

# Can Executive Equity Incentives Curb Corporate Violations?

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**Abstract.** The incentive system constitutes a critical dimension in the study of corporate violations. Executive equity incentives can align interests, reducing the likelihood of violations by listed companies. This paper employs data from non-financial and non-real estate A-share state-owned listed companies spanning 2011 – 2023 to investigate the impact of executive equity incentives on corporate violations. Empirical results demonstrate that executive equity incentives significantly curb corporate violations. Mechanism tests reveal that such incentives reduce corporate violations by mitigating earnings management. Heterogeneity analyses further indicate that the inhibitory effect of executive equity incentives on corporate violations is more pronounced in non-state-owned enterprises, companies audited by non-Big Four accounting firms, firms disclosing environmental-related information in annual reports, and enterprises with high external supervision transparency.

**Keywords:** Executive equity incentives; Number of corporate violations; Environmental-related information; Transparency.

## 1. Introduction

During the 13th Five-Year Plan period, under the leadership of the Communist Party of China, China achieved remarkable economic development, laying a solid macroeconomic foundation. The economy maintained medium-to-high growth while supply-side structural reforms deepened and economic restructuring advanced continuously. Concurrently, the Party pursued an innovation-driven development strategy, encouraging enterprises to transform and upgrade, thus fostering a macro-level environment conducive to innovation and inclusive growth. The 14th Five-Year Plan further emphasizes high-quality development, accelerating the establishment of a new development paradigm with domestic circulation as the core and mutual reinforcement between domestic and international circulations. This paradigm presents vast market opportunities for enterprises while imposing stricter compliance requirements. As key participants in the domestic market, enterprises must adhere to market rules, operate with integrity, and ensure the healthy and stable functioning of the domestic economy.

In the academic literature, corporate governance and incentive mechanisms have long been focal points of inquiry. Scholars have extensively explored the relationship between various incentive structures and corporate behavior, with some studies examining the impact of cash-based incentives on corporate performance and compliance, and others delving into equity-based incentives. However, the specific influence of executive equity incentives on corporate violations within China's unique economic and institutional context remains underexplored.

Existing research has shown that performance-based compensation incentives can reduce corporate violations by alleviating principal-agent problems (Yang & Li, 2022), with this effect being more significant in non-state-owned enterprises. Additionally, stock option incentives have been found to mitigate corporate violations by reducing earnings management and enhancing internal control quality (Wang & Zheng, 2024).

Against this backdrop, this study investigates whether executive equity incentives can curb corporate violations. Its innovations lie in two aspects: (1) From the perspective of "opportunities for managerial violations" a heterogeneity analysis is conducted based on whether environmental-related information is disclosed in annual reports. Results show that incomplete information disclosure increases the likelihood of investors receiving manipulated information, thereby creating opportunities for managerial misconduct. (2) Using the transparency ratings of the Shanghai and Shenzhen Stock Exchanges to measure external supervision intensity, a heterogeneity analysis further

demonstrates that executive shareholding ratios inhibit violations in highly transparent listed companies.

## **2. Theoretical Analysis and Research Hypotheses**

### **2.1 Executive Equity Incentives and Corporate Violations**

In the literature on corporate violations, incentive systems represent a core research direction. As noted by Chen and Zhou (2020), existing studies on corporate violations primarily focus on two types of incentives: monetary compensation (e.g., salaries and bonuses) and equity-based compensation (e.g., stocks and options). Drawing on the principal-agent theory proposed by Jensen and Meckling (1976), the separation of ownership and control in corporations leads to information asymmetry between executives and shareholders. Incentive-compatibility mechanisms can, to some extent, constrain executives' short-sighted behavior, aligning management's objectives with the long-term interests of the firm and curbing tendencies toward violations.

First, executive equity incentives achieve interest alignment (Jensen & Murphy, 1990). By aligning managers' goals with those of shareholders, equity incentives encourage shared risk-taking and reduce violations stemming from managerial myopia. Moreover, this realignment shifts managers' focus from external shareholder supervision to self-regulation, diminishing the probability of illegal activities. Second, as Chen and Ma (2011) argued, equity incentives increase the cost of violations for managers. Due to the long-term nature of such incentives, managers have a strong incentive to regulate their own behavior and monitor peers to avoid self-inflicted losses, thereby reducing the frequency of corporate violations. This leads to the first hypothesis:

Hypothesis 1: Implementing executive equity incentives reduces the number of corporate violations.

