

New Perspective of Earnings Management: The Effect of Outsiders' Requirements on Managerial Choice of Earnings Management Mechanisms

Nargis K.B. Makhaiel¹

Abstract

This paper aims at studying the relationship between the existence of a particular set of motivational parties in firms' context, and the executives' choice of certain earnings management (EM) mechanisms. Analysing 34 interviews with executives, financial analysts, external auditors and regulators, and the official documents help to find that the possible existence of a group of sophisticated outsiders in the Egyptian context, including: capital and credit markets, and the regulatory rules of Egyptian Stock Exchange constitutes influential EM motives; and that these parties appreciate and place more emphasis on the long-term operational results of the firms. The paper also finds that managers' intention to achieve compliance between the financial requirements of these motivating factors and the reported earnings necessitates using operational EM mechanisms, including: sales activities, overproduction, and advertising expenses which do not lead to outsiders' suspicion in a firm's performance and value. This paper contributes to literature by giving new perspective for EM by revealing that some of firm's interested parties care about long-term operational profits and cash flows instead of short-term profits; by highlighting the importance of identifying EM motives, and their unique requirements and expectations to accurately determine EM techniques; by building a theoretical framework for better understanding of the study; and by collecting first hand information through adopting interpretive approach.

Keywords: Earnings Management Motivations, Earnings Management Techniques, New Institutional Sociology Theory, Financial Suppliers, Egyptian Stock Exchange, Egypt

1. Introduction

Earnings management (EM) phenomenon exists due to the "game of information disclosure" between a firm's management and its stakeholders (DeGeorge et al., 1999; Levitt, 1998); and hence was emerged as a means of manipulating these figures in order to influence the perceptions of those stakeholders in relation to a firm's value, prospects, performance, and its earnings-based contractual outcomes (Healy & Wahlen, 1999; Indjejikian, 1999). As a result, considerable attention has been given to EM incentives pertinent to outsiders by research which has empirically assigned credit and stock markets as significant EM motives (see for example: Graham et al.'s (2005), and Roychowdhury (2006); Alghamdi, 2012; Shen and Huang (2013); Kasab, (2006); Kamel (2012), Aharony et al. (2010); Algharaballi (2013); Aerts and Cheng (2011); Maarof (2010). Given the central role of the earnings-based model in influencing the perceptions of stakeholders in relation to a firm's value and its performance, this makes it logical to claim that there are widespread attempts by managers to "learn" how to manage profits figures, to pay due attention to how they report these figures (Lev, 1989; McKee, 2005); and hence to create mechanisms enabling them to adjust the reported earnings so as to favourably influence those outsiders' perceptions.

¹Lecturer at Accounting Department, Faculty of Commerce, Tanta University, Egypt. Email: nargis.makhaiel@commerce.tanta.edu.eg, Mobile: +2 01277133885

In this regards, research has reported evidence that there are two approaches to manage earnings: accounting actions mechanisms and real business activities techniques (see for example: Abdel-Khalik, 1985; Teoh et al., 1998b; Eldenburg et al., 2011; Graham et al., 2005; Cohen et al., 2010; Enomoto et al., 2013; Zang, 2012). None of the available studies have examined the impact of the existence of certain motivational factors in a firm's environment that have particular requirements in relation to firms' performance on executives' intention to exploit particular EM mechanisms. Although, Hagerman & Zmijewski (1979, p. 142) argue that it is impossible to understand why executives choose certain mechanisms, "unless the motives of management are understood". This is supported by Bange & De Bondt's (1998) and Dechow & Skinner's (2000) argumenet that identifying managerial incentives for adjusting income is the most useful and powerful way to accurately identify EM mechanisms, leading to an enhanced understanding of the phenomenon (Bange & De Bondt, 1998; Dechow & Skinner, 2000). Moreover, current research has focused on investors and creditors as influential EM motives, and underestimated the motivating influence of Egyptian Stock Exchange's regulatory rules on managers' propensity to manipulate profits; although, Degeorge et al. (1999), Graham et al. (2005), McKee (2005) claim that not only shareholders and lenders, but also a number of other stakeholders such as: regulators, all rely primarily on the financial reports (FRs) in order to assess firms' performance. Therefore, Rezaee (2005) argues that "national stock exchange listing status or meeting minimum exchange listing requirements to prevent being delisted" might be an incentive for managing earnings figures; specially in Egypt, likewise many Arabic and developing countries, which its economy was rapidly moved in 1990s towards a more liberalized economy, resulting in a significant influence on reviving and rearranging the Egyptian Stock Exchange (hereafter EGX) and its regulations of listing and delisting securities. These areas surprisingly remain under-studied in spite of their importance, thus the aim of this paper is to do that, and to investigate: the motivational effect of EGX's regulatory rules on practicing EM; the financial requirements in which a particular set of firms' outsiders is interested; and whether or not the existing of certain EM motivational factors, having specified requirements can drive executives to use certain EM techniques. This study conducts interviews with four groups of individuals deeply involved in EM phenomenon including: financial preparers (executives); financial reports' users (financial analysts); and financial reports reviewers (external auditors and Stock Exchange's regulators); and contributes to prior EM literature by seeing the requirements of a set of firms' outsiders regarding the financial performance with new lens; and revealing the importance of accurately determining EM motivational parties and their requirements for better understanding of EM techniques which can be used. Hence, this paper is set out in five main sections followed by a summary, conclusion and conclusion. Section 2 reviews EM literature; Section 3 suggests theoretical framework; Section 4 outlines research method and methodology; Section 5 analyses data and reports the results and findings.

2. Literature Review

The past two decades have witnessed a rich and long history of academic research into the two main components of EM phenomenon namely: EM motives and EM mechanisms.

2.1 Earning Management Incentives

Empirical evidence supports the idea that EM is practiced mainly for manipulating outsiders' perceptions of a firm's prospect and value, i.e. credit and stock markets. Research finds that how close a firm is to violating its debt covenants and the need to obtain new loans with relaxed and favourable terms, e.g. interest rate; due date; credit terms, and hence with low costs, represent motivations for executives to manage earnings upwards in order to influence credit market's perceptions (Bartov (1993), Beneish et al. (2001), DeFond & Jiambalvo (1994), Dhaliwal et al. (1994), Graham et al.'s (2005), and Roychowdhury (2006); (Alghamdi, 2012; Burgstahler and Dichev (1997), Dechow et al. (1996), Graham et al.'s (2005), Kamel, 2006; Kamel and Elbanna, 2010; Shen and Huang (2013), Trueman & Titman (1988), and Watts and Zimmerman (1990). Research, also, finds that stock market represents another external EM motive due to its super premium, or overpricing the firms' stocks, which succeed in managing the reported earnings upward when they intend either to sell their stock to the public at a high price during certain corporate events, i.e. initial public offers or seasoned equity offers; or to beat financial analysts' financial expectations (Cohen et al. (2010); Darrrough & Rangan (2005); DuCharme et al. (2004); Kamel (2006); Kasab, (2006); Marquardt & Wiedmand (2004); Rangan (1998); Teoh et al. (1998a); Teoh et al. (1998b); Kamel (2012), Aharony et al. (2010); Algharaballi (2013); Aerts and Cheng (2011); Maarof (2010) (Abarbanell & Lehavy, 2003; Bartov, et al., 2002; Bhojra, et al., 2003; Cheng & Warfield, 2005; Gleason & Mills, 2008; Hribar, et al., 2006; Kasznik & McNichols, 2002).

2.2 Earnings Management Techniques

Bruns & Merchant (1990) and Hopwood (1987) argue that corporate executives are allowed to make various kinds of discretionary decisions, whether these are related to real economic activities, the choice of particular accounting policies, or both, which enable them to determine and direct the amount of earnings to be reported. Therefore, there are two main vehicles which can be used for managing the profit figures: accounting actions mechanism (hereafter AEM); while real economic activities constitute a further alternative vehicle (hereafter REM). Many research reports empirical evidence about using accounting methods, mainly: FIFO and straight-line depreciation methods, as income-increasing alternatives, for managing the reported earnings upwards (Abdel-Khalik (1985); Bowen et al. (1995); Healy et al. (1987) and Hagerman and Zmijewski (1979); Teoh et al. (1998b); Maarof (2010); Dhaliwal et al. (1994). Another stream of prior literature reveals that REM is considered another recent alternative approach for managing profits. Research reports evidence that executives can adjust investment and operating activities as mechanisms which enable them to boost the reported earnings. These activities include: overproduction and sales activities i.e. offering more lenient credit terms or sales discounts (Graham et al., 2005; Marquardt & Wiedman, 2004); Thomas & Zhang, 2002; Roychowdhury, 2006); adjusting R&D budget, and advertising expenses (Graham et al., 2005; Eldenburg et al., 2011; Perry and Grinaker, 1994; Bange and De Bondt, 1998; Baber et al., 1991; Bushee, 1998; Roychowdhury, 2006; Kamel and Elbanna, 2010; Cohen et al., 2010; Dechow and Sloan, 1991; Bens et al., 2002; Cheng, 2004; Darrough & Rangan, 2005); and disposing of long-term assets (Bartov, 1993; Herrmann et al., 2003; Black et al., 1998; Eldenburg et al., 2011). Few research investigates managerial decisions related to executives' choice of either real economic activities or accounting policies to be used as preferred EM techniques, and evidences that the use of REM is more prevalent and preferred than the use of AEM, specially, when there is a high level of investors protection (Enomoto et al., 2013); better informative environment and high quality audit (Sohn, 2011); and when the costs associated with the use of accrual-based are high compared with those associated with employing real activities (Zang, 2012). Similarly, Kamel and Elbanna (2012) report evidence that Egyptian IPO firms are not motivated to manage profits by using accounting accruals before going public.

