OWNERSHIP STRUCTURE AND EARNINGS MANAGEMENT: EVIDENCE FROM THE LISTED NON-FINANCIAL COMPANIES IN KENYA

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DECLARATION

Student's Declaration

I declare that this research proposal report is my authentic work and thereby never been previously published or submitted elsewhere for assessment or award of a degree in any institution of higher learning except for University of Nairobi.

Sign…… Date……

Saline Omondi

D63/72459/2014

Supervisor's Declaration

This research project report has been presented for examination with my consent as the University Supervisor

PROF. JOSIAH ADUDA

PROFESSOR OF FINANCE DATE: 13/10/2020

UNIVERSITY OF NAIROBI

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Most of all, I am extremely grateful to God the Almighty for His abundant grace and blessings throughout the project development period.

DEDICATION

I dedicate this research work to my dearest husband for the immense support throughout the entire research period; and to my precious mother whom, for the past months, has been a source of encouragement with her fullest and truest attention to complete my work with aboveboard self-confidence.

To God the Almighty, am grateful for the guidance, power of mind, strength, care and skills, for according me a healthy life. All these I offer to you.

LIST OF ABBREVIATIONS

CFO : Cash flow from operating activities

CMA : Capital Markets Authority

DA : Discretionary Accruals

DSE : Dare Salam Stock Exchange

EM : Earnings Management

NDA : Non-Discretionary Accruals

NI : Net Income

NSE : Nairobi Securities Exchange

OLS : Ordinary Least Square

PPE : Plant Property and Equipment

REC : Receivable

REV : Revenue

TA : Total Accruals

TA : Total Assets

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

ABSTRACT

The quality of financial reporting is an important matter to both regulators and investors. The purpose of preparing general purpose financial statements is to enhance objective decision making. Empirical evidence shows that investors rely on the earnings of a company to make decisions on whether to invest in the company or not, they also rely on the earnings of a company to decide if they will hold their investment or sell their stake in the company. Earnings also influence the stock prices and bonus earnings for internal management. Because of over reliance on this metric, most organizations have found reason to manipulate this number in order to influence the decision makers. Empirically the impact of ownership structure and earnings management has yielded conflicting results, with some studies concluding that there is a negative relationship whiles other studies indicating that there is a positive relationship. Moreover, most of these studies have not been done in Kenya. Therefore, the intent of the research was to demonstrate the relation between ownership structure and earnings management. Other supplementary objectives included establishing the connection existing between earnings management and enterprise size, age of the enterprise, profitability of the enterprise and capital structure. The theories anchoring the study included the agency theory, the bonus maximization theory and the passive hand theory. Descriptive Cross-sectional research design was used to conduct the census study. Secondary data was obtained from the entire 44 non-financial companies listed at NSE over a five-year period from 2015-2019.The study concluded presence of a statistically significant positive link between ownership structure, the size of the firm, firm profitability and earnings management. However, the investigation found no statistical interrelation between firm age, leverage and earnings management. The outcomes of the investigation confirm the assumptions of the bonus maximization theory and the passive hand theory. However, these results fail to confirm the assertions of the agency theory. Therefore, the study recommends that capital markets authority (CMA) should intensify its surveillance on big firms. Further the study proposes that the institute of certified public Accountants Kenya (ICPAK) should increase monitoring of the audits conducted on big firms. This is because large firms have the capacity to manipulate the auditors to overlook earnings management practices. Therefore, the study proposes that further inquiries should be undertaken to ascertain the interconnection between the quality of external audit and earnings management in Kenya. The study also suggests that independent studies should be done to find out the characteristics of institutional investors in Kenya and its relationship to earnings management.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The recent corporate scandals and liquidation of listed corporate entities in Kenya is a confirmation of the assertions of the agency theory. As postulated by the theory, managers cannot be trusted to watch over the affairs of maximizing the shareholders wealth with the same vigilance with which the shareholders themselves would have if they were managing the affairs of their companies. In Kenya the collapse of Uchumi, Nakumatt, chase banks and Dubai banks are classical demonstration that there exist agency problems in the management of publicly listed organizations (Waguma, 2019).

Waguma (2015) narrates that the Dubai bank, chase bank and Shelter Afrique case represent the clash of private interest of managers and the shareholders wealth maximization. In these three cases senior managers and directors originated subprime loans to companies which did not have the ability to repay the loans. Additionally, the directors of chase bank inconsistently allocated themselves loans from the shareholders and depositors' money and proceeded to hide this in their financial reporting. In the Uchumi and Nakumatt case the managers were involved in insider trading, by using privileged positions to trade with the organizations at non-arm's-length transaction. These managers formed companies which supplied goods at exorbitant prices (Business Daily, 2015).

In the cases illustrated above managers violated fundamental accounting principles in the representation of material facts on the face of financial statements. The financial loses made by chase bank and shelter Afrique were supposed to be reported as impairment to the assets. However, both the banks chose to extent the repayment

period thus underreporting their losses. Chase banks was also expected to report the loans advanced to the directors. Failure to do so was in direct conflict with the fundamental accounting principle of full disclosure and the entity principle. The managers also failed to disclose the loans originated to shareholders, this was in violation of the separate entity assumption principle. Any transaction involving the directors must be effectively disclosed so as to assist accounting information readers to arrive at an objective decision.

The agency theory of goal incongruence by Jensen and Meckling (1976) presupposed that the inclusion of foreign holding and institutional investors is likely to increase the monitoring role of the shareholders. Institutional investors usually bring with them wealth of experience in organizational management. For this reason, they are presumable to detect and deter earnings management. Therefore, their inclusion as shareholders is likely to reduce creative accounting. Al-Fayoumi, Abuzayed, and Alexander (2017) found results which support this notion. Their research concluded that increasing the manager's ownership in the company and including foreign owners in the structure is can disincentivize managers to participate in earnings management (EM)

However, the bonus maximization theory Hearly (1985) avers that institutional owners are mostly motivated by the level of bonus they earn from the companies they have invested in. They therefore care less about the future performance of the company but care more about the current bonus they can earn from the company. This theory therefore avers that short-term institutional owners and block shareholders are probable to exert pressure on management to participate in creative accounting. Their behavior is informed by the need to create more wealth for themselves. By declaring

falsified earnings these institutional owners are likely to increase their wealth by offloading their share to unsuspecting potential investors (Boulila & Mbarki, 2014).

1.1.1 Ownership Structure

Essays (2019) defined ownership structure as the composition of the various owners of the company. Empirical review has identified the three main ownership composition classified as follows; block holders, managerial ownership and institutional owners. The agency theory postulates that managers cannot watch over the business with the same vigilance the owners would. Saleem (2016) therefore proposes that managers should be allowed to own part of the company to encourage them to serve the best interest of the enterprise as opposed to pursuing their own private interest. Managerial ownership is therefore the proportion of a company ownership which is given to manager to entice them to align their goals to those of shareholders (Parveen et al., 2016).

Latif and Abdullah (2015) defined institutional ownership as the proportion of interest controlled by financial and non-financial institutions in a company. The institutional owners include, banks, insurance companies and pension schemes. They bring with them their managerial experience and good corporate governance to the company. Therefore, these institutional owners are anticipated to play an additional monitoring part in the company. Thus, reducing the chances of earnings management and improving organizational performance through prudent governance (Parveen et al., 2016).

Moslemany, Racha and Demyana (2019) defined external block holders as shareholders or group of shareholders who jointly own more than 5% of the company shares. They can have a controlling interest if they vote as a group or if they have

elected a representative to take care of their interest or they could jointly own a non-controlling interest if their ownership and voting patterns are disjointed. The impact of these external stock holders is dependent on their ownership stake and their goals in the organization. They are likely to play an increased monitoring role if they have long term interest contrary to short term interest. The ownership structure will be gauged by the proportion of shares owned by block owners (Institutional owners and pension fund owners).

