacy. Alternatively, acquisitive tactics, such as self-promotion, exemplification, ingratiation, enhancements and entitlements are used in situations when organizations expect to be met by approval (Benoit, 1995; Ogden and Clarke, 2005; Aerts and Cormier, 2009).

Strategic restructuring entails 'selectively confess[ing] that limited aspects of its operations were flawed' (Suchman, 1995: 598) and then decisively and visibly remedying them by introducing small and narrowly tailored changes. Two types of strategic restructuring have been identified: (1) creating monitors and watchdogs and (2) disassociation. Disassociation entails symbolically distancing organizations from negative influences. For example, executive replacement allows organizations to dissociate themselves from legitimacy-threatening events by blaming individuals. Organizations can also dissociate themselves from de-legitimated procedures and structures (Ogden and Clarke 2005).

From an institutional perspective, impression management is conceptualized as decoupling (DiMaggio and Powell, 1983). Decoupling entails rendering organizational structures and processes so that they *appear* to conform to social and institutional norms and rules. Decoupling manifests itself in espousing socially acceptable goals, redefining means as ends and ceremonial conformity (Linsley and Kajüter, 2008). Espousing socially acceptable goals, for example, involves claiming customer-focus or equal opportunities employer status when, in effect, the opposite is the case. Redefining means as ends, for example involves justifying closure of

employee pension schemes on the basis of the introduction of a new accounting standard.

Finally, ceremonial conformity entails adopting specific practices considered consistent with

rational behaviour, even though they do not improve organizational practices, for example public

sector organizations introducing private sector management accounting practices or performance

evaluation schemes (see Merkl-Davies and Brennan, 2011).

Critical perspective

The critical perspective is characterized by a critical realist view of organizational reality

combined with a critical stance. The aim of critical research is emancipation and commitment to

changing oppressive realities. The aim of critical impression management research is to expose

hidden interests in corporate reporting (Chua, 1986). This entails analysing the linguistic means

by which dominant constructions of reality are achieved. For example, Prasad and Mir's (2002:

96) analysis of CEO letters to shareholders of US oil companies in the 1970s and 1980s aims to

expose the 'hidden meanings [in corporate narrative documents] that serve the interests of the

socially and politically powerful'. Studies adopting a critical perspective predominantly focus on

the use of impression management during controversial issues and legitimacy threatening events,

such as privatisation (Craig and Amernic, 2004a, 2008), difficult financial circumstances

(Amernic and Craig, 2000), financial scandals (Craig and Amernic, 2004b) and transformational

changes (Amernic *et al*., 2007). The focus of analysis is on the way language is used by

managers to convince organizational audiences of the validity, legitimacy or necessity of

organizational changes, to portray financial scandals as isolated incidents, or to persuade

organizational audiences of the exceptional nature of the circumstances resulting in the negative

financial performance. However, language use in corporate documents is never 'innocent',

because it is used to achieve a variety of economic, social and political goals and is thus 'as ideologically saturated as … text[s] which wear [their] ideological constitution overtly' (Kress, 1993: 174). Thus, impression management can be regarded as part of 'routine' corporate communication used by management to 'control the way in which the corporate story is interpreted' (Crowther *et al*., 2006: 199).

Impression management is regarded as resulting from the desire of powerful managers to impose their perspective of (1) organizational activities and outcomes (White and Hanson, 2002; Amernic and Craig, 2004), (2) specific stakeholders with whom they are in conflict (Driscoll and Crombie, 2001; Prasad and Mir, 2002), or (3) socio-economic and socio-political issues affecting their activities or reputation such as climate change, minimum pay, or human rights (Livesey, 2002). Corporate narrative documents are assumed to have ideological effects in the sense that 'they can help produce and reproduce unequal power relations … through the ways in which they represent things and position people' (Fairclough and Wodak, 1997: 258). Language is regarded as a medium in which prevailing power relations are articulated. Impression management in the form of ideological bias focuses on rhetorical (e.g., repetition, hyperbole), semantic (e.g., metaphor, differentiation) and grammatical (e.g., passivisation) features employed by managers to impose their view of organizations and firm performance and of social, political or environmental issues affecting organizations (e.g., Crowther *et al*, 2006; Craig and Amernic, 2004a, 2004b). Metaphors entail 'understanding and experiencing one kind of thing in terms of another' (Lakoff and Johnson, 1980: 5) as a means of knowledge construction and perception engineering (Walters, 2004). In their analysis of Enron's Letter to Shareholders after the bankruptcy Craig and Amernic (2004b) show how metaphors of war, sport and extremism and

hyperbole are used to portray the firm's competitive advantage, despite mounting evidence to the contrary. Illustration 11 exemplifies the use of metaphors and hyperboles as a means of imposing management's monological interpretation of the organization and organizational activities and outcomes.

