Social Trust and Enterprise Earnings Management

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Abstract. Social trust, a crucial part of informal institution of enterprises, plays a significant role in corporate management. With enterprises listed on China's A-shares market traded on Shanghai-Shenzhen Stock Exchange from 2010 to 2020 as research samples, this study empirically investigates the impact of regional social trust on enterprise earnings management. The investigation shows that the agency cost and financing constraints are the pathways for the influence of social trust, and the influence is more prominent in non-state-owned enterprises and enterprises in eastern and western China. The research here has extended the research scope of informal institution and provided some guidance for improving the corporate management model.

Keywords: social trust; earnings management; informal institution; financing constraint; agency cost

1 Introduction

Over these forty-some years since China started its reform and opening-up initiative, the nation has enjoyed rapid economic growth, though its market environment and legal system show much room for improvement. This is termed "China's growth puzzle" in academia. Some scholars consider "informal institution" as the answer to the puzzle, because informal institution can, to some extent, displace defective formal institution and play a unique role in the economy (Allen, 2005[1]; Williamson, 2000[33]). Informal institution also weighs saliently in micro-governance of enterprises. Chen et al. (2013)[4] found that religious traditions have considerably improved corporate governance. Bi et al. (2015)[3] unveiled the instrumental role of traditional culture in improving the quality of corporate environmental information disclosure. Xu et al. (2019)[34] found that Confucianism would enhance enterprises' power for innovation. Social trust is a pivotal part of informal institution and plays a fundamental role in trading and other economic activities (Arrow, 1972)[2], because the trusting atmosphere it creates increases the reliability of the trading parties and reduces the risk of violation. Some point out that social trust can enhance the auditing quality and improve the investment efficiency of enterprises (Lei et al., 2014)[17]; some others uncover the role of social trust in curbing tax evasion of enterprises (Zhang et al., 2017)[38].

Earnings management is the corporate management's speculation to gain personal

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benefits at the cost of public interests. It turbocharges information asymmetry in the capital market and works against the long-term healthy development of enterprises. Though earnings management by accounting manipulations has been contained as China's legal and accounting systems improve, some have turned to the stealthier method of real earnings management (REM), making it more challenging to identify earnings management of enterprises (Fang et al., 2011)[8]. Over these years, corporate earnings management has been interpreted from different perspectives, such as media attention (Yu et al., 2011)[36], corporate strategic changes (Sun et al., 2016)[27], and power balance (Yang, 2022)[35], whereas studies that explore the correlation between informal institution and earnings management are rare.

Therefore, with enterprises listed on China's A-shares market traded on the Shanghai-Shenzhen Stock Exchange in 2010–2021 as the research samples, this study employs data from the Chinese General Social Survey (CGSS) to verify the influence of social trust on enterprise earnings management and explore the boundary conditions for the influence. The findings are as follows: (1) social trust and earnings management have significant negative correlations, indicating the role of social trust in inhibiting earnings management; (2) the agency cost and financing constraints are possible pathways for the influence of social trust on earnings management; (3) the role of social trust in inhibiting earnings management is more prominent in non-state-owned enterprises; (4) the role of social trust in curbing earnings management is more pronounced in eastern and western regions of China.

The main contributions of this study are as follows: first, the pathways of the influence of social trust on enterprise earnings management are empirically studied, and the research findings in corporate governance are enriched; second, from the angle of regional culture, this paper performs an empirical study on the social trust in the regions where the enterprises are located, which extends the scope of research on social trust; third, by verifying the influence pathways and heterogeneity tests, this paper explores the environment where social trust exerts its influence and its impact on economic growth, which provides some guidance for the practice of enterprises.

2 Theoretical Analysis and Research Hypothesis

2.1 Earnings Management

There are three motives for earnings management: the contracting motive, the capital market motive, and the motive for avoiding supervision (Du et al., 2022)[6]. Earnings management driven by the contracting motive is the corporate management's short-sighted behavior to seek personal benefits and avoid principal-agent conflicts. Earnings management driven by the capital market motive is speculation of the corporate managers who gloss over the enterprise's performance to go public or avoid special treatment and delisting. Earnings management to avoid supervision is the corporate managers' manipulation of the earnings to avoid market supervision or the enterprise's internal control.