1.1.2 Earnings Management

Saleem (2016) defined earnings managements as the willful falsification of financial reports with the intention of influencing a decision. Financial statements are used by both potential and present investors to make long- and short-term investment decisions. Investors rely on earnings figure as a standard measure of increasing their welfare or not. Managers are aware of this and are in most cases incentivized to manage earnings to coincide with the analyst predictions. Managers are more likely to participate in creative accounting if their pay is a function of performance (Zgarni, 2016).

Parveen, Malik, Mahmood, and Ali (2016) defined earnings managements as the purposeful misrepresentation of the generally accepted accounting principles with the aim of reporting a desired pre-determined outcome. This desired outcome could be in terms of reducing the current profit in order to pay less taxes or increasing the level of earnings in order to increase tom management bonus. In order to encourage prudent financial reporting, organizations have to put in place strong internal controls. This is usually done to reduce the goal incongruence between the shareowners and the managers. Elham et al., (2016) suggests that linking manager’s bonuses to long term

contingent goals like increase in market share or customer growth is likely to reduce EM.

Tsipouridou and Spathis (2014) has proposed the use of elective accruals determined through refined Jones (1995) version to measure the EM in an organization. This model assesses the suitability of loss provisions as provided for in the statement using a set of standard ratios. These ratios are capable of identifying the misrepresentations caused by selecting a biased basis of measurement criteria or accounting policy in presenting the financial information. The Jones model (1995) is capable of assessing the suitability of the estimates and measurements made by managers. Additionally, Amar, (2014) proposed the use of differed tax (liability and asset) as a measure of EM, these proponents claim that the level of differed tax is a measurement of the level of discretionary accruals since the tax agencies do not generally accept accruals in the computation of tax liability.

1.1.3 Ownership Structure and Earnings Management

Academic literature and the theoretical assumptions are inconclusive about the direction of the relationship which subsist between ownership composition and EM. Theoretically, it is expected that the inclusion of institutional owners in the ownership composition is likely to diminish the chances of earnings management owing to the increased monitoring by the institutional investors (Al-Fayoumi, Abuzayed, & Alexander, 2010).The assumptions of the agency hypothesis as advanced by Jensen and Meckling (1976) suggest that increasing block and management ownership is likely to reduce the incentives of creative accounting. However, the passive hand hypothesis postulates that institutional and block ownership creates more incentive for earnings management.

Empirically, literature on the subject matter does not agree on the direction of association. Boulila, and Mbarki, (2014) established a negative relationship between concentrated ownership compositions and creative accounting. Al Fayoumi et al. (2010) also concluded that block ownership increases monitoring and consequently this reduces creative accounting. Saleem (2016) instituted a negative interconnection between management ownership and EM. However, Latif and Abdullah (2015) found evidence supporting the notion that institutional owners increase creative accounting. Parveen et al., (2016) also denoted a positive interrelation between block ownership and creative accounting. While Habbash (2010) found that large shareholders are more likely to participate in EM particularly if they need to sell their stake in the short run.

1.1.4 Listed Non-Financial Companies in Kenya

Onditi (2015) defined non-financial institutions are companies who are not in the financial business. These companies are engaged in the manufacturing of goods, value addition, provision of services, provision of advisory and trading (buying and selling goods).The NSE has further divided the non-financial companies into different sectors representing the specific characteristics of the industries where the companies operate. These sectors encompass agricultural sector, automobile & accessories sector, commercial & services district, construction and allied quarter, energy and petroleum district, manufacturing and allied district and telecommunication and technology subdivision (Business Daily, 2020).

1.2 Research Problem

Financial statements are designed primarily to support both potential and existing investors to make objective decisions. These decisions include, buy, sell or hold decisions. The usefulness of these information is however compromised by earnings management. Earnings management occurs where there is a material misrepresentation of material facts in order to achieve a pre-determined goal. Mangers falsify financial statements for their own gain, they may also present a less faithful representation of facts because of their need to attract investors by raising earnings level.

The agency theory recommends that increasing management ownership is likely to diminish the goal incongruence between shareholders and managers. The hypothesis infers that if managers are given more ownership then they will watch over the affairs of the company with more vigilance since their status has been elevated to the level of owners (Jensen & Meckling, 1976). The hypothesis also avers that the presence of foreign owners and block stockholders in the ownership structure is likely to curtail the chances of creative accounting. Proponents of the theory assume that these shareholders bring with them experience thus increasing the monitoring role and hence reducing the chances of EM (Iraya et al., 2015).

However, the bonus maximization theory (Hearly, 1985), postulates that managers and institutions are propelled by the need to earn more bonus. Therefore, managers are likely to peruse strategies which will help them to maximize their bonuses as opposed to shareholders wealth. The theory further avers that these managers/Institutional investors will not hesitate to undertake creative accounting so long as it leads to the maximization of bonuses. Latif and Abdullah (2015) looked into the role of corporate governance and ownership composition in shrinking creative

accounting. Their study found that concentrated ownership enhances the chances of earnings misrepresentation.

It is therefore clear from the foregoing that there are both theoretical and empirical gap. The two anchoring theories give opposing prepositions, the assumptions of the agency theory portrays a negative association, while the bonus maximization theory portrays a positive correlation between EM and creative accounting. Empirical evidence is also inconclusive Latif and Abdullah (2015) and Parveen et al. (2016) established a negative tie-in between ownership and EM while, Boulila, and Mbarki (2014), Iraya et al. (2015) and Ekpulu et al. (2018) found a positive relation between EM and ownership structure.

Contextually most of the researches have concentrated on finding out the interconnection between corporate governance and creative accounting. In most cases ownership structure has only been used as an intervening variable. Waguma (2019) looked at earnings management and prices of stock of listed financial establishments in Kenya, the study did not however look at ownership structure. Iraya et al. (2015) also looked at the role of corporate governance on creative accounting in Kenya. All of these studies did not look at ownership composition as one of the explanatory variables. Hence, the current inquiry intends to provide answer to the question; what is the direction of interrelation between ownership composition and earnings management?

1.3 Objective of the Study

The key objective of the research is to investigate the correlation between ownership structure and earnings management. Other supplementary objectives include establishing the relationship between earnings management and firm size, age of the firm, profitability of the firm and capital structure.

1.4 Value of the Study

The general-purpose financial statements are designed to offer information to lenders, and investors to enable them make objective decisions about the reporting entity. Earnings management dilute the usefulness of the information presented on these statements. Creative accounting can be misleading and may cause the external users to make sub optimal decisions which may lead to huge loses. The study will therefore contribute immensely to decision making to the extent that it will educate the investors and government officials on how to detect earnings management.

The research will also contribute to policy development, capital markets authority is mandated by law to protect investors' interest. Their work is to ensure the public companies are managed efficiently. Earnings management compromise this objective to the extent that unsuspecting investors are exposed to these malpractices. The paper therefore will help in policy formulation by suggesting the signals of creative accounting. The paper will provide key ratios which can be used to monitor and prevent earnings management. CMA officials can then use the ratios to detect and monitor instances of EM. They can then come up with legal policies which will punish the perpetrators of EM.

The findings of the research will also add to existing literature since there is no general agreement on the direction of association. Proponents of a positive relationship avers that institutional owners and foreign owners have a short-term interest in the company. They are therefore more incentivized to pressurize the management to manage earnings. Conversely, proponents of a negative relationship aver that institutional owners have the knowledge and capacity of monitoring management. Their inclusion in the ownership structure is therefore increases management monitoring. This ensures the presentation of reports which present faithfully the effects of transactions and events of a company.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section is dedicated to look at the hypothesis which the study is anchored, previous literature on the subject matter, other variables affecting creative accounting other than ownership composition, the conceptual framework for the study and the chapter summary.

