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Effect of Female Directors on Earnings Management in Family Firms in Non-Financial Companies in Pakistan

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A B S T R A C T

This research. This research was designed to unearth the growth or reduction in earnings management practices due to the role of female directors' presence on the board. For analysing the abovementioned phenomena, a sample of 37 family firms for the period of 2010-17 was selected from the textile Industry. The data was collected from annual reports. The statistical tools of Correlation and Regression Analysis were used to combine the conclusions at a 5% level of significance. We found that family firms with a zero-percentage presence of female directors are controlled earnings management practices in Pakistan and gradually it increases but the results become good for 40 or more percentage female presence. The regression model with a p-value is 0.263 of female presence which is greater than the significance level value of 0.05, it means that the result is insignificant and we concluded that there is no significant effect of female presence on the board. The result for female CEO is significant with a p-value of 0.031 which is less than 0.05, the significance level. It means that female CEO has a negative significant effect on earnings management as found. This paper adds extensive knowledge to the female role on board diversity and its effect on the manipulation of accounting disclosure.

INTRODUCTION

This The important role of corporate governance is an unavoidable fact and, in the future, shareholders, investors, and business owners would pay due attention to it according to its importance. Corporate governance needs modernization in the boards accordingly to the latest trends and developments. The organizations also promote ethical and responsible business behavior (Nueno, 2016). The Board of directors is the authorized control team by their shareholders for the management, planning, and monitoring of a firm. The Board of directors is responsible for smooth operations and minimizes the costs

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arising from the separation of ownership from control (Fama and Jensen, 1983). A board of directors is the top management to handle the internal decision control systems and shareholders' interest of firms. The alignment of board and managers require ensuring the discipline of eliminating managers when they fail to contribute to the firm's value or pursue their own interests despite shareholders' interests (Jensen, 1993). Board diversity is one of the most important factors of different dimensions of the board (Milliken and Martins 1996; Kang et al. 2007). If there is board diversity in the decision-making process is it be expected to bring fruitful outcomes to the firm (Carter et al., 2003). The Board of directors must be authorized more than other managers and executives to play a strategic role in decision making (Langton and Robbins, 2007). The board of directors' main responsibility is to supervise and control the workplace activities for the interest of shareholders interest. Researches indicate that Competency and independence are the two major and effective tools for supervision on management (Beasley, 1996; Xie et al., 2003; Peasnell et al., 2005:2006). In past, earnings management occurred due to the negligence of the board of directors and audit committee (Ghosh, et al. 2010). A widely used definition of earnings management is given by (Healy & Wahlen, 1999): "Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the firm or to influence contractual outcomes that depend on reported accounting numbers".

Presently more attention is given to accrual-based earnings management as compared to real earnings management (Zang, 2012). Firms use accrual-based management to hide accrual economics performance under the umbrella of GAAP rules Gunny (2010); Dechow & Skinner (2000) but to change timing or structuring of financial transactions to manipulate accounting results, firms use Real earnings management (Gunny, 2010). Female directors without relevant financial backgrounds are not able to mitigate earnings management, irrespective of their outside directorships or tenure (Zalata et al., 2021).

In Norway, the board must have minimum 40% female directors (Ahrend & Dittmar, 2012). According to the security and exchange commission of Pakistan 2017 code has introduced a minimum requirement to appoint one female director mandatory on the board of directors Code-of-Corporate-Governance (2017) to avoid Gender discrimination practices that are common towards women in Pakistan in almost all sectors, especially business-related activities. This provides the gap for inclusion of gender factor in the board and CEO diversity effect on the earnings management to be searched and analysed. The objective of this is to establish the relationship between female presence on the board and earnings management**,** the second objective is to analyze the effect of female director presence in the board on earnings management**,** another objective is to examine the effect of female CEO in the board on earnings management.

LITERATURE REVIEW

Different authors have been explained earnings management in different ways. According to Healy & Wahlen (1999) defined “earnings management are those practices in which management intends to influence or deceive the shareholders through forged financial/accounting data about the disclosure of firms. Chen, et al. (2014) found managers of firms do earnings management use accounting methods allowed by accounting rules to influence firms’ accounting figures. Schipper (1989) found that the opportunistic nature of executive directors makes them compelled for earnings management practices.

Dhaliwal et al. (2010) observed that high-level expertise of accounting is vital to capture such technical issues of accenting to recognize earnings management. (Adams and Ferreira, 2009; and Srinidhi, et al. 2011) observed that the level of earnings management is less in those firms where the representation of females on the board is present as compared to those firms where female representation is none. Arun, et al. (2015) found in UK firms that earnings management is controlled in firms where female directors are independent and more. Adams & Funk (2012) found that female director's presence on the board is more benign than men but powerless. This opens doors for earnings management because of gender diversity on the board audit committee as most of the power in hands of male directors. The role of women directors on board has a significant effect on financial performance in Spanish firms (Campbell & Miguiez-Vera, 2008).

