

Greenwashing or Genuine Governance? A Review of ESG Strategies in Mitigating Earnings Management

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Abstract

This study conducts a comprehensive review of the relationship between Environmental, Social, and Governance (ESG) practices and profit management behavior in companies, with a specific focus on identifying genuine practices versus greenwashing. Using a systematic literature review method on 54 research articles published in reputable Scopus journals, the results of this study reveal three main findings: First, substantive ESG implementation significantly reduces accrual-based earnings management through increased transparency and strengthened corporate governance structures. Second, empirical evidence suggests that some companies use ESG disclosure as a greenwashing strategy to conceal earnings manipulation activities, particularly through real activities manipulation. Third, the effectiveness of ESG in mitigating earnings management is significantly influenced by contingency factors such as regulatory strength, industry characteristics, and corporate ownership structure. These findings have important implications for regulators in developing stricter ESG oversight frameworks and for investors in developing more comprehensive criteria for evaluating sustainable investments.

Keywords: ESG, Earnings Management, Greenwashing, Corporate Governance, Sustainability Performance



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INTRODUCTION

In recent decades, Environmental, Social and Governance (ESG) issues have become a major focus in sustainable business and investment practices (Gillan et al., 2021). Companies are increasingly adopting ESG strategies to enhance their reputation, meet investor demands and comply with increasingly stringent regulations. However, a critical question arises: do these ESG commitments truly reflect sustainable governance or are they merely greenwashing a manipulative tactic to create a positive image without substance? (Lyon & Montgomery, 2015). This phenomenon is relevant in the context of earnings management, where companies may use aggressive accounting practices to make financial reports appear attractive to stakeholders. Profit management has long been a concern in financial literature due to its potential to mislead stakeholders (Healy & Wahlen, 1999). This practice can be carried out through accrual-based manipulation or real activities manipulation, both of which have the potential to undermine the quality of financial statements. In the context of ESG, some studies suggest that companies with high ESG performance tend to reduce earnings management due to greater transparency and accountability (Y. Kim et al., 2012). However, other findings indicate that ESG can be used as a tool to divert attention from financial manipulation (Prior et al., 2008).

Greenwashing in ESG poses a serious challenge due to the difficulty of measuring the integrity of a company's sustainability commitments (Delmas & Burbano, 2011). Companies may publish impressive ESG reports that are not supported by substantive policies. If ESG is

used solely as an image-building tool, its impact on earnings management may be minimal or even counterproductive. Conversely, if ESG is implemented genuinely, it can strengthen corporate governance and reduce incentives for earnings manipulation (Dhaliwal et al., 2011). Previous studies on the relationship between ESG and earnings management are still fragmented and have not reached a consensus. Some researchers have found a negative correlation between ESG and earnings management, while others have found no significant relationship or even conflicting results (Garcia et al., 2017). This inconsistency highlights the need for a systematic review to integrate empirical findings and identify moderating factors, such as country regulation, company size or industry.

In addition, most previous studies have focused on ESG disclosure rather than ESG performance, which can lead to interpretative bias (Cho et al., 2015). Extensive ESG disclosure does not necessarily reflect actual practices, so analysis should consider performance metrics such as Sustainalytics, MSCI ESG Ratings, or Bloomberg ESG Scores. A more holistic approach is needed to distinguish between companies that are truly sustainable and those that are merely greenwashing. This study aims to systematically review the literature on the role of ESG in earnings management mitigation by considering information asymmetry, managerial incentives, and market pressure. By analyzing empirical studies from various countries, this review will provide a comprehensive understanding of whether ESG functions as an effective governance mechanism or merely as a tool for false legitimacy. These findings will be useful for regulators, investors, and researchers in evaluating the credibility of ESG practices.

Literature Review

ESG as a Governance Mechanism

According to stakeholder theory, companies with strong ESG commitments are expected to demonstrate greater transparency and accountability, thereby reducing incentives for earnings manipulation (Freeman, 1994). Studies show that high ESG performance is consistent with ethical corporate behavior, which in turn reduces EM (Y. Kim et al., 2012). However, legitimacy theory argues that companies may disclose ESG information to appear socially responsible while continuing to engage in questionable financial practices (Suchman, 1995). This creates a paradox where ESG can both constrain and facilitate earnings management, depending on corporate intentions.