There are two methods for earnings management: accrual earnings management (AEM), and real earnings management (REM) (Fang and Liu, 2017)[9]. The former relies on accounting manipulation to change the actual earnings of the enterprise, which has no impact on the enterprise's actual cash flow but will undermine the quality of accounting information and result in market information asymmetry. As the accounting system improves, AEM becomes more detectable and incurs risks for litigations. As a result, REM turns out a preferable option among enterprises. Different from AEM, REM involves adjustments to the enterprise's actual operational activities to alter the current cash flow and business earnings (Gunny, 2010)[11]. REM is highly elusive, and it was not until 2006 that some achievements were made in measuring REM. Roychowdhury (2006)[25] found that REM is realized through the manipulation of three aspects of business operation: the first is sales manipulation, which increases the sales by cash discounts and reduces the cash flow by credit sales. The second is the manipulation of the production cost, which expands the production scale apportioned fixed cost to reduce the cost of finished products and increase the earnings. The third is the manipulation of discretionary expenses, such as cutting R&D investments and advertising expenses. Therefore, Roychowdhury built the REM model based on models for manipulative cash flow, production cost, and discretionary expenses to measure the REM activities of enterprises. REM is, to some extent, a shortsighted behavior that not only negatively affects the enterprise's future, but provides misinformation of accounting that will lead enterprises to wrong investment decision-making (Nan and Tian, 2022)[23].

2.2 Social Trust and Earnings Management

Trust is the very foundation to succeed, which is true for both individuals and businesses. Trust underlies business activities and social interactions, while the loss of trust will drag down economic growth (Arrow, 1972)[2]. Social trust, as a form of informal institution, is lucrative in the market where the formal institution awaits improvement (Zhang and Ke, 2002)[39]. Existing works have proved that trust would help cut the trading cost (Knack & Keefer, 1997)[15], and enhance enterprises' risk-taking capacities (Shen, 2019)[26]; it has also been found that regions with a higher level of social trust have more appeal to investors and fewer cash holdings (He and Fan, 2015)[12]. Social trust can also reduce the opportunistic motives of the trading parties and hence increase the mergers and acquisitions (M&A) performance (Wang and Li, 2017)[30]. Earnings management is an opportunistic behavior, and will social trust affect this behavior of enterprises? In this study, the mechanism for the influence of social trust on earnings management is analyzed from the following three aspects:

First, social trust can, by alleviating the enterprise-agent conflict, curb earnings management activities of enterprises. According to the agency theory, the separation of the right of management from the right of ownership results in enterprise-agent conflicts, and a range of agency problems arise from the inconsistent interests between the enterprise's shareholders and the management. The management, under the pressure of performance assessment, resorts to earnings manipulation to gloss over the operation conditions and ease the pressure from the shareholders (Jiang & Ma, 2017)[14]. Social trust makes up for the defects of formal institution, and to some extent improves the corporate governance quality and reduces the risks of agency problems. In regions with a higher level of social trust, the board of directors shows more tolerance to the CEO and the chances of CEOs getting sacked because of performance problems are much lower than in the regions with a lower level of social trust (Hilary & Huang, 2015)[13]. Meanwhile, affected by social trust (Dohmen et al., 2012)[7], the management will think in favor of the shareholders and reciprocate the investors' trust instead of acting on egoism. Earnings manipulation will negatively affect the future of enterprises, and hence the management who appreciates the shareholders' trust is less likely to engage in earnings manipulations.

Second, social trust can, by loosening the financing constraints of enterprises, inhibit earnings management activities. Under strict financing constraints, enterprises suffer a higher cost to gain external investment, which triggers earnings manipulation (Wang & Yan, 2017)[31]. According to the signaling theory, enterprises furnish their financial statements through earnings manipulation and send misinformation to investors, leading them to wrong investment decision-making. Social trust can alleviate information asymmetry and considerably improve the quality of financial reports (Garrett et al., 2014)[10]. For investors, social trust enhances information transparency and reduces trading costs, so higher social trust will boost the investors' willingness to invest. Therefore, social trust can alleviate the financing constraints of enterprises and thereby discourage enterprises from earnings manipulation.