2.2 Theoretical Review

This part will examine the hypothesis linking the concepts of creative accounting and ownership concentration. The section will look at the assumptions of the theories, the proposers of the theories and the relationship between the theories and the subject matter. Specifically, three theories which will be reviewed in this section include the agency hypothesis as proposed by Jensen and Meckling (1976), the bonus maximization theory as proposed by Hearly (1985) and the passive hand theory as proposed by Bhide (1993).

2.2.1 The Agency Theory

The concepts of the agency relationships was first conceived by Adam Smith (1776) in their seminal works. The theory explains the fundamental conflicts which subsist between the owners of the company and the directors who have been selected to administer the affairs of the company on the account of the owners (Jensen and Meckling, 1976). According to the theory the distinction between ownership and administration is the major cause of conflict in this relationship. The private goals and aspirations of managers usually clash with the shareholders wealth maximization

objective. This is because managers are in constant desire to make wealth for themselves.

Proponents of agency theory have identified that the goal incongruence between the managers and the shareholders can be reduced by increasing the monitoring of managements actions. Zgarni (2016) concluded that the inclusion of institutional ownership in the ownership composition enhances the monitoring role of the owners thus reducing the agency conflict. Institutional owners are more stringent in their monitoring role and are more experienced in organizational management than the traditional shareholders. They are therefore more likely to put pressure on the managers to provide more accurate reports.

Al-Fayoumi et al (2017) also concluded that increasing the managers' ownership and including foreign owners in the structure is likely to minimize the chances of creative accounting. Therefore, the theory avers that ownership concentration is probable of resulting to a decline of EM. The reverse argument postulates that institutional owners are more likely to increase EM. This is particularly true if they invest in a company for the purposes of capital gain. They may participate in EM in order to drive the share price and benefit from the marginal increase in share price (Boulila & Mbarki, 2014).

2.2.2 Bonus Maximization Theory

The bonus maximization theory as put forward by Hearly (1985) postulates that managers with bonus components in their remuneration structure are probable of engaging in creative accounting in order to earn their dividends. The theory assumes that managers will be inclined to manage earnings in two scenarios; when they do not meet their targets, they will try to increase the entity's earnings. They will also

manage earnings when they overachieve their targets, in this case they will reduce the earnings so as to use the excess earnings in the subsequent years. The theory also assumes that it is highly probable that institutional investors will encourage EM because by doing so they are likely to benefit from the incremental marginal gains in the stock prices.

Empirical evidence shows that indeed institutional and block shareholders are likely to participate in EM. Latif and Abdullah (2015) found that increasing ownership concentration leads to increased EM. However, Boulila, and Mbarki (2014) found that ownership concentration reduces the discretionary accruals level in the financial reports. While Gonzalez and Garcia-Meca (2014) concluded that there is no link between creative accounting and ownership composition.

2.2.3 The Passive Hand Hypothesis

The passive hand hypothesis as proposed by Bhide (1993) postulates that institutional owners and external block owners are mostly short-term investors. This means that they are mainly concerned with short term gains as opposed to long term gains. The short-term goals therefore deter them from incurring effective monitoring cost needed to identify creative accounting. Moreover, they may place pressure on management to participate in earnings management if it will enhance their short-term earnings. Given the assumptions of the theory, it is contemplated that an increment in ownership concentration is probable of increasing EM.

There is empirical evidence supporting the passive hand hypothesis. Outa, Eisenberg and Ozili (2017) and Ponsian and Waweru (2018) found evidence supporting the assumptions of the passive hand hypothesis. Their studies concluded the inclusion of institutional owners and block holders in the ownership structure results to increased

creative accounting. This is owing to the fact that these owners are more concerned with the short-term capital gains associated with the declaration of increased earnings. Institutional owners can therefore encourage EM in order to drive up the share prices to enable them to sell their stake at higher prices.

2.3 Determinants of Earnings Management

This part deals with determinants affecting of earnings management other than ownership structure. In this section firm size, age of the firm, Profitability and leverage will be discussed. The section will provide empirical literature touching on the association between these variables and EM. The section will also discuss how these determinants are measured based on past studies.

2.3.1 Firm Size

Kinyua (2018) defined establishment size as the amount of resources controlled by the entity, economic resources are scare in their nature and as such firms compete to control optimal level of resources to remain competitive. The size of an enterprise is computed as a function of the total assets controlled by the enterprise. There exists divergent opinion on the interrelation between creative accounting and firm size. Proponents of a negative relationship avers that large establishments have little earnings management because they can afford qualified and competent auditors with the capacity to detect and prevent earnings management. Moreover, these firms also have the ability to institutionalize internal controls thus reducing earnings management (Bassiouny et al., 2016; Roy & Debnath, 2015b & Ali et al., 2015).

The challenging view opines that large establishments are probable of managing earnings as in comparison to small enterprises. Proponents of this view avers that large enterprises have more compulsion to meet investors and analysts' predictions

and a such are more prone to manipulate data (Mahdi et al., 2012).The study conducted by Uwuigbe et al., (2014) ratified the assertions that big firms manage earnings more than small firms. This study found that accounting malpractices committed by large firms are overlooked by auditors because they have a higher bargaining power as compared to small firms which pay relatively insignificant audit fees.

2.3.2 Age of the Firm

The age of the firm is the number in years that an enterprise has been in operation since its inception (Almajali, Alamro & Al-Soub,2012).The enterprise Age is measured through the natural log of the actual age calculated from the year of incorporation (Bassiouny et al., 2016). Empirical evidence points towards a negative interrelation between age and EM. Bassiouny et al. (2016) found that older firms participate less in EM, this is attributable to stringent regulations placed on them and the need to win investor confidence. However newer firms in the same sector were found to have more cases of creative accounting. Young firms are in need of growing their company, they participate in EM in order to get access to credit. Moreover, they have to keep up with the pressures of analyst prediction. Any slight variation in the risk profile is more detrimental to a new firm than older firms. Hence Younger firms are more likely to participate in EM.

2.3.3 Performance

Roy and Debnath (2015a) identified profitability as one of the explanatory factors of earnings management. Their study found out that profitable firms have low levels of accounting malpractice as compared to less profitable firms. Proponents of a negative relationship postulate that profitable firms have an inclination towards producing

transparent financial reports because they would like to win stakeholder confidence. Ajit et al. (2013) also concluded that firms which underperform are likely to engage in creative accounting as compared to highly profitable firms

Contrary to the above explanation, there is empirical attestation supporting the notion of a positive relationship between profitability and creative accounting. Sadeghi and Zareie (2015) looked at the link between EM and key financial ratios and concluded that a rise in the profitability of the firm was linked with a rise in creative accounting. Additionally, Roy (2016) concluded that firms with moderate performance and better liquidity were less likely to participate in EM. Ajde and Aderemi (2014) proposes the application of return on capital as an accurate assessment of profitability.

2.3.4 Leverage

Leverage is the inclusion of debt funding in the capital composition of an organization. Leverage introduces both risk and opportunity to the company. It allows the company to take advantage of the opportunities they would not have taken given their current level of capital. It also introduces risk in the business since the debt holders can wind up the company should there be a default (Sadeghi & Zareie, 2015). Theoretically the inclusion of debt holders in the ownership composition is expected to reduce creative accounting. Selahudin et al. (2014) concluded that higher debt financing leads to increased monitoring from the lenders. These lenders are likely to impose restrictions on spending and control the process of financial reporting.

Empirically the results of Rahmani and Akbari (2013) found that the in inclusion of debt in the ownership composition leads to the presentation high quality financial statements. The outcome revealed that Iranian firms with more debt in their books showed low levels of creative accounting. While those without debt financing had

higher incidences of earnings management. However, Uwuigbe et al. (2014) looked at leverage as a controlling variable in their study and found out that the inclusion of debt holders in the capital composition of the firm leads to increased EM in Nigeria. Leverage is computed as a portion of the total assets financed by the long-term debt (Gill et al., 2013).

