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FINANCE

EFFECT OF BOARD DIVERSITY ON EARNINGS MANAGEMENT IN FIRMS LISTED ON THE NAIROBI STOCK EXCHANGE

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ABSTRACT

Purpose of the Study: This study aims to assess the effects of technological advancement on crime scene processing, crime detection, and crime prevention in Kisumu East Sub-County, Kenya.
Statement of the Problem: The term "crime management" encompasses both actions and outcomes related to addressing crime in various settings. This study specifically examines the implications of technological advancements in crime management within Kisumu East Sub-County, Kenya.
Methodology: The study adopted a descriptive research design and collected data from 300 respondents within Kisumu East Sub-County, using a sample size of 169. Data were gathered through self-administered questionnaires, with consent obtained to adhere to ethical standards. SPSS 24 software facilitated the analysis, employing both descriptive and inferential statistics.
Findings: The findings reveal a significant relationship between crime detection and crime prevention, with crime detection showing a strong positive association (F=78.548, p-value=0.000). Crime scene processing also positively contributed, albeit to a lesser extent (Beta = .127).
Conclusion: The study concludes that technological applications significantly impact crime prevention, detection, and crime scene processing in Kisumu East Sub-County, Kenya. It highlights the critical role of technology integration into law enforcement practices.

Recommendations: The study recommends that law enforcement agencies in Kisumu East Sub-County prioritize the integration of technological solutions to enhance crime prevention efforts. It also advocates for the establishment of clear regulations and guidelines to govern the ethical use of technology in crime detection.

Key Words: *Board Characteristics, Board Diversity, Earnings Management, Listed Firms, Nairobi Securities Exchange*

INTRODUCTION

Governing boards, which include both executive and non-executive directors, play a crucial role in the administration of firms. Abubakar et al. (2020) describe them as the cornerstone of firm management, noting that effective boards are linked to improved organizational oversight. Similarly, Patel (2022) highlights their fundamental role in enhancing firm management. Wijesinghe et al. (2019) assert that the board of directors collectively holds the highest governing authority within an organization and bears responsibility for its long-term success. Furthermore, Issa (2019) emphasizes that boards serve as a vital governance mechanism, safeguarding the interests of the firm's shareholders. They play a pivotal role in overseeing managers, endorsing decisions, and charting the organization’s strategic direction, a sentiment echoed by Ali et al. (2021). Salem et al. (2019) add that boards oversee management on behalf of shareholders and act as a conduit between management and shareholders. Therefore, effectively leveraging governing boards as an internal governance mechanism is crucial for enhancing organizational performance and profitability.

Debnath (2019) states that firm directors are mandated to ensure compliance with accounting standards. According to Section 166A (3) of the Companies Act 1965, in the case of a holding company requiring consolidated accounts to be affirmed during the annual general meeting, the director must ensure that the company's accounts are prepared according to applicable accounting standards. This requirement is reinforced by the MASB under S. 165 (15c), which mandates directors to prepare accounts following the approved accounting standards.

Hassan and Marimuthu (2020) argued that diversity, encompassing gender, professional experience, ethnicity, age, and background, brings innovation, leadership, industry understanding, creativity, global relationships, and better decision-making. Freitas (2018) defines board diversity in terms of the representation of women and racial minorities, suggesting a positive and statistically significant relationship between the presence of women or minorities on boards and firm value measured by Tobin’s Q. Additionally, increased female representation tends to stimulate the hiring of more minorities. Although Garg and Tanwer, (2020) found no significant relationship between board diversity and firm value, they argue that the absence of such a relationship shouldn't deter the promotion of diversity on governing boards. Female board members are deemed crucial for their market understanding, positive corporate image, and their impact on the career

development of female staff members, thereby indirectly contributing to firm value. Despite its importance, female representation on governing boards remains low globally, with statistics from the Catalyst census indicating 12.4% representation in the US, 6.4% in the UK, and a mandatory minimum of 40% in Norway.

