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Does CEO narcissism matter? An examination of the relationship between board structure and earnings management in Kenya

Daniel Kipkirong Tarus and Fiona Jepkosgei Korir
Department of Accounting and Finance, Moi University, Eldoret, Kenya

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Abstract

Purpose – This paper examines how board structure influences real earnings management and the interaction effect of CEO narcissism on board structure-real earnings management relationship.

Design/methodology/approach – The authors used panel data derived from secondary sources from publicly listed firms in Kenya during 2002–2017. Hierarchical regression analysis was used to test the hypotheses.

Findings – The results indicate that board independence, board tenure and size have significant negative effect on real earnings management, while CEO duality positively affects real earnings management. Further, the interaction results show that CEO narcissism moderates the relationship between CEO duality and real earnings management.

Research limitations/implications – The results suggest that real earnings management reduces when boards are independent, large and comprising of long-tenured members. However, when the CEO plays dual role of a chairman, real earnings management increases. The authors also find that when CEOs are narcissists, the monitoring role of the board is compromised.

Originality/value – The study adds value to the understanding of how board structure and CEO narcissism influence the monitoring role of the board among firms listed at Nairobi Securities Exchange.

Keywords Board structure, CEO narcissism, Real earnings management, Kenya

Paper type Research paper

1. Introduction

Earnings management has generated considerable interest among scholars, industry practitioners, regulators and other stakeholders since the aftermath of global corporate frauds in the early 2000. It involves manipulation of earnings to create a more positive picture of a company's performance (Li and Hwang, 2019) and generally occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports either to mislead stakeholders or influence contractual outcomes that rely on reported financial statements (Dawar, 2014; Healy and Wahlen, 1999; Beasley, 1996). There is a general perception that managers practice earnings management opportunistically to maximize their own interest rather than shareholder interest. And, therefore, to mitigate this problem, agency theorists suggest mechanisms to extenuate such opportunistic behaviors which include

Since submission of this article, the following author had updated their affiliations: Daniel Kipkirong Tarus is at Rongo University, Rongo, Kenya.

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appointment of boards to provide oversight (Leuz and Wysocki, 2016; Fama and Jensen, 1983).

Although prior research have examined the relationship between board structure and earnings management, the findings remain mixed and inconclusive (Githaiga *et al.*, 2022; Goel and Kapoor, 2022; Chen *et al.*, 2015; Khalil and Ozkan, 2016; Abu-Dawleh *et al.*, 2022; Farrell *et al.*, 2013; Mather and Ramsay, 2006; Ahmad-Zaluki and Wan-Hussin, 2010; Iqbal and Strong, 2010). Given that some of these studies were conducted in developed markets, differences in contextual and institutional settings, culture and value systems as well as corporate governance frameworks could explain the inconclusive findings (García-Meca and Sánchez-Ballesta, 2009); therefore, there is need to reevaluate the implications of board structure and earnings managements in emerging markets. Some scholars have made a call for extending future studies to emerging markets because of its unique characteristics and, in particular, weak institutional and regulatory systems (Kontesa *et al.*, 2021; Lee *et al.*, 2023). Additionally, studies have not considered intervening variables as an avenue to address disparities in research findings. Building on the logic of upper echelons theory, the top executives and especially the CEOs affect corporate decision-making (Chatterjee and Hambrick, 2007; Hambrick and Mason, 1984) including financial reporting. Financial reporting presents a considerable opportunity to be influenced by CEOs because such reports entirely affect how the stakeholders perceive them. In line with this thinking, we argue that the personality of the CEOs has greater implications on firms' financial reporting. More specifically, we identified a more pronounced characteristic of the CEO narcissism because such CEOs have a high need for attention and praise as well as a strong desire to have their positive self-views reinforced (Petrenko *et al.*, 2016), and so influence financial reports of the firms they lead (Lin *et al.*, 2020). We, therefore, explored how CEO narcissism moderates the relationship between board structure and real earnings management.

Narcissism – an inflated, yet fragile self-concept of one's importance also called an exaggerated sense of self-esteem – is a personality trait associated with CEOs (Petrenko *et al.*, 2016). This trait often makes the CEOs aggressive and dominant over others and such CEOs are often driven by unyielding arrogance in making decisions (Cormier *et al.*, 2016). Studies have showed that CEOs with narcissistic tendencies are likely to "play loose" with the firms' financial position in order to shun remediation strategies and live in a fantasy world of delusion (Lin *et al.*, 2014). In other words, narcissistic CEOs make decisions that maintain a positive sense of self, engage in ego-defensive behavior and preserve their self-esteem, and as such, the financial reports of the firms they lead become an ideal setup to affirm their superiority (Cormier *et al.*, 2016). Although previous studies have investigated the relationship between boards and real earnings management (Kang and Kim, 2012; Garcia Osma, 2008), we extend this stream of research by examining the interaction role of CEO narcissism on financial reporting. We take cognizance of the fact that narcissistic CEOs have a domineering behavior that is likely to manifest in the board (Combs *et al.*, 2007) because studies have shown that they manage upward by flattering superiors (Chatterjee and Pollock, 2017) and so influence the ability of the board to ensure transparency, accuracy, completeness and disclosure of financial information (Zhang *et al.*, 2017). Indeed, Chen (2010) argues that major accounting scandals are largely associated with the unethical leadership of the CEOs. There are two reasons why CEOs influence financial reporting in a firm. First, financial accounting results act as a report card on the success and failure of a CEO (Amernic and Craig, 2010), and so a narcissistic CEO would report positive performance to preserve ego. Secondly, CEOs have the overall mandate of ensuring implementation and effectiveness of internal control systems (Lisic *et al.*, 2016) to control misreporting. Therefore, this study seeks to extend the existing body of knowledge on the role of a narcissist CEO in real earnings management literature in emerging markets, because studies have found narcissism to be culturally dependent (Chen, 2010) and often prevalent where collectivism and humility are less valued (Morris *et al.,* 2005). Most countries in emerging markets have narcissistic idiosyncrasies where there is heavy reliance on customs and values which largely favor the "big man syndrome," that is, leaders are held in high social status and even glorified, thus calling for empirical studies in this context.

Although extensive research has been done on earnings management in developed markets (Liu, 2020; Cornett *et al.*, 2009; Roychowdhury, 2006), there is paucity of research in emerging markets. Zimon *et al.* (2022) observed that country-specific factors, such as political, labor and cultural systems, significantly influence quality of firms' financial reporting. Studies have shown that the quality of accounting information generated by firms in emerging market is in doubt (Orazalin, 2020; Li *et al.*, 2014) and, as such, suggestions have been made for more research on earnings management in emerging markets (Kontesa *et al.*, 2021; Lee *et al.*, 2023). Drawing from institutions-based view, institutional structures serve to reduce uncertainties by establishing systems that facilitate economic interactions (Acemoglu and Robinson, 2012), and so organizational actions are influenced by existing institutional framework. Indeed, emerging markets are unique because they suffer from myriad institutional weakness such as lack of well-developed capital markets, weak investor protection mechanisms, concentrated ownership structures, government interference and weak value systems and cultures that often result in corrupt practices (Mangena *et al.*, 2012; Mak and Kusnadi, 2005; Chen, 2010), including lack of transparency in corporate reporting. We, therefore, study how corporate boards influence earnings management and the role of narcissistic CEOs in this relationship in Kenya.