2.4 Empirical Review

This section deals with the analysis of past academic literature detailing the studies which link creative accounting to ownership composition. The studies reviewed in this section have looked at earnings management as a dependent parameter and ownership composition as the main independent parameter. The first part of this section deals with global studies where the empirical evidence has been collected from foreign countries. While the second part of this section deals with literature whose evidence has been collected from Kenya.

2.4.1 Global Studies

Alexander (2019) looked at creative accounting and ownership composition using the Indonesian listed manufacturing enterprises. The independent variables included components of ownership composition (managerial ownership, controlling ownership, institutional ownership, and foreign ownership). Secondary data was collected for three years from 2014 to 2016 all years inclusive from the financial statements. The research used purposive sampling approach to come up with 36 companies to be utilized in the research. Multiple linear regression methodology was utilized to test the hypotheses. The research concluded that ownership concentration and creative accounting has a positive relationship. This is because institutional owners are

interested in maximizing their wealth by exaggerating the earnings before offloading the shares to unsuspecting investors.

Moslemany and Demyana (2019) investigated the implications of ownership concentration on creative accounting. Evidence was drawn from the listed firms in Egypt, the independent parameter was earnings management exemplified by discretionary accruals. The dependent variables included the indicators of ownership composition (block holder ownership, public ownership and managerial ownership). Other control parameters include, return on assets, establishment's size, age of firm and market to book value. The OLS regression outcomes denote a rise in block holder ownership results to a rise in creative accounting. However managerial holdings and public holdings were found not to have any statistical relationship.

Ekpulu et al. (2018) explored the relation between ownership concentration and creative accounting. The modified jones model was used to compute the level of material falsification of accounting information in the financial statements. Their inquiry used longitudinal panel research methodology to select a sample of 75 listed enterprises in Nigeria. Secondary Data was gathered across a 6-year time-phase from 2009 to 2014. The paper used OLS regression methodology and that an increase in the managerial ownership results to a decline in material representation of financial facts. However, the research found that there is no link between foreign ownership and creative accounting.

Bao and Lewellyn (2017) looked at ownership composition and earnings management in developing economies. Secondary data was collected for five years from 2012 to 2016 all years inclusive. The panel data consisted of 1200 data points from 24 countries, fixed outcomes and random outcomes regression methodologies were

utilized in data analysis. The study drew conclusions on the presence of a statistically significant positive interconnection between EM and institutional ownership.

Saleem (2016) looked at ownership structure and earnings manipulation employing a sample of 62 enterprises listed in the Amman stock exchange. The study used expert judgement as a sampling technique to select the sample companies. The inquiry employed a mix of ordinary least square regression approach and generalized least squares to analyze the data. The research revealed that a growth in ownership concentration results to a decline in creative accounting. External bond holders, family holding and foreign holding were found to reduce manipulation of financial statements.

2.4.2 Local Studies

Ponsian and Waweru (2018) examined how corporate governance affect the quality of financial reporting. Evidence was collected from 48 listed firms in Kenya and Tanzania. A total of 480 observations was gathered over a 10-year period, from 2005 – 2014. The experimental variables include (board diversity, the frequency of board meetings, audit committee, enterprise size, and ownership concentration). The explanatory variable was discretionary accruals. The outcome concluded that institutional ownership increases creative accounting. These results affirm the assumptions of the bonus maximization theory and the passive hand hypothesis.

Outa et al. (2017) sought to ascertain if the implementation of the code of ethics as provided by CMA can reduce creative accounting. The inquiry used a panel data consisting of 338 observations from 38 nonfinancial enterprises listed at the Nairobi securities exchange. Collection of data was over a ten-year period from 2004 to 2014. The experimental variable was computed using discretionary accruals while the

independent variable include the corporate governance index. The control parameters included profitability, leverage, cash flow and return on asset. The study utilized the random effects regression methodology to scrutinize the data. The results indicate that corporate governance index does not have any statistically significant relationship with creative accounting.

Ngalaka (2017) looked at how corporate governance activities affect the quality of financial reporting in Kenya. Data was gathered from the entire 66 enterprises listed at the NSE as of December, 2016. Quality of financial statements was measured using a composite score comprising DA and the guidelines of the international financial reporting standards framework. The independent variables included the various constructs of corporate governance as provided by the capital markets authority. The inquiry utilized both qualitative and quantitative analysis. The outcome indicates that the corporate governance index had a positive impression on the quality of financial reporting. This implies that increased monitoring reduces the chances of EM in an organization.

Iraya et al. (2015) explored the interrelation between corporate governance index and creative accounting. Evidence was collected from a sample of 49 establishments which had been continually trading at Nairobi stock exchange between January 2010 and December 2012.The independent variables consisted of ownership concentration, size of board, CEO duality and board activity. Secondary data was scrutinized using the OLS regression methodology. The outcome of the OLS regression output indicated that that a rise in ownership concentration results to a decline in creative accounting. This study therefore affirms the assumptions of the agency theory.

Riro and Waweru (2013) explored the impression of company characteristics on EM in Kenya. The inquiry utilized panel data incorporating 148 data points drawn from 37 establishments listed at the Nairobi stock exchange. Secondary data was drawn over a four-year period, 2009-2012.The experimental variable was earnings management while independent variables included (ownership structure, establishment size, and leverage and establishment profitability). The inquiry drew conclusions that an increase in institutional ownership and block holder ownership results to an increase in creative accounting.

2.6 Summary of the Literature Review

The chapter looked at three sections, theoretical review, determinants of earrings management and past empirical literature. Three theories were reviewed, the assumptions of the agency theory avers that block owners increase the monitoring of the company's affairs. The increased monitoring leads to a reduction of financial malpractice and earnings management. Contrarily, the assumptions of the bonus maximization theory and the passive hand theory postulate that block owners are only interested in maximizing their profits. The theories therefore conclude that the block owners are likely to encourage earnings management to the extent that the practice maximizes their bonus.

The literature review indicates that there are both contextual and conceptual gaps. Contextually most of the studies which link EM and ownership composition are set in countries outside Africa with more complex financial reporting systems; Alexander (2019) looked at creative accounting and ownership structure in Indonesia, Bao and Lewellyn (2017) looked at the influence of ownership concentration on EM in 24 European countries while Saleem (2016) looked at the impression ownership structure

pose on the quality of financial reporting in Jordan. All these studies were set in developed economies, the current study is set in Kenya which is a developing economy therefore the results are expected to be different,

Additionally, most of the studies done in Kenya have concentrated on the influence of corporate governance on earnings management, these research have concentrated more on figuring out the impact of internal and external controls on reducing the chances of creative accounting. Iraya et al. (2015), Ponsian and Waweru (2018) and Ngalaka (2017) looked at how corporate governance activities affect the quality of financial reporting in Kenya additionally Outa et al. (2017) sought to ascertain if the implementation of the code of ethics as provided by CMA can reduce creative accounting. However empirical evidence shows that internal controls are not sufficient to reduce earnings management because even the board of directors can participate in earnings management. Therefore, there is a need to look at how the external monitoring through block and institutional owners affect creative accounting.