3. Theoretical Framework: New Institutional Sociology

New Institutional Sociology (NIS) theory is a beneficial tool for understanding the reasons that lay behind the penetration of a particular practice, policy or an environmental requirement from the firm's context into its organizational life (DiMaggio & Powell, 1983; Moll, et al., 2006). NIS suggests that a firm's environmental penetration occurs because the firm is subject to pressures, i.e. coercive, exerted by the institutional context to incorporate and conform to those forces' requirements (DiMaggio and Powell, 1983; Meyer and Rowan, 1977; Scott, 1995).

3.1 Coercive Pressures: External Interested Parties Motives

According to DiMaggio and Powell (1983) and Moll et al. (2006), institutional coercive pressure refers to the external pressure either formal or informal which is exerted by other organizations, such as: governmental and regulatory bodies, and suppliers on a firm from its environment to force it in order to adopt certain procedures or requirements; in order for firms being provided with the necessary support and resources for continued existence, operation, success, and survival (DiMaggio & Powell, 1983; Pfeffer & Salancik, 2003).

Financial suppliers: carpenter and Feroz (2001) take the view that firms need financial resources from their environment in order to enhance their chances of survival. Reliance on the same financial providers significantly exerts coercive pressure on firms to meet those suppliers' requirements (Thompson, 1967 - cited in DiMaggio & Powell, 1983). This is supported by Powell's (1983) argument that "the *stronger party* to the transaction [financial suppliers i.e. capital and credit markets] can *coerce the weaker party* [firms] to adopt [certain] practices [managing FRs] in order to accommodate the *stronger party's needs* [publishing favourable financial results]" (cited in DiMaggio and Powell, 1983, p.154, emphasis added).

Regulatory bodies: coercive pressure also stems from the role and ability of regulatory bodies to regulate and limit firms' behaviour and actions (DiMaggio and Powell, 1983, 1991) by establishing explicit regulative activities, involving setting regulative rules, monitoring firms' conformity to such rules, and establishing rewards/sanctions for firms' conformity with or departure from such rules (Wickramasinghe & Alawattage, 2007).

As a result, those regulatory agents have an impact on the future performance and behaviour of firms (DiMaggio and Powell, 1983, 1991). Accordingly, Egyptian Stock Exchange (EGX) constitutes one of such institutional agents; a regulatory agent which exerts regulative coercive pressure on firms to conform with and meet its listing/delisting rules' requirements.

EGX's listing rules: according to Article (9)/ Item (A): Egyptian Securities Listing of the "Egyptian Financial Supervisory Authority's Board Decision" No. 50 for the year 2009², shares that are compliant with the following conditions at the time of submission of listing application shall be listed: F) "Net profit percentage before deduction of taxes *at last fiscal year* preceding listing application shall not be *less than 5% of the paid capital to be listed*, [which is] *originating from the company's practice of its business, which achieves the main purpose of the company...*" (emphasis added). "As exception from the above ... Shares of the company not fulfilling the condition (F) may be listed ... conditions ... that average annual net profits of the company ... for the *last three years* preceding listing application ... shall not be *less than 5%*, and provided that no losses are incurred during any of *the three fiscal years* preceding listing application" (emphasis added).

EGX's delisting rules: in accordance with Article 34 of the Capital Market Authority's Board of Directors Decision No. (94) of 2008³, "Listing Committee shall *delist the shares* of a company if the company does *not meet* the requirements of *the minimum net profit* and shareholders' rights for *two fiscal years* after the listing ..." (emphasis added). That is, there is a pressure exerted by EGX's rules on firms to report operational profits for more than one year. In fact, this pressure was significantly strengthened after adopting new economic system in Egypt, privatisation, in 1991 which has significant effects on activating EGX's role and its listing/delisting regulations. This is consistent with Greenwood and Hinings's (1996) argument that interplay between economic and institutional contexts can generate pressure to adopt certain behaviour- i.e. publishing favourable FRs. Powell (1991) and Scott (1991) argue that both institutional and economic pressures are exerted on firms which then seek to respond to and comply with them in order to secure their survival (Powell, 1991; Tsamenyi, et al., 2006). As a result, Oliver (1992) pays significant attention to the importance of incorporating economic considerations with institutional pressure as a way helping to precisely explain organizational behaviour when deciding whether or not an institutionalized activity is persistent, leading to an adequate and convincing view of organizations' behaviour in the modern world. This paper accordingly supposes that firms are exposed to coercive pressures exerted by institutional factors existing in Egyptian context, namely: capital and credit markets, and EGX, to meet their requirements, i.e. publishing favourable FRs, in order for firms being supplied with support and funds necessary for securing their operations and survival. That is, coercive pressures constitute motives for adjusting firms' earnings figures to comply with the requirements of such institutional parties; the question raised here is that how corporate executives react to such pressures.

The institutional literature answers this question by suggesting that when they face inevitable regulatory requirements or imposed practices (Oliver, 1992), these external institutional pressures drive powerful firms to search for and create a strategy designed to either compromise or avoid ("buffer") the influence of these pressures exerted by environmental agencies on their performance which, in turn, results in a "coupling/decoupling" process (Modell, 2002 and Zucker, 1987); as a device which can be employed by firms to link together the requirements of institutional elements and firms' technical activities which firms have to fight to combine in order to demonstrate that they are legitimate and 'acting in good faith' (Meyer and Rowan, 1977; Oliver, 1992). NIS continues to suggest that coupling/decoupling process should be based on using "rule-like", "taken-for granted" assumptions (Meyer & Rowan, 1977), e.g. real economic activities. Modell (2002) asserts that a decision aimed at compromise or avoidance the environmental requirements rests critically on managers' ability to evoke relatively unquestionable justifications for supporting the superiority and efficiency of the technique created, especially when it is compared with other alternatives. In this respect, Pfeffer (1981) argues that organizational politics -and activities- can be used as coupling (or buffering) mechanisms.

3.2 Real Business Activities-based Coupling Mechanisms: EM Techniques

² It mandated the article 9 of the Decree of the Capital Market Authority's Board of Directors No. 30 - Dated June 18, 2002.

³ It mandated Article Thirty-Four of the Decree of the Capital Market Authority's Board of Directors No. 30 -dated June 18, 2002.

Given the normal role of managers as decision-makers who inevitably possess private information about a firm's underlying operations, provides executives with the potential to make decisions related to these operational and real economic activities as a rule-based and legitimate strategies, e.g. sale discount policy, allowing them to manage firms' FRs in a way that enables them to be coupled with the requirements of external factors i.e. publishing favourable financial reports. In this regard, Jensen (2001, p. 309) states that "it is our job as ... managers ... to conform to the pressures of [external factors such as] equity and debt markets when those markets do not have the private competitive information that we possess [and when we have ability to make decisions related to the operational activity of the firm]". This argument raises a need to highlight the reasons behind the managerial intention to employ real-activities-based EM techniques as prevailing and taken-for-granted coupling tools so as to comply with and accommodate the requirements of institutional factors.

3.3 Consequences of Using Rule-based Coupling/EM Mechanisms

NIS suggests that firms' confidence, "maintain[ing] face", and securing the good faith of both their internal participants and external constituents are the source of appearing useful and legitimate (Meyer and Rowan, 1977). Thus, it is necessary for a company to undertake tasks and activities smoothly through proper, rule-based methods and through "policing internal operations", in terms of maintaining generally accepted institutional procedures and rules in order to protect its activities from being questioned and itself from being perceived as irrational. Hence, this helps a firm not only to justify its practices and activities but also to enhance its competence and confidence, strengthen its legitimacy, and sustain "continued moral[ity]" (Meyer & Rowan, 1977; Modell, 2002; Suchman, 1995). Meyer and Rowan (1977) make this point by highlighting that being seen as a legitimate firm has favourable effects in terms of helping a firm to avoid, or at least minimize, external and internal scrutiny, because organizations are operating in "environments that have institutionalized the rationalized rituals of inspection and evaluation" and which possess the means to discover activities and "deviations that undermine legitimacy" (ibid.). Another favourable and the most important consequence of being perceived as a trustworthy and legitimate firm is decreasing turbulence, maintaining stability, and mobilising support from a broader range of external bodies, e.g. external constituents, government or regulatory bodies (Carpenter & Feroz, 2001; Collier, 2001; DiMaggio & Powell, 1983; DiMaggio, 1988; Meyer & Rowan, 1977; Moll, et al., 2006; Oliver, 1992; Scott, 1987; Zucker, 1987). This enables a firm to enjoy support from external resource providers, gives it greater and more flexible access to resources, and in turn buffers it from failure and enhances its chances of success and survival prospects in the long term (Carpenter & Feroz, 2001; DiMaggio & Powell, 1983; DiMaggio, 1988; Meyer & Rowan, 1977; Moll, et al., 2006; Oliver, 1992; Scott, 1987; Zucker, 1987). Meyer and Rowan (1977) also make this point, arguing that organizations seek to achieve legitimacy with the public, the state, the capital market, and shareholders. In this way, an organization's credit position is improved, enabling it to obtain investment, debts and donations more easily which are necessary for their future survival prospects. Arthaud-Day et al. (2006) and Suchman (1995) assert that key audiences and financial resource providers are most likely to support and supply resources to desirable, proper, legitimate and trustworthy firms. Accordingly, this paper assumes that adopting real activities-based EM mechanisms, as legitimate and rule-based activities to accommodate the prevailing environmental requirements, namely publishing favourable FRs, emerges from a firm's need to enhance their legitimacy, which is essential for reducing outsiders' scrutiny e.g. investors and EGX's regulators, and mobilising support from external resource providers, necessary for securing their success and survive.

