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BOARD ETHNICITY, GENDER DIVERSITY AND EARNINGS MANAGEMENT: EVIDENCE FROM QUOTED FIRMS IN NIGERIA

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Abstract

This study investigated board ethnicity, gender diversity in relation to earnings management in non financial firms. It specifically examined the impact of foreign directorship, female gender, board size, board independence and firm size on earnings management. The study employed quantitative and a cross sectional survey data of non financial institution quoted in the Nigeria Stock Exchange as at 2014. Data were analyzed using descriptive statistics, correlation and multiple Least Square (MLS) regression. This study found that foreign board members, female gender in the board and board independence were negatively related to earnings management. It recommended that in a firm in which foreigners have shares, certain proportion of them should be appointed into the board so as to give room to cross ideology that can encourage or discourage earnings management practices. While one thrid of the total board should be women of different qualifications that can articulate ideas that will not pave way to earnings smoothening.

Keywords: Board ethnicity, gender diversity, earnings management, directors, Nigeria

INTRODUCTION

Board of directors as an organ of the firm is instituted to ensure good corporate governance. OECD (2004) noted that the board of directors is a legal requirement in most countries of the world and one of the essential prerequisites of good corporate governance of firms. The board of directors of a firm comprises people of different ethnicity and gender (male and female) charged with the responsibilities of monitoring and controlling management and ensuring credible reporting of earnings in the interest of diverse shareholders and other stakeholders. When the board of directors of a firm is not well constituted, the firm becomes vulnerable to earnings malpractice on the part of those charged with the management of the cooperation or entity (Siam, Laili, & Khairi, 2014). Earnings management practices do not only give false reflection of the firm's financial performance but bring about less dependable reported accounting numbers which consequently reduces investors confidence in the financial reports for the purpose of decision making. Nevertheless, accounting earnings are more realistic and of higher quality when managers' opportunistic behaviour is checked and reduced using monitoring systems like the board (Liu, Harris & Omar, 2013).

Although earnings management is permitted by law but it is deceptive. Sudden collapse and demise of most profile firms in the past were linked to poorly constituted board and deceptive earnings management practices (Goncharov, 2005; Liu, Harris & Omar, 2013). Earnings management activity of firms is chiefly an effort for executive directors to hide their private control benefits. Insiders can use their discretion in financial reporting to overstate earnings and conceal unfavorable earnings realizations (e.g., losses) that would have prompted outsider interference. Similarly, insiders can use accounting choices to understate earnings in years of good performance to create reserves for periods of poor future performance, effectively making reported earnings less variable than true firm performance.

Abdullah and Valentine (2009) indicated that board diversity and ethnicity can enhance organizational function, increase board independence, firms' performance and survival. To this end, Huse and Solberg (2006) noted that the presence of female in the board has a way of advancing board behavior and effectiveness, basically because women representation on corporate boards are more adequately ready for the board meetings than men.

Several extant studies on accounting literature stated that earnings manipulation is affected by the distinctiveness and incentives of the firm's executives (Meek et al., 2007; Jiang et al., 2008; Matsunaga and Yeung, 2008). However, to the best of our knowledge, existing studies have not recognized the role of foreign and female directorship in the board in relation to earnings management in Nigeria. This is the gap this study seeks to fill. While, the specific objectives of this study are to determine effect of foreign directorship, female gender, board size, board independence and firm size on earnings management.