The following is how this paper is organized: Section 1.1 describes the Kenyan context, Section 2 describes the theory and hypotheses development, Section 3 presents data and methods, Section 4 provides statistical analysis and Section 5 discusses and concludes the findings as well as the study's implications.

1.1 Kenyan context

With a gross domestic product (GDP) of $95 billion, Kenya is classified as a lower-middle-income country, which is ranked as the ninth largest economy in Africa, fourth in sub-Saharan Africa and is the dominant economy in the East Africa Community (EAC). Kenya is the commercial "gateway" and the economic and financial hub of East Africa region and stands at strategic location in the Eastern Africa serving five landlocked countries: Ethiopia, Uganda, Rwanda, Burundi and South Sudan. As a commercial hub of the region, Kenya has established institutions and enacted laws and regulations to promote good governance. Nairobi Stock Exchange (NSE) was established in 1954 to regulate trading in securities among the stockbrokers, which prior to that was largely unregulated. In 1990, Capital Markets Authority (CMA) was established through the Capital Markets Authority Act (Cap 485 A) to regulate capital market activities and facilitate an orderly and efficient capital market (Tarus and Ayabei, 2016).

At the outset of rise in global corporate frauds in early 2000, Kenya undertook measures to insulate itself against resurgence of corporate malpractices that threatened the existence of companies. It enacted Corporate Governance Code in the form of Sample Code of Best Practice of Corporate Governance, 2002, with the assistance of the Commonwealth Association for Corporate Governance and the Organization for Economic Corporation and Development (OECD). Largely, the provisions contained in the Code followed the Anglo-Saxon-based models of corporate governance, which required the boards to have a balance of both non-executive and executive directors, separation of roles of the chairman and CEO, establishment of audit committees, disclosing in the annual report the remuneration for the board and top management and providing a list of ten largest shareholders. These provisions had significant implications on the governance of listed firms; however, one weaknesses of the guidelines is that they did not specifically require a corporate governance report other than a mere disclosure and communication of various matters to shareholders (Waweru and Prot, 2018).

Kenya promulgated in a new constitution in 2010 that made significant provisions on good governance and the rule of law. The constitution established a new threshold and value system upon which the country operates; for example, Article 10 sets out the national values and principles of good governance, and Chapter six specifically deals with leadership and integrity. To operationalize the constitutional provisions contained in the Constitution of Kenya, 2010, the government has enacted and implemented several laws that deal with good governance, such as Leadership and Integrity Act, No. 19 of 2012, Public Officer Ethics Act, No. 4 of 2013, the Ethics and Anti-corruption Act, No. 22 of 2011 that addresses mechanisms to fight corruption, and Public Finance Management Act, No. 18 of 2012, which regulates the use of public finances.

Kenya embarked on its long overdue transition to a modern company and insolvency laws with the enactment of a new Companies Act, 2015, as well as Insolvency Act, 2015. The revised laws introduced a regime requiring substantial compliance and that companies are required to devote more resources in ensuring that their affairs are undertaken in accordance with laid down laws. Around the same time, the Corporate Governance Steering Committee issued a Draft Blueprint that proposes a series of actions to be undertaken to improve corporate governance in Kenya. The blueprint ranked the country low on accountability, investor protection, governance and general competitiveness. As a result of this, Kenya issued a revised Corporate Governance Guidelines, 2015, through the Gazette Notice No.1420 published in January 2016, to address emerging issues. The new code changed the "comply" or "explain" principle to "apply" or "explain". Unlike the "comply" or "explain" approach which requires companies to abide by the set standards or explain why they chose not to do so, the "apply" or "explain" corporate governance standards are recommendations on principles or practices rather than strict rules that companies are directed to abide (King Report III, 2009). This new approach based on principles recognizes that a satisfactory explanation for non-compliance will be acceptable in certain unique circumstances. The approach also requires boards to fully disclose any non-compliance with the code to stakeholders and include an assurance to move toward compliance. The revised code has introduced new requirements such as fixing a maximum period a director can serve in the board at 9 years, introducing mandatory professional training and development for directors, conducting frequent board evaluation, fixing the maximum age of directors at 70 years and recommending at least one of the Audit Committee members to hold a professional qualification in either accounting or auditing, among other provisions. The revised code has, therefore, moved corporate governance standards in Kenya one step closer to global standards.

Despite plethora of regulations, Kenya has continued to witness corporate failures largely attributed to poor governance, in particular, inefficient and ineffective boards (Iraya *et al.*, 2015; Outa and Waweru, 2016). Ernst and Young surveyed 100 Kenyan firms in 2018 and found that 53% of firms engaged in financial statement manipulation resulted in corporate failures. Some notable corporate failures include Uchumi Supermarket in 2006, CMC Motors in 2011, Imperial Bank in 2015, Chase Bank in 2016, Kenya Airways and Mumias. Although corporate failures abound, few studies have been conducted in Kenya. We find this quite surprising because governance challenges are attributed largely to such emerging markets that are characterized with institutional weakness. Kenya is replete with examples of frauds and corporate failures, and political interference with the way corporations are run, including the appointments of directors to these companies. We, therefore, study how board structure affects real earnings management, and the moderating role of a narcissistic CEO in Kenya.

2. Theory and hypotheses development

We explore the relationship between the board structure and real earnings management by drawing on the agency theory and the upper echelons theory. Agency theory posits that a firm is a nexus of contracts between the owners and the managers who are charged with utilizing the resources to generate wealth (Jensen and Meckling, 1976). It is based on the premise that agents have more information than the owners of capital (Adams, 1994), and so they may use this advantage to adversely affect the interest of the owners (Jensen and Meckling, 1976). The upper echelons theory, on the other hand, posits that corporate strategic choices and outcomes are determined by individual managerial background characteristics, especially the CEO (Chatterjee and Hambrick, 2007; Hambrick and Mason, 1984). Based on this perspective, financial accounting choices are key organizational outcomes for company's assessment by stakeholders, such as capital markets and investors (Plöckinger *et al.*, 2016), that can be opportunistically manipulated for the purpose of misleading the users, and so the CEOs may align their personal preferences on what the financial statements should reflect, which may influence the financial accounting choices and, subsequently, the level of earnings management.

2.1 The concept of earnings management

Earnings management involves use of judgment in the financial reporting and in structuring transactions largely to manipulate earnings with the intention of creating a positive picture of a firm's performance (Healy and Wahlen, 1999). It has received scholarly attention in the recent years because of the impact it has generated in the corporate scene. Earnings management is categorized into accruals earnings management and real earnings management (Roychowdhury, 2006). The accrual-based method is achieved by using discretionary accruals or modification of economic transactions to change the accounting appearance of reported performance, while real earnings management entails use of real activities with an intention to mislead the stakeholders to believe that the results reported in the financial statements are true and fair (Ferentinou and Anagnostopoulou, 2016). Real activities manipulation are management actions that deviate from normal business practices, primarily undertaken with the objective of meeting certain earnings target such as providing price discounts to boost sales, overproduction to reduce cost of goods sold and reduction of discretionary expenses (e.g. R&D, advertising and maintenance) (Roychowdhury, 2006). It involves restructuring of a firms' operations to boost current earnings (Ge and Kim, 2014). The use of these techniques varies across firms (Braswell and Daniels, 2017); for instance, manufacturing firms may increase production of stocks toward the end of the financial year, especially when the forecasted earnings are less than expected. The additional stocks result in less overheads per unit, resulting in a reduction in the cost of goods sold, which has the effect of increasing the reported earnings (Roychowdhury, 2006). Another approach involves deferring discretionary expenses, such as research and development, advertising and maintenance costs, to the next accounting period (Pacheco Paredes and Wheatley, 2017) in order to reduce the operating expenses for the year and, thereby, increase reported earnings. Investment decisions may also be used as a real earnings management tool which involves delaying capital projects resulting in deferring of expenses such as depreciation on fixed assets (Graham *et al.*, 2005). The results of deferring such depreciation expense are reduction of expenses and thus overcasting profits.