4. Research Method and Methodology

As suggested by Zikmund et al. (2010), human beings' experiences, behaviour, decisions, and motivations should be explored within the context in which those people live and work, because these factors are inherently shaped by their context. Thus, getting better understanding about whether executives intend to use certain EM mechanisms when there are certain EM motives existing in Egyptian context, necessitated adopting an interpretive approach that helps to elicit the opinions, beliefs, and attitudes of individuals deeply involved in EM phenomenon. The research method is semi-structured interviews which include opening and probing questions, as shown in table A: interview guide.

Table (A) The Interview Guide

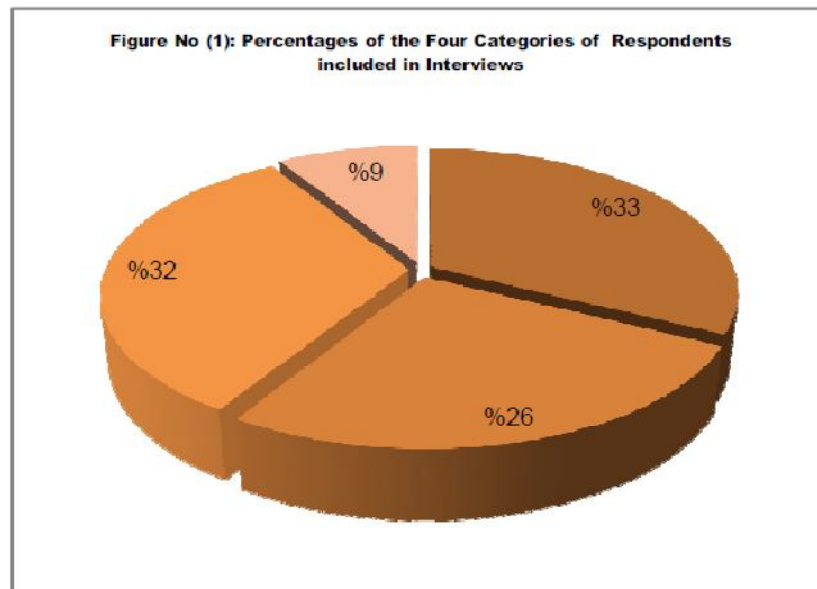
Part I : Introduction and background questions
Part II: Earnings Management Motivations: External Motives
Opening Question: in your opinion what motivates you (a firm management) to adjust the reported earnings of your firm (of such firm)?
Probing Questions:
1) do you think that firm's financial suppliers and Stock Exchange have considerable impact on modifying the financial results of a firm?
2) please could you clarify whether there is specific financial requirements of the firm's financial suppliers and Stock Exchange that significantly affect management intention to modify the financial reports?
Part III: Earnings Management Techniques
Opening Question:
If the firm's external parties have certain financial requirements motivating you (management) to modify the financial reports, do you think that those requirements influence your (management's) intention to choose a particular set of mechanisms for modifying FRs to meet these requirements? why?

Words in bold and between brackets indicate to the part of the question, which was changed to rephrase the whole question to be suitable for interviewing groups rather than firm's management group.

Interviewees were asked similar questions in different ways in order to check the validity of the responses of one group against the answers of others. In additions, Egyptian official documents and laws, e.g. company law No.159/1981; Egyptian Stock Exchange's rules; and Egyptian Accounting Standards (EASs), were included in the process of collecting and analyzing data.

Table (1) and Figure No (1) show that a total of thirty-four participants were interviewed, who were divided into four categories namely: firms' executives; investors; auditors; and EGX's regulators.

		No. of Interviewees	
Auditors:	Large firms	5	
	Small and medium firms	4	
Total		9 (26.4%)	
Financial report users (Financial analysts):	Securities Brokerage firm: Large	4	
	Medium	7	
Total		11 (32.4%)	
Firms' Executives:	Industrial Companies:	Textile industrial co.	1
		Pharmaceutical industrial co.	2
		Motor industrial co.	2
			5 (45.4%)
	Service Companies:	Restaurant and Hospitality co.	1
		Securities Brokerage co.	5
			6 (54.6%)
Total			11 (32.4 %)
Regulators:	Egyptian Exchange (EGX)		3
Total			3 (8.8 %)
Total interviewees			34 (100 %)



As shown in Table (1), the 'preparers' category (executives) makes up 32.4% of the interviewed participants. It consists of executives from five different companies, including three industrial companies (45.4%) and two service companies (54.6%). Industrial companies comprise: textile companies; pharmaceutical companies; and motor industry companies. Meanwhile, service companies include: restaurant and hospitality companies; and securities brokerage companies. The financial report users' category (financial analysts) makes up 32.4 % of the total interviewees; this consists of large companies and medium sized companies. The auditor category makes up 26.4% of the total interviewees and includes both large and small audit firms. Finally, the EGX regulators group makes up 8.8 % of the total interviewed sample. This diversity was an attempt to maximise the difference within the sample, and hence to create a representative and inclusive sample relative to the parent population for the sake of enhancing the validity of the study (Lewis & Ritchie, 2003). Using diversity sample also facilitated the collection of rich data and helped to identify the themes shared between different participants so as to ensure the reliability of the data collected. Also, for increasing the research reliability, most of interviews were conducted with senior employees who were likely to exhibit high levels of integrity; and with auditors, analysts, and the Stock Exchanges' authorities who had no incentive to be untruthful. Research participants were selected by using a purposive (criterion-based) sampling technique as a way to enhance the research validity, whereby respondents were chosen based on having certain features including: their knowledge and experience; their roles and professional positions; their attitudes, beliefs and perceptions, and their ability to shed light on EM phenomenon under study (Ritchie et al., 2003), demography of research's respondents is shown in tables 2,3, 4 and 5.

Table (2): Demography of EGX Regulators

Regulator	Position ¹	Age	Years of Experience	Certificate	Institution
REG1	-	49	10	PhD, UK	The Egyptian Exchange
REG2	-	39	6	MBA, Durham, UK	The Egyptian Exchange
REG3	-	43	8	MBA	The Egyptian Exchange

Table (3): Demography of Corporate Executives

Manager	Position	Age	Years of Experience	Certificate	Field/ Company
MAN1	Financial manager	42	12	Diploma in accounting and audit	Pharmaceutical industrial company
MAN 2	Accounting manager	37	9	Diploma in accounting and audit	Pharmaceutical industrial company
MAN 3	Financial controller	38	16	Master business administratn (MBA)	Car industrial company (assembling cars)
MAN 4	Financial manager	33	10	MBA	Car industrial company
MAN 5	Financial manager	50	25	MBA	Textile company
MAN 6	Financial manager	42	20	Diploma in accounting and audit	Restaurant and Hospitality
MAN 7	Financial manager	28	6	MBA	Brokerage company
MAN 8	CEO or Managing Director	60	41 in general 14 year in brokerage	MBA	Brokerage
MAN 9	Chairman of the Board of Directors	55	27	PhD in accounting	Brokerage
MAN 10	Financial manager	56	35	Master business administration (MBA)	Brokerage
MAN 11	Chief executive officer (CEO) Managing director	59	27	PhD in financial and economics	Brokerage

Table (4): Demography of External Auditors

Auditor	Age	Experience	Firm size	Certificates	Position
AUD1	26	4	Big	Master in auditing	Auditor
AUD2	28	6	Big	Master in auditing	Auditor
AUD 3	26	5	Big	Master in auditing and tax diploma	Auditor or Manager Deputy Director (direct auditor)
AUD 4	25	4	Big	Diploma in Auditing	Senior
AUD 5	45	12	Big	PhD in accounting and auditing	Partner
AUD 6	45	18	Small	PhD in accounting and auditing	Owner , partner
AUD 7	46	19	Small	PhD in accounting and auditing	Owner , partner
AUD 8	30	7	Small	Diploma in auditing	Senior
AUD9	30	6	Small	Master in auditing	Auditor

Table (5): Demography of Financial Analysts

Financial analysts	Age	Year of Experience	Position	Certificate (s)	Firm	
FAN1	42	16	Vice president/ researcher department	Certified portfolio management	Large	
FAN 2	28	6	Financial analyst	MBA, Master in Business Administration	Medium	
FAN 3	31	7	Technical Analyst	Master in economics	Medium	
FAN4	35	12	Head of research/ financial and technical analyst	Diploma in investment management / Master in investment management	Medium	
FAN 5	35	15	Managing director (CEO)	Diploma in analysis stock markets/ Diploma in Fundamental Islamic Finance	Medium	
FAN 6	60	25	Financial analysis	PhD in finance	Medium	
FAN 7	38	16	Managing director	MBA in financial analysis/ Diploma in financial analysis	Large	Vice president of the Egyptian committee of stock markets development, vice present of the Egyptian committee of finance and investment studies.
FAN 8	26	4	Financial analyst	Diploma in stock market studies/ MBA in markets stock studies	Large	
FAN 9	30	10	Financial analyst/ Manager of Research and of investment	Certificated Management Accounting (CMA) / Certificated financial managers(CFM)/ Chartered Market Techniques (CMT)/ Certificated Portfolio Managers (CPM)	Medium	
FAN 10	27	8	Financial analyst		Medium	
FAN 11	49	18	Financial analyst/ writer in the financial and economic press	MBA and PhD in finance	Large	Member in the Egyptian Capital Market Association ECMA, member of the Egyptian committee of stock markets development

Furthermore, prompting the research's validity entailed being unbiased during the analysis of the data collected (Lewis & Ritchie, 2003), this necessitated providing explanations for the phenomenon, not only by incorporating, analyzing and inspecting all the data collected about it without exception (Mehan, 1979; Silverman, 2010), but also by avoiding the use of brief "conversations, snippets" from interviews or just "a few well-chosen examples" (Bryman, 1988; Silverman, 2000). Data were then analysed by using Ritchie & Spencer's (2002) thematic approach, requiring the implementing of the following steps. First, the researcher constructed a thematic framework or index based on the research questions, and interview questions. Indexing was next step, in which researcher systematically applied the thematic framework to the gathered information in its textual form. Next, the researcher transferred the data from its original contexts to be rearranged in accordance with the headings and subheadings drawn from the thematic framework -i.e. according to each interview question.