Last, social trust gives rise to a form of moral restraint that will reduce the management's attempt at opportunistic behaviors (Zak & Knack, 2001)[37], and thereby suppress earnings manipulations. The social learning theory indicates that the moral atmosphere of a society affects individual decision-making. If individuals make decisions that go against the social codes of ethics, a sense of guilt will arise (Li et al., 2020)[18]. Social trust, as part of the social codes of ethics, constitutes a form of moral restraint that suppresses the earnings manipulations of enterprises. Moreover, social trust can improve the quality and efficiency of supervision, which increases the cost of rule violation (Uslaner and Brown, 2005)[28] and lowers the likelihood of rent-seeking of corporate managers.

Given all the details above, the following hypotheses are made:

H_1: Social trust can inhibit earnings manipulation of enterprises.

3 Research Design

3.1 Samples and Data

In this study, the research samples are enterprises listed on China's A-shares market traded on the Shanghai-Shenzhen Stock Exchange from 2010 to 2020; the data about enterprises are from the CSMAR database, and the data about social trust are from the CGSS database from 2010. The raw samples are processed by the following steps: (1) listed financial enterprises are removed; (2) ST and ST* enterprises are removed; (3) enterprises with missing or abnormal data are removed, and continuous variables are winsorized at 1% and 99% levels. Finally, data from 24501 enterprises are obtained.

3.2 Design of Variables

1) Dependent variable: earnings management. As with the study by Roychowdhury (2006)[25], a real earnings management (REM) model is constructed:

$$\frac{CFOit}{Ait-1}=\alpha_0+\alpha_1\frac{1}{Ait-1}+\alpha_2\frac{REVit}{Ait-1}+\alpha_3\frac{\Delta REVit}{Ait-1}+\varepsilon_{it} \tag{1}$$

$$\frac{PRODit}{Ait-1}=b_0+b_1\frac{1}{Ait-1}+b_2\frac{REVit}{Ait-1}+b_3\frac{\Delta REVit}{Ait-1}+b_4\frac{\Delta REVit-1}{Ait-1}+\varepsilon_{it} \tag{2}$$

$$\frac{DISEXPit}{Ait-1}=c_0+c_1\frac{1}{Ait-1}+c_2\frac{REVit-1}{Ait-1}+\varepsilon_{it} \tag{3}$$

$$REM_{it}=(-1)A_{CFO\mathrm{it}}+\mathrm{A}\_PROD_{\mathrm{it}}+(-1)A\_DISEXP_{\mathrm{it}} \tag{4}$$

where $A_{CFO\mathrm{it}}$ is the abnormal operational cash flow, A_$PROD$ is the abnormal production cost, A_DISEXP is the abnormal discretionary expense. Models (1), (2) and (3) are regressed by the industry and year to obtain the regression residual, i.e., the outliers in each indicator; then, Model (4) is sued to calculate the REM of enterprises.

2) Independent variable: social trust. According to studies by Li (2019)[21] and Wang et al. (2021)[29], this study refers to the result of the A33 question in CGSS "do you agree that most people are trustworthy in the society" to measure social trust. Five answers are provided to the question: "strongly agree", "agree", "neutral", "disagree", and "strongly disagree", where the data for "neutral" are removed, and the number of people who opt "strongly agree" and "agree" is divided by the number of total subjects in the survey to obtain Trust as the measure of social trust in the study area. Meanwhile, the CGSS data in 2014, 2016 and 2019-2020 are missing, and as social trust is a form of informal institution and has relative stability (Wang et al., 2021)[29], the 2010 data are substituted for the missing data.

3) Control variables: according to studies by Ou and Zhao (2022)[24] and Nan et al. (2022)[23], this study selects the enterprise's development capacity (Growth), return on total assets (ROA), asset-liability ratio (Lev), corporate size (Size), ownership concentration (Top1), unity of ownership with managerial power (Dual), audit opinion (Audit) as the control variables, the nature of the enterprise (SOE), the market level (Market), whether the auditing is performed by a Big Four accounting firm (Big4) as the missing control variables. Besides, two virtual variables, the year (Year) and the industry (Industry), are set to remove interference from the year and the industry. Table 1 displays the variables in this study.

