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# Does top executive gender diversity affect earnings quality? A large sample analysis of Chinese listed firms

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ABSTRACT

Using a large sample of Chinese listed firms, this paper examines whether the gender of top executives affects earnings quality. Unlike the findings documented in developed markets such as the U.S., our results show that earnings quality proxies, including earnings persistence, the accuracy of current earnings in forecasting future cash flows, the association between earnings and stock returns, and the absolute magnitude of discretionary accruals do not display significant differences for firms with female and male top executives. This study is the first to examine the relationship between gender and earnings quality in emerging markets such as China that offers managerial and policy implications.

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## 1. Introduction

In this paper, we investigate whether the gender of top executives affects earnings quality for a large sample of Chinese companies. Recent improvements in women's economic and social status have generated significant attention to the role of women in firms' upper echelon (McKinsey&Company, 2007). The growing concern about the lack of heterogeneity in the composition of board of directors since the Enron scandal in 2001 greatly inspired research in this area (Williams, 2003; Burgess & Fallon, 2003; Farrell & Hersch, 2005; Singh, 2007; Werhane, 2007). Research on gender and business ethics normally suggests that women are more ethical than men in attitudes and behaviors (Beltramini, Peterson, & Kozmetsky, 1984; Ferrell & Skinner, 1988; Betz, O'Connell, & Shepard, 1989; Akaah, 1989; Ruegger & King, 1992; Nguyen, Basuray, Smith, Kopka, & McCulloh, 2008). As earnings management is generally viewed as an ethical issue by managers and accountants (Bruns & Merchant, 1990), some studies also explore gender differences in earnings quality, and document a positive relation between female employees and earnings quality. Krishnan and Parsons (2008) find that gender diversity in senior management improves the quality of reported earnings. Shawver, Bancroft, and Senneti (2006) also indicate that female accountants were less likely to engage in earnings management.

McKinsey&Company (2007) reports that companies with three or more women directors and officers in Europe and the United States perform better in their corporate governance measures and financial performance. Improving financial performance and earnings quality is also becoming more critical in emerging markets. Take China as an example; over the last two decades, it has experienced incredible levels of growth and structural change coupled with numerous factors that have enhanced the complexity of its transformation. In this transitional economy, how to increase earnings quality and thus enhance market efficiency is a crucial issue that Chinese stock market regulators encounter. Given the difference in language, culture, economic development, legal systems, and personal values between developed and developing countries (Ge & Thomas, 2007; Lam & Shi, 2008; Whitcomb, Erdener, & Li, 1998), does the stated gender effect on earnings quality in developed countries also hold in developing countries? Do firms in emerging markets with female top executives also report higher quality earnings? These questions are addressed in this study by investigating the possible association between top executive gender and earnings quality in the largest emerging market in the world, China.

Our results show that earnings quality proxies, including earnings persistence, the accuracy of current earnings in forecasting future cash flows, the association between earnings and stock returns, and the absolute magnitude of discretionary accruals do not display any significant differences between firms with female and male top executives, which is inconsistent with the documented gender differences in earnings quality in the developed-country context. Our results indicate that advocating firms to hire more female managers may not be helpful to increase listed firms' earnings quality in China. Instead, China may need to seek other methods, such as

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increasing the heterogeneity of the board of directors by age, functional background, education, and tenure to enhance its listed firms' earnings quality.

Our paper contributes to the literature in several ways. First, the gender issue is receiving a considerable attention in the work place. The 2009 KPMG survey of 955 companies reveals that more than 61% of these companies now have diversity policy in place monitoring gender, age, race/ethnicity and disability (KPMG, 2009). Second, there is currently no empirical research to examine the relationship between earnings quality and top executive gender in developing countries. Only three related papers addressed gender ethical difference in China.[2] All of them adopted either experimental or questionnaire method and none of them examined actual behavior related to financial reporting or other aspects of earnings quality. In the light of the advantages of impartial secondary data in business ethics research (Nicholson & Bennett, 2009), we extend the existing research by examining actual reported financial numbers in a large sample of Chinese listed companies and comparing the earnings quality in companies with female and male top executives. Finally, increasing listed firms' earnings quality is even more important for emerging markets, such as China, as in those markets, financial reports are generally less transparent and the market is less efficient, which increases the transaction costs of the market. Academics, regulators, and other users of accounting information are thus interested in mechanisms that mitigate the tendency of the manager to engage in earnings management and thus provide higher quality financial reports. We extend this line of research by examining whether another characteristic of an organization, the gender of top executives, influences earnings quality or the likelihood of earnings management in an emerging market, China.

