Pacific-Basin Finance Journal 40 (2016) 17–35

Contents lists available at ScienceDirect

Pacific-Basin Finance Journal

journal homepage: www.elsevier.com/locate/pacfin

Gender differences in compensation and earnings management: Evidence from Australian CFOs

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ARTICLE INFO

Article history:
Received 5 February 2016
Received in revised form 20 July 2016
Accepted 27 July 2016
Available online 02 August 2016

JEL classification:
G34
J33
M41

Keywords:
Chief Financial Officers
Executive compensation
Gender pay gap
Earnings management
Risk aversion
Australia

ABSTRACT

We investigate the impact of CFO gender on CFO compensation and earnings management in Australia. In a sample of exchange-listed firms from 2006 to 2010, we find a significant gender pay gap in CFO compensation but much of this pay gap dissipates when female CFOs are matched using a propensity scoring method. Female CFOs tend to choose less risky remuneration packages with more cash and less non-cash component, with more salary and less bonus than their male peers. In addition, female CFOs are more conservative and deliver higher reporting quality compared to male CFOs. They engage substantially less in both accruals-based and real-based earnings management than their male counterparts. The difference in behavior of earnings management and in the selected compensation structures between male and female CFOs can be possibly explained by the gender-based difference in personal risk preference.

1. Introduction

There has been a significant increase in female representation in corporate senior management teams over the past decades.[1] According to the Australian Institute of Company Directors, the percentage of female directorship on the boards of Top 200 firms listed on the Australian Securities Exchange (ASX) has increased from 8.3% in 2009 to 20% in 2015.[2] It is generally acknowledged that executive gender plays a significant role in various corporate aspects, such as, reporting quality, compensation, firm performance, financing and acquisitions (Srinidhi et al., 2011; Lam et al., 2013; Low et al., 2015; Huang and Kisgen, 2013). Prior research has generally emphasized on the role of Chief Executive Officers (CEOs). As a result of a number of high profile corporate collapses and the enactment of legislation in the US and in Australia, the importance of Chief Financial Officers (CFOs) in firm management has been crystallized. Section 302 of the Sarbanes-Oxley Act (US) and Section 295 A of the Corporations Act (Australia) require

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[1] Some European countries have implemented gender quotas to increase the number of female directors on the board. For example, companies in Norway are required to have at least 40% of company board members to be women since 2003. A failure to achieve this mandatory quota leads to the company being delisted in the Norwegian stock exchange. Similarly, Germany passed a law requiring 30% of board seats to be filled by women by 2016.

[2] This statistics are from website of the Australian Institute of Company Directors (http://www.companydirectors.com.au/Director-Resource-Centre/Governance-and-Director-Issues/Board-Diversity/Statistics).

http://dx.doi.org/10.1016/j.pacfin.2016.07.004
0927-538X/

both CEOs and CFOs being personally responsible for accuracy and completeness of company financial reports. The result of these changes and the corresponding elevation of the role of CFOs enable CFOs to be treated as a unique and relatively homogeneous role within the executive ranks.[3]

As responses to the greater awareness of executive gender issues and the increasingly important role of CFOs, researchers are now investigating the influence of CFO gender on compensation and earnings quality (Gayle et al., 2012; Barua et al., 2010; Ge et al., 2011; Francis et al., 2015). However, mixed results have been found and those studies have generally focused on the US market. For example, Bertrand and Hallock (2001) do not find a gender pay gap for CFOs while Gayle et al. (2012) find a significant CFO pay difference in salary. Similar, Barua et al. (2010) and Peni and Vahamaa (2010) find that CFO gender significantly affects discretionary accruals whereas Ge et al. (2011) do not find evidence to support this relationship. In addition, past research has mainly concentrated on accruals-based earnings management and ignored the real transactions manipulation when examining the impact of CFO gender on earnings quality. In this paper we investigate whether the CFO gender has a material impact on CFO compensation and earnings management in Australia. We contribute to the literature by examining both accruals and real earnings management. We further examine how the risk-averse characteristic of female CFOs could potentially impact on their choice of compensation structure. To our knowledge, this is the first work in Australia that investigates the gender role at the CFO level and is an important step in uncovering pay inequity and earnings management behavior in this defined executive role.