Using direct quotations from participants' answers enhances the validity of the research in terms of providing accurate and correct interpreting, and representing in ways that they are perceived by the research respondents and population. Mapping was the final step in which the researcher focused on interpreting the data and provided answers to the research questions. This was achieved by defining concepts; searching for patterns and connections; providing explanations for internal patterns within the data; comparing the participants' perceptions, beliefs, or experiences; and developing strategies for and "maps" of the nature of EM incentives' impact on employing certain EM techniques.

5. Results

This section is concerned with providing empirical evidence through eliciting the interviewees' views regarding the factors motivating corporate executives to manage their firms' financial position in the Egyptian context, and in turn their opinions about whether or not meeting the requirements of these motivational factors needs employing certain mechanisms.

5.1 Earnings Management Motives

Research's respondents referred to financial suppliers and Egyptian Stock Exchange's regulatory rules as important EM incentives in the Egyptian context.

5.1.1 Financial Suppliers

All manager, auditor and analyst interviewed groups generally identify financial suppliers, i.e. investors and creditors, as an important source of pressures exerted on management to adjust the financial position of their firms for the sake of funding their activities. This is because "... without publishing favourable FRs financial suppliers, either stockholders or loan providers, will withdraw their money resulting in the closure of the firm and an end to its work" (AUD3, big firm, auditor).

Investors

When asked about investors as a motivational factor which influences them to favourably adjust the financial reports, all the interviewed participants were quick to distinguish between two kinds of stockholding, stating that: "in the EGX there are two kinds of investors: long-term investors and speculators" (REG2). "2 years ago the Egyptian market's structure consisted of 60-70% retail [speculators] and 30-40% institutions or long-term investors ... nowadays the percentage of investors has risen to more than 50% ... the current political and economic situations has caused the retail percentage to fall to less than 50% ... " (REG1). Interviewees' responses highlight that unlike "speculators who buy and sell securities in light of fluctuations in the market value of firms' stocks and, hence, care about short-term profits and the stock price to benefit and profit from the stock price fluctuations ..." (REG2); long-term or institutional investors are interested in increasing the firm's long-term-value on the stock market and its stock price in long run and thus their requirements are more concerned with long-term profits compared with short-term profits when evaluating and choosing a firm for investment. Analysts, executives and regulators all highlight that reporting a short-term profit just provides investors with a favourable first impression about the firm to be chosen as the best investment opportunity, due to "... two kinds of beneficial effects of reporting profits: capital gains in terms of an increase in the stock price (I bought the stock for 10 pounds and its market value became 15 pounds) and revenues in terms of dividends" (REG2).

Executives made the point that although "initial forecasts made by the investors and their representatives i.e. analysts are firstly influenced by reporting short-term losses or profits ..." (MAN11, a managing director); investors significantly fixate on reporting long-term profits. Analysts and regulators explained this by stating that investors are seen as long-term investment hunters who "usually try to choose the best opportunity from the many investment opportunities available on the stock market" (FAN8); which "... offers potential for further gains and is able to broaden its activities, survive, continue and success in the future..." (FAN10). Analysts, therefore, state that long-term investors care about long-term firm's value, and fundamentally base their investment choice on long-term financial achievements for the firms; accordingly, "the financial reports' analysis is done not over one year but over 3-5 consecutive years ..." (FAN9). To that effect, interviewed managers and analysts stated that because investors evaluate firms based on publishing long-term profits, more emphasis is placed on the sources of this kind of profits.

Analysts, therefore, highlighted that investors "... put more emphasis on whether a company sustains real profits and cash flows, resulting from its basic and operational activities ... ; and on whether a company sustains real losses i.e. operational losses ..." (FAN9); "... so as to be sure whether the company's profits are real and come from its basic activities as a permanent source of profits because of their concern with the company's ability to broaden its activities, continue, survive and prosper in the future" (FAN2). The analysts said that therefore "... the actual evaluation of the firms and their stocks' market value is based on long-term profits and cash flows from their operational and core activities ..." (FAN4). The analysts' group continues to state that "... I focus on the operational profits and cash flows more than any other kinds of profits or cash flows because they are a very clear indicator of the firm's financial strength that give me a picture of whether a company's cash flows and its liquidity are permanent and can be continuously created..." (FAN9); and "... exclude the positive change in profits number resulting from changes in accounting methods..." (FAN3). Thus, the regulators asserted that increasing the firm's revenues as the main source of operational profits has a positive effect on the firm's position in the stock market. So that, auditors and executives support the aforementioned views and add that managers "try to listen to investors' requirements" in terms of "meeting their requirements which exerts pressure on managers to adjust the firm's profits, resulting from basic activities of the firms over long-run" (FAN2).

Creditors

All executives generally stated that "my financial results affect my negotiation with the creditor and hence affect the credit terms ..." (MAN3, a financial controller). Because "profits, specially profits result from the firm's basic business, are an indicator of my ability to repay a loan" (MAN10, a financial manager). However, losses are a "red warning sign" for the possibility of losing the lender's money. Thus, executives', auditors' and analysts' groups indicated that, "of course reporting losses -*specially operational losses*- has direct negative effects on the creditors' willingness to provide such companies with funds ... they will be reluctant to offer finance to such a company ... or they might provide loans with very strict credit terms, if any" (MAN8, CEO). "The creditor will increase the interest rate because of the high risk related to the firm's ability to repay such debt in due time. In addition to providing me with less money than I need, the creditor will also shorten the whole repayment period, in which I must repay the debit and shorten the regular interim period" (MAN3, a financial controller). Consequently, executives' group believes in the importance of publishing cash flows and profits, resulting from operational activities as the "cornerstone" and an essential requirement for getting a loan. Because this makes creditors convinced about the firm's ability to continue, and hence its ability to meet its obligations. The executives and analysts indicated that therefore creditors "compete" to offer loans to firms with good operational profits. However, a lower level of these profits makes creditors reluctant to offer loans. Executives and auditors claim that, although reporting operational profits strengthens the bargaining position of the firm, it is not enough for the lender to base a credit decision on. A firm's financial position is another essential issue. Both groups believe that making credit decisions is based on to what extent the firm enjoys a strong financial position and publishes long-term profits. Respondents therefore recognise that lenders usually subject the firm to rigorous financial scrutiny by analyzing the firm's financial reports across many years for the sake of checking and determining to what extent the firm enjoys a healthy financial position and is able to continually report profits, which in turn reflects its ability to thrive and to repay the loan; accordingly, they decide whether or not it should be offered a loan. "Firms that depend on loans ... try to publish profits for at least two consecutive years to get funds from banks ..." (AUD8, small firm, senior). As a result of creditors' intention to analyse the firm's FRs over many years, and their concern on reporting profits realising from basic activities of the firm as essential requirements for getting a loan, executives reveal their intention to manage operational profits upward not only for one year but also for many years for the sake of publishing long-term favourable financial results and hence for getting a loan.

5.1.2 Regulatory Bodies

In Egypt, the official documents regarding listing/delisting rules of the firms' securities entail and hence force firms to publish profits. Regulators referred to these rules and stated that, when firms seek to be listed for issuing stocks for the first time, they must meet certain requirements of the EGX's listing department, including providing profitable financial statements.

The listing committee makes the final decision about whether or not the firm will be listed, based on its ability to "achieve profits of at least 5% of the firm in paid capital resulting from its *basic activities* for the last *three years* of listing application or registration and not reporting losses during such years." (REG3)". Similarly, analysts and auditors supported the regulators' view by stating that reporting profits in the period preceding the listing registration is a core requirement of the EGX for listing a company, and that "EGX will not help a company that achieves losses to obtain capital" (AUD7, small firm, partner). Moreover, the EGX's regulators emphasise the importance of continuous reporting profits by stating that, "referring to delisting rules, in the case of reporting losses or achieving profits of less than 5% of the firm's paid capital resulting from its *basic activities* for *two consecutive years*, the listing committee can delist this firm from the EGX. We delist firms which are low quality and which achieve a high percentage of losses to protect investors" (REG3). Regulators stress their role in protecting the EGX's dealers by acknowledging that, "as a regulator, I protect investors through following the EGX's rules to delist low quality securities ..." (REG2). The analysts group shares the view that, "the EGX review and re-evaluate the firm's listing situation, if it reports losses for 2 consecutive years it delists the firm for the sake of protecting investors" (FAN8). Therefore, executives, auditors and analysts agree that listed companies come under pressure to continuously report profits *resulting from operational activities* in order to remain listed on EGX. Interestingly, a chairman of the board of directors of a brokerage company highlights the fact that, "strict application of the EGX's listing/delisting rules, especially regarding reporting profits, resulted in decreasing the number of listed companies from 744 to 306 companies in 2005 and 2009 respectively ..." (MAN9, a CBD). Therefore, all the interviewed groups indicated a clear-cut consensus that "... the EGX's rules exert pressure on firms to report profits and hence provide a significant motive for managers to positively adjust the FR in order to continuously report operational profits and hence to meet the EGX listing requirements and to avoid delisting situation..." (AUD5, big firm, partner).

