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Beyond gender diversity: How specific attributes of female directors affect earnings management

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A B S T R A C T

We apply the system GMM regression estimation approach to a matched sample of French firms listed on Euronext Paris during the period 2001–2010 in order to investigate the relationship between female directors and earnings management by considering their specific (statutory and demographic) attributes. We first find that the presence of female directors deters managers from managing earnings. However, this finding does not hold when the statutory and demographic attributes of female directors are taken into account, thus showing that the detection and the correction of earnings management require particular competencies and skills. Interestingly, we find that business expertise and audit committee membership are key attributes of female directors that promote the effective monitoring of earnings management. An important implication of our findings is that the decision to appoint women on corporate boards should be based more on their statutory and demographic attributes than on blind implementation of gender quotas. Finally, our supplementary analysis reveals that female CEOs and CFOs are strongly inclined to reduce earnings management.

1. Introduction

Earnings management is generally defined as the practice of using discretionary accounting methods to attain desired levels of reported earnings (Gavious, Segev, & Yosef, 2012). Earnings management includes choosing accounting methods which provide reporting income that is advantageous for managers and the company but detrimental for external stakeholders (Krishnan & Parsons, 2008). The issue of earnings quality is discussed extensively in the accounting literature, and is an important area of concern for stakeholders. Earnings quality shows the extent to which stated earnings reveal an organization's financial situation to interested parties. If users of financial data are “misled” by the level of reported income, then investors' allocation of resources may be inappropriate when based on the financial statements provided by management (Healy & Wahlen, 1999). Managers are professionally responsible and ethically obliged to make sure that concerned parties

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receive high quality earnings reports in a timely manner (Krishnan & Parsons, 2008). Following the uncovering of major accounting scams involving large organizations (e.g. Enron), scholars have focussed on managers' motives for engaging in earnings management (Gavious et al., 2012). The literature mentions various factors, for example, debt covenants, pending litigation and the existence of performance-based compensation plans for management, that can motivate earnings management (Jones, 1991). All stakeholders and users of financial information require tools that can moderate managers' tendency to engage in earnings management (Krishnan & Parsons, 2008).

Several researchers have explored the impact of gender diversity on both financial reporting quality and earnings management (Arun, Almahrog, & Aribi, 2015; Gavious et al., 2012; Krishnan & Parsons, 2008; Labelle, Gargouri, & Francoeur, 2010; Peni & Vähämaa, 2010; Srinidhi, Gul, & Tsui, 2011). However, this issue requires further investigation. Equivocal methodologies and inconsistent findings have left researchers and managers perplexed. The main cause of this uncertainty is the excessive use of the agency hypothesis, which states that statutory diversity alone is enough to control management and provide motives to defend shareholders' interests (Fama & Jensen, 1983). Prior studies have also focused on the number or percentage of female directors in examining the relationship between board gender diversity and earnings management. Our study broadens this approach and extends beyond research on gender difference by exploring the channel through which female directors exert influence on earnings management. Following the approach proposed by Ben-Amar, Francoeur, Hafsi, and Labelle (2013), we consider both statutory and demographic attributes of female board members. Statutory diversity is a measure of heterogeneity in the process of board composition and is essential for effective monitoring of management (Fama & Jensen, 1983). Demographic diversity (e.g. education, skills and experience) leads to better decision-making by nurturing candidness and analytical decision-making among board members (Erhardt, Werbel, & Shrader, 2003).

Our initial sample consists of companies belonging to the CAC All-Shares index listed on Euronext Paris over the period 2001–2010, during which time women were appointed to boards on voluntary basis. Our sample period ends prior the amendment of the gender quota law by the French parliament in 2011. This legislation requires that, as from 2014, 20% of a firm's board members be women, rising to 40% as from 2016. Apart from the benefits of setting gender quotas, our study highlights the importance of female directors' attributes, as a consequence of which they are more effective in monitoring the corporate financial accounting process. In our paper, both gender diversity and the attributes of female directors are endogenously determined. We then employ a carefully formulated methodology for dealing with firm level differences, omitted variables, self-selection bias and endogeneity issues. We use propensity score-matching to match gender-diverse firms and non-gender-diverse firms with very similar characteristics. The analysis serves to determine whether sample firms differ in firm-specific characteristics, regardless of the role of gender diversity. We apply the system GMM regression estimation approach to the matched sample to correct for endogeneity bias.

Our findings first reveal a negative association between the presence of women on board and the magnitude of earnings management. After statutory and demographic attributes are added to the regression models, the results provide evidence of a positive relationship between female directors and earnings management. This finding suggests that specific attributes of female directors may promote the effective monitoring of earnings management and may also influence the nature of the linkage between the proportion of female directors and earnings management. As regards statutory and demographic attributes, we find that business expertise and audit committee membership are key attributes of women directors for the detection and correction of earnings management. On the other hand, women's leadership and experience are positively related to the level of earnings management. In a supplementary analysis, we also consider the case of women in two top executive positions, namely CEO and CFO, in relation to earnings quality (Francis, Hasan, Park, & Wu, 2015; Gavious et al., 2012; Peni & Vähämaa, 2010). Our findings provide evidence of a negative relation between female executives (CEOs and CFOs) and earnings management, with a more pronounced effect for female CFOs than for female CEOs.

Our paper contributes to the literature on the linkage between female board directorship and earnings management at least in two ways. First, we explore the black box relationship between gender diversity and firm performance by studying the mediating effect on it of a large set of female directors' attributes. Important implications of our findings are that the detection and correction of earnings management require particular competencies and skills and that the decision to appoint women on corporate boards should be based more on their statutory and demographic attributes than on blind implementation of gender quotas. Furthermore, our recommendations may be still germane after the implementation of the gender quota law, since this legislation says nothing about the required attributes of directors. Second, most of the existing studies are based on Anglo-American data and cannot be generalized, due to differences in governance and legal structures. Given that aggressive earnings management is more likely to occur in countries with less protection for minority shareholders (Bushman, Chen, Engel, & Smith, 2004; Duh, Lee, & Lin, 2009), our study offers a pertinent discussion on the relationship between board gender diversity and earnings management in a civil law country such as France.

The remainder of our paper proceeds as follows. Section 2 briefly discusses and highlights the value of studying the French institutional background. Section 3 concisely reviews the literature on gender diversity, female specific attributes and the extent of earnings management, and puts forward the hypotheses to be tested. Section 4 describes the data, methodology and variables used in the study. Section 5 presents the study's findings, and the final section contains our closing comments and avenues for future research.

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