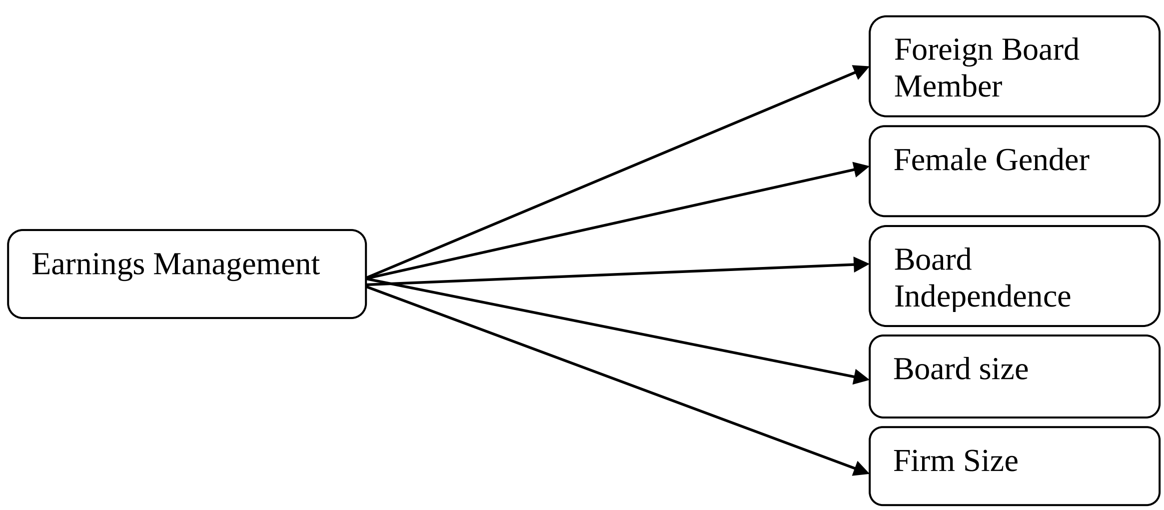
REVIEW OF RELATED LITERATURE

Conceptual Framework on Earnings Management

Earnings management has been defined and described in different ways. Healy and Wahlen (1999) defined "earnings management as manners in which management or corporate decision makers use judgment in financial statement either to mislead the shareholders about the firm's performance or to influence contractual outcomes that depend on reported accounting numbers". Chen, Luo, Tang and Tong (2014) viewed earnings management as choices made by corporate decision makers using accounting methods offered by laws and regulations to influence a firm's reported earnings. Schipper (1989) posited that earnings management is an intentional act by executive directors to influence financial presentation for personal gains. Lev, (2003) stated that management can have deliberate impact on the reported result by manipulating accounting record, without any effect on cash flows or on the real dimension of the firm, or by really involving a change in the firm's level of investment or operating activities.

Dhaliwal *et al.* (2010) see financial reporting issues as involving high levels of technical details and, hence a high degree of knowledge of accounting rules are required to recognize critical accounting issues at such high levels of earnings management. Earnings management could also involve executive directors ideas to capitalize on the loopholes in the law to attract earnings by way of tax avoidance and increase price for personal interests.

Figure 1. Conceptual framework



Foreign Board Member and Earnings Management

Foreign board members consist of individuals who are not citizens of the country in which the parent enterprise is located (Oxelheim & Randoy, 2003). Chiu, Teoh and Tian (2013) stated that the inclusion of at least one foreign director in boards of firms is associated with a growing tendency of directors to emphasize openness and frankness in performing their monitoring tasks, rather than giving priority to politeness and courtesy among board members. Foreign directors may bring different viewpoints to the boardroom given their different backgrounds and experiences. That is, as these directors come from outside the (local or national) inner circle of directors, they are more likely to exhibit independent thinking and to feel less reluctant to raise controversial issues. The presence of foreign directors can benefit discussions within the boardroom and potentially contribute to increased monitoring effectiveness (Srinidhi et al., 2011).

Reggy, Niels, Oxelheim, and Rand (2015) examined the effects of the presence of a foreign board member on earnings management by using a sample of 3,249 firm-year observations representing 586 non-financial listed Nordic firms during 2001–2008. The study revealed that the presence of a non-Nordic, foreign director is associated with significantly higher levels of earnings management and recommended that it may not necessarily be beneficial to appoint a foreign director to the board. However, Forbes and Milliken (1999) revealed that the presence of foreign directors may help prevent too high levels of cohesiveness of the board. Having examined the relationship between foreign board member and earnings management, we hypothesized that; *H_0: Foreign board members have no significant influence on earnings management among quoted firms in Nigeria.*