Table 1. Definitions of variables in this study

	Title	Symbol	Definition
Dependent variable	Real earnings management	REM	As described before
Independent variable	Social trust	Trust	As described before
Control variables	Enterprise development capacity	Growth	(Current turnover-previous turnover)/previous turnover

	Return on total assets	ROA	Net profit/total assets
	asset-liability ratio	Lev	Total liabilities/total assets
	Corporate size	Size	Natural logarithm of corporate assets
	Stock ownership concentration	Top1	Proportion of shares owned by the largest shareholder to the total shares
	unity of ownership with managerial power	Dual	If the manager is also the chairman, the value is 1; if not, the value is 0.
	Audit opinion	Audit	If the auditor issues "standard and unqualified opinions", the value is 1; if not, the value is 0.
	Nature of the enterprise	SOE	If the enterprise is a state-owned enterprise, the value is 1; if not, the value is 0.
	Market level	Market	The market level of the province where the enterprise belongs, which is represented by the Fangang index
	Whether the enterprise is audited by one of the Big Four accounting firms	Big4	If the enterprise is audited by a Big Four accounting firm, the value is 1; if not, the value is 0.
	Effect of the year	Year	The virtual variable of year
	Effect of the industry	Industry	The virtual variable of industry

3.3 Model Configuration

To test the hypothesis proposed in this study, the following model is established:

$$REM=\beta_0+\beta_1 Trust+\beta_2 Controls+Year+Industry+\varepsilon \tag{5}$$

where REM represents real earnings management, Trust is social trust, Controls are the control variables, Year and Industry represent the effect of year and industry, and ε is the random disturbance term. If the regression coefficient of social trust β_1 is significantly negative, the hypothesis holds, that is, the social trust suppresses earnings manipulation of enterprises.

4 Analysis of Empirical Research Results

4.1 Descriptive Statistics

Table 2 shows the result of descriptive statistics of the main variables. For the variable REM, the mean is 0.159, the minimum is 0.0019, and the maximum is 0.896, which indicates a large distinction between enterprises in their earnings manipulations. For the independent variable social trust (Trust), the minimum is 0.37 and the maximum is 0.75, where the large gap indicates the considerable difference in social trust across regions in China. This is consistent with the existing research findings.

Table 2. Descriptive Statistics

Variables	N	Mean	Min	P50	Max	SD
REM	24,501	0.159	0.0019	0.110	0.896	0.162
Trust	24,501	0.564	0.370	0.580	0.750	0.0928
Size	24,501	22.27	19.89	22.09	26.24	1.287
Lev	24,501	0.440	0.0595	0.435	0.898	0.204
ROA	24,501	0.0381	-0.236	0.0360	0.211	0.0622
Growth	24,501	0.169	-0.570	0.102	2.712	0.420
Top1	24,501	0.344	0.0873	0.323	0.742	0.148
Dual	24,501	0.248	0	0	1	0.432
Big4	24,501	0.0615	0	0	1	0.240
SOE	24,501	0.395	0	0	1	0.489
Market	24,501	9.307	-0.161	9.622	11.49	1.696
Audit	24,501	0.969	0	1	1	0.172

4.2 Analysis of Regression Results

Column 1 in Table 3 shows the regression result of social trust to earnings management, where the social trust has a regression coefficient of -0.021 and is significant at the 5% level; Column 2 displays the result with the fixed effects of the year and the industry controlled, where social trust has a regression coefficient of -0.046 and is significant at the 1% level; Column 3 displays the regression result after the introduction of three missing control variables—SOE, Market, and Big4, where social trust has a regression coefficient of -0.065 and is significant at the 1% level. These imply that social trust fosters an atmosphere of integrity, which alleviates the agency problems of enterprises and reduces the conflicts between the management and the shareholders. In this context, the management prioritizes the future of the enterprise over short-term benefits, hence reducing the likelihood of earnings manipulation.