The firms have more earnings management for the high percentage of women on the board (Francoeur, et al., 2008). There is insignificant relation between Gender diversity and board composition Firm’s performance (Carter et al., 2010). Morally women are stronger than men to involve any malpractices in business to get financial benefits (Khazanchi, 1995; Betz et al., 1989). In decision-making, women are careful and not peaceful as compared to men (Byrnes et al., 1999). Women are risk aversion especially in finance-related decisions (Powell and Ansic, 1997). Women are probably more ethical than men but the quality of earnings management is positively correlated with a high percentage of female directors present on board (Krishnan & Parsons 2008).

On the other hand, Sun et al. (2011) observed that female directors have no effect on earnings management and audit committees but Thiruvadi & Huang (2011) established an inverse relationship between female directors on the audit committee and earnings management. The earnings management practices observed minimum for the firms with female Barua et al., (2011) but negative and insignificant results were found by (Soebyakto, Mukhtaruddin, Delamat, Dewi & Pratama, 2018; Hemathilake, Ruparatne, & Meegaswatte, 2019). Females CFOs is more congenial towards accounting and financial rules and no association between earnings management and female directors (Peni & Vähämaa 2010). On the other hand, Gavious et al. (2012) found that women CEOs and earnings management are inversely associated and firms encounter low earnings management with women executive directors. Gender diversity in the US and French companies have no positive effect on earnings management and audit committees (Hili & Affes, 2012). The chairman and CEO are the decision-makers of the firm and responsible for effective daily operations. Their decisions may harm or benefit the company (Obigbemi, et al., 2016). Due to too much power then, in the Code of Corporate Governance, the government restricted an individual to hold both the position, which may be harmful to the company and other stakeholders as well. The CEO gender diversity positive and significant relationship was found in US firms by (Zalata, et al., 2018).

H1: *Is there any effect of female director presence on the board on the earnings management?*

H2*:* *Is there any effect of female CEO on the board on earnings management?*

METHODOLOGY

This research is quantitative in nature and secondary data was collected from annual reports and the data quantitatively measured and analyzed. The population of this study includes all textile sector non-financial firms registered in the Pakistan stock exchange (PSX). The total population of listed textile firms at PSX is 141 that includes all family and non-family firms/companies. A total of 37 family firms are selected using purposive sampling as used by (Enofe, 2017). Descriptive statistics, correlation, and regression analysis are used to analyze the data. The regression model is given below;

$Y = \alpha + \beta x + \varepsilon_i$ where

Y is a dependent (discretionary accrual used as a proxy of earnings management) variable

X is an independent (female presence in the board of directors) variable and α, β, are population parameters and ε_i is random error.

In this research dependent variable is earnings management. Earnings management takes advantage of how accounting rules are applied and creates financial statements that inflate or increased a large number of earnings, revenue, or total assets. Discretionary accruals were used as a proxy for earnings management by Jones (1991) and Dechow, Sloan & Sweeney (1995), where accrual means any transaction sans cash. Total accruals are the sum of discretionary accruals and non-discretionary accruals. According to Dechow (1994), discretionary accruals often provide managers the opportunities to manipulate earnings due to the flexibility available. Non-discretionary accruals are an obligatory expense that has yet to be realized but is already recorded in the account books. In this study, the female presence in the board and female CEO are independent variables. Gender diversity brings fruitful results and may increase motivation and loyalty (Burgess & Tharenou, 2002). CEO gender diversity is a dummy approach that takes the value “1” if the CEO of the firm is a female and “0” otherwise (Peni, 2014).

Family and non-family firms’ ownership structure is a big issue in business. Different researchers have defined different criteria of family and non-family firms. According to Miller et al., (2007) family firms are those in which the main designation is occupied by family members and many family members working in the firm. Another researcher Erling Barth et al., (2004) defines family firms have a minimum of 33% share but Jabeen et al., (2012) related family firms with minimum of 25 percent voting rights. From the above discussion, this study are base two criteria for the family business, i.e., 20% share and/or three members belong to the same family in top management for our research.

RESULTS & DISCUSSION

Table 4.1 Descriptive statistics of earnings management in family firms.