Female Gender and Earnings management

Females are known for their motivation and achievement, moral values, social stereotype and the relation between task performance and self-confidence in addressing issues that could positively enhance firm's performance. Schubert, (2006) indicated that a great deal of economic psychology literature claimed that females are more conservative and risk averse than men who are risk takers. Sanda, Mikailu, and Garba, (2010) established that the board of directors of the Nigerian quoted companies are predominantly male, with women accounting for 4.9%, 1.8% and 1.8% of all directorships, chairs and CEO's respectively. The study however did not show how board diversity is related to financial performance of firms in Nigeria. MacLeod Heminway, (2007) argued that women are more trustworthy than men, and are thereby less likely to manipulate corporate financial and other disclosures. Adams and Ferreira, (2009) and Srinidhi, Gul and Tsu (2011) observed that female representation on the board are associated with reduced levels of earnings management.

Ilanit, and Rami, (2012) examined female directors and earnings management in high technology firms. The study employed both a univariate and multivariate analysis approach and found evidence for a negative relation between the presence of female directors and earnings management. The findings indicated that accounting aggressiveness is affected by the proportion of women on the board of directors as well as on the audit committee. Furthermore, the paper found that earnings management is lower when either the CEO or the CFO is a woman. Arun, Almahrog and Aribi, (2015) investigated the effect of female directorship on earnings management practices of U.K companies. They found that firms with a higher number of female and independent female directors restrained earnings management practices in the UK. Arun, et.al. (2015) further noted that earnings management is affected by the presence of female directors on the board of directors and on the audit committee. We hypothesized that; *$H_0$2: Female gender board member has no significant influence on earnings management among quoted firms in Nigeria.*

Board Independence and earnings Management

Considerable numbers of literature have showed concern on association between board independence and reduced levels of earnings management (Hwang & Kim, 2009; Bruyneels & Cardinaels, 2014). Klein (2002) suggested that boards well thought-out to be more independent from CEO are more effective in monitoring the corporate financial accounting process and earnings management. Xie, Davidson and Dadalt (2003) found that earnings management is less likely to occur in companies whose boards include both more independent outside directors and directors with corporate experience. But the level of earnings management may influence the subsequent selection of board. Davidson *et al.,* (2005) found that, based on a broad cross-sectional sample of 434 listed Australian firms, a majority of non-executive directors on the board are significantly associated with a lower likelihood of earnings management. Peasnell *et al*., (2004) examined whether the incidence of earnings management by UK firms depends on board monitoring. Results indicate that the likelihood of managers making income-increasing abnormal accruals is negatively related to the proportion of outsiders on the board. Based on the relationship between board independence and earnings management, we hypothesized that; *$H_0$3: Female board members have no significant influence on earnings management among quoted firms in Nigeria.*

Board Size and earnings Management

The optimal size of board members is ensured by an adequate number of board members to perform the monitoring functions effectively. According to Rahman and Ali (2006), board size is positively related with earnings management. In contrast, Xie, Davidson, and DaDalt (2003) argued that smaller boards are better able to make timely decisions than large boards. However, they stated that larger boards with diverse knowledge are more effective for constraining earnings management than smaller boards. Xie *et al*. (2003) further stated that large boards with various experts are more likely to have a higher degree of independence than small boards. Similarly, Peasnell, Pope, and Young (2004) found that having a large board is better in reducing earnings management compared to smaller boards. We hypothesized that; *$H_0$4: Board size has no significant influence on earnings management among quoted firms in Nigeria.*