Table 3. Empirical Regression Results

Variables	(1) REM	(2) REM	(3) REM

Trust	-0.021**	-0.046***	-0.065***
	(-1.97)	(-3.87)	(-5.15)
Size	-0.012***	-0.007***	-0.007***
	(-12.34)	(-7.61)	(-6.88)
Lev	0.080***	0.071***	0.072***
	(12.95)	(11.11)	(11.24)
ROA	0.561***	0.502***	0.502***
	(29.89)	(27.34)	(27.27)
Growth	0.065***	0.068***	0.067***
	(26.44)	(28.46)	(28.03)
Top1	0.004	0.015**	0.020***
	(0.51)	(2.20)	(2.87)
Dual	0.005**	0.004*	0.003
	(2.28)	(1.67)	(1.08)
Audit	-0.058***	-0.054***	-0.053***
	(-9.58)	(-9.27)	(-9.01)
SOE			-0.011***
			(-4.62)
Market			-0.004***
			(-5.80)
Big4			0.007*
			(1.70)
Constant	0.413***	0.311***	0.348***
	(19.94)	(13.75)	(14.04)
Industry	No	Yes	Yes
Year	No	Yes	Yes
Observations	24,501	24,501	24,501
Adj.R^2	0.083	0.150	0.151

Note: the t value is shown in the bracket; ***, **, and * represent p<0.01, p<0.05, and p<0.1, respectively, which applies to all tables in this paper.

4.3 Instrumental Variable

To solve the problem of endogeneity, this study employs instrumental variables to perform regression analysis. As the data on social trust in this study are from CGSS, there are measuring errors. According to Cao et al. (2018)[5] and Liu et al. (2009)[22], the mileage of traffic facilities is found to have some influence on regional social trust, but not on the earnings manipulations of enterprises. Therefore, the mileage of regional traffic facilities is used as the instrumental variable in this study for two-stage regression to solve the problem of endogeneity. The data on the mileage of regional traffic facilities are obtained from the China Statistical Yearbook. Table 4 shows the regression result. In the first stage, the regression coefficient of the instrumental variable to social trust is 0.003, and it is significant at the 1% level, which implies the research findings of Cao et al. (2018)[5] and Liu et al. (2009)[22]. The F value in the first-stage regression is 49.7 and significant at the 1% level, which denies the weak instrument hypothesis and proves the effectiveness of the instrumental variable. In the second stage, social trust has a regression coefficient of -1.175 to earnings management and is significant at the 1% level. This also verifies our previous findings, suggesting that social trust can still effectively suppress earnings manipulation of enterprises when the problem of endogeneity is controlled.

Table 4. Two-stage Regression Results

Variables	(1) Trust	(2) REM
IV	0.003***	
	(6.21)	
Trust		-1.175***
		(-3.31)
Constant	0.694***	1.168***
	(50.64)	(4.41)
Control variable	Yes	Yes
Industry	Yes	Yes
Year	Yes	Yes
Observations	24,501	24,501
Adj.R^2	0.326	
Wald chi^2		2416.42

4.4 Robustness Tests

Robustness tests are performed in three ways. First, the measuring method for the independent variable social trust is changed. Specifically, the approach employed by Wang et al. (2021)[29] is used to change the social trust measurement method. Scores are assigned to different answers to the question: 5 to “strongly agree”, 4 to “agree”, 3 to “neutral”, 2 to “disagree”, and 1 to “strongly agree”; the sum score is divided by the number of subjects to obtain $Trust_1$. Column 1 in Table 5 shows the regression result: the regression coefficient of $Trust_1$ is negative and significant at the 1% level, which is consistent with the previous findings. Another method for robustness tests is removing the years of special conditions. As the financial standing of enterprises is affected during the stock market crashes in 2015 and 2018, data in these two years are removed, and Column 2 in Table 5 shows the regression result. The regression coefficient of social trust remains negative, and is significant at the 1% level, which is consistent with our previous findings. The third way is removing samples from regions of ethnic minorities. In this study, the samples from regions of ethnic minorities are removed, and the regression results are displayed in Column 3 of Table 5: the regression coefficient of social trust remains negative and is significant at the 1% level, which is in line with the previous findings. The results of robustness tests remain the same as the previous findings, implying the suppressing effect of social trust on earnings manipulation of enterprises.

