

SESSION 1: BOARD OF DIRECTORS: THEORY AND PRACTICES

THE INFLUENCE OF CEO GENDER DIVERSITY ON EARNINGS MANAGEMENT AND CORPORATE OVERINVESTMENT: A RESEARCH AGENDA

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Abstract

This research will focus on a study evoking the dilemma of the agency linking the principal to the agent. In the effects of the earnings management on the corporate overinvestment, along with the moderating role of the CEO gender, as a lever of control, our study focuses on a panel of 130 French companies over a period of four years, by the application of instrumental variables estimation (SLS).

1. INTRODUCTION

Practically, the stock markets are far from being perfect. In this regard, Jensen and Meckling (1976) suggest that information asymmetries on the capital markets may give rise to conflicts of interests between corporate managers and shareholders. This divergence of interests creates a deviation from the optimal level of investment and

consequently, companies will face inefficient investment situations. Along these lines, two types of ineffective investments are defined: the first one is overinvestment, from which the company invests in projects with a negative net present value; the second is defined as underinvestment, at which point the firm has insufficient resources available to finance investments with a net positive present value.

Nevertheless, the dissociation between ownership and decision-making authority, in the spirit of agency theory, creates a potential for managers to invest in non-optimal projects. La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1997) demonstrate that managers sometimes engage in additional investments that are opposed to the interests of the shareholders. In this area, corporate managers opt for diversified investment strategies that are not necessarily profitable, in order to improve their discretionary power.

In this matter, Jensen (1986) suggests that managers are likely to invest in projects beneficial to them, but this destroys the interests of the shareholders. Besides, managers refer to the implications of the information asymmetry, to privilege their own interests at the expense of those of the shareholders (Myers & Majluf, 1984). In this way, the earnings management by the corporate managers allow an inefficient allocation of company resources. Thus, information asymmetry can lead to a failure in the capital markets (Chen, Hope, Li, & Wang, 2011).

In this regard, it is essential to question the mechanisms that can control and monitor the problem of corporate overinvestment. We note in particular the moderating role of the CEO gender diversity, which is important in the supervision of management and the protection of the interests of external shareholders. It is also inevitable and can affect the relationship between earnings management and corporate overinvestment (Adams & Ferreira, 2009). We can note here that corporate governance has a role to play in reducing managerial opportunism. Thus, governance mechanisms may reduce agency problems in companies and moderates the effects of earnings management on corporate investment efficiency. In this study, we select the CEO gender, through its moderating role to examine its effectiveness in monitoring.

Our contribution in the literature is not limited to finding the relationship between earnings management and corporate overinvestment, but we will go further by looking for mechanisms that can reduce agency problems. The choice of this topic is legitimized by the nature of agency relationships within companies. It is explained by the legal and institutional characteristics of our study context. In fact, the French context is characterized by weak legal protection (La Porta et al., 1997). In this perspective, the added value of the board of directors is greater in countries where shareholders' interests are poorly protected (Dahya, Dimitrov, & McConnell, 2008).

2. LITERATURE REVIEW

The notion of agency is the central object in the current literature, which deals in this context with the philosophy of separation between decision making and ownership, with regard to divergence and conflicts of interest between the agent and the principals. It explains the desire that each agent seeks to maximize his own interest. The presence of behavior that causes divergence of interest and the presence of informational asymmetry encourages shareholders to put in place control and supervision mechanisms to motivate managers to react in the general interest of the firm (Jensen & Meckling, 1976).

However, the corporate governance system presents a set of measures and mechanisms intended to protect shareholders and investors from the opportunism of the managers (Charreaux, Couret, Joffre, Koenig, & de Montmorillon, 1998). In this way, financial disclosure occupies a central position in accounting research and presents a summary measure of the effectiveness of the firm's management. It is an indicator and is at the heart of the major concerns of the various stakeholders of the company (Dechow, 1994).

Conflicts of interest (Abdollahi & Pitenoie, 2020) indicated that firms will suffer from overinvestment and underinvestment and may therefore deviate from their optimal level of investment. Markarian and Michenaud (2019) examined the effects of earnings quality on capital investment efficiency. Their results show that the relevance of accounting figures helps to reduce the information asymmetry between the manager and other stakeholders. They explain that the presence of earnings management makes it possible to differentiate the best investment opportunities. According to Biddle, Hilary, and Verdi (2009), managers are always better informed than other stakeholders about the prospects of the firm. Thus, moral hazard and managers' decision-making space can lead to over or over-investment problems, depending on the availability of capital.

In the context of managerial opportunism, investment decisions are made by managers in suboptimal projects, and at a negative present value to increase the size of the firm. In a conflict of interest, this trend cannot be considered rational. Indeed, the managers act in this situation for several reasons.

Corporate managers may have motives and goals other than financial motives (reasons); they will try to increase their discretionary dispensation instead of investing in profitable projects, they will also try to improve their discretionary powers and subsequently increase their rootedness (Mueller, 1969).

The second motivation is related to the reputation and compensation of executives, which depends mainly on the size of the firm. Murphy (1985), Lambert, Larcker, and Verrecchia (1991) demonstrated that executive compensation depends primarily on the size

of the firm. They explain that the firm size makes it possible to help an optimal determination of the remuneration of the managers, (aiming at) ensuring their reputation and consequently increasing its value on the labor market.

According to Chen et al. (2011), various control mechanisms can be mobilized to reduce the problems of information asymmetry and develop a favorable monitoring environment for corporate strategic management. To better control the manager's opportunistic behavior, it's important to include the accruals quality. It makes the leaders more accountable for their decisions. They suggest that the high-earnings quality result reduces the discretionary space and the adverse leadership selection, therefore, could reduce the problem of overinvestment.

In this lineage, Fakhroni, Ghozali, Harto, and Yuyetta (2018), Li et al. (2017) show that the relevance of earnings quality helps firms to detect problems related to those two inefficient levels, and that allows shareholders to analyze and evaluate the relevance and effectiveness of investments. As a result, it tends to mitigate the conflicts of interest between the shareholders and the corporate managers.

In a rich information environment, managers have little incentive to reduce earnings quality. Indeed, the opportunistic manager's behavior can lead them to engage in inefficient investments to serve their own interests. In this sense, some researchers confirmed the importance of accounting transparency to reduce managerial latitude. Recently, Boubaker, Derouiche, and Nguyen (2015), Sitorus and Murwaningsari (2019) believe that the efficient information environment exacerbates the moral hazard and discretionary management of managers, which encourages them to adopt effective decisions and a better allocation of resources.

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