A more desperate approach of improving the reported earnings involves recording gains from selling profitable operating assets toward the end of the financial year with the aim of supporting the current stock prices (Braswell and Daniels, 2017). The investors are unlikely to know the purpose of such transactions and therefore unable to make the optimal investment decisions. Lastly, expediting increase in sales through offering more price discounts or more lenient credit terms (Sun and Lan, 2014) is used to manipulate earnings. Although such efforts may help the management portray increased performance, it may be useful in the short-term; however, investors with longer-term investment horizons may misprice stock prices based on the mistaken belief that the current period increase in sales revenue will be consistent over years.

2.2 Board independence and earnings management

One of the most important corporate governance mechanism is board independence, a term commonly used to refer to a director who is independent of the management and free from any business or other relationships which could interfere with the exercise of independent judgement or ability to act in the best interest of the shareholders (Davidson *et al.*, 2004). Proponents of independent directors rely on agency perspective, which suggests that boards should be populated with independent directors to enhance its monitoring role (Fama and Jensen, 1983) and possibly mitigate earnings management. Although this perspective is generally acceptable, the advocates of managerial hegemony theory argue that the independent directors' ability to effectively oversight the top management is dependent on the power of the CEO (Hashim and Devi, 2008), which is derived from its role in nominating board members.

The results of the relationship between board independence and earnings management are conflicting. While Peasnell *et al.* (2005) find empirical support for effective role of the independent directors in constraining earnings management in the US firms, others fail to find any association between board independence and earnings management (Bansal, 2021; Bradbury *et al.*, 2006). Some indicate that the effectiveness of the board is dependent on information flow (Duchin *et al.*, 2010). A study by Waweru and Prot (2018) found a positive relationship between earnings management and board independence in East Africa. They argued that boards in East Africa may be independent in form (structure) but not in substance (actual effectiveness), because of the presence of "gray" directors. Using a data set from Kenya, Outa *et al.* (2017) did not find any relationship between independent boards and earnings manipulation. Emerging markets present a unique setting for independent directors because of possible influence of political actors as well as high cost of information flow – a situation that has been found to affect the effectiveness of directors in mitigating earnings management (Chen *et al.*, 2020). In a meta-analysis of 36 studies, García-Meca and Sánchez-Ballesta (2009) indicated that board independence does not appear to be efficient in constraining earnings management in emerging markets because of how the directors are appointed, the interests they serve and the information asymmetry prevalent in this context. Outa *et al.* (2017) argued that independent directors may also be in such a minority on many boards that they are ineffective in the face of executive directors. This notwithstanding, independent directors are generally more vigilant and bring on board experiences, skills and knowledge that may prevent manipulative activities in the firm (Fama and Jensen, 1983; Nguyen and Nielsen, 2010). The requirement that the chairman of the audit committee must have accounting and financial background and should be independent provides more robust controls in presenting quality financial reports. We test the following hypothesis:

H1. Firms with more independent directors tend to have lower levels of earnings management.

2.3 Board tenure and earnings management

Board tenure, defined as the length of time board members serve in the board (Byrd *et al.*, 2010), can affect board's monitoring role. There are two conflicting perspectives regarding the effect of board tenure on its monitoring role. The first perspective is the belief that long-tenure board provides an effective oversight role as a result of experience, commitment and knowledge on financial reporting (Sun and Lan, 2014). This view suggests that long tenure enables the boards to acquire greater expertise and knowledge about the firm and its environment (Kor and Sundaramurthy, 2009), and the knowledge gained over time increases their monitoring capacity. A board with less familiarity with the firm and industry are more susceptible to the influence of top management. The second perspective draws its argument on the "friendliness hypothesis" which holds that long tenure breeds complacency since board members are more likely to develop friendly ties with managers whom they are supposed to monitor (Vafeas, 2003). Thus, long-tenured boards are more likely to tolerate bad behavior by CEOs, leading to earnings manipulations (Sun and Bhuiyan, 2020).

A number of studies examining the relationship between board tenure and earnings management have yielded mixed findings. For instance, some studies found a lower likelihood of financial reporting fraud in firms with long-tenured boards (Usman *et al.*, 2022; Beasley, 1996), while others found a positive relationship between earnings management and long-tenure board (Alquhaif *et al.*, 2021; Dhaliwal *et al.*, 2010). Kim and Yang (2014) investigated the relationship between board tenure and financial reporting quality among Korean firms. The results showed that the discretionary accruals decrease when the tenure of the board increases. Nugroho and Eko (2012), on the other hand, found that board tenure had no significant effect on earnings management. Although most of the studies suggest that long-tenure board is negatively associated with earnings management, empirical evidence on the effect of board tenure on real earnings management still remains unresolved. Hence, we test the following hypothesis:

H2. Firms with long-tenure boards tend to have higher levels of earnings management.

2.4 CEO duality and earnings management

CEO duality is a situation where the CEO holds two positions: the chairman of the board and a CEO (Farrell *et al.*, 2013). Scholars have labeled this form of leadership structure as a double-edged sword because the two roles held by the CEO increase decision-making power (Firth *et al.*, 2014). Agency theory suggests that if the interests of the chairman differ from that of the shareholders (Jensen, 1993), the dual roles of the CEO and chairman create opportunistic behaviors on the part of managers. Therefore, demarcation of duties may result in an efficient oversight of management actions (Fama and Jensen, 1983) because of the inherent checks and balances. In the absence of a clear boundary between the role of the chairman and the CEO, the monitoring function of the board over management may be at stake because the CEO has more discretion and predilection to manipulate financial reports (Nuanpradit, 2019). Stewardship theorists hold the view that CEO duality is an essential factor in unifying the leadership of the firm (Donaldson and Davis, 1991) in the sense that when the roles of the chairman and CEO are held by the same person, it will lead to unified corporate strategy (Abels and Martelli, 2013). Thus, this theory posits that firms with CEOs holding dual roles are likely to perform better than those with separate roles and are less likely to engage in manipulative activities such as earnings management (Ramdani and Witteloostuijn, 2010).

An examination of empirical studies reveals that scholars disagree on the impact of CEO duality on earnings management. As a result of these disagreements, some empirical evidence supports a positive relationship (Al Azeez *et al.*, 2019; Le and Nguyen, 2023), while others support a negative relationship (Alhmood *et al.*, 2023; Iraya *et al.*, 2015) and still others do not find any relationship (Alareeni, 2018; Chatterjee and Rakshit, 2023). The main argument is that CEO duality essentially bestows the CEO more power, which often leads to self-interest decisions at the expense of investors and other stakeholders. It essentially indicates that less control is likely to be exercised over management activities and behavior. The implication is there is a high likelihood of earnings management occurring in firms that has a CEO with dual roles. Hence, we postulate that:

H3. Firms with CEO duality tend to have higher levels of earnings management.