2.5 Conceptual Framework

The conceptual framework denotes a pictorial presentation of the relation between the dependent parameter (Earnings Management) and the independent variables (ownership structure). It also shows the relation between the dependent parameter and the independent parameters (firm size. profitability, age of the firm and Leverage) as illustrated in figure 2.1

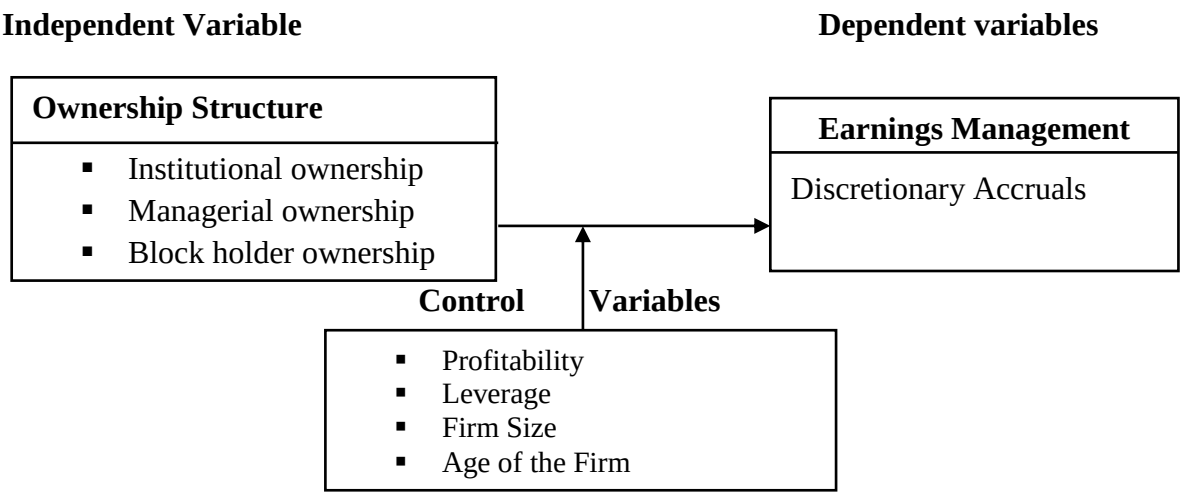

Figure 2.1: Conceptual Framework

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This section expounds the research techniques to be employed for the successful implementation of the research. The chapter discussed the various approaches of data collection, sampling technique which were used by the researcher. A brief description of the preferred research design was also discussed. The chapter also discussed how hypothesis was built and tested. Finally, the chapter discusses the appropriate regression methodology to be used and the relevant diagnostic tests conducted before the data was analyzed.

3.2 Research Design

Saunders and Thornhill (2016) described research design as detailed systematic, methodology of conducting academic research. The design provides a logical stepwise way of achieving the research objective. Mugenda and Mugenda (2003) defined it as a scientific approach followed by a researcher during the study. The plan details the number of things needed to be done for the research process to be successful. This study employs the use of descriptive research design to explore the relation between the explanatory variable and the experimental variable. This research design was appropriate because the variables under consideration had already occurred and the researcher needed to establish a connection between the dependent and the explanatory variables. Nyakiamo (2015) avers that descriptive research design is suitable where the variables under investigation have already occurred.

3.3 Target Population

A population is denoted as the total components that a researcher wants to make inferences about. Kothari and Garg (2014) on the other hand defined population a census enquiry or survey which involves the enumeration of all the items in a certain context. The study targeted to study the entire 44 non-financial establishments listed at NSE as per appendix 1.

3.4 Data Collection

The inquiry employed secondary data derived from financial statements, data about earnings management. Establishment size, financial performance and leverage were computed from the statement of cash flows, statement of financial position and the statements of comprehensive income. The age of the establishment was computed from the incorporation date as issued by the registrar of companies.

3.5 Diagnostic Tests

Diagnostic tests are undertaken to determine if the data set as collected by the researcher meets the necessary criteria for inferential statistics. These tests are designed to determine if the data set can be trusted upon to yield similar results if tests are done over time. Dawson (2007) proposed that normality tests, serial correlation and test on Homoscedasticity should be conducted before an inference is made about the data. These tests are done to confirm that the data is linearly distributed, the independent variables are not be related to each other and that there are no outliers in the data set. The research used skewness and kurtosis to test for normality, Durbin Watson test to assess auto correlation and the Breusch-Pagan test for Heteroscedasticity (Mugenda & Mugenda, 2003).

3.6 Data Analysis and Model/Presentation

The research utilized both descriptive and regression methodology to analyze the data. The descriptive statistics comprised of maximum value, standard deviation minimum value and mean. The study also looked at the correlation of the variables and the ordinary least square regression methodology to analyze the data and to make inference about the population.

3.6.1 Analytical Models

EM = α + β_1 Ownership structure + β_2 Profitability + β_3Firm Age + β_4Leverrage + β_5 Firm Size + ε

The regression equation therefore becomes;

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \varepsilon$$

Where;

Y = EM = Measured using the discretionary accruals (This paper used modified Jones model (1995) to assess discretionary accruals as a stand-in to assess earnings management.)

Equation 1 Modified Jones Model (1995) for measuring Discretionary Accruals

- DAi,t = (Accrual si,t)/TAi,t - NDA i,t

  Where

- DAi,t = Discretionary accruals for the ith cross section unit and time t.
- TAi,t-1 represents the total assets of ith cross section unit for the preceding year as represented as t-1 in subscript.
- NDAi, t represents the nondiscretionary accrual for the ith cross section unit for the year t. Given by the following formulae.

Equation 2 ; Modified Jones Model (1995) for measuring Non-discretionary accruals

$$NDA_t = \alpha_1\left(\frac{1}{A_{t-1}}\right) + \alpha_2\left(\frac{\Delta REV_t - \Delta REC_t}{A_{t-1}}\right) + \alpha_3\left(\frac{PPE_t}{A_{t-1}}\right)$$

Where

- NDAt = for non-discretionary accruals,
- ΔREVt = change in revenues
- ΔREC = changes in receivables for the year t with respect to year t-1.
- PPE = Change in the value of fixed assets for the year.
- α1, α2 and α3 are firm specific variables.

Total accruals = Net profit – cash flow from operations.

Equation 3: Modified Jones Model (1995) for measuring Total Accruals

TAt= NIt – CFO (1) where

- TAt = Total accruals for the year.
- Nit = Net profit for the year.

CFOt = Cash flow from operation

α = Constant Earnings management not affected by any other variable under consideration.

β_i, 1……5 = Regression coefficient of the Independent Variable

X_1 = Ownership Structure = (Percentage of shares owned by Institutional owners + percentage of shares owned by board members + percentage of shares owned by block owners).

X_2 = Profitability = Return on capital employed (Ordinary capital/Operating Profit).

X_3 = Firm Age = The natural log of the number of years since establishment.

X_4 = Leverage = The ratio of total assets funded by the long-term debt (Total long term debt/Total Assets).

X_5 = Firm size = Natural Log of total Non-current assets.

3.6.2 Test of Significance

The research employed one-tailed P-test for testing statistical significance of the individual explanatory variables on the variability of earnings management. To test the model's overall validity in explaining the earnings management, F-statistics was used at a 95% level of confidence and a 5% level of significance.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND INTERPRETATION

4.1 Introduction

This section presents the analysis of data based on the research objectives thereof, it denotes the descriptive statistics of the parameters, the correlation statistic and the computation of earnings management through utilization of the modified jones model. The section will also present the final regression results, the regression question and a section for discussing the results thereof.

4.2 Descriptive Statistics

The descriptive statistics shows the preliminary analysis of the data, it analyzes the mean, media, standard deviation, kurtosis, skewness, minimum and maximum values of the parameters. Table 4.1 displays the outcomes of the descriptive statistics

Table 4.1: Descriptive Statistic

	Profitability	Ownership Structure	EM	Size	Revenue
Mean	4.34	53.86	-0.05	103.80	81.54
Median	0.16	54.45	-0.03	4.99	3.42
Mode	149.05	97.00	41.86	11.92	1601.36
Std Deviation	32.26	30.74	21.37	423.91	342.24
Kurtosis	0.00	-1.25	0.00	0.00	0.00
Skewness	0.00	-0.01	0.00	0.00	0.00
Minimum	-229.09	0.97	-186.70	52.30	45.26
Maximum	193.49	68.81	164.34	3852.62	2544.63
Count	193	193	193	193	193

Source: Research Findings (2020)

The outcomes depict that net profit had a mean of 4.34 million this means that on average the non-listed firms at the NSE are averagely profitable. The maximum profit in this category of listed firms is 193.49 million while the minimum profit is a loss of 229.09 million. The mean ownership structure is 53.86 which means that on average

more than 50% of the companies' ownership is held by institutional investors, block shareholders and management shareholders. However minimum holding is 0.97 and the maximum institutional holding is 68.81%. The mean total accrual is -0.05, with a minimum of -186.70 and a maximum of 164.34. The average total asset is 103.8 million while the maximum value is 3852.62 and the minimum value is 52.3.The average revenue is 81.52 million while the maximum venue is at 2544.63 million and the minimum revenue is at 45.26 million. The kurtosis and skewness statistic shows that the data is symmetrical, which is an indicator that the data is normally distributed.

