UNIVERSITI TEKNOLOGI MARA

CORPORATE GOVERNANCE, POLITICAL CONNECTIONS AND EARNINGS QUALITY: EVIDENCE FROM EGYPT

DALIA ALI MOSTAFA HEMDAN

Thesis submitted in fulfilment
of the requirements for the degree of
Doctor of Philosophy
(Accountancy)

Faculty of Accountancy

September 2022

ABSTRACT

The current study examined the influence of internal and external corporate governance mechanisms on the quality of reported earnings (FREQ) for firms in Egypt. Internal corporate governance in this study consisted of CEO duality, board gender diversity, board independence, CEO compensation, audit committee size, audit committee meetings frequency, and audit committee independence, whereas external corporate governance in this study consisted of audit quality and ownership structure - foreign ownership and institutional ownership. Additionally, this study examined the moderating role of political connections in the relationships of internal corporate governance mechanisms with FREQ. With that, data of listed non-financial firms from 2008 to 2019 were obtained. The results revealed the negative influence of CEO duality and CEO compensation and the positive influence of Gender_2 (represented the presence of two female directors on the corporate board) and Gender_3 (represented gender critical mass) on FREQ. Besides that, this study demonstrated the positive influence of audit committee meetings frequency, audit committee independence, audit quality, foreign ownership, and institutional ownership on FREQ. The obtained results also revealed the moderating role of political connections on the negative relationships of CEO duality, gender_1, gender_2, CEO compensation, and board independence on FREQ. However, this study found no evidence on the moderating role of political connections in the relationships of the characteristics of audit committee with FREQ. Overall, this study contributed significant implications to the existing body of literature by supporting the view that strong internal corporate governance mechanisms (i.e., board gender diversity, audit committee meeting frequency, and audit committee independence) and external corporate governance mechanisms (i.e., audit quality, foreign ownership, and institutional ownership) improve the quality of reported earnings within the Egyptian context. The argument strongly supports the view that corporate governance can minimise agency conflicts by addressing the negative implications of information asymmetry. This study presented evidence on the negative role of political connections in the quality of earnings for firms in Egypt. Through additional tests, this study also proved the robustness of the main results and justified the positive implications of the quality of firms' reported earnings. This study presented significant theoretical and practical implications in the Egyptian context.

ACKNOWLEDGEMENT

Embarking on a PhD study is an opportunity to strengthen my research knowledge in the field of accounting so that I could be in a position to understand the financial policy of a firm in a better way. I must recognize that I have gained strong support from my supervisors and my family to sustain my enthusiasm for scholarly research along the PhD journey.

First, I must acknowledge my Main Supervisor, Assoc. Prof. Dr. Suhaily Hasnan, Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Malaysia, who has been giving me constructive comments on all stages of my thesis. Unquestionably, these comments enhanced the quality of my thesis. I still remember intensely how Assoc. Prof. Dr. Suhaily Hasnan challenged me to build a solid theoretical model with significant contributions to research knowledge during the beginning phase of my study. Notably, she has continued to raise innovative questions and different directions to me along my journey as a PhD candidate. I feel very fortunate to have had her supervision throughout my PhD journey. I feel that all could be explained in the following proverb. The oldest English-language use of the proverb has been found in Anne Isabella Thackeray Ritchie's (1837-1919) novel, Mrs. Dymond (1885) which stated "if you give a man a fish, he is hungry again in an hour and if you teach him to catch a fish you feed him for a lifetime". Thank you!

I am also grateful to my Co-Supervisor, Assoc. Prof. Dr. Mazurina Mohd Ali, Senior Lecturer, Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Malaysia, who has supported me throughout my PhD study.

Finally, I would like to thank my mother, Mrs. Amina Honey, who has encouraged and supported me throughout my PhD journey. Also, special thank you to Prof. Dr Saif Ur Rehman, Faculty of Management, Canadian University of Dubai, UAE, for his insightful comments and constructive suggestions to uplift the quality of my thesis.

TABLE OF CONTENTS

CHAPTER ONE
INTRODUCTION

1.1 Chapter Description

This chapter provides an overview on the quality of earnings and corporate governance mechanisms. This chapter also presents problem statement, research questions, and research objectives. Following that, the scope and significance of the current study are described. Thesis organisation is presented at the end.

1.2 Overview of Earnings Quality and Corporate Governance

The firms' financial reporting information quality (hereafter referred to as Earnings Quality) is one of the major concerns for investors. The importance of earnings quality is so critical that authorities throughout the globe spared no effort to steady markets augmenting investor confidence (Curti & Mihov, 2018). Global financial crisis causes transitory current earnings, dropping market capitalization and improbability about firms' future earnings (Shi, Aguilera, & Wang, 2020). However, the momentary and noisy earnings nature is expected to influence investors to explore their prospects of firms; expected earnings as the future becomes uncertain. In the Egyptian context, the Egyptian revolution financial crisis initiated in 2011 adversely compressed earnings quality and the Egyptian stock exchange (EGX) performance. Consequently, this results in shattered investor confidence that transformed many listed EGX firms' let down. Prior literature has shown shareholders' confidence crisis that resulted in investors' freak out during the previous crises (Uppal, 2020) and Statman, 1999; Talley and Johnsen, 2004). In the context of earnings quality during the crisis periods, apprehensions could be elevated towards the administration use of the accounting system adjusting earnings intentionally (Filip and Raffournier, 2012; Kousenidis, Ladas, & Negakis, 2013; Iatridis and Dimitras, 2013; and Persakis and Iatridis, 2015). Nevertheless, according to Arthur et al. (2015), the management prefers transparency in earnings quality to retain investor