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A study of big bath practices in the Egyptian capital market: an emphasis on CEO turnover and origin

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Abstract

Purpose – This study aims to investigate how major big bath accounting practices and CEO turnover in Egypt relate to one another, as well as the first to use the CEO's origin as a moderating factor.

Design/methodology/approach – This study uses 10-year longitudinal data from 2012 to 2021 and 290 firm-year observations from Egypt's listed nonfinancial firms that witnessed CEO turnover to identify the significant big bath accounting practices in Egyptian businesses after the Egyptian revolution and the COVID-19 pandemic. Using fixed and random effect models, the authors investigate the impact of CEO turnover on company earnings during the first year of a newly appointed CEO as an indicator of big bath practices after controlling CEO gender, experience, firm size, leverage, return on assets, return on equity and industry. The hypotheses were investigated using static panel data.

Findings – The results show the presence of big bath practices in the Egyptian market. Furthermore, big bath accounting practices are positively correlated with CEO turnover. Moreover, the results indicate that big bath accounting practices are only endured when external CEOs are employed, rather than internal ones.

Research limitations/implications – The sample size and availability of data are the main research limitations. In addition, this study only examined CEO turnover and CEO origin as moderators in big bath accounting. Thus, future research may consider other CEO characteristics and political factors associated with big bath practices.

Practical implications – The findings from this study offer valuable insights to investors and regulators for effective decision-making and governance practices within the Egyptian capital market, while also contributing to a more informed approach to emerging markets on a global scale.

Originality/value – The findings contribute to the big-bath and CEO turnover and origin literature by showing a lower ceiling for earnings manipulation and using Egypt as a case study due to its unique institutional environment.

Keywords CEO turnover, Earnings management, CEO expertise

Paper type Research paper

1. Introduction

Executive compensation, based on accounting metrics like earnings, often drives managers to manipulate earnings, especially during CEO turnovers, following the big bath theory,

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where CEOs attribute deficient performance to previous management, resulting in reduced profits (Kuang *et al.*, 2014). A "big bath" occurs when top executives exaggerate losses to present their companies more favorably in subsequent reporting periods (Kirschenheiter and Melumad, 2002). The big bath hypothesis suggests that top managers intentionally reduce earnings to pave the way for future increases (Strong and Meyer, 1987; Murphy and Zimmerman, 1993).

Numerous studies, spanning developed and developing nations, have shown significant correlations between big bath practices and CEO turnover (Putra and Setiawan, 2024; Breuer *et al.*, 2023; Hensel and Schöndube, 2022; Neto *et al.*, 2021; Mostafa, 2017; Bornemann *et al.*, 2015; Choi *et al.*, 2014). These consistent findings indicate that incoming CEOs often achieve greater financial success than their predecessors do by garnering support from both internal and external stakeholders. This encourages prospective CEOs to engage in significant bath activities for personal gain, aligning with the idea that incoming CEOs may lean toward opportunism. However, prior research presents mixed results regarding the prevalence of big bath accounting alongside CEO turnovers.

While earlier studies have explored the correlation between big bath accounting and CEO turnover in different contexts, the present study stands out as the first to leverage Egyptian data to examine this question within the context of Egypt. The primary objective of this study is to investigate the impact of CEO turnover on big bath practices in Egyptian enterprises. Additionally, this research aims to elucidate the relationship between CEO origin and its influence on this dynamic.

Egypt's crucial role in the Middle East stems from its historical and political significance. Studying big bath accounting during CEO changes in Egypt is vital for two main reasons. First, Egypt's institutional structure, characterized by a code law system and politically oriented accounting, differs from developed countries, leading to lower-quality accounting data. Second, Egypt's Corporate Governance Code, introduced in 2005, promotes transparent and responsible corporate management aligned with global standards, prioritizing stakeholder benefits.

Egypt has been criticized for its governance challenges, leading to the exploitation of company resources for personal gain (Hemdan *et al.*, 2023). The absence of independent directors, audit committees and external auditors contributes to the prevalence of big bath practices, which is more pronounced in emerging markets like Egypt, where the role of CEO power in information asymmetry is more pronounced.

Moreover, Mostafa (2017) found that opportunistic earnings management in Egypt is more common in low-performing enterprises to boost share prices. Kamel (2012) argued that big bath practices are more prevalent in Egypt's emerging market than in developed markets. He suggests that managers of Egyptian state-owned companies participating in IPOs may face conflicting interests in managing earnings changes. Egypt's unique institutional dynamics may influence CEO turnover differently compared to other developed markets.

Our study makes several notable contributions to the literature, management and accounting fields. First, there has been a pronounced emphasis in the academic literature on CEO turnover and big bath accounting within well-established jurisdictions such as the USA, the UK and various other developed regions, capturing the attention of regulators and investors in the USA. Nevertheless, there is a dearth of knowledge concerning the performance dynamics of emerging markets, as exemplified by Egypt. Second, while certain studies such as Godfrey *et al.*, 2003 make distinctions between routine and nonroutine CEO turnover, their findings often lack insight into the origins of the incoming CEO, which can have varied implications for earnings management. This study aims to fill this gap by examining the nuanced factors influencing big bath accounting practices and the origins of