FIRMS	MEAN	S.D	FIRMS	MEAN	S.D	FIRMS	MEAN	S.D
1	-0.18	0.10	14	-0.51	0.94	27	-0.08	0.11
2	-0.22	0.18	15	-0.18	0.14	28	-0.63	1.51
3	-0.13	0.17	16	-7.79	20.80	29	-0.22	0.88
4	-0.17	0.12	17	0.13	1.51	30	-0.58	1.37
5	-1.38	2.20	18	-1.29	2.63	31	-0.18	0.70
6	-0.29	0.24	19	-0.44	0.72	32	-13.34	33.72
7	-0.12	0.10	20	-0.52	1.05	33	-0.09	0.08
8	-0.11	0.06	21	-0.43	0.7	34	-0.34	0.28
9	-1.51	3.71	22	-2.98	8.90	35	-0.13	0.10
10	-6.43	17.89	23	-0.007	0.01	36	-0.22	0.17
11	-61.9	174.15	24	-0.23	0.23	37	-0.13	0.15
12	-7.22	20.14	25	-0.16	0.08	-	-	-
13	-2.39	6.19	26	-0.16	0.25	-	-	-

Table 4.1 results expose the earnings management on average in each firm with its standard deviation. The outcome of table 4.1 is vividly showed that most chunks of firms are involved in earnings management to some extent. The firms, 1-9, 14-15, 17-21,23-31, and 33-37 are involved in earnings management with low level as almost all have mean earnings management less than -2 with a low standard deviation, and firms 10,12,13,16 are involved in moderate earnings management with a moderate mean (i.e. less than -10) and moderate standard deviation. But the remaining firms are involved in a huge amount of earning management like firm number 11 with on average -61.9 and standard deviation 174.15, similarly firm number 32 with mean -13.34 and standard deviation 33.72. The least earnings management practices have been made in firm 23, which has a mean of -0.007 with a standard deviation of 0.01 that is almost nearly equal to zero but the maximum amount of earnings management has happened in firm number 11 with a high mean of -61.9 and standard deviation 174.15.

Table 4.2 Earnings management and female presence in the board of directors

Female presence slabs in percentages and average earnings management (EM)														
Firm	**≤ 10%**	**EM**	**Firm**	**≤ 20%**	**EM**	**Firm**	**≤ 30%**	**EM**	**Firm**	**≤ 40%**	**EM**	**Firm**	**≥ 40%**	**EM**
6	0	-0.29	1	16.06	-0.18	5	23.66	-1.38	34	32.81	-0.34	20	43.7	-0.52
9	0	-1.50	3	11.98	-0.13	7	21.88	-0.12	21	37.50	-0.43	32	57.1	-13.3
10	0	-6.42	8	19.45	-0.11	19	22.32	-0.44	2	33.48	-0.22	-	-	
11	8.9	-61.89	27	17.85	-0.07	24	28.57	-0.23	4	36.73	-0.17	-	-	
12	0	-7.22	30	12.50	-0.58	25	20.08	-0.16	-	-		-	-	
13	0	-2.39	31	17.19	-0.18	-	-		-	-		-	-	
14	0	-0.51	33	14.28	-0.08	-	-		-	-		-	-	
15	0	-0.18	35	13.17	-0.13	-	-		-	-		-	-	
16	0	-7.8	36	11.98	-0.	-	-		-	-		-	-	

		0			22						
17	0	0.13	37	10.71	-0.12	-	-	-	-	-	-
18	7.1	-1.29	-	-		-	-	-	-	-	-
22	0	-2.98	-	-		-	-	-	-	-	-
23	0	-0.007	-	-		-	-	-	-	-	-
26	0	-0.16	-	-		-	-	-	-	-	-
28	0	-0.63	-	-		-	-	-	-	-	-
29	5.4	-0.22	-	-		-	-	-	-	-	-

The disclosure of results drawn from earnings management and female presence in the board of directors of different firms is illustrated in table 4.2. The independent variable, it is the female presence on the board, showing the female presence on the board. Table 4.2 indicates very strange results for less than or equal to 10 percent female presence in the board, as we can observe that the firms that have zero percent female presence appear low earnings management as compared to those firms whose female presence percentage is 8.93. Even for firm 23, the earnings management almost equal to zero with no female presence on the board. the results for less than or equal to 20, 30, and 40 percent female presence in the board presents a little bit good picture as nearly same and low level of earnings management practices are experienced. But the condition is more worsen again for women presence percentage 40 or more percent as for the firm 32, the earnings management t is -13.3 with 57.10 female presences in the board of directors.

Table 4.3 Regression and Correlation analysis between earnings management and female presence in the board of directors in family firms.