5.2 Mechanisms Used for Adjusting the Firms' Financial Reports

Empirical evidence was provided about financial suppliers and stock exchange as significant corporate executives' motives to manage profits in order to comply with these motivational factors' requirements in terms of continuously reporting profits, resulting from the basic activities of firms. This section continues to present empirical evidence about the mechanisms which managers choose and employ to manage earnings for achieving this compliance. Executives mentioned "... two alternative techniques which are available and could be used for adjusting the financial position of a firm: accounting actions mechanisms; and operational activities mechanisms" (MAN1, a financial manager). When asked their views on whether they could change accounting methods as EM mechanisms, they said that: "thanks to the accounting standards⁴, which give me the green light to choose between the available accounting methods such as: inventory method and depreciation method, I can replace one method with another, enabling me to report less costs and hence higher profit figures, as a technique used for boosting my profits upwards" (MAN4, a financial manager). However, executives' group generally expressed their preference to "... make decisions regarding the basic and underlying activities such as: operational activities that include sales activities, advertising expenditures, and overproduction as another EM mechanism, which can be used to direct the reported earnings by adjusting the timing or/and scale of such activities..." (MAN9, a CBD). Most of interviewed groups, especially executives working in both the service and industrial sectors, stated that "a sales price reduction and granting more lenient credit terms are mechanisms which [managers] can resort to increase the firm's operational profits and, in turn, to make financial positive adjustment" (MAN 6).

As for advertising expenses mechanism, literature revealed that managers can increase their advertising spending to immediately boost sales, and hence, to make rapid adjustments in the firm's revenues and earnings (Cohen et al., 2010). The executives confirmed this issue by "... we can increase our operational profits and hence positively enhance our FRs by increasing revenues via increasing advertising activities ... " (MAN1, a financial manager). In addition, as specified in paragraph (69) of EAS (23) the "Intangible Assets" that: "examples of expenditure that is recognised as an expense when it is incurred include: ... expenditure on advertising and promotional activities ...". Thus, the executives group assert that reducing advertising expenditure can be used as a technique for managing profits in condition it must be used effectively; meaning that decreasing advertising expenses should not negatively affect the sales volume or the firm's market share.

⁴ EAS no (2) "Inventories" and EAS (10) "Property, Plant and Equipment

They continue to say that this can be achieved by choosing the cheapest advertising method but using it in the most effective way to keep advertising costs to a minimum. They stated that "... using cheap sources of advertisement, e.g. bulletin boards, enables them to inform customers about the firm's products/services, instead of using very expensive methods e.g. TV advertising, both can effectively advertise the firm's products/services, and hence firms' expenses can be reduced, leading to a possibility to boost operational profits upwards" (MAN8, CEO). The auditors confirmed the executives' claims by stating that "I reviewed a very famous firm in its field, and I noted that it had cancelled a TV advertisement which cost 2-3 million [Egyptian] pounds and replaced it with less expensive methods like advertising in the newspapers to boost its profits. These reduced costs have now become profits" (AUD3, big firm, auditor). The analysts and auditors also added that firms effectively reduce advertising costs by reducing the number of times an advertisement is shown on TV or shortening the duration of each advertisement. Finally, executives working in manufacturing companies mentioned overproduction as an EM technique and state that "we may produce a higher level of production than the normal given level in order to reduce the cost of goods sold. This is because overproduction causes fixed overhead costs to be spread over a large number of units, leading to a decline in the fixed cost per unit and hence the total cost per unit. This is done in order to increase the operating contribution margin per unit and, in turn, increase the annual operational profits" (MAN5; financial manager).

5.3 Justifications for Using Operational Activities EM

This section analyzed research participants' views to uncover the rationales for why managers choice and employ firm's operational activities and avoid using accounting actions as EM techniques when they become interested in obtaining funds or in meeting the requirements of EGX's listing rules.

5.3.1 The Effect of Operational Activities on Firm's Operational Profits and Cash Flows

Considering the significant effect of positive profits and cash flows, especially resulting from operational activities, on investors, creditors and regulators when evaluating the firms' market value and hence deciding whether to deal with them, makes all executives significantly in favour of using these activities to adjust the financial image and against using accounting actions. Their argument is based on the grounds that "when accounting actions [are used] to adjust the reported earnings, [this] results in neither real changes in firms' profits nor their cash flows; it is just a fake and theoretical change made in the accounting reports and in the profits figures ..." (MAN1, a financial manager). In a similar way, the majority of the analysts' group thought that, "when I achieve or report profits by changing the accounting policies, this does not mean I have cash flows, which is preferred by outsiders ..." (FAN7). Thus, analysts continue stating that the positive change in profits number resulting from changes in accounting methods is excluded from the financial analysis of the firm while evaluating its market value. By contrast, executives favoured the idea of using real actions as EM mechanisms "to modify the reality of the firm's profitability image by using methods which yield operational and actual profits and cash flows ..." (MAN2, an accounting manager). In light of this reason, the priority of adjusting advertising expenses; overproduction; offering sales discounts and easier credits terms used as preferred EM tools is justified. This is because using those techniques helps "a company [to] achieve sales' revenues and operational profits and cash flows resulting from its basic activity ... that has a positive and direct effect while analysing and evaluating the financial status of firms by financial providers and Stock Exchange..." (FAN6). By the same token, executives and analysts "... do not prefer using EM mechanisms which yield capital cash flows, i.e. fixed assets disposal because ... they are temporary profits deriving from non-operational or non-core activities of the firm" (MAN3, a financial control), which are "... exclude[d] ... from the financial analysis of the firm " (FAN5).

5.3.2 The Flexible Use of Operational Activities

Outsiders i.e. financial providers and EGX require publishing operational profits and cash flows in a continuous way. Thus, availability and flexibility of using a certain kind of financial adjustment mechanism influences the executives' preference for whether or not to employ it which helps them to achieve ongoing process of financial adjustments required by outsiders. In light of EM mechanism's flexibility which is reflected in the number of the times that it can be used, executives revealed their antipathy towards changing or using accounting methods as EM techniques. This is because of that, "although the accounting standards give me the right to change the accounting methods ... this change would be made in one direction and only one time ... and cannot not be changed back again ... they would consider as a single-direction EM tool which will not make [managers] able to continuously report favourable FRs" (MAN2, an accounting manager).

The executives and auditors explained this by stating that "... for instance, changing from one method of depreciation to another needs agreement and permission from both the general assembly of shareholders and auditor ... As an auditor, I will permit the client to change these policies for one year only and in one direction ... [and] it would be very difficult for them to get a permission to change the method again the following year for the sake of avoiding the professional responsibility involved in granting such permission" (AUD3, big firm, auditor). Thus, the analysts believed that, "... even if the changes in accounting policies succeed in increasing the profits one year, those changes will not affect the profit figures next year ..." (FAN11). Another important restriction for employing accounting policies to manage profits raised by new accounting standard no 5 by requiring firms to declare the retroactive effect of changing an accounting method on the FRs, as specified below: "When a change in accounting policy is applied retrospectively ... the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied" (Paragraph 22, EAS no 5). Thus, this standard creates obstacle for management if they want to change the accounting methods. Auditors took the view that "[this standard] works against management because it limits their freedom to make changes in the accounting methods ... [in terms of] force [ing] management to show the retroactive effect of changing an accounting policy on the profit figures, causing such practices to be curtailed" (AUD3, big firm, auditor). As for real economic activities, the majority of the auditors and executives believed in their continuous use. "Managers can use operational actions whenever they need to, at any time, and for an unlimited number of times and years ..." (AUD7, small firm, partner), because they are flexible "... EM tool in the management's hands ...which helps executives to continuously publish positive operational results" (AUD9, small firm, auditor). As a result, the auditors stated: "adjusting real economic activities is the EM method most preferred by the management, because its use is more flexible than accounting actions in adjusting profit figures" (AUD8, small firm, senior).