Greenwashing in the context of ESG

Greenwashing refers to the practice of companies creating a false impression of their environmental, social, or governance (ESG) commitments without accompanying concrete actions (Lyon & Montgomery, 2015). This phenomenon has become increasingly prevalent as investor and consumer demand for sustainable business practices has grown (Delmas & Burbano, 2011). Environmental, Social and Governance (ESG) itself is an evaluation framework used to measure the sustainability and ethics of a company's business (Friede et al., 2015). However, some companies use ESG as a marketing tool (window dressing) rather than integrating it into their core strategy (Walker & Wan, 2012). Some forms of greenwashing in the ESG context include Selective Disclosure, where companies only disclose positive ESG indicators while hiding poor performance (Bowen & Aragon-Correa, 2014); Vague Claims, using terms such as "environmentally friendly" or "sustainable" without concrete evidence (Torelli et al., 2019) and Symbolic Actions by undertaking small ESG actions that are widely publicized but have no significant impact (Marquis & Qian, 2014). A study by (E. H. Kim & Lyon, 2014) found that companies involved in greenwashing tend to have high levels of ESG disclosure but low environmental performance.

Earnings Management: Accrual-Based vs. Real Activities Manipulation

Earnings management is defined as management intervention in the external financial reporting process with the aim of obtaining personal gain or influencing stakeholders' perceptions of a company's economic performance (Healy & Wahlen, 1999). This practice is generally carried out through two main approaches: accrual-based earnings management (AEM) and real activities manipulation (RAM) (Roychowdhury, 2006). Earnings management can occur through:

1. Accrual-based earnings management: Altering accounting estimates to change reported earnings (Dechow & Skinner, 2000).
2. Real activities manipulation: Changing operational decisions (such as reducing R&D costs or delaying expenditures) to increase short-term earnings (Roychowdhury, 2006).

The impact of ESG on EM may vary depending on the manipulation method, with some studies finding that ESG reduces accrual-based earnings management but has no effect on actual activity manipulation (Garcia et al., 2017).

ESG and Earnings Management: Conflicting Empirical Evidence

ESG as an Obstacle to Earnings Management

Several studies support the idea that strong ESG practices can reduce earnings manipulation:

1. Y. Kim et al., (2012) found that companies with higher levels of CSR (as part of ESG) exhibit lower discretionary accruals, suggesting that ethical governance limits inaccurate financial reporting.
2. Dhaliwal et al. (2011) argued that ESG transparency enhances monitoring, making aggressive earnings management riskier.
3. Prior et al. (2008) showed that socially responsible companies engage in less earnings management due to stronger internal controls.

ESG as a Mask for Greenwashing

Conversely, other studies suggest that ESG can be used to conceal poor financial governance:

1. Cho et al. (2015) found that companies with high ESG disclosure but low performance are more likely to engage in EM, supporting the greenwashing hypothesis.
2. Lyon & Montgomery (2015) highlighted cases where companies exaggerated their ESG achievements to divert attention from financial violations.
3. Garcia et al. (2017) found no significant relationship between ESG and poor environmental practices (EM) in several industries, suggesting that the impact of ESG depends on context.

RESEARCH METHOD

Research Approach

This study uses the Systematic Literature Review (SLR) method to comprehensively examine the relationship between ESG (Environmental, Social, and Governance) strategies and earnings management. SLR was chosen because it provides a structured, transparent, and replicable synthesis (Tranfield et al., 2003). The SLR process will be conducted in several stages, including literature search, article selection, data extraction, and analysis and synthesis of the findings obtained (Wahyuni, 2025)

SLR Procedure

The first stage is **literature search** conducted using leading academic databases such as Scopus, which contains articles from (Emerald Insight, Pringer Link, Wiley, Science Direct, and EBSCO Host). This search focuses on studies relevant to ESG strategies that can mitigate earnings management. The keywords used in the search include (“Corporate Governance” AND “Earnings Management”), (“Greenwashing” AND “Earnings Management”) and (‘ESG’ AND “Earnings Management”). The inclusion criteria for selected studies include articles published in reputable Scopus international journals in the Business, Management and Accounting categories as long as the articles appear in the Scopus database search results. After the literature was identified, the second stage was the **selection of articles** based on more specific inclusion criteria, such as relevance to the main topic, quality of research methodology, and contribution to understanding ESG strategies in mitigating earnings management. Articles that did not align with the topic or had invalid methodologies were excluded from the review. This selection process also considers factors such as journals published in Scopus under the Business, Management, and Accounting category, the publication language (international language, i.e., English), and relevant keywords related to the topic. There are no restrictions on the year of publication to ensure a broad scope and identify novelty (research innovation).