According to Aljadba and Laili (2021) scholar from Havard University defines earning management as situation whereby people who are given authority to manage a firm, use verdict in financial reporting and structuring transactions to manipulate financial report with intention to give stakeholders wrong information on how the company is performing economically or influence other companies, in contractual agreement, that rely on the numbers in the reported accounts. Judgment and discretion in financial reporting (accounting methods and treatments) gives managers a chance whereby they can manage earnings which as a result can be of advantage or disadvantage on the quality of reported earning and the process of making decision (Debnath, 2019). Healy, et al. 1992 affirms that earning management can be viewed as behavior to maximize personal utilities in debt covenant and compensation. Assenga and Ofoegbuet al. (2018) argues under stock price motivation that, in order for managers to mislead the market, earning management is key. According to Ngatno et al. (2021) says that earning can be managed using transactions and using accounting methods and estimates. These transactions include asset sales or accelerating or deferral of revenue.

Earning Management practices within Chinese publicly traded companies have been employed as a means to reduce agency costs, particularly in addressing issues of 'tunneling' between large and small shareholders. This research highlights a connection between the extent of private control benefits that controlling shareholders can extract and the practice of earnings management within listed firms. These findings shed light on the strong motivation for Chinese listed companies to engage in earnings management when they face the risk of being delisted, as demonstrated by Feng et al. (2020). Furthermore, the examination of instances where controlling shareholders inappropriately allocate raised capital in rights issues indicates that earnings management in Chinese listed companies is predominantly driven by the phenomenon of tunneling, as suggested by Liu and Lu (2017).

Fama and Jensen (1983), a South African scholar, in his argument says that the important element in corporate governance and the effectiveness of the directors to supervise managers depends on the board structure. Hence the important attributes that improves the ability to mitigate earning manipulation are the board characteristics that include board

independence, board size, gender diversity and financial expertise. In their examination of earnings management practices concerning the avoidance of losses among all companies listed on the Johannesburg Stock Exchange in South Africa, Pududu and De Villiers (2016) contended that there was no discernible proof of earnings manipulation aimed at circumventing the reporting of minor losses or slight decreases in earnings in the South African context. This conclusion was ascribed to the relatively smaller scale of the Johannesburg Stock Exchange when compared to stock exchanges in the United States. Additionally, it was suggested that investors and analysts in South Africa might place more emphasis on alternative performance indicators such as revenue and headline earnings per share, rather than solely focusing on earnings

In Kenya, a research investigation was carried out to assess the impact of corporate governance on the manipulation of earnings by firms listed on the Nairobi Securities Exchange. The research highlighted that inadequate governance structures create opportunities for managers to engage in activities that could result in lower-quality reported earnings. The study's findings concluded that the size of the board had a statistically significant, adverse impact on earnings manipulation. Overall, the results demonstrated that corporate governance exerts a noteworthy influence on the practice of earnings management among companies listed on the Nairobi Securities Exchange (Nyatichi et al., 2020). Consequently, corporate governance emerges as a vital determinant of earnings management for companies listed on the NSE. There is no previous research has investigated the relationship between board characteristics and earnings management specifically among listed companies in various sectors. This study aims to address this gap by focusing on manufacturing firms listed on the Nairobi Securities Exchange. The objective is to provide additional evidence regarding the association between earnings management and board characteristics within the context of manufacturing companies listed on the Nairobi Securities Exchange.

Statement of the Problem

Previous studies mostly focus on the relationship between firm performance and the characteristics of the board. Harres et al. (2018) says that, when outside directors are in charge, the wealth of the stockholders increases. Chatterjee (2019) states that outside manager, are against attempt of takeover by greenmail. In Taiwan, poor corporate governance mechanism led to financial distress cases. The board of directors serves as the

central component of the corporate governance system, and the composition and characteristics of the board have a significant impact on both the monitoring functions of the board and the wealth of shareholders.