2.5 Board size and earnings management

Board size refers to the total number of directors serving in a board of an organization (Kent *et al.*, 2016), a characteristic that affects board effectiveness. Indeed, boards can become less effective in controlling management as board size increases due to problems of coordination and communication (Forbes and Milliken, 1999). Various theories have advanced different perspectives regarding the relationship between board size and corporate outcomes, for instance, resource dependency theory posits that increased board size may yield benefits to the firm by providing a network to the external environment and by securing a broader resource base, while agency theory postulates that the size of the board is an additional cost incurred to reduce the agency problems, and therefore, there is need for a trade-off between incremental benefits and costs (Jensen, 1993; Lipton and Lorsch, 1992).

Despite theoretical propositions, the results regarding the relationship between board size and earnings management are not so obvious. Some studies find a positive relationship (Alves, 2023; Githaiga *et al.*, 2022), others negative (Le and Nguyen, 2023; Yasser and Mamun, 2015; García-Meca and Sánchez-Ballesta, 2009), and in some empirical studies, no relationship is found (Ferris and Liao, 2019; Elghuweel *et al.*, 2017). Studies finding a negative relationship argue that larger boards have greater monitoring and oversight ability which reduces the likelihood of managers to manipulate earnings. In other words, large boards bring with it a pool of specialists with diverse skills, knowledge and experiences (Alareeni, 2018; Egbunike *et al.*, 2018) which possibly would help mitigate opportunistic activities.

Other studies find that large boards lead to escalation of agency problems, such as lack of proper coordination and communication in decision-making resulting in poor monitoring (Beiner *et al.*, 2004). These agency-related problems reduce the efficiency and effectiveness of the board to oversight and monitor the management (Bradbury *et al.*, 2006; Epps and Ismail, 2009), and therefore, smaller boards can be more effective in monitoring managerial behavior. Additionally, some empirical evidence indicate that larger boards can effectively reduce the likelihood of managers manipulating earnings through guidance from their cumulative knowledgeable and experienced board (Assenga *et al.*, 2018; Egbunike *et al.*, 2018). However, some studies support the argument that smaller boards constrain earnings management (Mersni and Ben Othman, 2016; Elghuweel *et al.*, 2017) because in smaller boards, individual members feel accountable to the board, and so take keen interest in board activities, including monitoring and reviewing financial reports. Therefore, the relationship between board size and earnings management remains unresolved, and so this study hypothesizes that:

H4. Firms with larger boards tend to have lower levels of earnings management.

2.6 Moderating role of CEO narcissism

Upper echelons theorists postulate that CEO experiences, values and personalities have a major influence on company decisions and outcomes (Hambrick and Mason, 1984; Hambrick, 2007). Recent studies have shown that CEOs' psychological traits influence financial outcomes such as financial reporting (Lisic *et al.*, 2016; Minichilli *et al.*, 2009). Although there are several traits, we focus on narcissism – a trait that has been found to influence CEO's decision-making (Petrenko *et al.*, 2016; Ham *et al.*, 2018). A growing body of evidence suggests that firms led by narcissistic CEOs suffer significant disadvantages (Chatterjee and Hambrick, 2007; Ham *et al.*, 2018; Rijsenbilt and Commandeur, 2017) because such CEOs are self-centered, domineering, have unyielding arrogance, engage in ego-defensive behavior and avoid failures in what they do in order to preserve their reputation or possibly boost performance-based compensation (Amernic and Craig, 2022; Ham *et al.*, 2017).

Theoretically, narcissistic CEOs may identify with the company they lead and, as a result, may take advantage of existing accounting measures to gain shareholder admiration (Zimon *et al.,* 2022). Specifically, narcissist CEOs have a high need for attention and praise as well as a strong desire to have their positive self-image reinforced (Cragun *et al.*, 2020; Ham *et al.*, 2017). Therefore, CEOs who exhibit high narcissistic tendencies are more likely to misreport for several reasons: first, narcissist are characterized by excessive self-focus and self-entitlement; as a result, they are likely to take actions that benefit them at the expense of others (Buchholz *et al.*, 2020); second, they tend to be more exploitative and believe that rules do not apply to them, and so are more likely to violate explicit rules and break social contracts Capallo *et al.* (2017); third, they are domineering in decision-making processes and are less willing to take advice from others. In some instances, they violate controls inherent in the organization, or even design systems that perpetuate their goals (Ham *et al.*, 2017).

Some narcissistic CEOs prefer to hire employees who are less likely to be effective monitors, preferably those that are younger, of lower status and less experienced (Chatterjee and Pollock, 2017; Combs *et al.*, 2007), as an avenue to extenuate their domineering behavior. Therefore, the high sense of entitlement, willingness to exploit others, need for recognition and domination in decision-making by narcissistic CEOs are reflected in financial misreporting (Capallo *et al.*, 2017). The domination by the CEO implies that the monitoring role of the board is compromised. It has also been found that narcissistic CEOs are less willing to take advice from others, because they consider themselves as highly intelligent and superior in their ability to control the business environment (Campbell *et al.*, 2004), and so the effectiveness of the independent directors in decision-making, including the quality of financial reports, may not be achieved. It is hypothesized that:

H5a. Narcissistic CEOs moderate the relationship between board independence and real earnings management such that at high levels of CEO narcissism, less independent boards are likely to engage in real earnings management.

Research has also indicated that a dual CEO has implication on earnings management. A narcissistic CEO who doubles up as a chairman is likely to extenuate earnings management in the firms they lead. Drawing from agency theory, managers generally pursue opportunistic interests in decision-making, and therefore, without proper mitigation measures, management are likely to maximize their own interest rather that shareholder benefit (Jensen and Meckling, 1976). A narcissist seeks continuous affirmation of their inflated self-view by exhibiting superiority, devaluing others and reacting aggressively to any criticism (Zhu and Chen, 2015a, b), and so a narcissistic CEO who is also the chairman will certainly push his or her agenda including manipulating earnings because of diminished monitoring and oversight by the board. A narcissistic CEO is a "know it all" manager, and given the position as a chairman who sets and directs the board agenda and discussions, may jeopardize the effectiveness of the board (Uppal, 2020). Given that such CEOs dominate and have arrogance laced in their management style, there is a high likelihood of earnings management in the firm. We hypothesize as follows:

H5b. Narcissistic CEOs moderate the relationship between dual CEOs and real earnings management such that at high levels of CEO narcissism, dual CEOs are likely to engage in real earnings management.

Board tenure has been found to have implications on the effectiveness of the board (Tarus and Ayabei, 2016). Drawing from friendliness hypothesis, Vafeas (2003) posited that long-tenured boards face a danger of establishing friendly relationships with management, thereby reducing their monitoring power. Byrd *et al.* (2010) also proposed "allegiance hypothesis," suggesting that long-tenured boards tend to shift allegiance away from the shareholders and toward management. A narcissist CEO, who has an exaggerated sense of self-importance and tries to present a positive sense of self, is likely to befriend boards the longer they stay in the board. Such CEOs always try to portray a positive image of the firm and carry themselves as intelligent and superior in their ability to manage (Campbell *et al.*, 2004). This confidence portrayed by the CEO is likely offer comfort to the board, and so reduce scrutiny of the decisions they make. The reduced board scrutiny increases the likelihood of financial misreporting. Therefore, we hypothesize that:

H5c. Narcissistic CEOs moderate the relationship between board tenure and real earnings management such that at high levels of CEO narcissism, long-tenure boards are likely to engage in real earnings management.