4.3 Correlation between Earnings Management, Ownership Structure, Age, Leverage and Size

The Pearson correlation is a preliminary analysis done to investigate the direction of association between two or more variables. Even though is does not show the relationship, it gives a direction of how the variables could be related. In this case table 4.4 depicts the correlation statistics between earnings management and ownership structure, Age, leverage and size of the company. The statistic is expounded as ensues, +/- 0-0.24 = no correlation, +/-0.25-0.49 = a weak correlation, +/-0.5-0.74 = moderate correlation and +/-0.75-1 = strong correlation.

Table 4.2: Pearson Correlation

	EM	Ownership Structure	Profitability	Age	Leverage	Size
EM	1					
Ownership Structure	0.832	1				
Profitability	0.890	0.834	1			
Age	0.155	0.106	0.160	1		
Leverage	0.219	0.146	0.193	0.800	1	
Size	0.757	0.847	0.799	0.158	0.117	1

Source: Research Findings (2020)

The outcomes denote that the correlation statistic for earnings management, ownership structure, profitability and size of the company is as follows 0.832, 0.890 and 0.757 respectively. This reveals existence of a strong positive correlation between the parameters because their correlation statistic is above 0.75. This is also an indication that the variables have a strong positive relation. However, Age and Leverage has no correlation with earnings management, their correlation statistic of 0.155 and 0.219 respectively show non-correlation between the variables. This is an indication that the variables have no statistical relationship.

4.4 Computation of Earnings Management Using the Modified Jones Model

This section shows how earnings management is computed the non-discretionary accruals (NDA) was calculated as follows. The independent variable (Total accruals/total assets of the preceding year) was regressed against the following variables; 1/lag total assets, PPE/Lag total assets and (change in Revenues – change in Receivables)/Lag total assets (Cohen & Zarowin, 2008).

4.4.1 Model Summary (Modified Jones Model)

The model summary provides the proportion of the non-discretionary accruals explained by 1/lag total assets, PPE/Lag total assets and (change in Revenues – change in Receivables)/Lag total assets.

Table 4.3: Model Summary

Model Summary	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.999a	0.998	0.998	0.345

a Predictors: (Constant), 1/TAi,(t-1), PPE/TAi, (t-1), (REV-REC)/TAi,(t-1),
b Dependent Variable: Non-Discretionary Accruals

Source: Research Findings (2020)

Table 4.3 depicts that 99.8% of the dependent parameter (Non-Discretionary Accruals) is illustrated by the selected predictors (Constant), 1/TAi,(t-1), PPE/TAi, (t-1), (REV-REC)/TAi,(t-1).This means that the model as set up explain the dependent variable exhaustively.

4.4.2 Analysis of Variance

On the other hand, the analysis of variance shows whether the model as set up is statistically significant or not; can the model be relied upon to predict non-discretionary accruals? If the F-value is more than 10 and or the Sig value is less than 0.05 then we deduce that the model is significant in expounding the changes in the dependent parameter (NDA).

Table 4.4: Analysis of Variance

ANOVA	Sum of Squares	Df	Mean Square	F	Sig.
Regression	3	19307.01	6435.670	53968.50	0.000
Residual	278	33.15	0.119		
Total	281	19340.16			

a Dependent Variable: Non-Discretionary Accruals
b Predictors: (Constant), 1/TAi,(t-1), PPE/TAi, (t-1), (REV-REC)/TAi,(t-1)

Source: Research Findings (2020)

Table 4.4 exhibits that the F value is greater than 10 while the Sig value is less than 0. 005. The research therefore concludes that the model is casuistically significant in justifying the changes in NDA. The study then proceeded to run the regression analysis to determine the various estimators of NDA.

4.4.3 Regression Model for the Computation of Non-Discretionary Accruals

The regression analysis shows the significance of the individual contributions of the independent parameters on the dependent parameters. A variable is presumed significant if the p value is below 0.05(alpha) otherwise it is deemed not significant.

Table 4.5: Regression Model for the Computation of Non-Discretionary Accruals

	Coefficients	Standard Error	t Stat	P-value
Constant	0.160	0.022	7.378	0.000
1/TAi,(t-1)	-577.945	1206.466	-0.479	0.032
PPE/TAi, (t-1)	-0.323	0.006	-51.686	0.000
(REV-REC)/TAi,(t-1)	0.046	0.011	4.191	0.000

Source: Research Findings (2020)

Table 4.5 illustrates that Constant, 1/TAi, (t-1), PPE/TAi, (t-1), (REV-REC)/TAi, (t-1) are all statistically significant variables in explaining the changes in the dependent variable. Their P values are less than 0.05, these coefficients were then used to calculate the value of NDA using the following equation

$$Y = \beta o + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \varepsilon$$

$$NDA = 0.160 - 577.95 x_1 - 0.323 x_2 + 0.046$$

This equation was used to calculate the value of NDA, the value of the NDA was then subtracted from total accruals to compute discretionary accruals (Discretionary accruals = Total Accruals -Non Discretionary Accruals).

4.5 Regression Analysis; Relationship between Earnings Management and Ownership Structure

This section presents the regression analysis between earnings management as computed above and the independent parameters under the study. The research applied ordinary least square regression methodology to gauge the impact of ownership structure, profitability, leverage, firm size and age of the firm on earnings management. This section has analyzed the proportion of the dependent variables illustrated by the independent parameters through the model summary. The statistical

significance of the model through the analysis of variance. Lastly it has presented the regression model and equation.

4.5.1 Model Summary

The model summary presents the fraction of the dependent variable illustrated by the explanatory variables collectively. This statistic investigates the impact of the explanatory variables as a team. Table shows the results of the model summary.

Table 4.6: Model Summary

Model Summary	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.913a	0.834	0.831	0.508

a Predictors: (Constant), ownership structure, Profitability, Leverage, Firm Size, Age of the Firm.
b Dependent Variable: Earnings Management

Source: Research Findings (2020)

The outcomes demonstrate that the r-square is 0.834, this means that 83.4% of the changes in earnings management is explained by ownership structure, profitability, leverage, firm size and age of the firm. These predictors explain a great proportion of the dependent variable hence further analysis can be done.

4.5.2 Analysis of Variance

The analysis of variance investigates whether the model as set out in the study is statistically significant. This statistic assesses whether the model is statistically significant or not. The study employed two tests to ascertain the significance of the model; The F-statistic and the Sig-statistic. The general rule for the two tests are as follows, the model is assumed to be significant if the calculated F-statistic is more than 10 and or if the Sig-statistic is less than 0.05.

Table 4.7: Analysis of Variance

ANOVA	Sum of Squares	Df	Mean Square	F	Sig.
Regression	5	355.94	71.19	276.37	0.000
Residual	276	71.09	0.26		
Total	281	427.03			

a Dependent Variable: Earnings Management
b Predictors: (Constant), ownership structure, Profitability, Leverage, Firm Size, Age of the Firm

Source: Research Findings (2020)

Based on the above rules table 4.4 exhibits that the F-statistic is 276.37, while the Sig-statistic is 0. 000. This signify that the model is statistically significant in expounding the changes in the dependent variables. The research can then proceed with further analysis.

4.5.3 Regression Model

The regression model shows the influence of the independent parameter on the dependent parameter. It depicts whether there is a statistical relation between the individual predictor parameter and the dependent parameter. The general rule to test the statistical significance is based on the significance level. At 95% level of significance the variable is deemed significant if the P-value is less than 0.05. Variables which are not significant are excluded from the regression equation as they cannot be relied upon to make statistical inference.