### **2.2 Earnings Management, Executive Equity Incentives, and Corporate Violations**

Building on the research of Yuan et al. (2014), equity incentive systems tie managers' interests closely to those of shareholders, prompting managers to reduce earnings management and thereby corporate violations. According to the optimal contract theory (Fu et al., 2019), stock option incentives encourage managers to voluntarily disclose high-quality information, improving the transparency of earnings disclosures and reducing violations. Conversely, in environments with weak corporate governance, managers may manipulate financial indicators through earnings management to whitewash financial statements, increasing the risk of violations (Liu et al., 2019).

Specifically, executive equity incentives motivate managers to maximize corporate value through prudent financing and investment decisions, reducing earnings management by alleviating principal-agent conflicts and thereby curbing violations. Additionally, such incentives limit managers' ability to manipulate accounting items (e.g., selling and administrative expenses) that affect profits, further decreasing the likelihood of violations. This leads to the second hypothesis:

Hypothesis 2: Executive equity incentives reduce corporate violations by decreasing earnings management in listed companies.

## **3. Research Design**

### **3.1 Sample Selection and Data Source**

This study uses a sample of non-financial, non-real estate A-share state-owned listed companies from 2011 to 2023. Sample screening criteria include (1) exclusion of financial and real estate firms, (2) exclusion of Special Treatment companies, and (3) exclusion of firms with missing data. The final sample comprises 5,127 companies, with financial data sourced from the CSMAR database. Variables are winsorized at the 3% and 97% levels to mitigate the influence of extreme values.

### 3.2 Variable Definition

#### 3.2.1 Dependent Variable

The dependent variable is the number of violations by listed companies. Drawing on the research of Wei and Geng (2018) and other scholars, Frequency is used to denote the number of violations committed by a listed company in a given year. Types of violations subject to punishment include, but are not limited to, profit fabrication, asset overstatement, false records (misleading statements), delayed disclosure, material omissions, false disclosures, fraudulent listing, illegal capital contributions, unauthorized fund reallocation, corporate asset misappropriation, insider trading, illegal stock transactions, price manipulation, illegal guarantees, and general accounting irregularities.

#### 3.2.2 Independent Variable

The independent variable is executive equity incentives. Following Xu et al. (2019a), this study measures executive equity incentives using Manholds, the ratio of shares held by executives to the total number of shares outstanding (i.e., executive shareholding ratio). Executives include the general manager, deputy general managers, and other management personnel specified in company regulations. Given the close correlation between a firm’s long-term stability and incentive effectiveness, as well as the complex interplay between executive shareholding ratios and equity incentives, the executive shareholding ratio is employed as a proxy variable for executive equity incentives.

#### 3.2.3 Control Variables

Drawing on existing studies by Qiao et al. (2024) and Yin and Zhang (2024), the following control variables are included: Current ratio (Current = current assets / current liabilities); Quick ratio (QR = (current assets - inventory) / current liabilities); Cash ratio (Cash = cash and cash equivalents / current liabilities); Equity multiplier (EM = total assets / total shareholders’ equity); Asset-liability ratio (Lev = total liabilities / total assets); Long-term loan-to-assets ratio (LTL = long-term loans / total assets); Operating cash flow-to-liabilities ratio (Coverage = net operating cash flow / total liabilities); Number of directors (Board, including the chairman); Number of senior managers (Supervisor, as disclosed in annual reports); Total senior management compensation (Salary, excluding allowances); Return on equity (ROE = net profit / shareholders’ equity balance).

Table 1 Descriptive Statistics

	N	Mean	SD	Min	Median	Max
Frequency	39820	0.217	0.550	0.000	0.000	2.000
Manholds	40394	0.115	0.176	0.000	0.002	0.584
Current	40445	2.614	2.319	0.503	1.781	10.840
QR	40445	2.142	2.116	0.328	1.369	9.737
Cash	40445	0.903	1.199	0.049	0.440	5.459
EM	40445	1.917	0.851	1.089	1.637	4.720
Lev	40445	0.400	0.197	0.077	0.390	0.797
LTL	40445	0.036	0.061	0.000	0.002	0.242
Coverage	40439	0.199	0.299	-0.284	0.129	1.140
Board	40389	2.109	0.192	1.609	2.197	2.485
Supervisor	40388	1.781	0.352	1.099	1.792	2.485
Salary	40301	15.028	0.739	13.550	15.007	16.586
ROE	40399	0.066	0.101	-0.268	0.073	0.256