The debate on the size of the board has continued to intensify; however, in this study, we argue that a narcissist CEO is likely to influence a larger board as opposed to a smaller board because of challenges of coordination and communication (Forbes and Milliken, 1999). The agency-related problems affect the efficiency and effectiveness of the board in monitoring management (Bradbury *et al.*, 2006; Epps and Ismail, 2009), especially in a situation where the firm has a narcissistic CEO. Such CEOs are likely to take advantage of the challenges of the board and take the lead in decision-making. We, therefore, argue that firms led by narcissistic CEOs and characterized by larger boards are more likely to engage in earnings management, largely because of weak monitoring power.

We hypothesize that:

H5d. Narcissistic CEOs moderate the relationship between board size and real earnings management such that at high levels of CEO narcissism, larger boards are likely to engage in real earnings management.

3. Methods and data

3.1 Data sources

We used data from listed firms at the NSE for the period 2002–2017. In total 51 firms were used in the study, giving 816 firm-year observations. We collected data for the variables from various sources. Data on boards were collected from the company's financial reports under the "Board of Directors" and "Corporate Governance Report" sections, while information on real earnings management and control variables was obtained from the published financial statements. These data were generated using content analysis, which has been hailed as the most comprehensive and informative method for obtaining information from company websites and annual reports (Prado-Lorenzo *et al.*, 2012).

3.2 Measurement of variables

3.2.1 Independent variables. We measured board independence as a percentage of seats held by unaffiliated directors (Tarus and Ayabei, 2016). Board tenure was measured using the number of years each board member has spent in the firm as a director (Hu *et al.*, 2015). Since some directors may have spent less than a year in the company, we calculated tenure on a monthly basis, which was then converted to yearly equivalence by taking into consideration board members who have served for less than one year (Tarus and Aime, 2014). Following prior research, we measured CEO duality as a dummy variable set to 1 if the CEO is also the chairman, otherwise 0 (Abed *et al.*, 2011). Board size refers to the total number of directors serving in the board of a firm (Kent *et al.*, 2016). We measured board size by counting the number of individuals serving as a board member (Uyar *et al.*, 2021).

3.2.2 Dependent variable. Following the approach used by Al-Amri *et al.* (2017), we measured real earnings management using abnormal cash flow from operations, abnormal discretionary expenses and abnormal production.

We estimated normal cash flows, production and discretionary expenses using the following regression equation:

$$CFO_{it}/TA_{it-1} = a_0 + a_1(1/TA_{it-1}) + a_2(SALES_{it}/TA_{it-1}) + a_3(\Delta SALES_{it}/TA_{it-1}) + \varepsilon_{it} \tag{1}$$

Where CFO is cash flows from operations; $SALES_t$ is sales; TA_{t-1} is total assets at the beginning of the year; and $\Delta SALES_t$ is changes in sales.

After estimating the parameters in equation (1), $ACFO_t$ is measured as the difference between the ratio of the actual values of cash flows from the operating activities to total assets and the estimated value of equation (1). Since the signed value of abnormal cash flows from operations decreases with sales manipulation, a high value of $ACFO_{it}$ indicates low real earnings management.

$$DISX_{it}/TA_{it-1} = a_0 + a_1(1/TA_{it-1}) + a_2(SALES_{it-1}/TA_{it-1}) + \varepsilon_{it} \tag{2}$$

where:

$DISX_t$ is discretionary expenses; and $SALES_{t-1}$is lagged sales

The second measure of real earnings management is abnormal discretionary expenses (ADISX*it*), which is obtained using the residual value of equation (2). Discretionary expenses is a sum of selling, general and administration expenses, advertising and research and development expenses (Al-Amri *et al.*, 2017; Ferentinou and Anagnostopoulou, 2016; Pacheco Paredes and Wheatley, 2017). Hence, abnormal discretionary expenses is the difference between the ratio of the actual value of discretionary expenses to total assets, and the estimated values of discretionary expenses derived from equation (2).

Since a reduction of discretionary expenditures results in lower values of abnormal discretionary expenses, a high value of ADISX*it* reflects lower real earnings management.

$$\begin{aligned} PROD_{it}/TA_{it-1} = a_0 + a_1(1/TA_{t-1}) + a_2(SALES_{it}/TA_{it-1}) + a_3(\Delta SALES_{it}/TA_{it-1}) \\ + a_4(\Delta SALES_{it-1}/TA_{it-1}) + \varepsilon_{it} \end{aligned} \tag{3}$$

where $PROD_t$ is production cost; and $\Delta SALESt-1$ is lagged change in sales.

The third measure of real earnings management is abnormal production cost, which is measured as the residual value of equation (3). Production cost is the cost of goods sold (COGS) (Sun and Lan, 2014). The abnormal production cost is given by the ratio of the actual production cost to total assets minus estimated values of production cost derived from equation (3). A high value of APROD indicates high real earnings management because overproduction leads to higher value of abnormal production costs.

Finally, to achieve a comprehensive measure of REM, the three indicators of abnormal cash flow from operations, abnormal discretionary expenses and abnormal production costs are combined into a single indicator as suggested by Ferentinou and Anagnostopoulou

(2016). This measure is calculated by multiplying ACFO and ADISX by (−1) so that the larger their value, the higher their upward REM, and then adding together all resulting amounts plus the value of APROD to derive one single comprehensive measure of REM. The multiplication of ACFO and ADISX by (−1) is justified given that lower values of ADISX and ACFO indicate higher upward REM, while higher values of APROD indicate higher upward REM (Al-Amri *et al.*, 2017).

3.2.3 Moderating variable. We followed the approach of Chatterjee and Hambrick (2007) to measure narcissism using unobtrusive indicators collected from the audited financial statements. Due to data limitation, we used the prominence of the CEO's photograph in the company's annual report and the use of the first-person's singular pronouns in the CEO's report. We also employed an additional indicator by Tang *et al.* (2018) using the number of formal titles of the CEO. The company's annual report provides an opportunity for the CEO to report on the company's prospects but also to showcase himself or herself as a firm leader. It is expected that a narcissistic CEO will seek a great deal of visibility in the annual report as a declaration that he/she is more important than others in the firm (Chatterjee and Hambrick, 2007). We, therefore, adopted Chatterjee and Hambrick's (2011) 4-point scale of the prominence of the CEO's photograph in the company's annual report as follows: 4 points if the CEO's photo is of him/her alone and occupies more than half a page; 3 points if the photo is of the CEO alone and occupies less than half a page; 2 points if the CEO is photographed with one or more fellow executives; and 1 point if there is no photograph of the CEO. The level of narcissism was determined as a ratio of the number of points attained to the total number of possible outcomes.

We also used speech, a form of expressive behavior reflecting the most dominant personality trait of an individual (O'Reilly *et al.*, 2018), to measure narcissism. The use of first-person singular pronouns in the CEO's report is an indicator of self-absorption. The use of first-person's singular pronouns was adapted from Capallo *et al.* (2017), which was measured as a ratio of the first-person singular pronouns to total first-person pronouns in the CEO's report calculated as follows:

$$\frac{\sum_n (I, me, mine, myself)}{\sum_n (I, me, mine, myself, we, us, our, ourselves)}$$

The number of formal titles was defined as the number of official titles a CEO has, as indicated in the annual reports. Prior studies show that narcissistic CEOs would wish to be recognized by a number of titles – a sign of superiority (Tang *et al.*, 2018). Following Tang *et al.* (2018), the ratio of formal titles of the CEO is given by the total number of official formal titles of the CEO divided by total number of official formal titles of all top-level management. We developed a narcissism index following the approach of Chatterjee and Hambrick (2007).