The third stage is **data extraction**. This stage involves collecting important information from the selected articles. This includes key findings on ESG Strategies in Mitigating Earnings Management and the methodologies used in each study. The data extraction process is conducted systematically by creating tables that summarize relevant information such as research methods (type of research and data analysis techniques). The final stage is **analysis and synthesis** of the findings, which is done by reviewing and combining the results of the analyzed articles. This analysis aims to provide a comprehensive overview of ESG Strategies in Mitigating Earnings Management. The synthesis of the research results will be done by comparing the findings from various sources to assess the extent to which ESG strategies mitigate earnings management. Are they categorized as greenwashing or corporate genuine?

Table 1. Study on ESG Strategies to Reduce Profit Manipulation Prior to the Removal of Reconciliation Requirements

Keyword	Article in Scopus
"ESG" AND "Earnings Management"	40
"Greenwashing" AND "Earnings Management"	8
"Good Corporate Governance" AND "Earnings Management"	33
"Greenwashing" AND "Corporate Governance"	23
Total	104

Table 2. Article Reconciliation Process

Previous article Reconciliation Requirements for removal	104
Duplicate article title	(6)
Articles discontinued in the Scopus index	(9)
An article classified as a Systematic Review	(5)
Articles that cannot be accessed	(9)
Articles irrelevant to the topic	(21)
Final total of articles to be analyzed	54

RESEARCH RESULT AND DISCUSSION

Table 3. Journals And Scopus Indexing Selected In The Data Inclusion Process

Journal name	Scopus rating	Number of Articles
Abacus	Q3	1

Accounting Research Journal	Q2	1
Afro-Asian Journal of Finance and Accounting	Q4	1
Asian Economic and Financial Review	Q3	1
Asian Journal of Accounting Research	Q2	3
Asian Review of Accounting	Q2	1
Asia-Pacific Journal of Business Administration	Q1	1
Australasian Accounting, Business and Finance Journal	Q2	2
Business Ethics, the Environment and Responsibility	Q1	1
Business Strategy and the Environment	Q1	1
China Journal of Accounting Research	Q2	1
China Journal of Accounting Studies	Q3	1
Cogent Business and Management	Q2	3
Contemporary Economics	Q2	1
Corporate Governance (Bingley)	Q1	3
Corporate Social Responsibility and Environmental Management	Q1	3
Emerging Markets Review	Q1	1
EuroMed Journal of Business	Q1	1
Financial and Credit Activity: Problems of Theory and Practice	Q4	1
IBIMA Business Review	Q4	1
International Journal of Disclosure and Governance	Q2	4
International Journal of Finance and Economics	Q2	1
Investment Management and Financial Innovations	Q3	1
Journal of Accounting in Emerging Economies	Q1	1
Journal of Applied Business Research	Q4	1
Journal of Business Economics and Management	Q2	1
Journal of Business Ethics	Q1	3
Journal of Cleaner Production	Q1	1
Journal of Financial Reporting and Accounting	Q1	1
Journal of Global Responsibility	Q2	1
Journal of Indonesian Economy and Business	Q3	1
Journal of Management and Governance	Q1	1
Journal of Real Estate Finance and Economics	Q1	1
Journal of Science and Technology Policy Management	Q2	1
Managerial Finance	Q2	2
Real Estate Management and Valuation	Q3	1
Review of Accounting Studies	Q1	1
Risks	Q2	1
WSEAS Transactions on Business and Economics	Q4	1
Total		54

Table 4. Details of Articles by Category Based on Theory Used

Theory in Used	YEAR			
	<2016	2017-2019	2020-2022	2023-2025
Agency Theory	2 (Shan, 2015) (Nagar & Raithatha, 2016)	2 (Saftiana et al., 2017) (Klann & Beuren, 2018)	2 (Ghozali et al., 2022) (Rizani et al., 2022)	4 (Sanjaya & Setiawan, 2023) (Salihi et al., 2024) (Comporek, 2024) (Ajayi & Akinsomi, 2024)
Alignment theory				
Contingency Theory		1 (Marchini et al., 2018)		
Entrenchment Theory				
Finance Theory	1 (Lin et al., 2016)			