5.3.3 The Operational Activities' Ability not to Attract External Scrutiny

In accordance with paragraph 13 and 29 of the EAS no (5), "Accounting Policies, Changes in Accounting Estimates and Errors", "an entity shall select and apply its accounting policies consistently for similar transactions"; "when a voluntary change in accounting policy has an effect on the current period or any prior period ... an entity shall disclose: (a) the nature of the change in accounting policy; (b) the reasons why applying the new accounting policy provides reliable and more relevant information ...". All the members of the auditors' group and the majority of the analysts' group referred to these accounting standards and stated that reviewing the firms' FRs is guided by the professional standards, which require continuous use of the accounting methods over many years and also require the firm to announce the reasons behind any changes in its accounting policies, and for the external auditor to search for, agree on and report such reasons. Thus, the executives expressed the idea that, due to the influence of the professional standards on the adoption of particular accounting methods and on any changes to them "... [these practices] must attract the auditor's attention ... [because] according to the requirements of those standards, the core duty of the auditors is to disclose any changes in the accounting method and the reasons for these changes in the audit report ... [This makes them a] very sensitive issue for the auditor" (MAN6, a financial manager), [leading] to give due attention to the consistent application of the accounting methods. Many of the executives, auditors and analysts interviewed groups revealed a conclusive consensus on this argument by expressing the idea that the influence exerted by the accounting standards on "... the application of the accounting methods and any changes to them are related to, and governed by, accounting standards ... thus they not only attract the auditors' attention but also that of all scrutinising or regulatory bodies (e.g. Egyptian Financial Supervisory Authority), due to the fact that ... all those bodies ... have the same aim: protecting stockholders' rights and values" (AUD1, big firm, auditor). "In Egypt, there are very strict monitoring activities from regulatory bodies for frequent changes in the accounting methods" (FAN7).

The executives and analysts agreed on this issue and added that "changing accounting policies needs disclosure and hence will be questioned by many different parties, e.g. the auditor, the Egyptian Financial Supervisory Authority, and the tax agency; hence it becomes clear and visible to other outsiders, e.g. investors and financial analysts. Consequently analysts highlighted that such changes come under the spotlight, meaning that "anybody who tries to evaluate a firm can easily recognize that any change in its accounting methods is a way of artificially changing the profit figures and adjusting the financial reports" (FAN2).

Thus "... those changes alert [external parties, e.g. financial analysts and investors] to the fact that there is something wrong in the firm and make [them] doubt the firm's credibility; leading to negative effects on [their] expectations and hence on the stock price ..." (FAN11).

Hence "... [executives] are not in favour of employing accounting actions to sustain outsiders' trust in the firm and protect its stock value from reduction ..." (MAN6, a financial manager). At the opposite end of the spectrum stands the use of real economic activities of the firm. Unlike the accounting methods, decisions related to firms' operational activities techniques are not circumscribed by professional standards. The majority of highly experienced executives', auditors' and analysts' groups asserted that "real economic activities including: operational activities are related to administrative decisions where there are no rules governing them..." (MAN11, CEO). All the executives', auditors' and analysts' interviewed groups explained that "making financial adjustments via the operational activities of the business is a normal administrative practice and part of general operational decisions, which are made in the normal course of running the firm's activities. Making those decisions is in the hands of the firm's management ... [management] fundamentally control them, and is a part of their responsibility for running the firm in order to pursue its financial targets" (MAN3, a financial controller). The executives' and auditors' groups continued explaining that "... professional standards do not require [auditors] to disclose in their reports the reasons for changes made in the real economic activities ..." (AUD1, big firm, auditor). Hence, it is outside of their remit either to "... negotiate with and ask the firm's management to justify those changes or to accept/reject such changes" (AUD4, big firm, senior). Auditors should not "intervene in the company's decisions regarding the expenses or revenues, because these decisions are up to the company's management" (MAN7, a financial manager). The analysts shared this view and highlighted that "... auditor's comments on changes in real actions, e.g. sales policy, is not a part of his or her core job" (FAN9). The executives, auditors' analysts' and regulators' groups add that not only auditors but also "... other regulatory bodies, i.e. the Egyptian Financial Supervisory Authority, do not check or monitor real economic activities ... [because] this task is outside of their remit or monitoring scope" (FAN9), thus, "... externally, nobody has the right to ask [management] about the decisions made regarding, [for instance], reducing the advertising costs or decreasing the sale price" (MAN10, a financial manager). Similarly, the regulators confirmed that "it is up to [management] to either reduce or increase [the firm's] expenses; it is not a part of the monitoring bodies' responsibility" (REG2). To this effect, the executives stated that "... modifying the profit figures through real economic activities does not result in either attracting attention of or conflicts with monitoring and controlling agencies, e.g. the Financial Supervisory Authority, the Tax Agency or external auditors ..." (MAN2, an accounting manager). Therefore, executives revealed that employing real economic activities for the sake of managing profits through reporting increases in the firm's basic profits is not observable by outsiders such as: financial suppliers and does not negatively affect the credibility, visibility and transparency of our FRs and hence increases their confidence and trust in the firm, resulting in increased stock price ... This leads to managerial preferences for using these activities as EM mechanisms" (MAN2, an accounting manager).

6. Summary, Discussion and Conclusion

EM literature has remained the relationship between existing certain EM motives and using particular EM mechanisms unclear. Thus, the aim of this study is to explore whether or not the existence of certain EM motivational factors in Egyptian environment drives firms' executives to search, choose and exploit particular mechanisms in order to manage profits and, hence, to meet the requirements of these factors. Getting better understanding of this relationship, in the particular setting of Egypt, necessitated using NIS theory, and conducting interviews to elicit the opinions, beliefs, and attitudes of 34 individuals deeply involved in EM phenomenon including: firms' executives; investors and analysts; external auditors; and Stock Exchange's regulators. As a result, the primary limitation of this study is in the application of the results to other settings. This calls for future research investigating these same phenomena in other settings by using the same theory and research philosophy or by adopting others. This paper concludes that investors' concern on long-term profits and cash flows from basic activities is one reason which is often given by managers to justify their concern with their firm's long-term financial results, specially resulting from operational and basic business of the firms. This is consistent with McKee's (2005) argument, there is a significant association between the firm's operating profit and its stock price; and with Kamel and Elbanna's (2012) findings that there is a positive relationship between cash flows from operations and offering price of IPO firms. Being able to report continuous and long-term profits and cash flows from firms' operational and core activities is essential requirement to get a loan with better credit terms.

Thus, managers portrayed the credit market as one of the strongest justifications for their concern with reporting long-term profits and cash flows, resulting from operational activities for obtaining credit easily. This managerial concern is used as another motive for managing the operational profits and cash flows number over long-run. Similarly, the EGX's rules for listing and delisting firms' securities are considered to be one of the most influential motives or pressures exerted from the firm's context on management to manage long-term profits and cash flows, which should result from the main business of the firm, i.e. its core and operational activities in order for a firm to be listed or to remain listed. This is consistent with Leuz et al.'s (2003) study which documents the effect of the stock market's regulative rules on the practice of EM and provides evidence that, in countries with a developed stock market and strong shareholder rights (e.g. United Kingdom and United States), EM is practiced less than in countries with less well-developed stock markets and weak investor rights (e.g. Germany and Sweden). This paper continues to conclude that the executives' intention to conform to or comply with the requirements of those outsiders, who appreciate legitimate, credible and trustful firms, is regarded a considerable driver for them to employ operational activities that are made in the normal course of running the firm's activities, including: lower the sale price and widen the boundaries of the credit terms; managing advertising budget upwards or downwards; and overproduction, as mechanisms designed to manage profits upward by increasing revenues and operational profits and cash flows of the firms on which outsiders basically depend while evaluating the market value of firms.

This is supported by McKee's (2005) argument, operating or core earnings are expected to continue in the future, and thus analysts and investors "typically project growth rates for core earnings ... to estimate the value of a stock". Employing operational activities of a firm as EM techniques is due to their ability to help executives to comply with the outsiders' requirements in terms of reporting operational profits and cash flows for many years. This is because that unlike the use of accounting decisions, employing real business activities positively affects the operational profits and cash flows of the firm; their use is flexible, enabling manager to adopt them at any time, and for an unlimited number of times and years; and does not attract external scrutiny, leading to enhance firm's legitimacy and credibility that outsiders fundamentally appreciate. These results are supported by arguments that managers use their discretion to manage the capital market's perceptions of the company's performance in order to be perceived as legitimate and reputable so as to either minimise outside intervention and scrutiny (Leuz et al., 2003) or enable firms to "allocate the increasingly scarce financial resources" and facilitate the resource allocation process (Scapens and Roberts, 1993 and Collier, 2001). This paper contributes to literature by revealing: 1) publishing long-term operational profits and cash flows of firms is the focus of the sophisticated outsiders ; 2) the motivating effect of EGX's listing/delisting rules on managing operational profits; 3) and the prominence of identifying EM motives in a certain setting for better understanding the managerial choice of certain EM techniques. These conclusions open doors for further research to: a) investigate another EM motivational factor in firms' context; b) study the effect of another set of EM motives on managerial choice of EM techniques which can be favourably applied. For instance, there is a call for investigating mechanisms that can be used in a case of existing motives to manage profits downwards such as: managerial propensity to enjoy tax reduction or tax exemption. This paper also has contributions on the theoretical level by setting theoretical framework for the study through adopting New Institutional Sociology (NIS) theory; improving the original framework of NIS through considering the institutional and economic pressures as 'dichotomous', leading to enhance NIS's ability to provide better explanation for organisations' behaviour and decisions; and adopting interpretive approach.

Considerable limitation of this study is its focus on certain kinds of industrial sectors: pharmaceutical, motor and textile; and on two service sectors: restaurant and hospitality, and brokerage. Thus further research is called for to extend the investigation by including other sectors. The last limitation is that EM motivations and mechanisms are shaped and significantly influenced by firms' context which are continuously changing; hence these aspects are not fixed, but change over time, meaning that they require continuous investigation. The possible practical implications of this research's findings, knowing current attitudes towards motives encouraging executives to practice EM and EM mechanisms which can be applied and preferred, especially when these motivational factors exist, could be useful to regulatory authorities and professional associations either in Egypt or in developing and emerging nations with similar characteristics to Egypt.