CEO changes. This comprehensive understanding helps reconcile inconsistent findings on the impact of CEO change and origin on big-bath accounting practices. Third, this study pioneers research on big bath accounting and CEO turnover in the Egyptian capital market, investigating how CEO origin influences these practices. big bath accounting within well-establish jurisdictions such as the USA, the UK and various other developed regions, capturing the attention of regulators and investors in the USA. Nevertheless, there is a dearth of knowledge concerning the performance dynamics of emerging markets, as exemplified by Egypt. Second, while certain studies such as Godfrey *et al.*, 2003 make distinctions between routine and nonroutine CEO turnover, their findings often lack insight into the origins of the incoming CEO, which can have varied implications for earnings management. This study aims to fill this gap by examining the nuanced factors influencing big bath accounting practices and the origins of CEO changes. This comprehensive understanding helps reconcile inconsistent findings on the impact of CEO change and origin on big-bath accounting practices. Third, this study pioneers research on big bath accounting and CEO turnover in the Egyptian capital market, investigating how CEO origin influences these practices. Unlike prior studies in emerging market such as Brazil, Indonesia and Korea (e.g. Da Silva *et al.*, 2023; Vania *et al.*, 2018; Choi *et al.*, 2014), our research focuses on Egypt's distinct market undergoing transitions. Egypt's code-law system and politically oriented accounting pose unique challenges in big-bath accounting. Finally, the study highlights the importance of understanding managerial practices and motives for effective corporate governance rules and financial standards, preventing downward earnings manipulation and enhancing earnings quality.

The findings of this study are important because they reveal the impact of CEO turnover and origin on big bath accounting practices in an emerging market. This can help regulators and policymakers develop robust corporate governance codes to prevent abuse, bankruptcy and financial crises. These insights are valuable for stakeholders such as CEOs, banks, shareholders, government entities and creditors, enabling informed decisions and mitigating the big-bath phenomenon.

In Section 2, we critically review the relevant literature and present the hypotheses. Section 3 details the research methodology. Section 4 presents and analyzes the results in detail. Section 5 concludes the paper and provides recommendations for future research.

2. Literature review and hypotheses development

During leadership transitions, nonfinancial companies often engage in a "big bath" practice, which involves conserving resources by reducing costs in the CEO's first year, attributing negative outcomes to previous leadership and lowering performance benchmarks. Despite extensive research, there is no clear motivation for this behavior.

2.1 Theoretical framework

This study examines the impact of agency theory and big bath theory on CEO turnover in financial reporting techniques such as big bath accounting.

2.1.1 Agency theory. Alves (2021) argued that managers may use aggressive accounting techniques to falsify financial statements in big bath accounting, especially during subpar performances. Agency theory suggests that a principal engages an agent to perform a service and delegate decision-making authority, potentially leading to imbalances in the principal-agent relationship. Information asymmetry can result in misleading actions by individuals seeking to maximize their own interests, especially when the management must serve the principal.

Nugroho *et al.* (2018) and Soekapdjo *et al.* (2018) highlighted the importance of earnings management in addressing knowledge asymmetry and ensuring fairness in financial transactions. They argue that managers may manipulate financial figures to influence outcomes, whereas Leuz *et al.* (2003) emphasized the need for effective earnings management to impact the stock market, improve management compensation, avoid lending agreements and avoid government regulations. Soekapdjo *et al.* (2018) suggested that managers may act opportunistically due to information asymmetry among investors, often using financial statements to deceive lenders and investors. One such practice is the "big bath" practice, in which managers intentionally inflate expenses or losses to improve future performance, potentially increasing profitability and satisfying shareholders. Previous literature highlights that this frequently occurs, especially with CEO turnover.

2.1.2 Big bath theory. Big bath theory posits that companies with low profitability each year may use discretionary write-downs to further reduce earnings in the present era. Profits may be manipulated upward to increase an upcoming bonus or downward if the manager believes that the company is unable to meet its contractual earnings targets.

In this context, a unique manifestation of earnings management comes to the forefront, especially during CEO turnover. Big bath theory posits that CEOs often attribute subpar performance to the actions of preceding management, leading to the reporting of reduced profits (Kuang *et al.*, 2014). This phenomenon, commonly referred to as a "big bath", occurs when top executives intentionally exaggerate losses, aiming to portray their companies in a more favorable light in subsequent reporting periods (Kirschenheiter and Melumad, 2002). The underlying idea behind the big bath hypothesis is that top managers deliberately decrease earnings with the strategic intention of setting a stage for future increases (Strong and Meyer, 1987; Murphy and Zimmerman, 1993).

In conclusion, big bath accounting practices and their effects on CEO turnover are explained by both agency and big bath theories.

2.2 CEO turnover and big bath accounting

Ameila and Eriandani's (2021) study on CEO turnover in Indonesia revealed that new CEOs often adopt an "earnings bath" strategy, intentionally reducing corporate profitability to set lower benchmarks. Nugroho *et al.*'s (2018) study found no discernible difference in the big bath accounting model for earnings management when comparing CEO changes between routine and nonroutine changes in the same Indonesian context.

Silva *et al.* (2023) and Shen and Wang's (2019) research on CEO turnover and big bath approaches reveal that the relationship may vary depending on the specific conditions. Silva *et al.* (2023) examined big bath accounting in Brazil's emerging market, where incumbent CEOs cut earnings only when profitable. Shen and Wang (2019) find significant reductions in earnings and asset quality in Taiwanese commercial banks.

Studies show a positive correlation, but a meaningful connection is lacking because of contextual disparities, including country-specific variables and the precise nature of turnover.

Egypt's unique setting and insufficient investor protection legislation lead to power abuse, with CEOs with longer tenures potentially resorting to poor earnings quality to advance personal interests, posing a threat to less secure shareholders.