Nyatichi, (2020) highlighted that, in spite of the impressive performance of the Nairobi Securities Exchange (NSE), companies listed on the NSE continue to grapple with challenges related to ownership structure. Some controlling shareholders have exploited their authority to pursue personal gain, often to the detriment of minority shareholders. This has led to financial scandals, as exem Decisions related to the earnings management of these companies are greatly influenced by the choices made by the board, which can either enhance or harm the company's performance plified by the collapse of well-established firms like Daima Bank, Trust Bank, Euro Bank, Imperial Bank, Uchumi Supermarket, Nakumatt Supermarket, and Chase Bank, among others. Additionally, there is a recurring pattern of listed companies being temporarily suspended from trading on the NSE due to compromised financial results released by Kenyan firms.

According to Brickley and James (2017), there exists a negative relationship between CEO compensation and the presence of outside directors. Conversely, Weisbach (2018) suggests that CEOs who have outside directors and subsequently face poor performance are more likely to resign or leave their positions. Studies from previous researchers argue that agency cost can be reduced by an efficient board of directors. Beasley (2016) find that due to existence of audit committee and outside directors, the chances of financial statement fraud are minimal.

Friedman (2004) investigates if management can increase stock prices during initial public offerings by tempering with accounting earnings. Erickson and Wang (2019) tried to find out the behavior of earnings management of stock-for-stock mergers. Toeh et al. (2018) tried to find out impact of managing earning on seasoned equity offering. All the aforementioned studies indicate that investors face challenges in discerning the quality of earnings based on accounting standards. Were (2018) suggests that factors such as market-to-book value ratio, earnings management, and firm size positively impact stock returns. However, there is currently a lack of research conducted in Kenya specifically on earnings management within individual sectors of listed companies. This study aims to provide further insights into the relationship between board characteristics and earnings management in manufacturing firms listed on the Nairobi Securities Exchange, thereby contributing to a deeper understanding of the topic

Objective of the study

To determine the effect of board diversity on earnings management in firms listed on the Nairobi Stock Exchange.

LITERATURE REVIEW

Theoretical Literature Review: Agency Theory

The inception of Agency theory can be traced back to 1973 when Stephen Ross and Barry Mitnick formulated the concept (Mitnick, 1973). The theory emerged as a response to the agency problem that arises when company management prioritizes personal gains over the interests of shareholders (Jensen & Meckling, 1976). In modern corporations, the separation of ownership and control often leads to divergent objectives between the principal (shareholders) and the agent (management), as explained by the tenets of agency theory (Hoskisson et al., 1999). In addition, agency theorists have recognized the board as a tool of owners to rein in managers' opportunistic behavior and thus solve the agency theory (Stiles & Taylor, 2001). Therefore, supervisors must be monitored in order to correct their aberrant actions (Asogwa al. 2019).

Since agency theory is by far the most popular method for studying corporate governance, the make-up of the board is often seen as crucial to finding solutions to agency theory (Aguilera et al., 2018). While proponents of agency theory may see the principal as the root of the "principal and agent problem," critics like Perrow (1986) point out that the principal may also be to blame. A behavioral agency theory was created by agency theory's detractors to account for factors like agents' incentives and proper remuneration. (Sanders & Carpenter, 2003; Pepper & Gore, 2012; Wiseman & Gomez-Mejia, 1998). According to the Agency Theory, the board should be made up of impartial members, and the CEO and Chairman should report to different people. Managers can distort the company's economic performance by manipulating earnings, as shown in a study of the connection between board independence and Earnings Management. This is made possible by the agency theory (Ngatno & Youlianto, 2021). This theory helps in understanding the role board independence plays in earnings management.

Researching the board composition and financial performance of non-financial companies traded on the Nairobi Securities Exchange (NSE) is a perfect opportunity to use agency theory, which states that disagreements emerge when principals and agents have different

priorities. This theory sheds light on the ways in which size and independence of the board might affect the monitoring and control processes that affect the quality of financial reporting (Jensen & Meckling, 1976). Although agency theory has a solid grounding and enough of evidence to back it up, one of its limitations is how it treats self-interest and formal controls in isolation. Yet, improving corporate governance standards in Kenya may be achieved by gaining an awareness of their strengths and limitations.

