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EARNINGS MANAGEMENT IN ISLAMIC AND CONVENTIONAL BANKS: DOES OWNERSHIP STRUCTURE MATTER? EVIDENCE FROM THE MENA REGION

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Abstract

The aim of this paper is to compare earnings management between conventional and Islamic banks and to examine whether ownership structure affects earnings management in the banking industry of emerging markets. Using a sample of Conventional and Islamic banks from Middle Eastern and North African (MENA) countries, we first found evidence that Islamic bank manage less their earnings than conventional banks. Second, both Islamic and conventional banks with more concentrated ownership use discretionary loan loss provisions to manage their earnings. Third, institutional owners encourage earnings management in Islamic banks and State participation increases earnings management in conventional banks. Finally, family owners reduce this practice in both types of banks.

Keywords: Earning management, Conventional banks, Islamic banks, MENA countries Ownership structure.

1. Introduction

The subject of bank earnings management in the accounting literature had drawn the attention of academic researchers and regulators during the last decade. A growing body of empirical research theoretically and empirically investigates different hypotheses related to earnings management in banks. Some researchers provide evidence of earnings management and the tools used by managers to manage earnings (Beatty, et al. 1995, Beaver & Engel 1996), others examine the motivation of managers to manipulate bank earnings (Kanagaretnam, et al. 2004; Kim & Kross 1998; Anandarajan, et al 2005...). The rising interest in this theme relates to the unique position of the banking sector in financial intermediation and the payment system. More specifically, opacity of banks and high leverage level stimulate excessive risk taking1 putting the entire economy at a greater risk as shown after the 2008 recession. In this regard, bank earnings management increases information dissemination problems between banks and investors and reduces the banking sector stability (Quttainah, et al. 2013).

Like in non-financial firms, ethics appear to enhance accounting numbers quality by reducing unethical business activities like opportunistic earnings management, (Brief et al, 1996). Indeed, ethics norms are assimilated to monitoring mechanism constraining opportunistic manager behavior. An important source of ethical behaviour is the religion, In fact, well-established branch of the literature advances that religion has an important role in shaping the economic behavior of organizations (Weaver & Agle, 2002 and Callen & Fang, 2013). Regarding accounting studies, many studies established an association between religious social norms of the firms’ environment and earnings management practices. For instance, Dyreng et al, (2012) add to the evidence that US firms with higher levels of religious adherence report high earnings quality and have less risk of fraud. In an international level McGuire et al. (2012) show that US firms being headquartered in areas with strong religious are more likely to manipulate earnings. Against this background, Islamic banks based on Islamic principles

1 By relying on depositors for their funding and by the presence of the central bank as a last resort lender.
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