Hemdan *et al.* (2023) suggested that CEO tenure plays a significant role in acquiring power, potentially affecting earnings quality in the Egyptian context. However, Hemdan *et al.* (2021) find a negative association between CEO tenure and reported earnings quality in Egyptian firms from 2008 to 2019. It is noteworthy that these two studies stand as the sole contributions in the Egyptian context, probing the impact of CEO power and tenure on earnings quality, which in return highlights our research gap. Consequently, our study adds

a novel dimension to the existing Egyptian literature by being the first to explore the existence of big bath practices in an emerging market such as Egypt, in addition to being the only study that scrutinizes the effects of CEO turnover on big bath practices.

This study suggests that CEO turnover in Egypt could lead to significant "big bath" practices, where CEOs prioritize personal interests over less-protected stakeholders, highlighting the potential for CEOs to engage in earnings management. Considering this, the following hypotheses were tested:

H1. A newly appointed CEO tends to engage in big bath practices during a turnover year.

2.3 CEO origin and big bath accounting

Quigley *et al.* (2019), Geertsema *et al.* (2018) and Choi *et al.* (2014) contribute to the understanding of the impact of CEO origin on big bath practices. Yu (2012) suggests that internal promotions increase the likelihood of such occurrences, whereas Choi *et al.* (2014) argued that external recruitment increases these practices. Geertsema *et al.* (2018) found that internally promoted CEOs have less incentive to manipulate earnings and attribute issues to their predecessors.

Glaum *et al.* (2023), Lewellen and Lewellen (2021), Setyawan and Anggraita (2018) and Kuang *et al.* (2014) revealed that newly appointed external CEOs, especially those taking over after nonroutine or performance-driven turnovers, are more prone to earnings management than internal CEOs. They prioritize policies that enhance incentives more rapidly, often neglecting long-term considerations in opportunistic decision-making. External CEOs are motivated to demonstrate their superiority, face shorter career horizons and engage in more earnings management than internal CEOs.

In contrast, Nurmayanti and Rakhman (2017) found that internal CEOs have higher profit quality than external CEOs, while Haque *et al.* (2022) found that a big bath is more likely to occur when the incoming CEO is internally promoted, and during the 2020 COVID-19 pandemic, internal CEOs outperform external CEOs. In times of crisis, external CEOs' limited knowledge of firm capabilities and weak connections with internal stakeholders can negatively impact firm performance, whereas CEOs with deep crisis resilience competencies fare better.

However, Setyawan and Anggraita (2018) found no discernible relationship between a new external CEO and big bath practices. Li (2014) pointed out that international studies in this area have yielded mixed results.

Sharawi (2023), Mansour *et al.* (2023) and Khlif and Samaha (2019) studied the impact of CEO attributes on financial reporting quality in Egypt. They explored the roles of gender, duality, expertise and age in this context. Mansour *et al.* (2023) used CEO characteristics as a moderating variable in their investigation of diversification and banks' financial soundness in the emerging Egyptian market. Khlif and Samaha (2019) advocated further research to assess the moderating influence of additional CEO characteristics on board independence and internal control quality in emerging markets.

This study aims to address a gap in Egyptian research by investigating how a CEO's origin status affects the relationship between CEO turnover and big bath accounting practices. No previous study has explicitly examined this moderating effect among listed Egyptian firms. Drawing on the significance highlighted by Hensel and Schöndube (2022) in considering additional variables impacting big bath practices, this study aims to enrich the literature by exploring the moderating role of CEO origin. Considering Egypt's distinct corporate environment, it is anticipated that CEO origin plays a significant role in shaping

the relationship between CEO turnover and big bath practices. As such, the research hypothesis is formulated as follows:

H2. CEO origin moderates the relationship between CEO turnover and big bath practices in the turnover year.

3. Research methodology

3.1 Data collection and sample selection

The study initially included all Egyptian exchange (EGX)100 listed firms on the Egyptian Stock Exchange from 2012 to 2021, excluding the financial sector (24 firms), firms without CEO turnover (36 firms) and firms with incomplete CEO information (11 firms). The final sample comprised 290 observations from 29 publicly traded Egyptian firms with CEO turnovers and complete financial data during this period (see Table 1).

Data on the occurrence of big bath accounting and control variables, including ROE, ROA, SIZE and INDUSTRY, are sourced from DataStream Thomson Reuters. Additionally, information on CEO turnover, CEO origin and CEO characteristics such as gender and financial expertise were manually extracted from the Board of Directors' reports on official company websites and the Egyptian stock market website.

The manufacturing and service industries are emphasized because of their rapid growth in Egypt and the presence of listed companies on the Egyptian Stock Exchange, while the banking and finance industries are excluded because of distinct corporate governance regulations.

The 2012–2021 study period began in 2012, with the Egyptian Revolution in early 2011. Since then, Egypt has seen revenue declines in manufacturing, construction, trade and tourism. Managerial earnings manipulation may have hurt financials in 2011. This was done to protect their reputation after the economic impact of the Egyptian revolution. Furthermore, the emergence of the COVID-19 pandemic in subsequent years exerted additional pressure on financial reporting quality within the Egyptian capital market, increasing the likelihood of big bath behavior due to sudden financial losses and political costs (ElHawary and Elbolok, 2024; Mohamed and Elbolok, 2022; and Danysh-Hashemi, 2022). Our cutoff year was 2021, focusing on the year after turnover. Therefore, we collected the most recent data from our study.

Table 2 shows the industry distribution of the sample firms. Our sample comprised 27% real estate and 1% textiles and durables, utilities, shipping and transportation services, industrial goods, services, automobiles, paper and packaging. Thus, the final sample size was 29 firms, with 290 observations.