	Model			Descriptive		
	coefficients	t-vale	P-Value	Variables	Mean	S.D
Constant	-4.76	-2.06	0.040	DA	-3.04	29.70
Female %age	0.124	1.12	0.263	Female %age	13.88	15.62
	-			-	R = 0.06 5	R^2 = 0.004

Table 4.3 depicts the overall results of the earnings management and female presence on the board of directors. The descriptive figures show the abnormal result with a negative mean for discretionary accruals (earnings management) and high slandered deviation for female presence on average percentage 13.88. the regression model shows the significant result for constant with a p-value is 0.04 which is less than the standard value of significance level, but the result for female presence percentage is insignificant with a p-value 0.263 which is greater than 0.05, the significance level. It means that female presence has no positive effect on earnings management but Umer, Abbas, Hussain, & Naveed (2020) document the negative association of gender-diverse corporate boards with earnings manipulative practices. The correlation (R) analysis gives a very weak correlation between earnings management and female presence on the board of directors. There is just a 6% relationship between female presence on the board of directors and earnings management. The coefficient of determination explains the percentage variation role of female presence in the board. The value of R^2 is 0.004; it means that the female role plays just 0.04% of the total variation in preventing earnings management.

Table 4.4 Regression and Correlation analysis between earnings management and female CEO in board in family firms.

	coefficients	t-vale	P-Value
Constant	-0.011	−0.04	0.967
Female CEO	-0.107	−2.15	0.031
R	0.306	R^2	0.094

Table 4.4 depicts the overall results of the earnings management and female CEO in the board. The regression model shows an Insignificant result for constant with a p-value is 0.967 which is more than the standard value of significance level, but the result for female CEO is significant with a p-value of 0.031 which is less than 0.05, significance level. It means that female CEO has a negative significant effect on earnings management. The correlation (R) analysis gives a low correlation between earnings management and female CEO on the board. There is just a 30% relationship between female CEO on the board and earnings management, this result is in line with Gull, et al., (2017) as they found in family firms in France that EM and women CEOs and CFOs are adversely associated. The coefficient of determination explains the percentage variation role of female presence in the board. The value of R^2 is 0.094; it means that the female CEO role plays just 9.4% of the total variation in preventing earnings management.

CONCLUSION & RECOMMENDATION

The main theme of this research paper was to conduct the role of female director's presence in the board and female CEO to impede earnings management. As we observed in table 4.1 that almost all firms are involved in earnings management practices to the least or more extent. Some firms' earnings management access to a low level nearly to zero like firm number 23, its earnings management is -0.007 but some maximized up to high level like firm number 11, its earnings management is -61.89. Table 4.2 portrays the percentage presence of female directors on the board and the amount of earnings management in each firm. The discoveries of results are very strange because for zero percentage of female presence in the board the earnings management is just -0.007 as we already mentioned in the above paragraph. In the previous research papers of other authors, the outcomes of our findings are not matched with the prior results, as most of the prior research papers had been shown the positive effect of female presence, Adams & Ferreira, (2009); Srinidhi, Gul & Tsu (2011) and Arun, et.al., (2015) in circumvent from earnings management practices.

Correlation and regression analysis results presented in table 4.3, in the descriptive portion the discretionary accruals proxy of earnings management mean is -3.04 and on average 13.88 percent of female presence on the board. The correlation (R) figure shows a weak correlation, just a 6.5% relationship between female presence and earnings management. The value of the coefficient of determination (R^2) explains only 0.4% of the total variation preventing earnings management and the remaining 99.6% earnings management due to other variables. The second portion of table 4.3 explains the regression model with a coefficient of female presence is 0.124 and a p-value is 0.263 which is greater than the significance level value 0.05, it means that the result is insignificant and we concluded that there is no significant effect of female presence on the board.

Table 4.4 depicts the result for female CEO is significant with a p-value of 0.031 which is less than 0.05, this result is in line with Gull, et al., (2017) as they found in family firms in France that EM and women CEOs and CFOs are adversely associated. The coefficient of determination explains the percentage variation role of female presence in the board. It means that female CEO has a negative significant effect on earnings management. The correlation (R) analysis gives a low correlation between earnings management and female CEO on the board. There is just 30% relationship between female CEO on the board and earnings management. The value of R^2 is 0.094; it means that the female CEO role plays just 0.9.4% of the total variation in preventing earnings management.

Recommendations

Pakistan is a male-dominated and religious mind setup society and the females are pressed and fearful, therefore female presence has no fertile effect on the prevention of earnings management. Female presence on board could play a positive role in discouraging earnings management practices if the females on board could not belong to the firms' owner family and give them more independence. Therefore, it is suggested that the security and exchange commission of Pakistan must impose the condition that the female board members must not be the kith and kin of the owner. Further, our results are limited small sample size and larger sample size could be used to bring different results.

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