Firm size and earnings management

The size of the firm is vital in assessing the level of earnings management practices. Most management of corporate organizations takes advantage of the size of the firm to manipulate financial statement in such a way that can impress the dispersed shareholders and users. The firm size may have a positive or a negative impact on earnings management. Previous studies document that managers of highly leveraged firms have strong incentives to use income increasing accruals to loosen the contractual debt-constraints (Ali *et al*. 2008; Jiang *et al*. 2008) Nevertheless, highly indebted firms may be less able to practice earnings management because they are under close scrutiny of lenders. Banderlipe (2009), Jiang, Lee and Anandarajan (2008) and Peasnell, Pope and Young (2000) found that larger firms are associated with lower absolute discretionary accruals. However, Lobo and Zhou (2006) contend that large firms may have more incentives to increase earnings because this can bring more benefit to their managers. Following the outcome of the relationship between foreign board member and earnings management, we hypothesized that; *$H_0$5: Firm size has no significant influence on earnings management among quoted firms in Nigeria.*

Theoretical Framework

This study is anchored on agency theory. The agency theory originated from the work of Adolf Augustus Berle and Gardiner Coit Means with its main emphasis on agent and principal relationship in early 1932. Berle and Means (1932) argument was that managers and owners of firms differ in interest resulting to conflict. Berle and Means (1932) work was improved upon by Jensen in the 1960s and 1970s. Jensen and Meckling (1976) viewed agency as a contractual relationship between one or more persons (the principals) appoint another person (the agent) to carry out some services by delegating some decisions making authority to act on their behalf. A key argument of agency theory is that firms characterized by a separation of ownership and control are fraught with agency problems between managers and shareholders (Jensen & Meckling, 1976; Fama & Jensen, 1983).

One symptom of agency problems is lower earnings quality as indicated, and based on agency theory, the board of directors is a crucial mechanism to restrain executive directors' opportunistic behavior.

METHODOLOGY

Research Design

The study employed quantitative and a cross sectional data of non financial institution quoted in the Nigeria Stock Exchange for the year 2014. A total of one hundred and twenty-six (126) firms' in non financial sector constituted the population. A total of seventy seven (77) firms formed the sample size which are selected using purposive sampling. Meanwhile, the sample size was arrived by adopting number estimation formular by Yamanes, (1967). The statistical formula is stated, thus:

$$n = \frac{N}{1 + N(e^2)}$$

Where:

n= sample size

N= Population size

e= Level of significance desired, given that:

e = 0.07 and N = 124

$$n = \frac{124}{1+156(0.07)^2} = 77$$

Model Specification

The extent of earnings management is most commonly assessed by the discretionary accruals in reported earnings (Francis, Reichelt & Wang, 2005). Meanwhile, Dechow *et al* (1995) observed that the original Jones model is unable to capture the impact of sales-based manipulation because accounts receivables should not be considered as nondiscretionary accruals. Hence, they proposed a modification to the original Jones model known as the Modified Jones model (1995).

Finally, for the purpose of this study, our model is specified as:

$DA_{it} = \alpha_0 + \alpha_1 FBM_{it} + \alpha_2 FG_{it} + \alpha_3 BI_{it} + \alpha_4 BS_{it} + \alpha_5 FSIZE_{it} + \mu$

Where;

a_0 = Constant

The parameters: a_1, a_2, a_3, a_4 and a_5, represent the coefficients.

it = firm (i) at time (t).

Our apriori expectations were: $\alpha_1 < 0$; $\alpha_2 < 0$; $\alpha_3 <$, $\alpha_4 >$ or < 0 and $\alpha_5 >$ or <0

RESULTS AND DISCUSSION

Table 1: Descriptive Statistics: Observations 77

	DA	FD	BG	BI	BS	FSIZE
Mean	601579.6	0.535032	0.312102	0.896098	9.792994	10.24971
Std. Dev.	124.6579	0.977495	0.464834	0.174002	3.213077	0.781446
Skewness	3.547144	7.854028	0.811040	5.566998	0.482953	-0.254207
Kurtosis	16.51215	84.82314	1.657785	32.62002	3.523079	3.344122
Jarque-Bera	15.23601	45.41074	28.99713	65.50244	7.893097	2.465586
Probability	0.016300	0.002340	0.000001	0.000000	0.019321	0.291477

Table 1 showed that discretionary accrual (DA) was at mean value of 601,579.6 units and compared to standard deviation of 124.6579 units, positive skewness of 3.547units to right which if far from valiance or mean of 0, and kurtosis of 16.5122 units compared to bench mark of 3 units suggested high level of earnings management practices among sampled firms financial reports.

