THE RELATIONSHIP BETWEEN MINORITY DIRECTORS AND EARNINGS MANAGEMENT: AN EMPIRICAL ANALYSIS IN THE ITALIAN INSTITUTIONAL SETTING

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Abstract

The quality of corporate governance is widely believed to play an important role in determining the quality of accounting numbers and of a firm's overall disclosure. Specifically, as predicted by the agency theory, prior literature suggests that a set of board of directors' characteristics constrains earning management activities and contributes towards the integrity of financial statements. Among the various corporate governance features, the two measures of board monitoring that have been broadly related to higher earnings quality and less earning management are the proportion of outside (independent) directors and the existence of an audit committee (Klein, 2002; Xie et al., 2003; Peansell et al., 2005). However, some recent studies show that the relation between independent directors and the financial disclosure quality is not univocal and that not all independent directors have the same effectiveness in fostering corporate transparency (Marchetti et al., 2018).

Therefore, this study focuses on a specific category of independent directors, namely the independent directors nominated by minority

shareholders and analyzes the effectiveness of independent minority directors in preventing earnings management activities. In particular, this paper analyzes the Italian context as it offers an ideal setting to examine the relationship between minority directors and earnings quality. In fact, roughly a decade ago, the so-called "slate voting system" has been introduced in Italy to facilitate the appointment of directors proposed by minority shareholders or, more generally, by non-controlling shareholders.

After controlling for a set of variables that affects earnings quality, findings from this paper suggest that independent minority directors can be effective in constraining earnings management activities, enhancing the quality of financial reporting.

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