Illustration 11: Critical perspective – analysis of metaphors and hyperboles

Illustration 11.1: Metaphors (of sport and extremism)
Enron's performance in 2000 was a <u>success</u> by any measure, as we continued to <u>outdistance the competition</u> and solidify <u>our leadership</u> in each of our major businesses.

Illustration 11.2: Hyperboles
Enron has built <u>unique</u> and <u>strong</u> businesses that have <u>tremendous opportunities for growth</u>. These businesses … can be <u>significantly expanded</u> within their <u>very large</u> existing markets and extended to new markets with <u>enormous growth potential</u>.

 (Source: Craig and Amernic, 2004b: 821 and 824).

Differentiation refers to people understanding the world in terms of significant pairings, contrasts, or dualities, such as up-down, mind-body, public-private, etc. which are often seen 'in contradiction to each other, frequently with one term assuming dominance' (Llewellyn, 2003: 670). Differentiation is a characteristic feature of discourse which is used to set up specific value systems and thus indicates the stance adopted (Fairclough, 2003). In their analysis of managerial discourse ('CEO-speak') during a six month period following an incident in a German nuclear power plant, Beelitz and Merkl-Davies (2012) find that CEOs strategically use the discourse of stakeholder engagement as a means of signalling change, yet maintain the *status quo*. It suggests that CEOs strategically use discourse to manufacture organizational audiences' consent regarding the continued operation of the nuclear power plant affected by the incident. Illustration

12 shows the role differentiation plays in identifying stances in a particular discourse. The examples juxtapose the organization's initial technocratic discourse and subsequent discourse of stakeholder engagement.

Illustration 12: Critical perspective – analysis of differentiation

(1) Organizational purpose

Regulatory body (obligation)	*Stakeholders (Trust)*
Clearly, immediate and extensive information was submitted to the <u>authorities</u>" (Document 4)	"Ensuring that the general public feel safe and <u>trust</u> our ability to provide power" (Document 9)

(2) Stakeholder identification and salience

"<u>Employees</u> at nuclear power plants often don't understand other people, while outsiders don't understand nuclear energy." (Document 3)	"Employees at nuclear power plants often don't understand <u>other people</u>, while <u>outsiders</u> don't understand nuclear energy." (Document 3)

(Source: Beelitz and Merkl-Davies, 2012: 116-117).

FUTURE RESEARCH DIRECTIONS

Most prior research is archival, inducing interpretations from accounting narratives in published corporate reports. Relatively little is understood about the processes underlying their construction (Gibbins *et al*., 1990 is an exception). Who writes the accounting narratives? In this respect, Goffman's (1981) differentiation between (1) the principal, whose position the text reflects, (2) the author, who performs the writing task, and (3) the animator, who articulates the text, may be useful. Even less is understood about the effect of accounting narratives on organizational audiences. Prior research is generally based (1) on share price reaction studies, which make inferences about the interpretation of accounting narratives by shareholders depending on the behaviour of share prices; and (2) on experiments, often conducted on students. There is relatively little direct research on shareholders and stakeholders.

Potential and pitfalls of impression management research

The characteristics of managers in relation to their communication choices, and the reactions of audiences to managerial impression management, are under-researched opportunities. There is lack of consensus on whether impression management in a corporate reporting context has an impact on organizational audiences. Are they taken in by impression management or do they see through it, thus treating it as executive hyperbole ('cheap talk')? If they are susceptible to impression management, why is this the case? Prior research attributes the predisposition of organizational audiences towards impression management to cognitive limitations and affective factors. There is little understanding of the short-term as well as long-term effects of the impact of impression management (if any). Further, most prior research focuses on accounting narratives in corporate reports, particularly in annual reports. Less attention is given to other disclosure vehicles (e.g., press releases, prospectuses and statements and speeches by senior management) and to other reporting contexts outside the annual reporting accountability cycle (e.g., *ad hoc* corporate reporting, such as during initial public offerings, bankruptcy, takeovers, redundancies, fatalities, other crisis events). Four explanations were put forward for discretionary accounting narratives. Two of these, hubris and retrospective sense-making, have attracted little attention, thus providing opportunities for researchers. Of the four perspectives discussed in the chapter, the sociological and critical are under-researched. On the downside, impression management research does not lend itself to large sample sizes. Much corporate reporting impression management research is conducted manually. Where computer software packages are applied, there are concerns at the validity of using such methods. By contrast, with manual

techniques, there are concerns around reliability and replicability issues, due to the subjective nature of the coding involved.