Foreign director which was at mean value of 0.5350 units and high standard deviation of 0.9775, coupled with positive skewness value of 7.85402 units to right and high kurtosis value of 84.8231 which is more than compulsory 3 units further suggested that presence of few foreigners in the board of sampled firms. Similarly, board gender which has a mean value 0.3121 units and high standard deviation of 0.4648 units, positive skewness of 0.8110 and kurtosis value of 1.6578 which is less than bench mark of 3units implied that moderate proportion of females were appointed into board of sampled firms. Board independence (BI) which was at mean value of 0.8961and low standard deviation of 0.1740 coupled with positive skewness value of 5.5670 units and high kurtosis value of 32.6200 units indicating that greater proportion of the board members constituted the board of the sampled firms. Board size was at mean value of 9.7930 suggested that sampled firms were at average of 10 members. Finally, firm size (FSIZE) measured with natural logarithm revealed a mean value of 10.2497units and standard low deviation of 0.7814 units suggesting that the sampled firms were large in size running into billions of naira. It is deduced that all the variables are normally distributed expect firm size which is more than critical 5% significance level, hence we proceed to correlation matrix to check for multicollinearity problem as shown in table 2.

Table 2: Correlations of Variables

	DA	FD	BG	BI	BS	FSIZE
DA	1.000000	- 0.139697	- 0.007790	-0.038719	0.204327	0.346476
FD		1.000000	0.025161	0.026958	0.046715	0.201353
BG			1.000000	-0.121109	0.290323	-0.070495
BI				1.000000	-0.048314	-0.001132
BS					1.000000	0.147270
FSIZE						1.000000

Table 2 showed associations among variables examined. The result showed that when discretionary accrual is at unit value, presence of foreign director, female in the board and board independence exhibited negative relationship of -0.1397, -0.0078 and -0.0387 respectively. Board size and firm size were at positive values of 0.2043 and 0.3465. The results of the pearson correlation matrix further indicated that none of the associated variables had perfect correlations suggesting absence of multicollinearity. Bryman and Cramer, (1997) suggested that Pearson's correlation relationship in excess of 0.80 is suspected of exhibiting multicollinearity. Hence we proceed to the least square in table 3.

Table 3: Multiple Least Square

Dependent Variable: DA Method: Least Squares

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Sample (adjusted): 77 Included observations: 77 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-504.2478	125.8670	-4.006195	0.0001
FD	-9.180590	9.779588	-0.938750	0.3494
BG	-6.276418	21.32567	-0.294313	0.7689
BI	-0.280151	0.598887	-0.467786	0.6406
BS	6.242354	3.089605	2.020438	0.0451
FSIZE	48.90876	12.43734	3.932412	0.0001

Table 3...

R-squared	0.150348	Mean dependent var	60.15796
Adjusted R-squared	0.122214	S.D. dependent var	124.6579
S.E. of regression	1.167923	Akaike info criterion	12.39614
Sum squared resid	2059706.	Schwarz criterion	12.51294
Log likelihood	-967.0968	Hannan-Quinn criter.	12.44357
F-statistic	5.343955	Durbin-Watson stat	2.194846
Prob(F-statistic)	0.000149		

Table 3 revealed that coefficient of determination (R^2) which has a value of 0.15503 with discretionary accrual, suggested that only 15 percent of the variations were accounted for by the independent variables. The adjusted coefficient of determination, ($\bar{R}^2$) the adjusted R-square of 0.1222 with discretionary accrual, implying that only about 12.2% of the systematic variations are explained while 87.8% are unexplained, hence captured by the stochastic disturbances.