Empirical Studies

According to Morrison et al. (2014), women on board complement their male counterparts in management, which improves board's effectiveness. Previous research has found that female leaders' decision-making and risk-taking styles differ from their male counterparts. Women leaders, according to Barber and Odean (2017), tend to be more conservative than their male counterparts. O'Fallon and Butterfield (2018) and Vermeir and Van Kenhove (2018), both experts in the area of corporate governance, found that female directors made and acted in a more ethical manner when making decisions. As a result, they are less likely to take advantage of their positions as managers (Zalata et al., 2019). Moreover, other studies have shown that women directors are ethical and take minimal risk in financially focused decision-making. (Doan & Iskandar-Datta, 2020; Yahya et al., 2020). Female directors are particularly valuable in male-dominated fields, according to research by Chen et al. (2019). The authors also found that companies with a majority of women on their boards had better financial results because their directors were less likely to be overly aggressive in their investment and purchase strategies. That's why it's more likely that boards with women on them will rein in unethical tactics like EM.

Research into the correlation between female parity on boards and EM has yielded conflicting results. According to research by Arun et al. (2018), companies in the UK with a greater proportion of women and independent women on the board of directors tend to adopt more conservative EM practices and achieve better financial results. Similar findings are found in an investigation of the correlation between gender diversity on boards and the prevalence of earnings manipulation in European nations conducted by Kyaw et al. (2017According to Kyaw et al. (2017), in countries with advanced gender parity, a board with balanced gender representation is more effective in detecting and preventing revenue manipulation. Lakhal et al. (2017) observed a correlation between increased representation of women on boards of directors and decreased earnings

manipulation in a sample of 170 French companies over a four-year period. Saona et al. (2018) conducted research on nonfinancial businesses in 10 European countries, including Finland, from 2006 to 2016, and found that a diverse board is likely to reduce earnings manipulation practices.

On the other hand, Arioglu (2020) examined non-financial companies listed on the Borsa Istanbul between 2009 and 2017 and did not find evidence of female directors impacting earnings manipulation. Similarly, Abdullah and Ismail (2016) studied non-finance firms listed on Bursa Malaysia over a four-year period from 2008 to 2011 and found that the presence of women on boards and audit committees did not significantly affect earnings manipulation. Sun et al. (2017) also reported no association between the proportion of female directors on audit committees and earnings manipulation.

In summary, research findings regarding the impact of gender diversity on earnings manipulation vary. While some studies suggest a positive relationship between gender-balanced boards and reduced manipulation, others have found no significant association. It is important to consider the context and specific characteristics of the companies and countries under investigation when interpreting these findings. In Kenya , Were (2018) assessed the effect of board gender diversity on the performance of commercial banks. The goal of this research was to determine whether or not private banks in Kenya benefited from having more women represented on their boards of directors. Research was conducted over a 12-year time frame. (1998-2009). The step-wise regression technique was used in this research. The research found that commercial bank boards in Kenya were predominantly male and included few female representatives. The research also found that there were only eight women on the board of directors. The research found, however, that commercial banks in Kenya did not significantly benefit from having more women on their boards of directors. Letting et al. (2017) looked into the connection between board diversity and EM performance in NSE-listed businesses. Board members' ages, sexes, areas of expertise, and levels of schooling were the study's independent variables. No statistically meaningful relationship was found between the number of women on a board and any of the EM metrics. Without taking into account the differences between businesses operating in various sectors, study will look at manufacturing firms listed in Nairobi securities exchange.