3.2.4 Control variables. We controlled for variables that have been found to influence earnings management. Firm size measured as the natural log of total value of firm assets (Sun and Lan, 2014) was controlled. Studies have shown that large firms are less likely to engage in manipulation of earnings because such firms attract more attention among stakeholders than small firms; for instance, they are more exposed to regulators such as tax authorities, and so are unlikely to select accounting policies that tend to lower profits. We also controlled firm performance measured using return on equity because there is evidence to suggest that firm performance determines the level of earnings management (Mostafa and Ibrahim, 2019; Lee *et al.*, 2006).

3.3 Model specification

We used the following analytical models to test our hypotheses.

$$\mathrm{Re}m_{it} = \beta_0 + \beta_1 Firsize_{it} + \beta_2 Firper_{it} + \varepsilon_{it} \quad \text{(Model 1)}$$

$$\mathrm{Re}m_{it} = \beta_0 + \beta_1 Firsize_{it} + \beta_2 Firper_{it} + \beta_3 Boinde_{it} + \beta_4 Boten_{it} + \beta_5 CEOdual_{it} + \beta_6 Bosize_{it} + \varepsilon_{it} \quad \text{(Model 2)}$$

$$\mathrm{Re}m_{it} = \beta_0 + \beta_1 Firsize_{it} + \beta_2 Firper_{it} + \beta_3 Boinde_{it} + \beta_4 Boten_{it} + \beta_5 CEOdual_{it} + \beta_6 Bosize_{it} + \beta_7 Ceonarc_{it} + + \beta_8 Boinde^{*} Ceonarc + \beta_9 Boten^{*} Ceonarc + \beta_{10} CEOdual^{*} Ceonarc + \beta_{11} Bosize^{*} Ceonarc + \varepsilon_{it} \quad \text{(Model 3)}$$

Where *Rem* (real earnings management); *Boinde* (board independence); *Boten* (board tenure); *CEOdual* (CEO duality); *Bosize* (board size); *Ceonarc* (CEO narcissism); *Firsize* (firm size); *Firper* (firm performance).

4. Empirical results

4.1 Descriptive statistics

The mean and standard deviation are presented in Table 1. The results show that 82.1% of the board members were independent, while board members serve an average of approximately 11 years in the firms they lead. The average number of members in the board is 9, and 40.9% of the CEOs of firms under consideration in the study exhibit narcissistic traits.

4.2 Correlation results

We performed correlation analysis among the variables; the results indicate that board independence is negatively correlated with real earnings management ($r = -0.120, p < 0.05$), suggesting that board independence is related to lower earnings management. Board size also is also negatively correlated with real earnings management ($r = -0.185, p < 0.05$), suggesting that a larger board is related with lower earnings management possibly due to diversity of skills and knowledge inherent in largeness. CEO duality is positive and significantly correlated with real earnings management ($r = 0.164, p < 0.05$), indicating that dual CEOs are related with higher earnings management. CEO narcissism also indicated a positive and significant correlation with real earnings management ($r = 0.200, p < 0.05$), suggesting that higher levels of CEO narcissism is related with higher earnings management.

Stats ($n = 708$)	Mean	SD	Min.	Max.
Real earnings management	0.055	0.577	−3.35	4.77
Board independence	0.821	0.163	0.133	2.2
Board tenure	10.922	1.318	3.5	14.53
CEO duality	0.015	0.124	0	1
Board size	9.369	2.76	0	17.93
Firm size	16.269	1.818	10.716	20.28
ROE	0.22	0.136	−0.662	0.336
CEO narcissism	0.409	0.142	0.112	0.851

Source(s): Table created by the authors

Table 1.
Descriptive statistics

Variable	1	2	3	4	5	6	7	8
1. Real earnings management	1							
2. Board independence	−0.120*	1						
3. Board tenure	−0.056	0.075*	1					
4. CEO duality	0.164*	0.169*	−0.015	1				
5. Board size	−0.185**	−0.163*	−0.277*	−0.145**	1			
6. CEO narcissism	0.120*	0.023	0.043	0.020	−0.144*	1		
7. Firm size	0.167*	−0.152*	−0.014	−0.020	0.376*	0.126*	1	
8. Financial performance	−0.232**	0.015	0.134*	0.020	−0.011	−0.115*	−0.007	1

Note(s): **Correlation is significant at 0.01 level; *significant at 0.05 level (two-tailed). N = 816
1, real earnings management (REM); 2, board independence; 3, board tenure; 4, CEO duality; 5, board size; 6, CEO narcissism; 7, firm size; 8, financial performance
Source(s): Table created by the authors

Table 2.
Correlation results

The correlation between board tenure and earnings management is negative but not significant (see Table 2).

4.3 Regression analysis

We tested the model using moderated regression analysis. Our empirical approach can potentially be affected by endogeneity problem and, therefore, consistent with other studies we mitigated the likelihood of reverse causality using lags where the dependent variable was measured at time t, while the independent and interaction variables were measured at time t–1 (Lee *et al.*, 2023). The results for testing the hypotheses are shown on Table 3. Model 1 contains the results of regression analysis incorporating only the control variables. The results shows that as firms increase in size, they tend to engage more in real earnings management as compared to small firms ($\beta = 0.054, p < 0.05$). This is contrary to the findings of previous studies, indicating that large firms are more visible to stakeholders and regulators, thus minimizing earnings management. We believe that real earnings management is practiced by large firms because real earnings manipulation is harder to detect (Ge and Kim, 2014) and has more payoff if it goes undetected. Consistent with other studies, we find better performing firms tend to engage less in real earnings management as compared to those that are underperforming ($\beta = -0.726, p < 0.05$).

The second model examined the effect of board structure on real earnings management. Hypothesis 1 predicted a negative and significant relationship between board independence and real earnings management. The results supported this proposition ($\beta = -0.234; p < 0.05$), implying that independent boards appear to be an efficient mechanism in constraining real earnings management in Kenya. Hypothesis 2 postulated that a positive and significant relationship exists between board tenure and real earnings management. The results indicated a negative and significant relationship ($\beta = -0.319; p < 0.05$). Thus, the results failed to support the hypothesis. The probable reason is that long-tenured boards tend to accumulate the experience, expertise and skill base – a necessary ingredient in performing their monitoring and advisory role, and therefore offers the board requisite firm-/industry-specific knowledge that can help monitor financial reporting processes effectively. Long-tenure also helps the board to form social ties necessary for consultation and sharing of information among themselves, which is key in effective monitoring of management. Hypothesis 3 postulated a positive and significant relationship between CEO duality and real earnings management. The results support the proposition ($\beta = 0.643; p > 0.05$) and are consistent with the agency perspective suggesting that agents pursue their personal interests