The low coefficient of determination was indication of high level of earnings management practices among sampled firms. The overall coefficient statistic was at 5.3440 and minimal standard error of regression value of 1.1679 is an indication that the results are suitable for prediction. Durbin Watson (DW) statistics of 2.1948, indicated absent of autocorrelation. The result revealed that three variables (foreign board member, female gender and board independence are not statistically significant, while board size and firm size are statistically significant.

DISCUSSIONS OF FINDINGS

The study showed that foreign board member is not statistically significant, meaning that foreign director has no significant effect or negatively related to earnings management practices among sampled firms in Nigeria. The result supported the apriori expectation. The implication is that the presence of a foreign director has a say in the board that is decisive to scrutinize the executive director. This suggests that the presence of a foreign director is associated with reduced levels of earnings management. This buttressed views of extant studies like Forbes and Milliken, (1999) who noted that foreign director in the board constraints earnings management, while Reggy, et.al., (2015) argued against the view that the presence of foreign director is associated with significant higher levels of earnings management.

Also the study revealed that female gender which is a proxy for female director is not statically significant and negatively related to earnings management practices. The result supported the apriori expectation. This indicated that female gender in the board has no significant influence on earnings management. This finding buttressed the view of Arun, et.al.,

(2015) who investigated the effect of female directorship on earnings management practices of U.K companies and found that firms with a higher number of female and independent female directors restrained earnings management practices in the UK.

Similarly, board independence is not statistically significant and as well in line with the apriori expectation. It is an indication that board independence is fundamental in the monitoring and controlling of management who choose to run the affair of the firm for their personal gain and as well discourage earnings management practices. This Davidson etal (2005) and Klein (2006) there is negative relationship between board independence and earning management proxied by absolute discretionary accrual.

It is observed that board size is statistically significant to earning management. Although, the result suggested that board size has significant influence on earnings management Ebrahim (2007) and Xie et.al (2003) documented that large board size can reduce earnings management or lower level of discretionary accruals. The implication of the findings is that board size of most firms examined is small.

Finally, firm size is statistically significant and the coefficient value indicated positive. This implied that firm size has significant influence on earnings management. However, Banderlipe (2009), Jiang, et.al.,(2008) and Peasnell, et.al., (2000) found that larger firms are associated with lower absolute discretionary accruals. This suggested that most of the firms investigated were small in size.

CONCLUSION AND RECOMMENDATIONS

The board of directors remains a crucial organ of firms because of the assigned responsibilities and tasks of controlling and monitoring managers against any form of earnings management practices. Appointments of foreign and female members into the board of directors were to ensure constraints against opportunist behaviors of management for personal gains and benefits. The Size of the board of firms is necessary in constituting members into the independence board made up of people of different ethnic and gender background with the main concern of distraction of managers' selfish motive of manipulating financial statements. Effective and efficient board required presence of foreign and female in the board of directors. Since earnings management is a deceptive approach on the part of managers, ethnicity and gender board could be suitable in discouraging earnings management practices in Nigeria. It is therefore recommended that:

(1) In a firm in which foreigners have shares, certain proportion of them should be appointed into the board so as to give room to cross ideology that can encourage or discourage earnings management practices. In effect, the board should be a representation of

different ethnicity, tribes or race which makes it difficult to easily concur to earnings management practices.

(2) Women are seen to be too rigid to be compromised or manipulated deceptive and especially when it comes to issues that have to do with transparency. Women of credible and reputable characters should be appointed into the board of directors. In effect, 1/3 of the total board should be women of different qualifications that can articulate ideas that will not pave way to earnings smoothening.

(3) Board independence should be for people who have the character of integrity, transparency and accountability. They should be able to look into actions of management and work against any manipulations. Certain proportion of women should be included in the independence of board directors instead of allowing it to be a men forum. Also a certain percentage of foreigners who are shareholders should be incorporated into the independent board.

(4) Shareholders of firms should come up with modalities in the Annual General Meeting that could help to improve the firm size. Also board of directors should design strategies that could enhance size of the firm and which cannot be easily prone to earnings management practices.

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