Company identification	Beyond criteria	Meeting criteria
All listed EGX100 firms		100
All listed Egyptian financial firms	(24)	
Firms that *did not experience* CEO turnover	(36)	
Firms that *experienced* CEO turnover		40
Firms missing financial data	(5)	
Firms missing information on the CEO Turnover	(6)	
Total observations units		29

Source: Authors own creation

Table 1. Criteria of research samples

3.2 Measurement of variables

3.2.1 Big bath. The dependent variable, big bath accounting, is derived from the company's annual reports, consistent with previous studies (Godfrey *et al.*, 2003; Bornemann *et al.*, 2015; Pettersen and Søderberg, 2016; Hassan *et al.*, 2020; Geertsema *et al.*, 2018). In line with established methodologies, a firm is classified as using big bath accounting if it reports a decrease in earnings during its inaugural year. Researchers have found that such practices artificially lower performance benchmarks in subsequent periods without significantly impacting CEO compensation or reputation.

To operationalize this concept for analysis, a dummy variable is used: it takes a value of one if the firm records a decline in earnings during the CEO's first year and zero otherwise (Geertsema *et al.*, 2018). This approach aligns with previous studies, such as Bornemann *et al.* (2015), who observed that newly appointed CEOs may manipulate performance benchmarks by attributing profit declines to their predecessors, justifying subsequent improvements.

3.2.2 CEO turnover. Conversely, CEO turnover serves as the independent variable and is measured in line with previous studies (Bornemann *et al.*, 2015; Shen and Wang, 2019; Darouichi *et al.*, 2021; Hensel and Schöndube, 2022; Arif *et al.*, 2023). The occurrence of a CEO change event was identified by tracking changes in the CEO's name from year to year on the Board of Directors' report on the official company website and the Egyptian stock market website. A dummy variable is then used for comparison purposes, taking a value of one if the CEO changes during the sample period and zero otherwise.

3.2.3 CEO origin. The moderator variable, CEO Origin, is measured as a dummy variable with a value of one if the CEO is internally appointed and zero if externally hired, consistent with prior studies (e.g. Kuang *et al.*, 2014; Bornemann *et al.*, 2015; Nurmayanti and Rakhman, 2017; Setyawan and Anggraita, 2018).

To determine whether a CEO is internal or external, we examine the start date. If a CEO has been with the company for at least two years before their promotion, they are categorized as internal CEOs. Bornemann *et al.* (2015) observe that external CEOs increase discretionary spending more than internal promotions, and former employees are more likely to engage in big bath accounting practices during turnover periods.

3.2.4 Control variables. Our study integrates control variables for firm-level characteristics and CEO attributes linked to big bath practices and CEO turnover, as seen in

Industry	Obs.	%
Food, beverages and tobacco	7	0.24
Textile and durables	1	0.03
Building materials	2	0.06
Utilities	1	0.03
Basic resources	2	0.06
Shipping and transportation services	1	0.03
Real estate	8	0.27
Industrial goods, services and automobiles	1	0.03
IT, media and communication services	3	0.10
Paper and packaging	1	0.03
Health care and pharmaceuticals	1	0.03
Contracting and construction engineering	1	0.03
Total	29	0.100

Source: Authors' own creation

Table 2.
Industry distribution

prior research (Choi *et al.*, 2014; Bouaziz *et al.*, 2020; Darouichi *et al.*, 2021; Sonda and Sutrisno, 2022; Arif *et al.*, 2023; Putra and Setiawan, 2024). Firm size (SIZE) is the natural logarithm of total assets and captures the company's scale. Leverage (LEV) represents the ratio of total liabilities to total assets, indicating a firm's debt level. Return on assets (ROA) reflects profitability, calculated as earnings before interest and tax over total assets. Return on equity (ROE) serves as a performance proxy, calculated as earnings over total shareholder equity. CEO gender (CEOGEN) is categorized as male (1) or female (0), considering gender-specific behavioral differences. CEO expertise (CEOEXPER) is a dummy variable indicating financial experience (1) or lack thereof (0), which influences the choice of earnings management. Industry dummies are also included to account for sector-specific effects, with a manufacturing sector dummy variable distinguishing firm operating in manufacturing (1) from others (0), aligned with previous methodologies (Hope and Wang, 2018) See Table 3.

3.3 Big bath model for testing hypotheses

The following explanatory variables in Model (1) were used in ordinary least squares regression to assess the relationship between CEO turnover and big bath practices. This study estimates the following regression models to test the hypotheses statistically:

$$BIGi = \beta 0 + \beta 1 CEOTURN_t + SIZ_t + LEV_t + ROA_t + ROE_t + CEOEXPER + CEOGEN + IND + \varepsilon t \quad (1)$$

where BIG_i is the tendency of firm i to take a big bath during the sample period. It is a dependent dummy variable that equals one if the firm reports a decrease in earnings during the first year of the CEO and zero otherwise; $CEOTURN_t$ refers to the change in the CEO. It is a dummy variable that equals one if the CEO of the firm in the sample period is changed, and zero otherwise; SIZ_t indicates the size of firm i in the sample period. It is measured as the natural logarithm of total assets, *and* LEV_t represents the leverage of firm i in the sample period. It is estimated as the ratio of debt to equity. ROA_t refers to the return on assets and proxies for firm performance. It is measured as Ratio of earnings before interest and tax to total assets. ROE_t refers to the return on equity and proxies for firm performance. It is measured as the ratio of earnings to total shareholders' equity; *INDt (Industry type)* refers to the industry sector of the firm; it is a dummy variable that equals one if it is an industrial sector, and zero otherwise. *CEOEXPER* refers to CEO experience; it is a dummy variable equal to 1 if the CEO has financial and accounting expertise, and 0 otherwise. *CEOGEN* refers to CEO gender; it is a dummy variable equal to 1 if the CEO is male and 0 if the CEO is female. Moreover, the impact of CEO origin (insider or outsider) as a moderating factor on big bath accounting was investigated using model (2):

$$BIGit = \beta 0 + \beta 1 CEOTURNit + \beta 2 CEOORIGit + \beta 3\, SIZit + \beta 4 LEVit + \beta 5 ROAit + \beta 6 ROEit + \beta 7\, \beta 7 CEOEXPER + \beta 8 CEOGEN + \beta 9 INDit + \varepsilon it \quad (2)$$