The remainder of the paper proceeds as follows: the next section reviews the literature, develops the hypotheses, and then presents our research design. This is followed by a description of our sample, a descriptive analysis, and the study's results. Concluding comments complete the paper.

## 2. Literature review and hypothesis development

### 2.1. Related studies

Business ethical differences between genders have been broadly studied. Prior literature suggests that women and men exhibit distinct differences in values and interests, and in proclivity for unethical business behavior (Gilligan, 1982; Betz et al., 1989). Men are more interested in economic benefits and career success, and are more likely to break rules to achieve competitive success, while women are oriented more toward harmonious relationships and helping others, are socialized into more communal values, and are less likely to be unethical (Betz et al., 1989; Butz & Lewis, 1996; Mason & Mudrack, 1996).

Empirical evidences concerning gender impact on ethical judgment are mixed. Collins (2000) reviews forty-seven articles published in *Journal of Business Ethics* during 1982–1999. Of these, thirty-two studies reveal that females are more ethically sensitive than males; while fifteen other studies suggest that gender has no impact on ethical attitudes and behaviors. Ford and Richardson (1994) survey fourteen studies on the relationship between gender and ethics. Seven of them document a higher level of ethical consciousness for females than males, while seven other studies do not identify gender differences in ethical attitudes and practices. Taken together, prior literature suggests that the gender effect on ethical behavior is not always significant, but when differences are identified, females appear to be more ethical than males. Inconsistent findings documented by prior research also suggest that gender differences may be context specific.

With the growing number of studies in this area, the research scope has broadened from a single context to the comparison among countries (or areas). For example, Roxas and Stoneback (2004) find that the ethical decisions between genders differ under different cultural contexts, and Bernardi and Guptill (2008) study 713 students from seven different countries and find that the notion that women are more ethically conscious than men only holds in the U.S. and Canada. Despite the need for gender diversity in the business field and research in developing countries, studies on gender differences remain scarce in developing countries such as China. Hong and Xiao (2007) find that females and males do not show any differences in environmental concern after controlling for their environmental knowledge factor. Roxas and Stoneback (2004) select students from eight different countries as research subjects, and discover that females are less likely to behave ethically in China than in developed countries. By collecting data through personal interviews with working persons of mass transit systems and shopping centers in Beijing and Hong Kong, Lam and Shi (2008) find that females have a lower acceptability of unethical behaviors in Hong Kong, whereas gender effect is not statistically significant in Mainland China. However, none of those studies examine actual ethical behavior between genders.[3]

We extend the literature by empirically examining the relationship between top executive gender and firm earnings quality using actual reported financial numbers for a large sample of Chinese listed firms. Specifically, we examine whether the gender of Chief Executive Officers (CEO) and Chief Financial Officers (CFO) affects firm earnings quality among Chinese listed firms. CEO and CFO are the senior executives who are more likely to have influence over financial reporting decisions. CFOs are responsible for financial reporting process in their organizations, and Cullinan and Sutton (2002) document that over 70% of financial statement frauds directly involve firm CEOs/presidents. CEO and CFO are also the two senior managers the Sarbanes-Oxley Act (SOX) requires to certify the accuracy and completeness of firms' financial reports (Sarbanes-Oxley Act, 2002).

### 2.2. Hypothesis development

Inspired by prior literature which suggests women possess a higher level of ethical consciousness than men, some studies have investigated whether gender affects managerial willingness to engage in earnings management. Krishnan and Parsons (2008) find that gender diversity in senior management improves the quality of reported earnings. Shawver et al. (2006) also indicate that female accountants were less likely to engage in earnings management. Based on a survey of accounting students, Clikeman, Geiger, and O'Connell (2001) document no significant differences in the men's and women's attitudes toward earnings management. However, most studies in this field are based on the U.S. data. A global study conducted by McKinsey&Company (2007) suggests that companies where women are most strongly represented on the board of directors or at top-level management exhibit better governance and financial performance. As the gender difference referred above may be context specific, the findings identified in other countries may not hold in China due to institutional and cultural differences.

McKinsey&Company (2007) identifies several barriers that prevent women obtain and succeed in senior executive positions including the double burden syndrome of finding a right balance between work and domestic responsibilities, the greater effort of adaption for women to assert their talents and gain recognition in the executive position, the difficulties for women to identify with success,

[2] Please refer to Part 2 paragraph 4 for details of the three studies.

[3] Some researchers advocate empirical research in this area (Loe, Ferrell, & Mansfield, 2000; Du & Tang, 2005).