Table 5. Results of Robustness Tests

Variables	(1) REM	(2) REM	(3) REM
$Trust_1$	-0.040***		
	(-5.68)		
Trust		-0.068***	-0.059***
		(-4.90)	(-4.35)
Constant	0.452***	0.336***	0.343***
	(12.83)	(12.19)	(12.86)
Control variable	Yes	Yes	Yes
Industry	Yes	Yes	Yes
Year	Yes	Yes	Yes
Observations	24,501	19,567	23,403
Adj.R^2	0.151	0.151	0.148

5 Further Research

5.1 Mechanism Test: Agency Cost

As shown in the previous analysis, social trust can reduce agency costs by alleviating enterprise-agent conflicts to reduce the likelihood of earnings management. When there are conflicting interests between the agents and owners of enterprises, the agents are likely to engage in earnings manipulation, glossing over the financial reports to cope with pressure from the corporate management. Social trust can alleviate conflicts and reduce the likelihood of opportunistic behaviors. By referring to Kang et al.'s work (2021)[16], this study uses the ratio of overhead expenses is used to measure the agency cost (AC), and the three-step method is used to assess the mechanism.

Table 6 shows the regression result. Column 1 shows the regression result of social trust to the corporate agency cost: social trust has a regression coefficient of -0.031 and is significant at the 1% level, indicating that social trust can reduce the agency cost of enterprises. As Column 2 shows, the regression coefficient of the agency cost to corporate earnings management is 0.094 and significant at the 1% level, indicating that the corporate agency problem can trigger earnings manipulations; however, the regression coefficient of the agency cost to social trust is -0.062 and significant at the 1% level, indicating that the agency cost is the mechanism pathway for the impact of social trust on the earnings management of enterprises.

5.2 Mechanism Test: Financing Constraint

Based on the analysis above, the financing constraint is a possible mechanism pathway for the impact of social trust on earnings management. As China's capital market starts late, enterprises face some constraints in seeking external financial support. Social trust can improve the efficiency of information transmission and partly serve as business credit (Li et al. 2020)[19]. Under strong financing constraints, enterprises may turn to earnings manipulation to gain more financial support. Therefore, the three-step method is used to test the mechanism pathway of financing constraints.

The KZ index proposed in the study by Wei et al. (2014)[32] is employed in this study to measure financing constraints. Column 3 in Table 6 shows the regression result of social trust to financing constraints, where the regression coefficient of social trust is -0.363 and significant at the 1% level, indicating that social trust can partly alleviate the problem of financing constraints. As shown in Column 4 of Table 6, the regression coefficient of financing constraints to earnings management is 0.021 and significant at the 1% level, indicating that the financing constraint is likely to trigger earnings management; however, the regression coefficient to social trust is -0.058 and significant at the 1% level, suggesting that the financing constraint is a mechanism pathway for the impact of social trust on earnings management of enterprises.

Table 6. Tests of Influence Mechanism of Social Trust on Earnings Management of Enterprises

Variables	(1) AC	(2) REM	(3) KZ	(4) REM
Trust	-0.031***	-0.062***	-0.363***	-0.058***
	(-6.12)	(-4.94)	(-3.17)	(-4.66)
AC		0.094***		
		(5.96)		
KZ				0.021***
				(29.57)
Constant	0.511***	0.300***	6.706***	0.211***
	(50.72)	(11.46)	(29.68)	(8.46)
Control variable	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes
Observations	24,501	24,501	24,501	24,501
Adj.R^2	0.325	0.152	0.220	0.180

5.3 Influence of the Nature of Enterprises

Given the special market system in China, state-owned enterprises (SOEs) and non-state-owned enterprises (NSOEs) show substantial differences in their operational mode and supervision strength (Kang et al., 2021)[16], and the influence of social trust on earnings manipulations varies as the nature of the enterprise differs. In SOEs, the strong pressure from supervision makes it more costly for the management to engage in earnings manipulation; in NSOEs where formal institution shows limited effects, informal institution like social trust plays a stronger role. Therefore, to identify whether the influence of social trust on the enterprise's earnings manipulation differs as the nature of the enterprise varies, this study divides samples into a group of SOEs and a group of NSOEs to perform regression.