Although there are some similarities between Australia and the US, the differences between the two countries make it interesting to see if the US findings of the impact of CFO gender on compensation and earnings management also apply in Australia. Similar features of Australia and the US include a regulatory framework which requires CFOs to certify company financial reports and a low proportion but significant increase recently of female CFOs in listed corporations. Our data shows only 7.37% of Australian listed firms employ female CFOs and the similar percentage (8%) is observed in the US market (Barua et al., 2010). The number of female CFOs has, nevertheless, increased significantly in both Australian and US corporations. In our sample, 9.52% of Australian CFOs were women in 2010 versus 2.53% in 2006. This figure for the US market was 7.5% in 2005 versus 3% in 1994 (Huang and Kisgen, 2013).

In spite of some similarities, Australia and the US differ remarkably in some aspects. The first difference is that female and male CFOs in the US work in firms with similar total assets (Barua et al., 2010) while Australian female CFOs are employed mostly by much smaller firms. Our data shows that the median sales of firms with female CFOs is about $64 million dollars which is approximately 9 times smaller than that in firms employing male CFOs. The board structure of Australian firms is distinguished from their US counterparts with Australian boards being smaller, having a lower proportion of executive directors and less likely being chaired by CEOs (Bugeja et al., 2012a). In addition, the proportion of Australian CFOs who are a member of the company board of director is roughly 5 times higher than that reported in the US market (Duong and Evans, 2015). This difference implies that Australian CFOs could be potentially involved in making more strategic decisions. Another difference between the two countries is in the structure of CFO compensation. The US CFOs are remunerated heavily towards non-cash component such as shares and options (Balsam et al., 2012) whereas Australian CFOs receive more cash component (salary and bonus) in their compensation package (Duong and Evans, 2015). The final aspect that distinguish Australia and the US is that the regulation on audit committees, which play an important role in constraining earnings management, is less prescriptive in Australia than that in the US (Wilson, 2011). While the audit committees of all listed US firms are legislated to have solely independent directors, this requirement for Australian listed firms is to follow the best practice guidelines issued by the ASX.

Our evidence is based on the original sample of 556 firm-year observations of exchange-listed firms in Australia from 2006 to 2010. We find that female CFOs mainly work for small and medium enterprises (SMEs) and are concentrated in consumer stables and financial industries. There are no female CFOs in male-dominated industries, such as, information technologies, telecommunication and utilities. The majority of firms employ male CFOs with less than 10% of firms employing female CFOs. Female CFOs choose less risky remuneration packages by receiving significantly more in cash and less in non-cash components than male CFOs. They also have higher proportion of salary and lower proportion in bonus to total compensation than their male CFOs. Female CFOs have similar qualifications compared to their male peers and the performance of companies is not significantly impacted by the CFO gender. Women CFOs tend to own more company shares, have shorter tenure and be less likely to have a seat on the company board of directors compared with their male counterparts. In addition, companies with female CFOs are smaller in size, have lower leverage and higher percentage of female directors on the board.

In contrast to the US studies (Bertrand and Hallock, 2001; Gayle et al., 2012), it is found that there is a significant gender pay gap in Australian CFO compensation in our original sample. The average total compensation of female CFOs is less than half of that paid to their male counterparts. Furthermore, this pay gap does not decrease when there are female directors on the company board or on the compensation committee. However, the CFO gender pay gap dissipates when we replicate the original analysis with a matched sample using a propensity score matching method. It suggests that the CFO pay disparity could be the size effect as it is generally recognized that larger firms primarily offer higher remuneration packages to their executives. Despite having lower pay, female CFOs deliver higher reporting quality compared to their counterparts. It is found that female CFOs are more conservative in both accruals and real earnings management policies. Companies with female CFOs have significant lower earnings management than companies with male CFOs, and this result is robust in the propensity score setting. The gender-based

[3] There is evidence in the literature that CFOs possess superior information due to their roles in the firm's financial policy and financial reporting process (Geiger and North, 2006; Jiang et al., 2010)). Wang et al. (2012) find that CFO trades are more informative about future stock returns than CEO trades. Similarly, Wang and Wang (2014) shows that CFOs trades are predictive of new information in future earnings for firms in a poor information environment.