### 3.3 Model Construction

The empirical analysis employs the following regression model to examine the impact of executive equity incentives on corporate violations:

$$Violation_{it} = \beta_0 + \beta_1 Manhold_{it} + \beta_2 Controls_{it} + Company_i + Year_t + \varepsilon_{it} \quad (1)$$

where  $i$  and  $t$  represent the enterprise and the year respectively;  $Violation_{it}$  represents the number of violations of the listed company;  $Manholds_{it}$  represents the executive shareholding ratio;  $Controls_{it}$  represents the above - mentioned series of control variables;  $Company_i$  and  $Year_t$  represent the company fixed effect and the year fixed effect respectively; and  $\varepsilon_{it}$  represents the random error term.

## 4. Empirical Analysis

### 4.1 Baseline Regression Results

Table 2 illustrates the impact of executive shareholding ratios on the number of corporate violations, incorporating both firm and year-fixed effects. Column (1) presents the regression results for the number of violations without control variables, where the executive shareholding ratio is significantly negative at the 1% level. Column (2) shows the regression results after introducing control variables: the executive shareholding ratio exhibits a significant negative effect on the dependent variable at the 1% level. Specifically, a one-unit increase in the executive shareholding ratio is associated with a 0.211-unit reduction in actual corporate violations, indicating that executive shareholding ratios significantly inhibit the number of violations by listed companies. In other words, implementing an executive equity incentive system helps corporate management improve governance mechanisms and standardize operational conduct, thereby reducing corporate violations.

Table 2 Baseline Regression

	(1) Frequency	(2) Frequency
Manholds	-0.324*** (-10.28)	-0.211*** (-6.54)
Constant	0.255*** (58.08)	0.239* -1.690
Firm FE	YES	YES
Year FE	YES	YES
Control	NO	YES
Observations	39454	39314
$R^2$	0.338	0.347

Note: \*\*\*, \*\* and \* denote significance at the 1%, 5% and 10% levels, respectively, with t-values in parentheses. Robust standard errors are derived from clustering adjustments. The same applies below.

### 4.2 Mechanism Test

The preceding analysis indicates that executive equity incentives suppress corporate violations. To further explore the underlying mechanisms, this study examines whether managers manipulate financial statements to obtain equity incentives, a behavior that may incentivize earnings management and related violations. Drawing on Zhu et al. (2024), this analysis uses administrative expenses (Cost) and selling expenses (Selling) as proxies for earnings management and follows Jiang (2022) to test mediating effects. As Perols and Lougee (2011) note, earnings management often leads to financial statement whitewashing and data fraud, increasing violation risks.

Table 3 reports the regression results for administrative and selling expenses. Column (1) shows that executive equity incentives have a significantly negative impact on administrative expenses, indicating that firms with equity incentives exhibit lower administrative costs. Column (2) demonstrates a similarly significant negative effect on selling expenses, suggesting that equity incentives constrain the growth of selling expenses. These results imply that the absence of equity incentives may drive managers to engage in improper earnings management, whereas well-designed incentive systems can mitigate financial statement manipulation.

Table 3 Mechanism Test

	(1) Cost	(2) Selling
Manholds	-0.336*** (-13.82)	-0.406*** (-10.89)
Constant	13.799*** -121.920	12.892*** -71.600
Firm FE	YES	YES
Year FE	YES	YES
Control	YES	YES
Observations	39773	39046
$R^2$	0.919	0.902

### 4.3 Heterogeneity Analysis

#### 4.3.1 Ownership Heterogeneity

Executive equity incentives may exhibit differential effects across firm ownership types. Following Guo et al. (2025), the sample is divided into state-owned enterprises (SOEs) and non-state-owned enterprises (non-SOEs). Table 4 shows that the executive shareholding ratio is significantly positive in SOEs (Column 1) but significantly negative in non-SOEs (Column 2). This suggests that equity incentives are more effective in non-SOEs, where managers prioritize corporate value maximization, whereas SOE managers may focus more on career advancement and personal interests..