This study's results might be of assistance to Egyptian accounting standards setters by providing useful information about the influential effect of adopting new accounting standards [such as EAS no (5) which requires reporting the retroactive effect of changing an accounting method on the reported profit figures] on curbing the use of accounting methods to manage earnings. This helps standards setters to review accounting standards in order to adjust and determine the optimal level of management discretion, and to either adjust or add additional level of disclosure for the sake of enhancing the credibility of financial reporting. This, in turn, helps those authorities to make further improvement on the quality of FRs and increase the level of transparency in these reports.

References

- Abarbanell, J. and Lehavy, R. (2003), Can Stock Recommendations Predict Earnings Management and Analysts' Earnings Forecast Errors?", *Journal of Accounting Research*, 41(1), 1-31.
- Abdel-Khalik, A. (1985), The Effect of LIFO-Switching and Firm Ownership on Executives' Pay, *Journal of Accounting Research*, 23(2), 427-447.
- Aerts, W. and Cheng, P. (2011), Causal Disclosures on Earnings and Earnings management in an IPO Setting", *Journal of Accounting and Public Policy*, 30 (5), pp. 431-459. .
- Aharony, J. and Wang, J. and Yuan, H. (2010), Tunneling as an Incentive for Earnings Management During the IPO Process in China, *Account Public Policy*, 29, 1–26.
- Alghamdi, A. (2012), Investigation into Earnings Management Practices and The Role of Corporate Governance and External Audit in Emerging Markets: Empirical Evidence from Saudi Listed Companies, Unpublished Ph.D Thesis, Durham University, UK.
- Algharaballi, E. (2013), Earnings Management Practices and Subsequent Firm Performance of Companies Liskting on the Kuwait Stock Exchange (KSE), Unpublished Ph.D Thesis, University of Southern Queensland.
- Arthaud-Day, M., Certo, S., Dalton, C. and Dalton, D. (2006), A Changing of the Guard: Executive and Director Turnover Following Corporate Financial Restatements, *Academy of Management Journal*, 49(6), 1119-1136.
- Baber, W., Fairfield, P. and Haggard, J. (1991), The Effect of Concern about Reported Income on Discretionary Spending Decisions: The Case of Research and Development. *Accounting Review*, 66(4), 818-829.
- Bange, M., and De Bondt, W. (1998), R&D Budgets and Corporate Earnings targets. *Journal of Corporate Finance*, 4(2), 153-184.
- Bartov, E. (1993), The Timing of Asset Sales and Earnings Manipulation, *Accounting Review*, 68(4), 840-855.
- Bartov, E., Givoly, D. and Hayn, C. (2002), The Rewards to Meeting or Beating Earnings Expectations, *Journal of Accounting and Economics*, 33(2), 173-204.
- Beneish, M., Press, E. and Vargus, M. (2001), The Relation Between Incentives to Avoid Debt Covenant Default and Insider Trading, working paper, Indiana University..
- Bens, D., Nagar, V. and Wong, M. (2002), Real Investment Implications of Employee Stock Option Exercises, *Journal of Accounting Research*, 40(2), 359-393.
- Bhojra, S., Hribar, P. and Picconi, M. (2003), Making Sense of Cents: An Examination of Firms That Marginally Miss or Beat Analyst Forecasts, working paper, Cornell University.
- Black, E., Sellers, K. and Manly, T. (1998), Earnings Management Using Asset Sales: An International Study of Countries Allowing Noncurrent Asset Revaluation, *Journal of Business Finance & Accounting*, 25(9-10), 1287-1317.
- Bowen, R., DuCharme, L. and Shores, D. (1995), Stakeholders' Implicit Claims and Accounting Method Choice, *Journal of Accounting and Economics*, 20(3), 255-295.
- Bruns, W. and Merchant, K. (1990), The Dangerous Morality of Managing Earnings. *Management Accounting*, 72(2), 22-25.
- Bryman, A. (1988), *Quantity and Quality in Social Research*, Unwin Hyman, London.
- Burgstahler, D. and Dichev, I. (1997), Earnings Management to Avoid Earnings Decreases and Losses, *Journal of Accounting and Economics*, 24(1), 99-126.
- Bushee, B. (1998), The Influence of Institutional Investors in Myopic R&D Investment Behavior, *Accounting Review*, 73(3), 305-333.
- Capital Market Authority (CMA), (2002), Decree of the CMA's Board of Directors No. 30 "Securities Listing & Delisting Rules of Cairo & Alexandria Stock Exchanges", Egypt.
- Capital Market Authority (CMA), (2008), CMA's Directors Decision No. (94), "Amendment of CASE Listing and Delisting Rules", Egypt.

- Carpenter, V. and Feroz, E. (2001), Institutional Theory and Accounting Rule Choice: An Analysis of Four US State Governments' Decisions to Adopt Generally Accepted Accounting Principles, *Accounting, Organizations and Society*, 26(7-8), 565-596.
- Cheng, Q. and Warfield, T. (2005), Equity Incentives and Earnings Management, *The Accounting Review*, 80(2), 441-476.
- Cheng, S. (2004), R&D Expenditures and CEO Compensation, *The Accounting Review*, 79(2), 305-328.
- Cohen, D., Mashruwala, R. and Zach, T. (2010), The Use of Advertising Activities to Meet Earnings Benchmarks: Evidence from Monthly Data, *Review of Accounting Studies*, 15(4), 808-832.
- Cohen, D. and Zarowin, P. (2010), Accrual-based and Real Earnings Management Activities Around Seasoned Equity Offerings, *Journal of Accounting and Economics*, 50(1), 2-19.
- Collier, P. (2001), The Power of Accounting: A Field Study of Local Financial Management in a Police Force, *Management Accounting Research*, 12(4), 465-486.
- Company Law No.159 (1981) "On Joint Stock Companies, Partnerships Limited by Shares & Limited Liability Companies", Egypt.
- Darrrough, M. and Rangan, S. (2005), Do Insiders Manipulate Earnings When They Sell Their Shares in an Initial Public Offering? *Journal of Accounting Research*, 43(1), 1-33.
- Dechow, P. and Skinner, D. (2000), Earnings Management: Reconciling the Views of Accounting Academics, Practitioners, and regulators, *Accounting Horizons*, 14(2), 235-250.
- Dechow, P. and Sloan, R. (1991), Executive Incentives and the Horizon Problem: An Empirical Investigation. *Journal of Accounting and Economics*, 14(1), 51-89.
- Dechow, P., Sloan, R. and Sweeney, A. (1996), Causes and Consequences of Earnings Manipulation: An Analysis of Firms Subject to Enforcement Actions by the SEC. *Contemporary Accounting Research*, 13(1), 1-36.
- DeFond, M. and Jiambalvo, J. (1994), Debt Covenant Violation and Manipulation of Accruals, *Journal of Accounting and Economics*, 17(1-2), 145-176.
- Dhaliwal, D., Frankel, M. and Trezevant, R. (1994), The Taxable and Book Income Motivations for a LIFO Layer Liquidation, *Journal of Accounting Research*, 32(2), 278-289.
- DiMaggio, P. and Powell, W. (1983), The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields, *American Sociological Review*, 48(2), 147-160.
- DiMaggio, P. and Powell, W. (1991), Introduction, in Powell, W. and DiMaggio, P. (Eds.), *The New Institutionalism in Organizational Analysis*, University of Chicago Press, Chicago, (pp. 1-38).
- DiMaggio, P. (1988), Interest and Agency in Institutional Theory, in Zucker L. (Ed.), *Institutional Patterns and Organizations: Culture and Environment*, MA, Ballinger, Cambridge, pp. 3-21.
- DuCharme, L., Malatesta, P. and Sefcik, S. (2004), Earnings management, Stock Issues, and Shareholder Lawsuits, *Journal of Financial Economics*, 71(1), 27-49.
- Egyptian Financial Supervisory Authority (EFSA) (2009), EFSA Board's Decision No. 50, Egypt.
- Egyptian Society of Accountants and Auditors (ESAA) (2006). Egyptian Accounting Standard (2), "Inventories". Egypt: Ministry of Investment.
- Egyptian Society of Accountants and Auditors (ESAA) (2006). Egyptian Accounting Standard (5), "Accounting Policies, Changes in Accounting Estimates and Errors". Egypt: Ministry of Investment.
- Egyptian Society of Accountants and Auditors (ESAA) (2006). Egyptian Accounting Standard (10), "Property, Plant and Equipment. Egypt": Ministry of Investment.
- Egyptian Society of Accountants and Auditors (ESAA) (2006), Egyptian Accounting Standard (23), "Intangible Assets". Egypt: Ministry of Investment.
- Eldenburg, L., Gunny, K., Hee, K. and Soderstrom, N. (2011), Earnings Management Using Real Activities: Evidence from Nonprofit Hospitals, *Accounting Review*, 86(5), 1605-1630.
- Enomoto, M., Kimura, F., and Yamaguchi, T. (2013), Accrual-Based and Real Earnings Management: An International Comparison for Investor Protection, working paper, Kobe University, Japan, 26 March.
- Gleason, C. and Mills, L. (2008), Evidence of Differing Market Responses to Beating Analysts' Targets Through Tax Expense Decreases, *Review of Accounting Studies*, 13(2/3), 295-318.
- Graham, R., Harvey, R. and Rajgopal, S. (2005), The Economic Implications of Corporate Financial Reporting, *Journal of Accounting and Economics*, 40(1-3), 3-73.