RESEARCH METHODOLOY

The study employed a descriptive research design, defined by Kothari (2004) as an inquiry focused on fact-finding and exploration to describe the current state of affairs. This design aims to uncover and report existing conditions, describing various aspects such as behavior, attitudes, values, and characteristics (Mugenda & Mugenda, 2013). The target population included all eight manufacturing firms listed on the Nairobi Securities Exchange as of December 31, 2022 (source: www.nse.co.ke). Due to the small number of listed firms, sampling was not conducted. Instead, a census approach was adopted, collecting data from all eight firms. Data were extracted from their annual reports and underwent an editing process by the researcher. The data were then entered into Excel and transferred to STATA for analysis. Descriptive statistics were computed to determine the mean, standard deviation, minimum, and maximum values of the variables. Pearson's correlation analysis was conducted in STATA to generate a pairwise correlation matrix, providing insights into the direction and strength of the relationships among the variables under study.

FINDINGS AND DISCUSSION

Descriptive Statistics

The research used descriptive statistics to characterize the data set's properties and characteristics. In it, the study's data and metrics were summarized. Among the descriptive statistics used were measures of central tendency and spread. Minimum, value, variance, standard deviation, and maximum values were all used as measures of spread in this research. Mean is one of the central tendency metrics included in this dataset. Both the dependent variable (Earnings management) and the independent variable (board directors' diversity) had their standard deviation, mean, maximum, and lowest values computed in the research. Table 1 displays the variable's descriptive statistics from 2019 to 2023.

Table 1: Panel Data Descriptive Statistics'

	Earnings management	Board Diversity
N	40.00	40.00
Min	0.26	0.14
Max	0.64	0.53
Mean	0.43	0.33
Std Dev	1.21	0.10
Skewness	0.30	0.02
Kurtosis	1.77	2.18

Based on Table 1, the mean earnings management score during the study period (2019 to 2023) was 0.427 with a standard deviation of 1.12. This suggests that firms engaged in moderate levels of earnings management, with a variance in scores ranging from a minimum of 0.261 to a maximum of 0.639. Additionally, the mean ratio of board diversity was reported as 0.333 (33.3%), with a standard deviation of 0.101 (10.1%), and ratios varying from 0.143 to 0.534. This indicates a moderate but notable diversity within boards, reflecting minimal disparity in gender and ethnic representation across firms.

Corroborating earlier research, the findings confirm that earnings management remains prevalent in financial reporting. Studies like Bartov et al. (2002) and Cohen et al. (2004) have suggested that aggressive earnings management can undermine capital market trust and impair long-term shareholder wealth. Similarly, studies on board diversity, such as those by Carter, Simkins, and Simpson (2003) and Campbell and Mínguez-Vera (2008), indicate limited gender and ethnic diversity across boards, with few exceptions in regions like Spain where higher female representation has been noted. These parallels reinforce the persistent relevance of these issues in corporate governance.

Table 2: Regression Fixed Effect of Board diversity on Earnings management

Fixed-effects (within) regression			**Number of obs**	**=**	**40**
Group variable: FIRMID			Number of groups	=	8
R-sq:			Obs per group:		
within =		0.1575	min =		5
between =		0.4853	avg =		5
overall =		0.3504	max =		5
			F(1,31)	=	5.79
corr(u_i, Xb)	= 0.2161		Prob > chi2	=	0.0222

EM	**Coef.**	**Std. Err.**	**T**	**P>t**	**[95% Conf.**	**Interval]**
BD	0.07876	0.032721	2.41	0.022	0.01255	0.14503
_cons	0.058559	0.040562	1.44	0.159	-0.02417	0.14128

The findings from the fixed effect model showed that among manufacturing businesses listed at the Nairobi Securities Exchange, Kenya, board diversity explained 35.04% (Overall R square=0.3504) of the variance in earnings management. The ANOVA statistics assess the model's overall significance. Since the model's F-statistic is 5.79, which is more

than 0, we may conclude that the estimated parameters are not zero. The premise here is that industrial companies listed on the Nairobi Securities Exchange in Kenya would benefit from a more diverse board when it comes to earnings management. At P<0.05, this impact is considered significant.

