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Does gender diverse board mean less earnings management?

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ABSTRACT

We examine the effect board gender diversity has on earnings management in European countries. The findings reveal that a gender diverse board mitigates earnings management in countries where gender equality is high. This provides an explanation to the inconclusive findings in the literature.

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1. Introduction

The effort to improve gender diversity in the corporate workforce in Europe is a continual process. In the 21st century, countries such as Norway and Italy have enforced legislations to increase female representation in the boardrooms, while other countries such as the UK have issued strong recommendations to increase female representation on the board. Meanwhile, similar legislations are taking effect in France and Belgium. The benefits female directors bring to the company, however, are inconclusive.

Barua et al. (2010), Srinidhi et al. (2011), Thiruvadi and Huang (2011) found strong evidence that S&P firms with more women on the corporate board report higher quality earnings. This is explained

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as a result of the tendency of female directors to abide by ethical values and regulations (Barua et al., 2010; Ittonen et al., 2013), female directors being more risk averse than male directors (Watson and McNaughton, 2007; Rau, 2014), and/or heterogeneity in the decision making process by different genders (Bosquet et al., 2014). However, in studying Chinese companies, Ye et al. (2010) found no influence of gender on earnings quality. Several potential explanations included the limited ability of female directors to influence male members of the board (Sun et al., 2011), and the homogeneity in ethical values between male and female directors (Ye et al., 2010).

In this paper, we examine the effect of board gender diversity (hereinafter, BGD) on earnings management (hereinafter, EM) in Europe. We find that female directors mitigate EM under one condition – when gender equality is high. The results show that it is the level of women's rights empowered by the institutional setup that fosters the effect, not the proportion of female board members nor the gender regulations. These findings have implications for legislators, regulators, and analysts.

The paper is organised as follows. The next section describes the data and the methodology. Section 3 contains estimation results. Section 4 provides some concluding remarks.

2. Data and methodology

Our sample consists of all European companies whose BGD data are available in the Thomson Reuters Asset4 database and accounting data in the DataStream. There are 970 companies whose annual board and accounting data are available for the period from 2002 through 2013.

EM is measured by the magnitude of accruals which proxies the extent to which managers exercise discretion in reporting earnings (Dechow, 1994; Leuz et al., 2003). In general, earnings may be over/under-stated to meet certain earnings targets or over-stated in certain situations such as before equity issuance. Both our measures have been scaled by price or cash flows from operations to control for differences in firm size and performance.

EM1: proxies the management of earnings through aggregate accruals; following Dechow (1994) EM1 is constructed as:

$$EM1_{it} = \frac{(\text{earnings}_{it} - \text{net cash flows}_{it})/\text{number of shares outstanding}_{it}}{\text{price}_{it-1}},$$

where net cash flows$_{it}$ (net CF$_{it}$) = CF from operations$_{it}$–(CF from investing$_{it}$ + CF from financing$_{it}$).

EM2: proxies the management of earnings through operating accruals; following Leuz et al. (2003) *EM2* is calculated as:

$$EM2_{it} = \frac{|\text{accruals}_{it}|}{|\text{CF from operations}_{it}|},$$

where accruals$_{it}$ = (Δtotal current assets$_{it}$–Δcash and cash equivalents$_{it}$)–(Δtotal current liabilities$_{it}$–Δshort term debt included in current liabilities$_{it}$–Δtaxes payable$_{it}$)–depreciation and amortization expenses$_{it}$.

Our variable of interest, BGD, is often a result of good corporate governance (Brammer et al., 2007; Srinidhi et al., 2011). Besides, firm characteristics also affect the firm's EM practices (Barua et al., 2010; Ye et al., 2010). To control for these factors, we obtain the following governance and control variables:

– *gender:* percentage of female directors on the board.
– *indep:* percentage of independent directors on the board.
– *duality:*ordinal variable equals to 0 if the CEO is not simultaneously the board chairman, 1 if the CEO is simultaneously the board chairman, and 2 if the CEO is simultaneously the board chairman and if the board chairman has been the CEO of the firm.
– *bsize:* natural logarithm of board size.
– *fsize:* natural logarithm of market value.
– *growth:* price to book value.
– *leverage:* total debt over total assets.
– *profitability":* return on assets.

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