Relationship between organizational reputation, image, legitimacy and impression management

Prior impression management research does not differentiate between situations affecting an organization's desirability (reputation and image) and situations affecting its appropriateness (legitimacy). However, due to differences in the characteristics of reputation, image and legitimacy (see Table 1), organizations may use different communication choices, depending on whether organizational reputation, image, or legitimacy is affected. Impression management (in the form of symbolic management) might be more effective when organizational image is affected, as it is dynamic and thus more susceptible to change than reputation or legitimacy. By contrast, substantive management by changing organizational practices and the adoption of violated values might be more effective when organizational reputation and legitimacy is under threat, as they are more stable than image. Short-term communication choices, such as symbolic management and substantive management, might be more effective in situations affecting reputation and image than legitimacy. Long-term communication choices, such as isomorphism and decoupling, might be more effective in situations affecting legitimacy.

 Organizational audiences' actual beliefs about organizational desirability or acceptability are difficult to establish by archival research. Aerts and Cormier (2009) measure external legitimacy concerning organizational environmental responsibility by analysing the press media coverage of environmental issues relating to the firms in their sample. These press articles are classified as good news, bad news, or neutral news coverage. Legitimacy is equated with good news

coverage. However, it could be argued that they measure environmental reputation or image, as legitimacy is associated with appropriateness, whereas reputation and image are associated with evaluation.

Interaction between management and organizational audiences

A social constructivist view of organizational reality implies that organizational reputation, image and legitimacy are discursively constructed in interactions between organizations and their audiences over time. Impression management thus needs to be conceptualized as an interactive process between organizations and their audiences, i.e., a process of negotiation between management and organizational audiences (Ginzel *et al*., 2004). This process consists of at least three phases:

(i) the account generation process during which managers provide interpretations of issues or events,

(ii) the reaction of organizational audiences to managers' interpretations of issues or events, and

(iii) a subsequent account generation process during which managers attempt to negotiate a resolution between its initial account and the interpretation thereof by organizational audiences.

The negotiation process constitutes a struggle over meaning with both parties aiming to have their definition of reality accepted (Suchman, 1995: 597). Driscoll and Crombie (2001), Beelitz and Merkl-Davies (2012), and Brennan et al. (2014) are rare examples of studies of impression management as an interactive process between two parties. Driscoll and Crombie (2001) analyse a conflict between a large timber firm and a small monastery situated in a forest where the firm is operating. They find that the timber firm uses language and symbolic activity to increase its own

legitimacy and decrease the legitimacy of the monastery. Beelitz and Merkl-Davies (2012) analyse the discursive negotiation of legitimacy between an energy company and organizational audiences following an incident in a German nuclear power plant. They find that managers use discourse to manufacture organizational audiences' consent. Brennan et al. (2014) develop a methodology based on the concept of dialogism to analyse the interactions between Greenpeace and six textile firms during a conflict over environmental performance.

Insights for preparers and users of corporate reports

This chapter has provided evidence that preparers use the flexibility inherent in corporate narrative reporting to mislead users. Organizations, such as the Global Reporting Initiative advocate a balanced reporting framework which reflects firm economic, environmental and social impact – the so-called triple bottom line. If managers continue to adopt questionable reporting practices, they risk bringing upon themselves increasing regulation in this domain. Users of corporate reports need to be aware of these practices, as a means of detecting the potential underlying deception involved. Research in psychology finds the texts of individuals who engage in deception to show distinct linguistic characteristics. Merkl-Davies *et al.* (2011a) adapt a content analysis approach based on the linguistic style associated with self-presentational dissimulation developed by Newman *et al.* (2003).

Concluding comment

In this chapter, we consider how accounting narratives may be used for impression management purposes. After some discussion of the corporate reporting context, impression management is considered by reference to four perspectives on impression management (economic,

psychological, sociological and critical). Seven communication choices in discretionary accounting narratives in corporate reports are examined in some detail (see illustrations 1-12). The chapter concludes with some suggestions for future research and some insights for preparers and users of corporate reports.

Impression management is a rich and complex phenomenon. Depending on the disciplinary perspective adopted (economic, psychological, sociological, critical), impression management can be conceptualized as reporting bias, self-serving bias, symbolic management/decoupling or ideological bias. If accounting narratives are used for impression management purposes, this can have a negative impact on shareholders, stakeholders and society at large. Impression management constitutes an important area of research, as it not only has the potential to undermine financial reporting quality (resulting in adverse capital allocations), but may also contribute to social and political inequality. However, due to its subtle, more qualitative nature and the consequent difficulties in data collection and coding (often manual), it may not attract as many researchers as other forms of managerial opportunistic behavior, such as earnings management. Still, so many questions remain unanswered that it represents a fertile opportunity for researchers looking for an under-researched field with rich potential.

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