4. Results and discussion

4.1 Descriptive analysis

Table 4 provides descriptive statistics for the continuous variables, including control firm-level variables such as firm size, leverage, return on assets (ROA) and return on equity

Variables	Measuring tool	Previous studies
Dependent variable		
Big bath accounting (BIGBATH)	Dummy variable that equals one if the firm reports a decrease in earnings during the first year of the CEO and zero otherwise	Bornemann *et al.* (2015); Pettersen and Søderberg (2016); Hassan *et al.* (2020); Geertsema *et al.* (2018)
Independent variables		
CEO turnover (CEOTURNt)	Dummy variable that equals one if the firm witnessed CEO turnover in this year and zero otherwise	Kim *et al.* (2021), Geertsema *et al.* (2018), Da Silva *et al.* (2023)
Moderating variable		
CEO origin	Dummy variable that equals one if the CEO is internal and zero otherwise	Glaum *et al.* (2023), Haque *et al.* (2022), Choi *et al.* (2014)
Control variables		
Firm size (SIZE)	Natural logarithm of total assets	Bouaziz *et al.* (2020), Da Silva *et al.* (2023)
Firm leverage (LEV)	Total debt/total assets	Bouaziz *et al.* (2020); Mohamed and Elbolok (2022)
Firm return on assets (ROA)	Ratio of earnings before interest and tax to total assets	Abdullatif *et al.* (2019), Bouaziz *et al.* (2020); Da Silva *et al.* (2023)
Firm return on equity (ROE)	The ratio of earnings to total shareholders' equity	Abdullatif *et al.* (2019)
Industry type (INDT)	Dummy variable, 1 if a firm is manufacturing sector and 0 otherwise	Hope and Wang (2018)
CEO gender (CEOGEN)	Dummy variable, 1 if CEO is male and 0 if CEO is female	Alqatamin *et al.* (2017); Bouaziz *et al.* (2020), Yami *et al.* (2023); Putra and Setiawan (2024)
CEO expertise (CEOEXPER)	Dummy variable, 1 if the CEO has financial and accounting expertise, and 0 otherwise	Bouaziz *et al.* (2020); Gounopoulos and Pham (2018)

Source: Authors' own creation

Table 3. Measurement of the variables

(ROE). These statistics, including means, medians, variances, standard deviations, skewness, minimums and maximums, were calculated using the SPSS software and are presented in the table.

The descriptive results indicate a wide range of variation within the study sample. The mean values of the companies' size, leverage, ROA and ROE were 9.199, 1.094, 0.0284 and −0.0202, respectively. Similarly, the median values for these variables were 9.203, 0.362, 0.040 and 0.0866, respectively.

Across the 29 Egyptian companies, the firm size had a mean value of 90%, suggesting that the sample firms listed on the EGX tend to be relatively large, with many of them experiencing CEO turnover. This finding aligns with previous studies by Adi *et al.* (2020) and Khani *et al.* (2019). The mean and median values of SIZE and LEV are close, indicating low skewness, while ROA and ROE exhibit larger skewness. The standard deviations for SIZE, LEV, ROA and ROE are 0.74, 3.46, 0.16 and 1.52, respectively.

Table 5 presents descriptive statistics for the dichotomous variables, including the dependent variable (Big Bath), independent variable (CEO Turnover), the moderator (CEO Origin) and the control CEO characteristics variables (CEO Gender and Experience), all measured as dummy variables.

The descriptive statistics reveal that the occurrence of big bath accounting, based on the firm's report on a decline in profitability during the CEO transition year, was observed in 15

out of 290 observations, with 255 instances of no CEO change and 35 instances of CEO turnover over the ten-year study period:

> Furthermore, the recruitment of 54% of the 35 newly appointed CEOs from within the organization suggests that internal CEOs may influence the correlation between a big bath and CEO turnover. This finding is consistent with previous studies by Altarawneh *et al.* (2022), Yahaya (2022) and Haque *et al.* (2022), which indicate that when an incoming CEO is promoted internally, there is a higher likelihood of a big bath. External CEOs often lack firm capabilities knowledge and strong relationships with internal stakeholders, while internal CEOs possess a better understanding of core competencies for resilience development.

> Moreover, the analysis reveals that 14 out of the 35 CEOs (40%) have financial experience. This finding aligns with research by Putra and Setiawan (2024) in Indonesia, who reported a similar percentage, and Qi *et al.* (2018) in China, who found a slightly lower percentage. Managers with financial and accounting experience are better equipped to navigate complex accounting standards, potentially reducing the need for real earnings management strategies.

Table 5 also highlights that most of the CEOs are male, with only 3 out of 35 (8.5%) being female. This result is consistent with findings from Putra and Setiawan (2024), and Barua *et al.* (2010), indicating low representation of female CEOs. Social and institutional barriers in Egypt, as documented in the literature by Abdelzaher and Abdelzaher (2019) and Elsaid and Elsaid (2012), contribute to this disparity. However, efforts to promote gender diversity, such as the decrees issued by the Financial Regulatory Authority mandating female representation on boards, indicate steps toward gender equality. Research by El-Dyasty and Elamer (2023) suggests that female executive directors in Egypt are less inclined toward earnings management, potentially improving financial reporting quality.