Table 4.8: Regression Model

	Coefficients	Standard Error	t-Stat	P-value
Constant	1.005	0.170	5.911	0.000
Ownership Structure	0.164	0.058	2.820	0.005
Profitability	0.302	0.023	12.991	0.000
Age	0.050	0.015	0.414	0.679
Leverage	0.001	0.153	0.003	0.997
Size	0.102	0.023	4.350	0.000

Source: Research Findings (2020)

$Y = \beta o + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \beta_4 x_4 + \beta_5 x_5 + \varepsilon$

$Y = 1.005 + 0.164\ x_1 + 0.302\ x_2 + 0.102\ x_5.$

Table 4.4 exhibits the findings of the regression analysis, constant has a coefficient of 1.005 and a p-value of 0. 000. This illustrates presence of a statistically significant positive constant earnings management; the earnings management which is not associated to any variable under the study. Ownership structure has a statistically significant positive association with earnings management since the p-value is <0.05; (B=0.164, 0.005).A unit increase in the ownership structure (the proportion of shares owned by institutional owners, managerial owners and block holder owners) results to a growth in earnings management by 0.164.

The outcomes also indicate that company profitability has a positive significant relation with earnings management (B= 0.302, 0.000). A unit increase4 in the profitability of the firm results to a growth in earnings management by 0.302 units. However, the age of the firm and the firm leverage has been established not to have any statistical association with earnings management. Their p-values are more than the minimum threshold of 0.05; 0.679 and 0.997, respectively. The study can therefore not interpret their coefficients. On the other hand, the size of the firm has been found to pose a statistically significant interconnection with earnings management (B= 0.102, 0.000). A growth in the size of the firm by one unit results to a growth in earnings management by 0.102 units.

4.6 Discussion of Research Findings

The results established a positive interconnection between ownership structure and earnings management. An increase in block holder ownership, institutional ownership and managerial ownership was found to increase earnings management. These outcomes postulate that institutional ownership encourages the application of earnings management. These results are in line with the assumptions of the bonus

maximization theory which postulates that managers are probable of participating in earnings management if their pay is pegged on the bonus they earn (Hearly, 1985). The theory also aver that institutional owners are likely to encourage aggressive accounting if by doing so they will gain from the marginal increase in the stock prices which is caused by the managed results (Cheng & Reitenga, 2009).

Additionally, the positive link between earnings management and ownership structure support the assumptions of the passive hand theory. this theory aver that, managers and institutional owners are more concerned with their self-interest; short term marginal gains in terms of dividends and increase in stock prices (Cheng & Reitenga, 2009). Institutional owners do not have a long term interest in the affairs of the company and are therefore less likely to invest in monitoring the affairs of the company thus the name passive hand. This is particularly true if they invest in a company for the purposes of capital gain. They may participate in EM in order to drive the share price and benefit thereof (Boulila, & Mbarki, 2014). Therefore, the positive results affirm these assumptions.

However, these findings contradict the assumptions of the agency hypothesis as proposed by Jensen and Meckling (1976). The hypothesis avers that managers if left on their own are likely to peruse their own wealth maximization goals as opposed to maximizing the wealth of the shareholders. Therefore, the theory proposed increased monitoring of the managerial action in order to align the management's goals to those of the shareholders. Zgarni (2016) found that one of the ways of enhancing monitoring in a company is the inclusion of institutional owners. These owners come with expertise and knowledge on organizational management. It is therefore expected that their inclusion in the board of directors is likely to increase the monitoring role and reduce aggressive accounting practices. However, the results found positive

results indicating that the inclusion of these owners actually do increase earnings management.

Empirically these results underpin the conclusions of Moslemany and Demyana (2019) found positive tie-up between earnings management and ownership structure in Egypt. They also support the findings of Alexander (2019) who investigated the relation between earnings management and institutional ownership in Indonesia and found a positive relation. These results also support the findings of Riro and Waweru (2013) who investigated firm characteristics and earnings management and found existence of a positive interrelation between concentrated ownership structures and earnings management. However, these results contradict the findings of Iraya, Mirie and Muchoki (2015), Saleem (2016) and Ekpulu, Godspower and Omoye (2018) who found a negative connection between concentrated ownership structures and earnings management.

The results also established a positive relation between profitability and earnings management. An increase in profitability was found to lead to an increase in earnings management. These outcomes confirm the conclusions of Sadeghi and Zareie (2015) who looked at the key factors contributing to earnings management and concluded that profitability had a positive association with creative accounting. However, the results contradict the findings of Roy and Debnath (2015a) who concluded an extant negative relation between profitability and earnings management. Their research found that profitable firms have a low inclination to manage earnings since they are already profitable. Moreover, they would want to maintain the investor confidence and are less likely to engage in financial malpractices such as earnings management which may impair the investor relationship (Ajit et al., 2013).

The research additionally established a statistically significant positive connection between the size of the establishment and EM. The bigger the firm the greater the propensity to participate in earnings management. These outcomes confirm the assertions that large establishments are more predisposed to manage earnings to meet the analyst and investors' prospects. Moreover, these firms have the capacity to arm-twist the external auditors to overlook earnings management since they pay high audit fees (Rahmani & Akbari, 2013 and Uwuigbe et al., 2014). However, these findings contradict the conclusions of Roy and Debnath, (2015b) and Bassiouny et al., (2016) who instituted a negative relationship between earnings management and the size of the company. These studies found that large firms have the financial muscle to hire competent auditors which are likely to help in identifying and inhibiting earnings management.

The outcomes revealed no significant link between age and earnings management. These result the findings of Bassiouny et al. (2016) who sought to explore the influence of firm age on EM and found a negative relationship. The results indicate that earnings management can happen to both newly formed companies and old companies well. The results also indicate non-existent relationship between leverage and earnings management. These findings contradict the notion that the debt holders increase surveillance in the company. Selahudin et al., (2014) concluded that higher debt financing leads to increased monitoring from the lenders. These lenders are likely to detect and prevent earnings management. However, the current study found no relationship between leverage and earnings management.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter details the summary of the research findings, the conclusions made therefrom and recommendations. The chapter also discusses the challenges faced during the investigation and how those challenges were resolved and finally the chapter looks at the recommendations for further studies.

5.2 Summary

The research attempted to find out the relation between ownership structure and earnings management of the non-listed financial establishments in Kenya. Other supplementary objectives include establishing the relation between earnings management and establishment size, age of the establishment, profitability of the establishment and capital structure. Data was gathered from financial statements of the 44 NSE listed non-financial companies. The inquiry employed SPSS to scrutinize the data through descriptive statistics (mean, median and standard deviation), correlation statistic and regression.

The ordinary least square regression methodology found that T 83.4% of the changes in earnings management is explained by ownership structure, profitability, leverage, firm size and age of the firm. The ANOVA statistics also concluded that the model was statistically significant in clarifying the changes in earnings management. The regression outcomes indicate existence of a statistically significant positive connection between earnings management and ownership structure. A growth in the concentration of ownership structure was found to lead to an increase in earnings management. The regression outcomes also indicated a positive relation between

profitability and earnings management. An increase in the profitability of the firms by one unit was found to increase aggressive accounting practices by one unit.

The study also found a positive interconnection between the establishment size and earnings management. An increase in the size of the establishment was found to increase earnings management by one unit. However, the study found no link between the age of the firm, leverage and EM. The outcomes also found that the assumptions of the bonus maximization theory and the passive hand hypothesis theory hold. Contrarily, the findings refute the assumptions of the agency theory.