Table 3.
Regression results

Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Intercept	−0.243* (0.038)	−0.249* (0.018)	−0.255** (0.010)	−0.209* (0.041)	−0.267** (0.008)	−0.257** (0.009)	−0.267** (0.008)	−0.209* (0.041)
Controls								
Firm size	0.054** (0.000)	0.054** (0.000)	0.053** (0.000)	0.052** (0.000)	0.053** (0.000)	0.052** (0.000)	0.053** (0.000)	0.053** (0.000)
Firm performance	−0.726** (0.000)	−0.726** (0.000)	−0.699** (0.000)	−0.705** (0.000)	−0.699** (0.000)	−0.686** (0.000)	−0.692** (0.000)	−0.707** (0.000)
Main effects								
Board independence		−0.234** (0.000)	−0.23** (0.000)	−0.28** (0.000)	−0.228** (0.000)	−0.208** (0.000)	−0.205** (0.000)	−0.263** (0.000)
Board tenure		−0.319** (0.005)	−0.018** (0.005)	−0.219** (0.004)	−0.118** (0.006)	−0.039** (0.004)	−0.119 ** (0.004)	−0.019** (0.004)
CEO duality		0.643** (0.008)	0.938** (0.01)	0.515** (0.010)	0.649** (0.009)	0.734** (0.001)	0.939** (0.001)	0.944** (0.001)
Board size		−0.035** (0.000)	−0.032** (0.000)	−0.033** (0.000)	−0.032** (0.000)	−0.032** (0.000)	−0.033** (0.000)	−0.033** (0.000)
Moderating variable								
CEO narcissism			0.014* (0.027)	0.02 (0.141)	−0.001 (0.947)	0.014** (0.000)	0.014 (0.113)	0.009* (0.045)
Interactions								
Board independence*CEO narcissism				−0.012† (0.086)				−0.201* (0.037)
Board tenure*CEO narcissism					0.001 (0.369)			0.002 (0.330)
CEO duality*CEO narcissism						0.539 (0.003)**		0.523 (0.004)**
Board size*CEO narcissism							0.101† (0.079)	0.107* (0.043)
Summary statistics								
Chi-square	133.40** (0.000)	179.56** (0.000)	217.99** (0.000)	204.55** (0.000)	232.85 (0.000)	222.89 (0.000)	239.1 (0.000)	241.41** (0.000)
Likelihood ratio change (LR)		16.61** (0.002)	26.51** (0.000)	−8.76 (1.000)	−0.8 (1.000)	8.48** (0.004)	−3.76 (1.000)	17.40** (0.003)
AIC (Akaike's information criterion)	301.199	292.588	268.079	278.843	270.883	261.6	267.356	285.193
BIC (Bayesian information criterion)	542.406	552.000	532.042	547.357	539.397	530.114	540.421	547.360

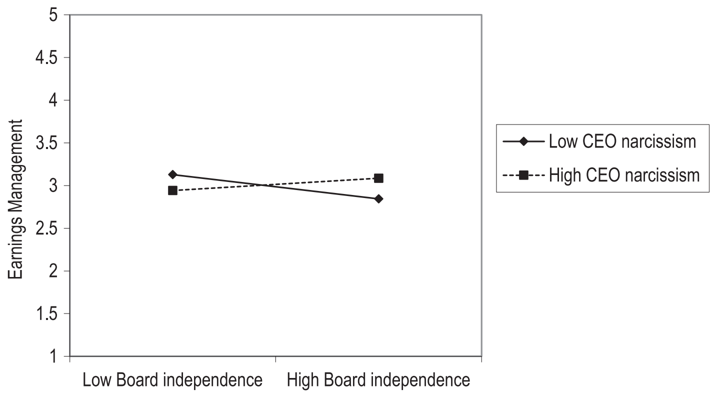
Note(s): **Significant at the 0.01 level; *significant at the 0.05 level; †significant at 0.1. level. The *p*-values are reported in parentheses
Rem (real earnings management); *Boinde* (board independence); *Boten* (board tenure); *CEOdual* (CEO duality); *Bosize* (board size); *Ceonarc* (CEO narcissism); *Firsize* (firm size); *Firper* (firm performance)
Source(s): Table created by the authors

as opposed to that of shareholders (Jensen and Meckling, 1976) and so engage in real earnings management opportunistically for short-term gains, such as performance-based compensation. Hypothesis 4 predicted a negative and significant relationship between board size and real earnings management. The results support the proposition ($\beta = -0.035$; $p < 0.05$). This implies that larger boards are effective in constraining real earnings management. A possible explanation for this might be that larger boards may have a pool of experienced and knowledgeable members to provide effective oversight role. Additionally, larger boards may have more independent directors with corporate and financial expertise that is required to control financial reporting malpractices.

Models 3–8 test the interaction effect of CEO narcissism on the relationship between board structure and real earnings management. Hypothesis *5* (a) postulated that narcissistic CEOs moderate the relationship between board independence and real earnings management such that at high levels of CEO narcissism, independent boards reduce real earnings management. Our results supported this proposition ($\beta = -0.201$; $p < 0.05$). Hypothesis *5* (b) predicted that narcissistic CEOs moderate the relationship between CEO duality and real earnings management such that at high levels of CEO narcissism, dual CEOs are likely to engage in real earnings management. Our results support the proposition ($\beta = 0.523$; $p < 0.05$). The results suggest that a narcissist CEO who also chairs the board is likely to engage in earnings management in order to reinforce a positive sense of self-image, enhance their feeling of superiority and attract attention and praise. Hypothesis 5 (c) postulated that narcissistic CEOs moderate the relationship between board tenure and real earnings management such that at high levels of CEO narcissism, long-tenure boards are likely to engage in real earnings management. The results were positive and not significant; thus, our hypothesis was not supported ($\beta = 0.002$; $p > 0.05$). Hypothesis 5 (d) predicted that narcissistic CEOs moderate the relationship between board size and real earnings management such that at high levels of CEO narcissism, larger boards are likely to engage in real earnings management. Our results found support for the proposition ($\beta = 0.107$; $p < 0.05$). This implies that when firms have narcissistic CEOs, large boards are ineffective in controlling real earnings management. This may be as a result of inefficiencies related to large size.

4.4 Additional analysis

We also presented our results using mod graphs as shown in figures to further probe the interactions (Aiken *et al.*, 1991). The interaction presented in Figure 1 indicates that when the



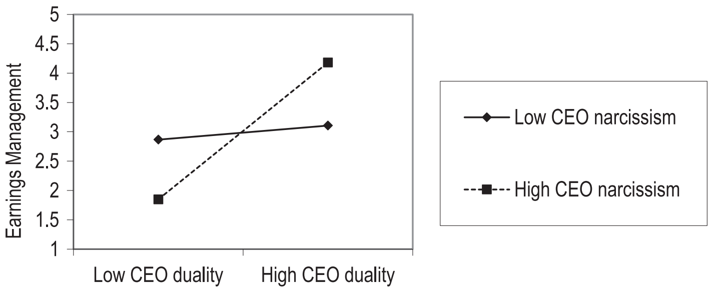
Source(s): Figure created by the authors

Figure 1.
Interaction of CEO narcissism and board independence to earnings management

CEO is highly narcissist, independent board mitigates earnings management. In other words, narcissistic CEOs are controlled by independence boards, thus mitigating earnings manipulation. The results in Figure 2 indicate that when a CEO is narcissist, CEO duality tends to increase earnings management. Figure 3 reveals that under high CEO narcissism, large boards tend to affect the effectiveness of the board in mitigating earnings management.