Table 4. Descriptive statistics for continuous variables

Variable	mean	Median	Var.	Skew	SD	Min.	Max.	Obs.
SIZE	9.19955	9.20344	0.553	0.339	0.74394	7.92774	11.0337	290
LEV	1.09416	0.36234	12.013	5.136	3.46602	−21.179	38.9174	290
ROA	0.02841	0.04044	0.026	−6.934	0.1618	−1.99	0.39127	290
ROE	−0.0203	0.0867	2.319	−14.928	1.52269	−24.685	2.02308	290

Source: Authors own creation

Table 5. Frequency table for dichotomous variables

Variable	Dummy variable	Frequency
Big bath accounting (BIGBATH)	The firm reports a decrease in earnings during the CEO's first year =1	15
	Otherwise = 0	275
CEO turnover (CEOTURN)	If the CEO of the sample firm changes= 1	35
	Otherwise =0	255
CEO origin	if the CEO is internal = 1	19
	if the CEO is external = 0	16
CEO expert	if CEO has financial experience =1	14
	Otherwise =0	21
CEO gender	Male = 0	32
	Female =1	3

Source: Authors' own creation

Table 6 presents a cross-tabulation of the dependent variable (Big Bath) and the independent variable (CEO Turnover), both measured as dummy variables. The analysis reveals that among the examined firms, CEO turnover in Egypt is low, with only 35 instances compared to 255 instances without change. CEOs have long tenures in Egypt, and 20 instances of a big bath occurred only with the appointment of a new CEO. This observation suggests that big bath practices are more likely to occur after a CEO change, which may support H_1 and aligns with previous research by Silva *et al.* (2023), Breuer *et al.* (2023) and Neto *et al.* (2021), which suggested that such practices may be encouraged following a CEO change.

4.2 Correlation analysis

Table 7 uses the VIF test to evaluate multicollinearity in regression analysis, with an estimated mean VIF of 1.13, which is below the commonly accepted threshold of 3, indicating that there is no significant multicollinearity among our variables.

Table 8 shows a correlation matrix with significant relationships, with the highest coefficient between BIG BATH and firm size at 0.4064. A coefficient of 0.680 is considered the threshold where Multicollinearity issues, as per Gujarati (2003), can negatively affect regression analysis results. The absence of multicollinearity issues, confirmed by VIF test results in Table 7, supports these findings.

Furthermore, the results in Table 8 indicate significant relationships between the independent variable BIG BATH and the dependent variable CEOTURN, as well as the control variable CEOEXPER, at the 5% level of significance. Additionally, CEOTURN is correlated with LEV and SIZE at the 10% level of significance, while LEV is also correlated with ROA and IND.

4.3 Panel-data analysis

This research section presents the results of panel regression analyses for testing the study's hypotheses, using a static panel data analysis approach for 29 firms in Egypt from 2012 to 2021.

4.3.1 Estimates of panel data models. The panel data analysis uses pooled cross-section and time series data to examine the relationship between big bath and CEO turnover and other determinant variables for selected listed firms, controlling for specific effects across firms. Tables 9 and 10 display panel data estimates for the selected study period, using fixed and random effects methods, with and without CEO origin. The Hausman test is then used to choose between the two models: fixed and random.

Table 9 presents the Panel data model estimates for Big Bath and CEO Turnover. Across all models, consistent results are observed, indicating robustness in parameter coefficient estimates. The results show a significantly positive relationship between BIG BATH and CEOTURN at the 1% significance level, suggesting *the acceptance of* H_1 and confirming a relationship between CEO turnover and the tendency to engage in big bath practices in the

Variable		CEO turnover 0	1	Total
Big	0	255	15	270
	1	0	20	20
Total		255	35	290

Source: Authors' own creation

Table 6. Cross tabulation of the two dummy variables (big bath and CEO turnover)

Variable	VIF	I/VIF
IND	1.25	0.799008
SIZE	1.21	0.827708
ROE	1.17	0.858281
ROA	1.13	0.88765
LEV	1.12	0.891286
CEOEXPER	1.08	0.924394
CEOGEN	1.06	0.942201
CEOTURN	1.01	0.994041
Mean VIF	1.13	

Table 7. Multicollinearity test using VIF

Source: Authors' own creation

Variable	BIG	CEOTURN	SIZE	LEV	ROA	ROE	IND	CEOEXPER	CEOGEN
BIG	1								
CEOTURN	0.10588**	1							
SIZE	−0.4064	−0.02825*	1						
LEV	−0.0329	0.36996*	0.03714	1					
ROA	−0.0804	−0.02372	0.10145	−0.0518*	1				
ROE	0.01193	−0.03548	−0.0384	0.21178	0.24255	1			
IND	0.03868	−0.06325	−0.3756	−0.1033*	−0.1578	0.03582	1		
CEOEXPER	0.0663**	−0.0223*	−0.0656	0.1569	0.0389	0.0346	−0.084	1	
CEOGEN	0.0282	0.0216	0.0961	0.0151	−0.0131	−0.0129	−0.0156	−0.0121	1

Table 8. Correlation matrix of research variables

Notes: The symbols *, ** and ***signify statistical significance at the 10, 5 and 1% levels, respectively
Source: Authors' own creation

Egyptian capital market. Additionally, CEO expertise is significant at the 10% level. The coefficient of determination (R^2) is 26%, with an adjusted R^2 of 20.5%, indicating that 20.5% of the variation in the big bath model can be explained by the independent variables (CEO turnover, CEO gender, experience, firm size, ROA, ROE, leverage and industry), while 79.5% of the variation remains unexplained by the model. Table 11 also presents the results of the Hausman test, which rejects the fixed effects model in favor of the random effects model, given that the p-value is greater than 0.05.