Table 4 Ownership Heterogeneity

	(1) State-Owned	(2) Non-State-Owned
Manholds	0.746*** -2.810	-0.183*** (-5.14)
Constant	0.433** -2.040	0.411** -2.110
Firm FE	YES	YES
Year FE	YES	YES
Control	YES	YES
Observations	12368	25932
$R^2$	0.343	0.371

#### 4.3.2 Audit Quality

To investigate the heterogeneous impact of external supervision on corporate governance, this study divides the sample into Big Four-audited and non-Big Four-audited firms, following Wang et al. (2024). As shown in Columns (1) and (2) of Table 5, executive shareholding ratios exhibit no significant effect on Big Four-audited listed companies, but significantly inhibit violations in non-Big Four-audited firms. This suggests that high-quality auditors (i.e., the Big Four) provide stronger supervisory oversight, reducing the likelihood of financial violations due to their rigorous audit standards. Drawing on Guedhami et al. (2014), such oversight mitigates information asymmetry and restricts management's ability to manipulate financial statements, thereby curbing violations. Consequently, executive equity incentives are more effective in reducing violations for non-Big Four-audited firms, where external supervision is relatively weaker.

Table 5 Big Four Audit or Not

	(1) Big Four Audit	(2) Non-Big Four Audit
Manholds	-0.296 (-1.18)	-0.209*** (-6.34)

Constant	0.284	0.200
	-0.450	-1.330
Firm FE	YES	YES
Year FE	YES	YES
Control	YES	YES
Observations	2248	37015
$R^2$	0.385	0.350

### 4.3.3 Environmental Information Disclosure

From the perspective of "opportunities for violations" listed companies may face issues that affect the completeness of information disclosure. Following Yuan and Bai (2025), the sample is further divided into firms that disclose environmental-related information in annual reports and those that do not. Columns (1) and (2) of Table 6 present the regression results: the executive shareholding ratio is significantly negative in Column (1) but insignificant in Column (2). This indicates that incomplete information disclosure exacerbates information asymmetry, as investors are more likely to receive manipulated information, creating opportunities for managerial violations. However, drawing on Balsam et al. (2014), effective internal control improvements by management can mitigate corporate losses. In this context, executive equity incentives enhance internal supervision, more effectively controlling violation risks and demonstrating a stronger inhibitory effect on the frequency of corporate violations.

Table 6 Environmental Information Disclosure

	(1) Disclosing Environmental Information	(2) Non-Disclosing Environmental Information
Manholds	-0.199*** (-5.78)	-0.051 (-0.32)
Constant	0.299* -1.940	0.436 -0.810
Firm FE	YES	YES
Year FE	YES	YES
Control	YES	YES
Observations	34339	4007
$R^2$	0.362	0.558

### 4.3.4 Corporate Transparency

Based on the degree of external supervision, the Shanghai and Shenzhen Stock Exchanges annually evaluate listed companies on six indicators — authenticity, accuracy, completeness, timeliness, fairness, and compliance—assigning four grades: A (excellent), B (good), C (qualified), and D (fail). Following Zhang et al. (2022), this study classifies these grades into high-transparency (grades A and B) and low-transparency (grades C and D) groups. Columns (1) and (2) of Table 7 report the regression results of executive shareholding ratios on the two transparency groups. The results show that executive shareholding ratios significantly inhibit violations in high-transparency listed companies, indicating that when enterprises are under high supervision and transparency, equity incentives for management reduce the frequency of violations. Conversely, in low-transparency listed companies, managerial manipulation is less likely to be detected, increasing the likelihood of violations.

Table 7 Corporate Transparency

	(1) High Transparency	(2) Low Transparency
Manholds	-0.137*** (-4.08)	-0.137 (-1.20)

Constant	0.161	0.503
	-1.060	-1.370
Firm FE	YES	YES
Year FE	YES	YES
Control	YES	YES
Observations	28880	9650
$R^2$	0.325	0.500

#### 4.4 Instrumental Variables

To address potential endogeneity, this study employs a lagged one-period executive shareholding ratio (Manholds\_L1) as an instrumental variable, following Yang and Li (2022). This choice is justified by the persistent nature of equity incentives, which exhibit stable long-term trends and mitigate short-term fluctuations. The lag structure also addresses the time-lag effect between incentives and corporate behavior.