- Greenwood, R. and Hinings, C. (1996), Understanding Radical Organizational Change: Bringing together the Old and the New Institutionalism, *The Academy of Management Review*, 21(4), 1022-1054.
- Hagerman, R. and Zmijewski, M. (1979), Some Economic Determinants of Accounting Policy Choice, *Journal of Accounting and Economics*, 1(2), 141-161.
- Healy, P., Kang, S. and Palepu, K. (1987), The Effect of Accounting Procedure Changes on CEOs' Cash Salary and Bonus Compensation, *Journal of Accounting and Economics*, 9(1), 7-34.
- Healy, P. and Wahlen, J. (1999), A Review of the Earnings Management Literature and Its Implications for Standard Setting, *Accounting Horizons*, 13(4), 365-383.
- Herrmann, D., Inoue, T. and Thomas, W. (2003), The Sale of Assets to Manage Earnings in Japan, *Journal of Accounting Research*, 41(1), 89-108.
- Hopwood, A. (1987), The Archeology of Accounting Systems. *Accounting, Organizations and Society*, 12(3), 207-234.
- Hribar, P., Jenkins, N. and Johnson, W. (2006), Stock Repurchases as an Earnings Management Device. *Journal of Accounting and Economics*, 41(1-2), 3-27.
- Indjejikian, R. (1999), Performance Evaluation and Compensation Research: An Agency Perspective, *Accounting Horizons*, 13(2), 147-157.
- Jensen, M. (2001), Value Maximisation, Stakeholder Theory, and the Corporate Objective Function, *European Financial Management*, 7(3), 297-317.
- Kamel, H. (2006), Earnings Quality Evaluation with Special Reference to the Earnings Management of Egyptian IPOs Initial Public Offering, Unpublished PhD, Cardiff University, Wales.
- Kamel, H. (2012), Earnings Management and Initial Public Offerings: A new Perspective from Egypt, *Journal of Accounting in Emerging Economies*, 2 (2), 96-118.
- Kamel, H. and Elbanna, S. (2010), Assessing the Perceptions of The Quality of Reported Earnings in Egypt, *Managerial Auditing Journal*, 25 (1), 32-52.
- Kamel, H. and Elbanna, S. (2012), Investigating the Phenomenon of Earnings Management in the Egyptian Stock Market, *Corporate Governance*, 12 (3), 337-352.
- Kasab, Y. (2008), Assessment of the Firms Management's Influence on Reported Profits by Using Accruals: Determining Managerial Motives for Managing Profits and Market Reactions for This Behaviour, Unpublished PhD Thesis, Tanta University, Egypt.
- Kasznik, R. and McNichols, M. (2002), Does Meeting Earnings Expectations Matter? Evidence from Analyst Forecast Revisions and Share Prices, *Journal of Accounting Research*, 40(3), 727-759. .
- Leuz, C., Nanda, D. and Wysocki, P. (2003), Earnings Management and Investor Protection: An International Comparison, *Journal of Financial Economics*, 69(3), 505-527. (1)
- Lev, B. (1989), On the Usefulness of Earnings and Earnings Research: Lessons and Directions from Two Decades of Empirical Research, *Journal of Accounting Research*, 27(3), 153-192.
- Levitt, A. (1998), *The Numbers Game*, Remarks Delivered at the NYU Center for Law and Business, New York, NY.
- Lewis, J. and Ritchie, J. (2003), Generalizing from Qualitative Research, in Ritchie and Lewis (Eds.), *Qualitative Research Practice: A Guide for Social Science Students and Researchers*, Sage, London, 263-286.
- Maarof, H., (2010), The Role of Corporate Governance in Reducing Negative Earnings Management: A Case of Syria, Unpublished Master Dissertation, Helwan University, Egypt.
- Marquardt, C. and Wiedman, C. (2004), How Are Earnings Managed? An Examination of Specific Accruals, *Contemporary Accounting Research*, 21(2), 461-491.
- McKee, T. (2005), *Earnings Management: An Executive Perspective*, Thomson, Mason.
- Mehan, H. (1979), *Learning Lessons: Social Organization in the Classroom*, Harvard University Press, Cambridge, Mass.
- Meyer, J. and Rowan, B. (1977), Institutionalized Organizations: Formal Structure as Myth and Ceremony, *The American Journal of Sociology*, 83(2), 340-363.
- Modell, S. (2002), Institutional Perspectives on Cost Allocations: Integration and Extension, *European Accounting Review*, 11(4), 653-679.
- Moll, J., Burns, J. and Major, M. (2006), Institutional Theory, in Hoque Z. (Ed.), *Methodological Issues in Accounting Research: Theories, Methods and Issues*, Spiramus Press, London.
- Oliver, C. (1992), The Antecedents of Deinstitutionalization, *Organization studies*, 13(4), 563-588.
- Perry, S. and Grinaker, R. (1994), Earnings Expectations and Discretionary Research and Development Spending, *Accounting Horizons*, 8(4), 43-51.

- Pfeffer, J. (1981), *Power in Organizations*, Pitman Pub, Marshfield, Mass.
- Pfeffer, J. and Salancik, G. (2003), *The External Control of Organizations: A resource Dependence Perspective*, Stanford Business Books, Stanford, Calif.
- Powell, W. (1991), Expanding the Scope of Institutional Analysis, in Powell and DiMaggio (Eds.), *The New Institutionalism in Organizational Analysis*, University of Chicago Press, Chicago, 183-203).
- Rangan, S. (1998), Earnings Management and the Performance of Seasoned Equity Offerings, *Journal of Financial Economics*, 50(1), 101-122.
- Rezaee, Z. (2005), Causes, Consequences, and Deterrence of Financial Statement Fraud, *Critical Perspectives on Accounting*, 16(3), 277-298.
- Ritchie, J., Lewis, J. and Elam, G. (2003), Designing and Selecting Samples, in Ritchie, J. and Lewis, J. (Eds.), *Qualitative Research Practice: A Guide for Social Science Students and Researchers*, Sage, London, pp. 77-108.
- Ritchie, J. and Spencer, L. (2002), Qualitative Data Analysis for Applied Policy Research, in Huberman (Ed.), *Qualitative Research Companion*, Sage, Thousand Oak, pp. 305-329.
- Roychowdhury, S. (2006), Earnings Management Through Real Activities Manipulation, *Journal of Accounting and Economics*, 42(3), 335-370.
- Scapens, R. and Roberts, J. (1993), Accounting and Control: A Case Study of Resistance to Accounting Change, *Management Accounting Research*, 4(1), 1-32.
- Scott, R. (1995), *Institutions and Organizations*, Sage, Thousand Oaks.
- Scott, W. (1987), The Adolescence of Institutional Theory, *Administrative Science Quarterly*, 32(4), 493-511.
- Scott, W. (1991), Unpacking Institutional Arguments, in Powell, W. and DiMaggio, P. (Eds.), *The new Institutionalism in Organizational Analysis*, pp 164-182.
- Shen, C.-H. and Huang, Y.-L. (2013), Effects of Earnings Management on Bank Cost of Debt, *Accounting and Finance*, 53, 265-300.
- Silverman, D. (2000), *Doing Qualitative Research: A Practical Handbook*, Sage Publications, London.
- Silverman, D. (2010), *Doing Qualitative Research*, SAGE, London.
- Sohn, B. (2011), The Effect of Accounting Comparability on Earnings Management, working paper, City University of Hong Kong, Hong Kong, September.
- Suchman, M. (1995), Managing Legitimacy: Strategic and Institutional Approaches, *The Academy of Management Review*, 20(3), 571-610.
- Teoh, S., Welch, I. and Wong, T. (1998a), Earnings Management and the Underperformance of Seasoned Equity Offerings, *Journal of Financial Economics*, 50(1), 63-99.
- Teoh, S., Wong, T. and Rao, G. (1998b), Are Accruals during Initial Public Offerings Opportunistic? *Review of Accounting Studies*, 3(1/2), 175-208.
- Thomas, J. and Zhang, H. (2002), Inventory Changes and Future Returns, *Review of Accounting Studies*, 7(2/3), 163-187.
- TTrueman, B. and Titman, S. (1988), An Explanation for Accounting Income Smoothing, *Journal of Accounting Research*, 26, 127-139.
- Tsamenyi, M., Cullen, J. and González, J. (2006), Changes in Accounting and Financial Information System in a Spanish Electricity Company: A New Institutional Theory Analysis, *Management Accounting Research*, 17(4), 409-432.
- Watts, R. and Zimmerman, J. (1990), Positive Accounting Theory: A Ten Year Perspective, *Accounting Review*, 65(1), 131-156.
- Wickramasinghe, D. and Alawattage, C. (2007), *Management Accounting Change: Approaches and Perspectives*, Routledge, London .
- Zang, A. (2012), Evidence on the Trade-Off between Real Activities Manipulation and Accrual-Based Earnings Management, *The Accounting Review*, 87 (2), 675-703.
- Zikmund, W., Babin, B., Carr, J. and Griffin, M. (2010), *Business Research Methods*, South-Western, Mason, OH.
- Zucker, L. (1987), Institutional Theories of Organization, *Annual Review of Sociology*, 13, 443-464.