Table 10 presents the results of the Panel data model estimation for big bath and CEO turnover moderated by CEO origin, testing H_2.

The results from Table 10 indicate that CEO turnover is significant at the 1% level, while CEO origin and CEO expertise are significant at the 5% level. This suggests that CEO origin, particularly the internal CEO (with a value of 1 in its measure), has a significant moderating impact on big bath accounting practices during turnover years in the Egyptian capital market, thereby *supporting* H_2. Furthermore, it is observed that the adjusted R^2 value increases after adding CEO origin to the model, indicating improved explanatory power. Additionally, Table 12 presents the results of the Hausman test, which rejects the fixed effects model and accepts the random effects model, as the p-value is greater than 0.05. Table 13.

4.3.2 Model diagnostics. Tables 9 and 10 provide a comprehensive assessment of the validity of the presented models, including tests for homoscedasticity and autocorrelation of

Variables	Fixed	Random	Pooled
CEOTURN	0.4122955*	0.4263998***	0.4281759***
SIZE	0.0313467	−0.0016611	−0.00192218
LEV	−0.0004	−0.0021991	−0.0023885
ROA	0.0105001	−0.0886864	−0.0977032
ROE	−0.0012725	0.0026835	0.0031334
IND	0.00023	0.0184665	0.0176802
CEOGEN	0.00012	0.0172765	0.0174282
CEOEXPER	0.1725158*	0.0432378*	0.0430892**
Constant	−0.3654166	−0.0243465	−0.0213517
R^2		26%	
Adj R^2		20.5%	

Notes: The symbols *, ** and ***signify statistical significance at the 10, 5 and 1% levels, respectively
Source: Authors' own creation

Table 9. Estimates of panel data models for big bath and CEO turnover

Variables	Fixed	Random	Pooled
CEOTURN	0.4122955***	0.4238040***	0.4255111***
SIZE	0.0313467	−0.0011882	−0.0015238
LEV	−0.0004	−0.0018812	−0.0020727
ROA	0.0105001	−0.0792495	−0.0888106
ROE	−0.0012725	0.0021059	0.0025628
IND	0.00012	0.0202025	0.0193009
CEOGEN	0.000002	0.0221903	0.0221018
CEOEXPER	0.172518*	0.0490093**	0.0485041**
CEOORIGIN	0.000022*	0.0195750**	0.0186126*
Constant	−0.3654166	−0.0464116	−0.0417979
R^2		41.3%	
Adj R^2		39.8%	

Notes: The symbols *, ** and ***signify statistical significance at the 10, 5 and 1% levels, respectively
Source: Authors' own creation

Table 10. Estimates of panel data models for big bath and CEO turnover, moderated by CEO origin

	p-value
Hausman test	0.3472

Source: Authors' own creation

Table 11. Hausman test for big bath and CEO turnover

residual values. Homoscedasticity assumes a constant variance of residuals across independent variables, while autocorrelation correlates consecutive residuals in a time series, implying independent errors in regression models. Table 12 shows significant levels for tests greater than 0.05, indicating the acceptance of the null hypothesis, which assumes homoskedasticity of the error term. Furthermore, the Durbin-Watson value, close to 2, confirms the model's validity and homoscedasticity assumption, thereby enhancing the robustness and credibility of the research findings.

4.4 Discussion of the results

The empirical findings reveal a positive correlation, validating the first hypothesis H_1 and indicating a significant relationship between CEO turnover and big bath strategies. The Egyptian market's inefficiency, coupled with limited demand for current information due to regulatory deficiencies, contributes to this phenomenon. New CEOs are found to use aggressive earnings management tactics, consistent with the big bath theory and aligned with agency theory principles. The study emphasizes the need for regulatory reforms to mitigate such practices and enhance transparency in Egypt's capital market.

These findings align with those of Silva *et al.* (2023), who observed an increase in big-bath accounting following CEO changes in Brazil. CEOs in profitable companies often use accrual earnings management to control profits, often over production cuts or discretionary spending increases. This practice becomes more prevalent when turnovers are forced, or incoming CEOs are overconfident. A global study by Glaum *et al.* (2023) revealed widespread adoption of big-bath accounting practices after CEO turnovers, influenced by CEOs' discretion in their countries. Neto *et al.* (2021), Mielcarz *et al.* (2023) and Elsheikh *et al.* (2023) show a meaningful relationship between CEO turnover and earnings management, with new CEOs actively managing earnings in their initial years. Similarly, Pettersen and Søderberg (2016), Shen and Wang (2019), Hassan *et al.* (2020) and Colak and Liljeblom (2022) show that CEO turnover positively impacts big bath behavior, with larger write-downs and lower earnings discretionary accruals observed. However, Theiss *et al.* (2019) did not find a significant correlation between CEO turnover and big bath accounting.

Our results also indicate that CEO origin, particularly internal CEOs, significantly moderates big bath accounting methods during CEO turnover year, supporting the second hypothesis, H_2. This aligns with agency theory, suggesting agents manipulate financial figures to influence outcomes, impact the stock market and enhance management compensation, especially in settings like Egypt, where CEOs tend to have long tenures, as found by Hemdan *et al.* (2023). Long CEO tenures can lead to increased power and potentially lower earnings quality, but board independence can mitigate this. The limited number of CEO turnovers in our sample emphasizes the need for reasonable restrictions on CEO tenure. Egypt's lack of mandatory corporate governance rules, including independent directors, audit committees and external auditors, has led to the adoption of big bath practices (Kamel and Elbanna, 2010). To address this, Egyptian directors should follow global best practices, guided by accounting theories like agency and stakeholder theory.