Table 7 shows the regression result of the two groups of samples. Column 1 displays the regression result of SOEs, and the regression coefficient is not significant, indicating that the effect of social trust on earnings management is not significant in SOEs. Column 2 displays the regression result of NSOEs, where the regression coefficient is -0.103 and significant at the 1% level, indicating that the inhibiting role of social trust on earnings management of enterprises is observed in NSOEs.

Table 7. Heterogeneity analysis of the influence of social trust on earnings management of enterprises

	SOE	NSOE	Eastern China	Central China	Western China
Variables	(1) REM	(2) REM	(3) REM	(4) REM	(5) REM
Trust	0.002	-0.103***	-0.063***	-0.025	-0.080**
	(0.13)	(-6.11)	(-3.70)	(-0.64)	(-2.16)
Constant	0.275***	0.366***	0.351***	0.330***	0.318***
	(8.18)	(9.97)	(10.50)	(5.43)	(5.12)
Control variable	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes
Year	Yes	Yes	Yes	Yes	Yes
Observations	9,670	14,831	17,190	4,321	2,990
Adj.R^2	0.172	0.142	0.142	0.181	0.189

5.4 Influence of Regional Differences

Across China's vast territory, the economic and cultural norms vary between regions, so the regional difference should be considered in studies on informal institution (Li et al., 2018)[20]. In eastern and central China where the market and formal institution is well-developed, informal institution plays a very limited role. In western regions, however, formal institution is to be improved and informal institution hence has a stronger presence. Therefore, the samples are divided into three groups, enterprises in western China, central China, and eastern China, to perform regression.

The regression results are shown in Columns 3, 4, and 5 of Table 7. For enterprises in eastern China, the regression coefficient of social trust is -0.063 and is significant at the 1% level; the regression coefficient of social trust is -0.08 and shows significance at the 5% level for enterprises in western China, while no significance is observed in the regression result for samples in central China, which means the effect of social trust is mainly observed in enterprises in eastern and western China, but not significant in enterprises in the central region of China.

6 Conclusions and Recommendations

6.1 Conclusions

With enterprises listed on China's A-shares market traded on Shanghai-Shenzhen Stock Exchange from 2010 to 2021 as the research samples, this study employs the CGSS data to investigate the correlation between social trust and enterprises' earnings management and the influence mechanism of social trust. It is found that social trust can suppress enterprises' earnings manipulation by alleviating agency conflicts, reducing financing constraints, and creating moral restraints, which means enterprises in regions with more social trust are less likely to engage in earnings manipulations. The influence of social trust on earnings management is realized through the pathway of financing constraints, and this influence is more pronounced in non-state-owned enterprises and enterprises in the eastern and western regions of China. Analysis shows that social trust, as a form of informal institution, positively affects corporate governance and suppresses speculative behaviors of enterprises like earnings manipulation.

6.2 Recommendations

As reform and opening-up deepen, accounting distortion poses considerable obstacles to the health of the market. With social trust as the research focus, this study explores the relation between informal institution and corporate governance. The following recommendations are proposed accordingly. First, the corporate management, as agents, should honor their promise to the principal and orient their behaviors to the healthy and sustained development of the enterprise instead of engaging in speculation to gain personal benefits at the cost of others' legitimate interests. Second, the government should pay more attention to informal institution like social trust while improving the formal institution. The government should promote the core social value of "integrity" and incorporate it into the social codes of ethics, rewarding honest behaviors and punishing dishonesty. Policies should be issued to encourage business integrity and reduce speculative behaviors like earnings manipulations. Third, non-state-owned enterprises and enterprises in regions where the market system is less developed are more likely to engage in earnings management because of market competition, financing challenges, and the absence of effective market supervision; therefore, it is necessary to coordinate regional development and promote informal institution like social trust as a solution to relieving the pressure of these enterprises.

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