Greenwashing Theory				
Independence Resource Theory				
Institutional Theory	1 (Xue & Hong, 2016)			
Legitimacy Theory				
Moral Licensing Theory				1 (Soeprajitno et al., 2024)
Optimal Contracting Theory				
Pecking Order Theory				
Signalling Theory				
Slack Resources Theory				
Stakeholders Theory		2 (Benyarisawat, 2019) (Velte, 2019)	1 (Bui et al., 2021)	3 (Zhang et al., 2023) (Tohang et al., 2024) (Primacintya & Kusuma, 2025)
Stewardship Theory				
Voluntary Disclosure Theory				
Tidak dijelaskan secara eksplisit	3 (García et al., 2012) (Anglin et al., 2013) (Campa & Donnelly, 2014)	1 (Du et al., 2018)	3 (Ma & Yoo, 2022) (Nagy et al., 2022) (Thomas et al., 2022)	
Combination of the 2 theories above	1 (Lakhal, 2015)	1 (Sial et al., 2018)	3 (Putri & Prasetyo, 2020) (Velte, 2021) (Borralho et al., 2022)	7 (Saleh et al., 2023) (Samarakoon et al., 2024) (Chouaibi & Zouari, 2024) (ElHawary & Elbolok, 2024) (Ekawati, 2025) (Kolsi & Al-Hiyari, 2025) (Lestari & Muthmainnah, 2025)
Combination of more than 2 theories above		2 (Mahrani & Soewarno, 2018) (Rezaee & Tuo, 2019)	5 (Mohmed et al., 2020) (Alsaadi, 2021) (Chouaibi & Zouari, 2022) (Fera et al., 2022) (Y. Adeneye & Kammoun, 2022)	8 (Y. B. Adeneye et al., 2024) (Amarna et al., 2024) (Chouaibi & Zouari, 2024) (Liu et al., 2024) (Masmoudi & Ben Salem, 2024) (Mukhtaruddin et al., 2024) (Hamed, 2025) (Sabirali et al., 2025)

Tabel 6. Articles with the Most Citations Top 5 Rankings

No	Author	Title	Proxy Earnings Management	Cited	Result
1	(Mahrani & Soewarno, 2018)	The effect of good corporate governance mechanism and corporate social responsibility on financial performance with earnings management as mediating variable	Modified Jones model (1995)	167	GCG reduces earnings management, while CSR actually improves earnings management practices.
2	(Rezaee & Tuo, 2019)	Are the Quantity and Quality of Sustainability Disclosures Associated with the Innate and Discretionary Earnings Quality?	Modifikasi model Dechow & Dichev (2002) yang diperluas oleh Francis et al. (2005; 2008) dan Moon Jr. (2014) untuk memisahkan komponen innate dan discretionary dari kualitas laba	159	The quantity of sustainability disclosure (measured by the existence of sustainability reports) is positively related to innate earnings quality, but negatively related to discretionary earnings quality. Meanwhile, the quality of sustainability disclosure (measured by the use of GRI guidelines and the level of implementation) is positively related to both types of earnings quality
3	(Velte, 2019)	The bidirectional relationship between ESG performance and earnings management – empirical evidence from Germany	<ul style="list-style-type: none"> • AEM diukur dengan model Kothari et al. (2005) • REM diukur dengan Abnormal Cash Flows from Operations (AB_CFO), Abnormal Production Costs (AB_PROD), Abnormal Discretionary Expenses (AB_EXP) 	94	ESG performance negatively affects accrual-based earnings management (AEM); Governance performance has the strongest negative impact on AEM; There is no significant relationship between ESG performance and real earnings management (REM).
4	(Velte, 2021)	Environmental performance, carbon performance and earnings management: Empirical evidence for the European capital market	<ul style="list-style-type: none"> • ACC with modified Jones model • The REM is measured by Abnormal Cash Flows from Operations (AB_CFO), Abnormal Production Costs (AB_PROD), Abnormal Discretionary Expenses (AB_EXP) 	79	Environmental performance reduces accrual-based earnings management (ACC) and improved environmental performance leads to higher real earnings management (REM).
5	(Shan, 2015)	Value relevance, earnings management and corporate governance in China	abnormal related-party transactions (ABNRPT) from Lo and Wong (2011)	76	Good corporate governance practices restrict earnings management.