Table 12.
Hausman test for big bath and CEO turnover moderated by CEO origin

	p-value
Hausman test	0.2316

Source: Authors' own creation

Table 13.
Homoscedasticity and autocorrelation tests

Homoscedasticity	
$chi^2(1)$	983.63
Prob > chi^2	0.61
Autocorrelation	
Durbin–Watson d-statistic	2.01

Source: Authors' own creation

This finding also supports Yu (2012)'s finding that internal promotions increase the likelihood of a big bath for incoming CEOs. Altarawneh *et al.* (2022) and Yahaya (2022) found that internal CEOs can hinder earnings management. Haque *et al.* (2022) found that internal CEOs outperformed external CEOs during crises like the COVID-19 pandemic. In crisis situations with limited investment opportunities, external CEOs' limited knowledge of firm capabilities and weaker connections with internal stakeholders can hinder firm performance. On the contrary, Glaum *et al.* (2023) and Bornemann *et al.* (2015) found that external CEOs, who take over after turnovers, are more likely to manage earnings and increase discretionary spending. They often do big bath accounting due to their prior positions. According to Kuang *et al.* (2014), Nurmayanti and Rakhman (2017) and Geertsema *et al.* (2018), internally promoted CEOs have fewer conflicts of interest and less motivation to manipulate earnings, blaming their predecessors. External CEOs may be more motivated to manage earnings in their early years, suggesting better earnings management. However, due to their predetermined tenure and lack of long-term concern, external CEOs must perform better and control earnings more strictly, often turning to short-term tactics. However, Setyawan and Anggraita (2018) found no relationship between CEO origin and big bath practices.

Additionally, the study reveals that CEO experience significantly impacts big bath accounting practices, aligning with Putra and Setiawan (2024) findings that CEO experience enhances earnings management. The study sample's CEOs' long tenures support this correlation, indicating Egypt's low CEO turnover rate. However, this contradicts previous studies (e.g. Qawasmeh and Azzam, 2020; Sonda and Sutrisno, 2022) that found CEO experience does not influence earnings management. This study also found that other control variables, such as CEO gender, firm size, leverage, ROA and ROE, did not significantly affect CEO turnover or big bath accounting practices. This is consistent with Adi *et al.* (2020) who found no significant impact of ROA and firm size on big baths, while Yami *et al.* (2023) and Khani *et al.* (2019) found a negative relationship between CEO gender, ROA, firm size and earnings management.

5. Conclusion

Managers often use big bath practices to manipulate earnings, typically through substantial write-offs reflecting asset devaluations stemming from poor performance, market pressures or economic changes. These tactics serve to mitigate losses and potentially enhance financial outcomes (Hope and Wang, 2018). New CEOs may attribute losses to their predecessors, claim credit for profits and use discretionary accruals to boost compensation or solidify their positions by influencing financial outcomes. This study examines how CEO turnover affects big bath accounting, particularly in relation to CEO origin, especially in emerging economies like Egypt where governance regulations are less stringent, and how this moderates the impact on earnings quality.

The study supports the first hypothesis that new CEOs tend to engage in big bath activities during their initial tenure. This result aligns with agency and big bath theories and existing literature (e.g. Breuer *et al.*, 2023; Glaum *et al.*, 2023; Colak and Liljeblom, 2022; Neto *et al.*, 2021; Hassan *et al.*, 2020). In new CEOs' early days, cost-cutting is common to save funds. Previous management is often blamed for problems, particularly in markets such as Egypt with weak governance, which can extend CEO tenures and keep turnover low.

Furthermore, we investigate how CEO origin affects big bath accounting practices over time. Our findings support the second hypothesis, showing that CEO origin significantly influences big bath practices during turnover years. Internal CEOs tend to engage in more big bath practices initially compared to external CEOs. This corresponds with prior research

(e.g. Altarawneh *et al.*, 2022; Haque *et al.*, 2022; and Yahaya, 2022), which suggests that internal CEOs have better insight into core competencies, whereas external CEOs may feel pressured to demonstrate their abilities due to lower survival expectations and unfamiliarity with internal stakeholders.

This study contributes to accounting literature by examining CEO traits and big bath accounting in post-2011 revolution and COVID-19 contexts in Egypt, an emerging economy with limited governance regulations affecting earnings quality. Additionally, it enriches the big bath accounting literature by emphasizing the importance of CEO turnover and origin while controlling for factors like gender and experience. The study suggests that boards should assess incoming CEOs, especially external ones, to prevent autocratic leadership. Implementing limits on CEO tenures and expanding top executive roles can enhance internal governance, benefiting investors who recognize the impact of CEO traits on financial reporting. Active shareholder engagement can influence share prices positively. Auditing firms are advised to reassess methodologies and intensify scrutiny during CEO turnover, incorporating fraud assessments and evaluations of earnings quality.

The study's main limitation is that it focuses on two CEO characteristics that may not fully capture the complexities of big bath practices, suggesting further exploration of factors like manager-controlled accounting variables and diverse CEO traits. A more comprehensive analysis of companies without CEO turnover and a deeper exploration of political influences and corporate events could enhance the robustness of the findings.

To fully understand big bath accounting, researchers should consider factors beyond CEO turnover and origin, compare practices across Arab and Middle Eastern countries and explore regulatory and corporate governance frameworks. Investigating the motivations behind CEOs' big bath policies is also a promising avenue for future research.

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