Table 8 presents two-stage least squares (2SLS) results. In Stage 1 (Column 1), the coefficient of Manholds\_L1 is significantly positive, confirming the instrument's relevance. The under-identification test and weak-instrument test reject invalid instrument hypotheses, validating exogeneity and relevance. Stage 2 (Column 2) shows that a one-unit increase in the executive shareholding ratio reduces violations by 0.24 units, reinforcing the robustness of the negative relationship.

Table 8 Instrumental Variables

	(1)	(2)
	Manholds	Frequency
Manholds_L1	0.712***	
	-75.970	
Manholds_hat		-0.240***
		(-4.76)
Identification Tests		33774.46***
Weak Instrument F-statistic		2946.65***
Under-Identification Test		5771.64***
Firm FE	YES	YES
Year FE	YES	YES
Control	YES	YES
N	34330	34330

#### 4.5 Robustness Tests

##### 4.5.1 Replacing the Dependent Variable

To conduct robustness analysis, this study replaces the dependent variable from the annual number of violations with a binary indicator of whether a violation occurred in the year, following Xu et al. (2019b). Specifically, Fraud is coded as 1 for violations and 0 otherwise. The regression results in Column (1) of Table 9 show a significantly negative coefficient at the 1% level, indicating that equity incentives enhance firms' risk aversion capabilities, making violations less likely and reducing their frequency. This suggests that executive equity incentive systems effectively align managerial and shareholder interests, facilitating corporate value maximization.

##### 4.5.2 Replacing the Dependent Variable

Drawing on Zhang (2024), this study uses Violanum—the ratio of annual violations to total violations during the observation period—as an alternative dependent variable. Column (2) of Table 9 reveals a significantly negative coefficient at the 1% level, consistent with the baseline conclusion that executive shareholding ratios inhibit violations. This consistency implies that equity incentives

align managerial and shareholder interests, reducing fraud and violations caused by managerial short-sightedness.

#### 4.5.3 Changing the Observation Interval

To address potential lag effects in violation disclosure, this study excludes data from 2022 - 2023, following Wang and Zheng (2024). The regression results in Column (3) of Table 9 show a significantly negative coefficient at the 1% level, indicating that the inhibitory effect of equity incentives remains robust after accounting for the time lag between violation occurrence and detection. This confirms executive equity incentives as an effective corporate governance mechanism, independent of sample period biases.

Table 9 Robustness Tests

	(1) Fraud	(2) Violanum	(3) 2011-2021
Manholds	-0.136*** (-6.34)	-0.075*** (-4.61)	-0.268*** (-6.51)
Constant	0.241*** -2.650	0.188*** -3.430	0.105 -0.620
Firm FE	YES	YES	YES
Year FE	YES	YES	YES
Control	YES	YES	YES
Observations	39314	21708	29600
$R^2$	0.326	0.066	0.379

## 5. Conclusions

This study examines the impact of executive equity incentives on corporate violations using a sample of non-financial and non-real estate A-share state-owned listed companies from 2011 to 2023, incorporating firm and year-fixed effects. The findings reveal that implementing executive equity incentives significantly reduces violations by listed companies. Mechanism analysis indicates that executive equity incentives diminish the likelihood of corporate violations by reducing earnings management. Heterogeneity analysis further shows that the effect of executive equity incentives in curbing corporate violations is more pronounced in non-state-owned enterprises, firms audited by non-Big Four accounting firms, companies disclosing environmental-related information in annual reports, and those with high external supervision transparency. Robustness tests, including altering the dependent variable to whether violations occurred in the current year or violation frequency, and changing the observation period, consistently confirm that executive equity incentives reduce corporate violations.

The study's conclusions suggest three key implications: First, diversify performance metrics. Policies should urge firms to adopt a mix of financial (e.g., net profit) and non-financial indicators (e.g., environmental compliance, employee satisfaction) in executive equity incentive plans. For example, linking incentives to specific sustainability targets or turnover rate controls can align management with long-term corporate goals and reduce short-term violations for financial gains. Second, enhance disclosure transparency. Regulations should require detailed disclosures of incentive plans, including performance indicator rationale, strategic measures for achievement, and adjustments. This allows shareholders and markets to monitor executive behavior, curbing improper incentives obtained through information manipulation. Third, strengthen shareholder rights protection. Legal reforms should lower the threshold for shareholder lawsuits against suspected incentive-related violations and impose liability for losses during litigation. This promotes greater accountability in incentive implementation and discourages non-compliance.

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