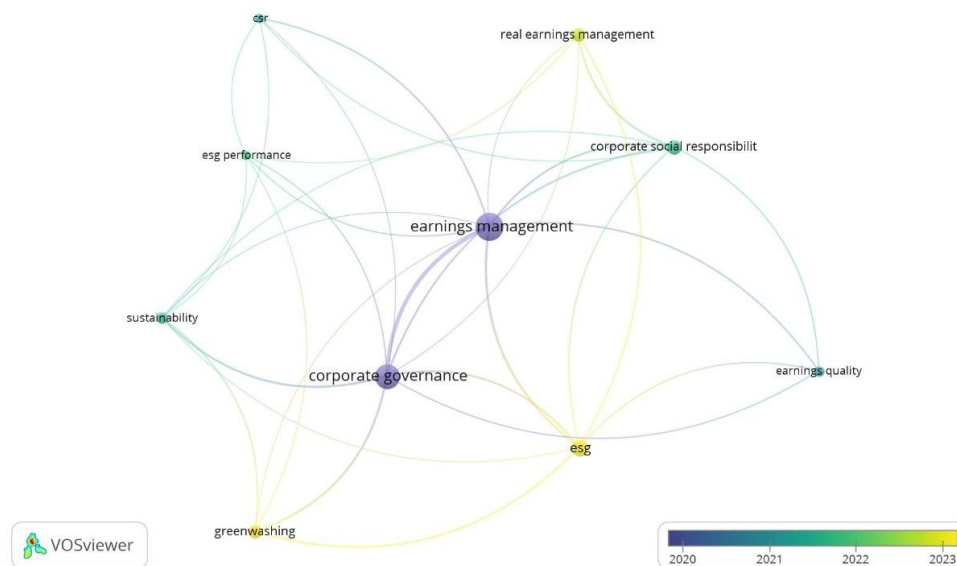


Figure 1. Visual Overlay VoS Viewer (Data processed, 2025)

The figure shows the results of a keyword co-occurrence network analysis created using VOSviewer software, which is commonly used in Systematic Literature Reviews (SLRs). This visualization displays a number of keywords that are interconnected based on their frequency of co-occurrence in previous studies. The main keywords that appear include real earnings management, corporate social responsibility (CSR), ESG, earnings quality, sustainability, and corporate governance, which are interconnected, indicating that these topics are frequently discussed together in academic literature from 2020 to 2023. The visualization from VOSviewer depicts a conceptual network divided into several color groups, each representing interrelated research themes. Red nodes, for example, group topics such as real earnings management, earnings management, and earnings quality, indicating a research focus on profit management practices and financial statement quality. Green nodes include corporate social responsibility (CSR), sustainability, and greenwashing, indicating research themes centered on sustainability and corporate social responsibility. Meanwhile, blue nodes may represent corporate governance and ESG performance, emphasizing the role of corporate governance in economic, social, and environmental performance. Thick, brightly colored connecting lines indicate strong and frequently discussed relationships in the literature, such as between CSR and greenwashing, reflecting the abundance of research criticizing inauthentic CSR practices. Conversely, thin or less prominent lines indicate relationships that are still under-explored, such as the connection between sustainability and earnings quality.

Trend analysis of this visualization reveals that topics such as greenwashing and sustainability are becoming increasingly prominent in research in 2022–2023, indicating a shift in academic interest toward environmental and business ethics issues. Meanwhile, classic topics such as earnings management and corporate governance remain dominant, but with a new emphasis on their integration with sustainability practices. For future research, this visualization highlights several gaps that warrant further exploration. For example, the relationship between earnings quality and greenwashing remains understudied, despite the important implications of these concepts for corporate transparency. Additionally, future research could investigate how real earnings management practices are influenced by pressure to meet sustainability standards or the role of corporate governance in moderating the relationship between CSR and financial performance.

CONCLUSION

This study systematically examines the relationship between Environmental, Social, and Governance (ESG) strategies and profit management practices, as well as exploring whether ESG commitments are genuine or merely greenwashing. Based on a comprehensive literature review, it can be concluded that the relationship between ESG and profit management is not linear, but rather complex and dependent on various contextual factors. Companies with high ESG performance tend to demonstrate better transparency and accountability, thereby reducing accrual-based earnings management (AEM) practices. This is supported by stakeholder theory, which states that strong ESG commitments can strengthen corporate governance and reduce incentives for financial manipulation, as shown by research by Kim et al. (2012) and Dhaliwal et al. (2011) show that companies with high ESG scores have lower levels of discretionary accruals. In addition, there is evidence that ESG can be used as a greenwashing tool, whereby companies use impressive ESG disclosures to cover up questionable financial practices. Studies by Cho et al. (2015) and Lyon & Montgomery (2015) found that companies with high ESG disclosure but poor performance are more likely to engage in earnings management. This phenomenon is supported by legitimacy theory, which explains that companies may use ESG as a branding tool without substantive implementation. Additionally, the impact of ESG on earnings management varies depending on the manipulation method, with ESG being more effective in reducing AEM but less influential on real activity manipulation (RAM). Overall, these findings have important implications for regulators, investors, and researchers. Regulators need to strengthen ESG reporting standards to prevent greenwashing, while investors should be critical in assessing the credibility of companies' ESG commitments. Future research could further explore moderating factors such as country regulation, firm size, and industry, as well as investigate the relationship between greenwashing and profit quality, which remains understudied. Thus, this study makes a significant contribution to understanding the complex dynamics between ESG, profit management, and sustainable business practices.

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