5.3 Conclusions

The research concludes that there is a statistically significant positive tie-up between ownership structure and earnings management. An increase in ownership concentration was found to result to a growth in earnings management. The research thus concluded that institutional investors and block holders are short term investors who are only interested in the dividends gained and the marginal increase in stock prices. These types of investors therefore encourage the management to take part in earnings management to benefit from the marginal increase in stock prices. The study also concludes that the company's size is positively linked to earnings management. The larger the establishment the higher the propensity to participate in earnings management. The study therefore concludes that large firms use their string negotiation power to arm-twist the auditors to overlook inappropriate financial reporting.

Profitability of the firm was established to pose a positive relation with earnings Management. The study therefore concludes that profitable firms are under pressure to keep up with analyst's expectations and therefore they manage earnings to meet the analyst's predictions. The study found nonrelation between age of the establishment, leverage and earnings management. The study therefore concludes that debt holders in Kenya do not perform the monitoring role. Conventionally it is expected that debt holders would increase the monitoring role in a company, in this case they would minimize aggressive accounting practices in the company. However, the results show that there is no relationship hence we conclude that these debt holders have not taken up this role in the listed companies.

The study also concludes that the assumptions of bonus maximization theory and the passive hand theory hold. These theories aver that institutional investors and the block holder shareholders are short term profit seeking investors and as such they have no interest in the long-term goals of the organizations. These theories further postulates that the inclusion of these type of investors in the ownership structure is likely to increase earnings management to the extent that by doing so they are likely to increase their short-term profit maximization goals. Hence the positive results between EM and organization structure confirm these assumptions. However, the study concludes that the supposition of the agency theory does not hold. The theory assumes that the inclusion of institutional investors results to a rise in oversight role and therefore a decrease in aggressive accounting practices.

5.4 Policy Recommendation

The research found evidence suggesting that institutional owners do not enhance monitoring of the management. In fact, the evidence alludes to a possible collusion between internal management and the institutional owners to manage earnings. The study therefore recommends to CMA to increase its monitoring in companies whose ownership structures have institutional owners and block shareholders, this will help in safeguarding the interest of unsuspecting minority shareowners.

The results constituted a positive relation between the size of the establishment and earnings management. This means that larger firms have a higher propensity to participate in earnings management as compared to smaller establishments. The study therefore recommends that capital markets authority (CMA) should intensify its surveillance on big firms. This is because large firms control far much bigger shareholders interest as compared to smaller firms. Further the study proposes that the institute of certified public Accountants Kenya (ICPAK) should increase monitoring of the audits conducted on big firms. This is because large firms have the capacity to manipulate the auditors due to the high audit fees they pay. Therefore, ICPAK should act as an additional independent party to safeguard the interest of the shareholders.

5.5 Limitations of the Study

The study faced the following challenges, the first challenge was premised on the fact that the study was conducted in the middle of a pandemic Corvid 19, initially this looked like a big challenge because supervision of the research prior to the pandemic was overly physical. However, this problem was solved through the online supervision instituted by the university. Additionally, there was a data collection and validation challenge, prior to the pandemic one could walk to the various offices to

confirm or verify missing data either from the CMA offices of from the individual company offices. However, during the pandemic most of the offices were closed, the researcher resolved these problems by engaging the relevant officers using the available online tools.

The researcher also encountered the problem of collecting information about the age of the company. Some of the companies had not published their year of establishments. The researcher resolved this problem by calling the various company secretaries of these companies to confirm the year of establishment. The research also faced the challenge of collecting information about the ownership structure. Some companies had not published this information's researcher sought for this information from the company secretary.

5.6 Suggestion for Further Studies

The research found a positive interrelation between ownership structure and earnings management. The findings contradict the assumptions of the agency theory which posit that institutional investors and block shareholders increase monitoring in the company. Thus, the research proposes that a research be conducted to examine whether the inclusion of these investors lead to increased monitoring. Other studies should also be done to find out the characteristics of institutional investors in Kenya. This study will help to provide responses to the following questions about the institutional investors; are they long term or short term. Do they have the capacity and willingness to detect and deter earnings management?

The research established a positive link between the establishment's size and earnings management. This is an indication that the there is a possible collusion between the external auditors and the internal management. This research therefore implies that further inquiries should be carried out to reveal the interconnection between the

quality of external audit and earnings management in Kenya. The research further suggests that an independent investigation be done to determine if large firms can compromise the audit quality.

The study concluded the absence of a relation between leverage and earnings management. Nevertheless, there are several empirical evidence illustrating that the inclusion of debt increases monitoring and eventually reduces the chances of creative accounting. However, most of these studies have been done outside Kenya, the current research thus proposes that research should be undertaken to ascertain the interrelation between leverage and earnings management. The study also proposes that future studies be done to reveal the influence of ownership structure on earnings management evidence from the east African listed enterprises (Kenya, Uganda, Tanzania and Rwanda).This study will provide insights of how the various east African countries differ in the management of their organizations and financial reporting transparency.

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APENDIX: The list of listed Non-financial Companies in Kenya as at 31 December 2019.

#	Name	Code	Sector
1	Eaagads Ltd	EGAD	Agricultural
2	Kakuzi	KUKZ	Agricultural
3	Kapchorua Tea Kenya Plc	KAPC	Agricultural
4	Limuru Tea Plc	LIMT	Agricultural
5	Sasini Tea and Coffee Ltd	SASN	Agricultural
6	Williamson Tea Kenya Plc	WTK	Agricultural
7	Car and General (K) Ltd	CGEN	Automobiles and Accessories
8	Deacons (East Africa) Plc	DCON	Commercial and Services
9	Eveready East Africa Ltd	EVRD	Commercial and Services
10	Express Ltd	XPRS	Commercial and Services
11	Kenya Airways Plc	KQ	Commercial and Services
12	Longhorn Publishers Plc	LKL	Commercial and Services
13	Nairobi Business Ventures Ltd	NBV	Commercial and Services
14	Nation Media Group Plc	NMG	Commercial and Services
15	Sameer Africa Plc	SMER	Commercial and Services
16	Standard Group Ltd	SGL	Commercial and Services
17	TPS Eastern Africa (Serena) Ltd	TPSE	Commercial and Services
18	Uchumi Supermarket Ltd	UCHM	Commercial and Services
19	WPP ScanGroup Plc	SCAN	Commercial and Services
20	ARM Cement Ltd	ARM	Construction and Allied
21	Bamburi Cement Ltd	BAMB	Construction and Allied
22	Crown Berger Ltd	CRWN	Construction and Allied
23	East African Cables Ltd	CABL	Construction and Allied
24	East African Portland Cement Ltd	PORT	Construction and Allied
25	Kenya Electricity Generating Company Plc	KEGN	Energy and Petroleum
26	Kenya Power and Lighting Ltd	KPLC	Energy and Petroleum
27	Total Kenya Ltd	TOTL	Energy and Petroleum
28	Umeme Ltd	UMME	Energy and Petroleum
29	Centum Investment Company Ltd	CTUM	Investment

30	Home Afrika Ltd	HAFR	Investment
31	Kurwitu Ventures Ltd	KURV	Investment
32	Olympia Capital Holdings Ltd	OCH	Investment
33	Trans-Century Ltd	TCL	Investment
34	Nairobi Securities Exchange Plc	NSE	Investment Services
35	BAT Kenya Plc	BAT	Manufacturing and Allied
36	BOC Kenya Plc	BOC	Manufacturing and Allied
37	Carbacid Investments Plc	CARB	Manufacturing and Allied
38	East African Breweries Ltd	EABL	Manufacturing and Allied
39	Flame Tree Group Holdings Ltd	FTGH	Manufacturing and Allied
40	Kenya Orchards Ltd	ORCH	Manufacturing and Allied
41	Unga Group Ltd	UNGA	Manufacturing and Allied
42	Safaricom Plc	SCOM	Telecommunication and Technology
43	Stanlib Fahari Income-REIT	FAHR	Real Estate Investment Trusts
44	Barclays NewGold ETF	GLD	Exchange Traded Funds

Source (Business daily,2020)