At β=0.07876, t=2.41, and p-value=0.022, the predicted coefficient of board diversity is noticeably non-zero. Being less than 0.05, the computed coefficient is statistically significant at the 5% level of significance. An increase of one unit in board diversity would cause profits management levels to rise by 0.07876 units, according to the predicted coefficient of board diversity in this case. Since the constant's p-value is less than 0.05, we may conclude that it is statistically significant. The regression model is as shown below

$$Earnings\ management\ (EM) = 0.058559 + 0.07876 Board\ Diversity\ (BD)$$

The study therefore rejected the third null hypothesis that board diversity does not affect earnings management of manufacturing firms listed at Nairobi Securities Exchange, Kenya and thus that there is an effect of board diversity on earnings management. This implies that increase in board diversity would results to increase in earnings management of manufacturing firms listed at Nairobi Securities Exchange, Kenya. Outcomes are in line with those of Waweru (2018), who aimed to find out how non-financial companies listed on the Nairobi Securities Exchange (NSE) fared in the market after implementing a more diverse board. Board diversity significantly improved company performance in the marketplace as assessed by Tobin's Q for non-financial businesses listed in Kenya, according to the data. Islam (2019); Bagieńska (2016); Ianniello (2020); Mandal and Goswami (2018)

The Resource Dependence Theory advocates for diversity on boards as it can lead to broader corporate networks and improve financial performance (Waddock & Groves, 1997). Diversified corporate boards, in terms of age, gender, education, nationality, and expertise, are seen as strategic resources that provide linkages to external resources, thereby enhancing financial performance (Ingley & Van der Walt, 2011). Similarly, the findings align with the Stakeholder Theory, which emphasizes considering the interests of various stakeholders in corporate decision-making. This theory supports the idea of a well-diversified board that accommodates and aligns the interests of all constituents to create firm value (John & Senbet, 2018). For instance, the Johannesburg Securities Exchange experienced a positive impact on market value from having a diverse board.

However, the outcomes of the study present mixed findings when compared to other research. Akpan and Amran (2014) observed that the presence of women on the board was negatively correlated with a company's sales, suggesting that appointing women to directorships might primarily serve public relations purposes with little substantial impact on company performance. Additionally, Abu, Okpeh, and Okpe (2016) found no significant effects of gender diversity on the performance of Nigerian banks, whether through female board members, independent non-executive board members, or chief executive officers.

Conversely, Temile, Jatmiko, and Hidayat (2018) reported that companies listed on the Nigerian Stock Exchange performed better financially with more women on the board. In their study, the presence of a female chief executive officer was irrelevant, but a female chief financial officer had a significant impact. Wachudi and Mboya (2012) found that commercial banks' performance was unaffected by gender diversity. Letting et al. (2012) identified a statistically significant and negative association with price-earnings ratio (PER) related to board education and the presence of women on boards, whereas the number of women on the board and their specialization significantly influenced return on equity (ROE) and dividend yield (DY). The research also examined dividend yield, price earnings, and return on assets (ROA) for all companies listed on the Nairobi Securities Exchange, presenting a comprehensive view of the varying impacts of board diversity.

CONCLUSIONS

The study concludes that board diversity has a significant positive effect on earnings management. An increase in board diversity in terms of gender and expertise results in a significant increase in earnings management. Therefore, board diversity is a significant predictor of earnings management for manufacturing firms listed on the Nairobi Securities Exchange, Kenya. Consequently, the third null hypothesis was not supported.

RECOMMENDATIONS

The study recommends that manufacturing firms prioritize efforts to enhance board diversity to improve decision-making processes and promote inclusivity. This involves actively seeking out directors from diverse backgrounds, encompassing gender, ethnicity, and expertise. By fostering a culture of diversity and inclusion at the board level, firms can achieve better governance outcomes, improved financial performance, and enhanced

stakeholder trust. Furthermore, boards should implement diversity initiatives and monitor progress towards achieving greater representation.

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