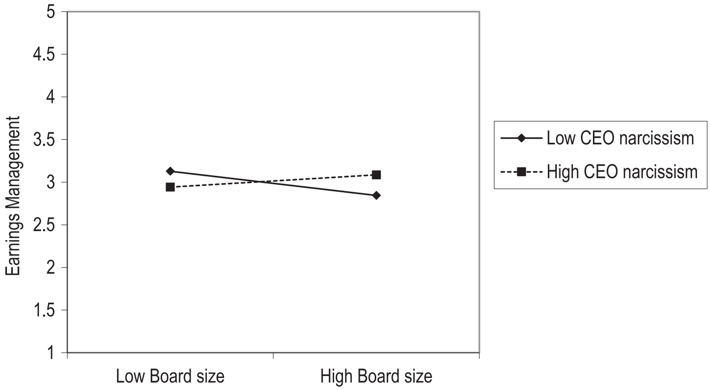
5. Discussions and conclusions

The existing research on the relationship between board structure and earnings management remains inconclusive. This study is motivated by scanty empirical evidence in the Kenyan context. In this paper, and consistent with agency theory, we conceptualized that the role of boards is to mitigate earnings management. Several board structures have been proposed in order to monitor management in Kenya, for instance, the Corporate Governance Code identified board independence as an avenue to control and monitor management. We, therefore, hypothesized that independent boards mitigate real earnings management. Our results supported this proposition. In other words, the more independent the boards are, the less the incidences of corporate fraud (Beasley, 1996). Independent directors are not required to have any ties with the organization and solely present to serve shareholders interest. Drawing from resource dependency perspective, boards bring with them skills, expertise and experience that ensure effective monitoring of management, thus preventing real earnings management (Wang *et al.*, 2022). We note that board independence is critical especially in a country that is confronted



Source(s): Figure created by the authors

Figure 2.
Interaction of CEO narcissism and CEO duality to earnings management



Source(s): Figure created by the authors

Figure 3.
Interaction of CEO narcissism and board size to earnings management

with legal, institutional and ethical challenges; however, such independence adds value when information flows freely (Cragun *et al.*, 2020) and the board have sufficient and adequate firm-specific knowledge to detect earnings management.

Secondly, we found that long-tenured boards mitigate earnings management. The possible explanation for this is the expertise hypothesis proposed by Vafeas (2003) indicating that long-tenured directors can monitor the financial reporting process effectively owing to their privileged skills and experience in the firm/industry. The corporate governance code of 2016 curbs the number of years a board member can serve to 9 years (Outa *et al.*, 2017), but on the same vein allows for retirement by rotation. This effectively provides a window for continuity of the board through a staggered approach – a provision that is designed to mitigate undesired practices such as earnings management. CEO duality has been found to affect corporate decision-making (Krause *et al.*, 2014), and, therefore, we argue that dual CEOs increase real earnings management in Kenya. Our results supported this proposition largely because a CEO who is also a chairman may undertake real activities management to portray a positive image about self and the organization. In fact, narcissistic CEOs may not stand the shame precipitated by corporate failures, and so will tend to make equivocal accounting choices to present their firm's financial status in their best possible light (Amernic and Craig, 2010). Lastly, we found that contrary to our predictions, large boards are more vigilant than small boards and, therefore, constrain real earnings management. Drawing from agency theory, the greater the number of people in the board, the greater the monitoring activity (Fama and Jensen, 1983) largely due to pooling of specialists from various disciplines, thus mitigating real earnings management. According to Sun and Lan (2014), the larger the boards, the more committees are established, and the more vigilance improves.

We performed interactions to further explain how boards influence real earnings management in Kenya. Consistent with upper echelons theory, we argued that the effectiveness of the board in mitigating real earnings management depends on the personality traits of the CEO. We tested this proposition using CEO narcissism, a personality trait that is characterized by sense of entitlement and self-centeredness, and believe that one is better than others (Chatterjee and Hambrick, 2007). We found that indeed CEO narcissism plays an important role in board monitoring. We found that at high levels of CEO narcissism, independent boards mitigate earnings management in Kenya. Substantial literature indicate that narcissistic CEOs dominate the decision-making process in a firm and are more likely to take advantage of accounting choices to advance their personal gains (Buchholz *et al.*, 2020) by projecting their firms' financial status in their best possible light. They achieve this by dominating others; for instance, they hire lower-status, younger and less experienced top management team (Chatterjee and Pollock, 2017). And so to mitigate the possibility of earnings management, independent board provides the control required in the firm. We also found that a dual CEO who is a narcissist engages more in financial misreporting because decision-making power is concentrated in one person, who may manipulate decisions at the board level. Finally, narcissistic CEOs render large boards ineffective in terms of monitoring management. We believe that a narcissist CEO by the nature of his or her personality controls large boards, and, by extension, affects their vigilance in financial reporting.

5.1 Implications

The findings of this study make several contributions to theory, practice and policy. Despite the introduction and review of corporate governance codes in Kenya, listed firms still face governance challenges. We found that consistent with corporate governance guidelines across the world, independent boards are effective monitors in Kenya. Consistent with expertise hypothesis, long-tenured boards were found to be effective in mitigating against real earnings management in Kenya, and so the Corporate Governance Guidelines 2015 has made a provision for staggering the board. Therefore, it is suggested that to improve the expertise of the board, there is a need to introduce mandatory professional training as well as conduct frequent board evaluations to assess effectiveness. We also found that larger boards are more resourceful in enhancing corporate reporting largely due to the accumulation of people with skills and experiences in board matters, and in particular possibility of getting more independent directors with varied skill base. CEO duality is a structure that is largely discouraged in the guidelines. We concur with extant literature that duality has a dark side, more so in a country like Kenya where the legal and regulatory environment, including the value system, is weak. Too much power bestowed on one individual in an environment characterized by institutional weakness results in financial frauds. This study also introduces personality traits to corporate governance and finds that CEO narcissism affects the earnings management. In particular, a narcissistic CEO can be prevailed upon by an independent board with regard to financial misreporting. Additionally, a narcissistic CEO who also sits as a chairman of the board accumulates the decision-making power and as a result engages in financial misreporting. Therefore, separation of roles of CEO and chairman is key to curb earnings management in Kenya. In this study, we found that large boards are effective in controlling earnings management, especially when the CEO is a narcissist.

For practice and policy, this study recommends that boards in Kenya should have independent boards to avoid financial misreporting. Although some firms still practice CEO duality against the provisions of corporate governance guidelines, there is a danger of engaging in real earnings management because of lack of appropriate oversight and controls. We also found that long-tenure boards are effective in mitigating financial misreporting, and therefore, we suggest that boards adopt staggering approach to address the tenure problem. Additionally, large boards provide a pool of expertise that help in constraining real earnings management, and so there is need to reduce the incidences of small boards. We further find that CEO narcissism affects corporate governance of firms in Kenya, and so maintaining an independent board will largely solve the governance problems emanating from such personality traits. It is, therefore, imperative for regulators in Kenya to develop a viable regulatory framework and enforce actions to mitigate the potential consequences of real earnings management. The study clarifies the interactions between boards and CEOs in managing company affairs, particularly earnings management. As a result, this will assist investors in making investment decisions.

5.2 Limitations and areas for further research

The study has several limitations. First, the study relied on archived data contained in the financial statements. Although unobtrusive measures of CEO narcissism were collected using the secondary data from the archived data, some of the information on the CEOs report may not be exactly from the CEO but rather from the editorial team of the company. Hence, further research can be explored using primary data such as NPI 16, which incorporates the perceptions of the respondent on the level of CEOs narcissism. Additionally, disaggregating earnings management into single indicators may present an opportunity for new findings. While the study considered the four constructs of board structure – board independence, board tenure, CEO duality and board size – there are also a number of board structure constructs that can help in mitigating real earnings management. Further research can be explored on how constructs such as board activity, diversity and multiple directorships affect real earnings management.

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Corresponding author
Daniel Kipkirong Tarus can be contacted at: kdtarus@gmail.com