

NEXUS OF BOARD DIVERSITY AND EARNINGS QUALITY

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ABSTRACT

Within the field of accounting study, the phrase earnings quality is frequently employed. There is currently no agreement on what this phrase implies or how to assess it because it has taken on a variety of various forms. This study therefore examine the impact of board diversity on earnings quality. The data for this study were collected from secondary data which include text books, journal, and website. The literature review covered the scope of 1971 to 2023 period. The study therefore conclude that persistence indicates the sustainability or recurrence of earnings. The study also recommend that companies should strive for persistence earning as it indicates the sustainability or recurrence of earnings.

Keywords: Age, Board Diversity, Earning Quality, Educational Qualifications, Nationality

1. INTRODUCTION

The board of directors of an organization is made up of senior management and top executives. By ensuring that the company is operated successfully and in the interests of all stakeholders, the board acts as a bridge between the widely dispersed (and occasionally global) shareholders and those who manage or create value for the company (Prasad, 2009). It seeks to accomplish this by maintaining a balance between the two sets of power, namely the power of shareholders (money power) and the power of managers who administer the business. This ensures both the organization's growth and survival. According to academics, a board with a diverse representation achieves these goals more effectively. Board diversity refers to the diversity that exists throughout the board's membership. The conditions for strict fiduciary obligations to be met by the board of directors are established by national legislation. Every public company in Nigeria is required to abide by clause It is true that a company's capacity for growth is strongly dependent on its capacity for profit-making, as this is what fuels the expansion of the business and, in turn, what fuels the trust of its creditors and investors. It is crucial to hunt for trustworthy earnings indicators because of this. The quality of such earnings is determined by how closely the reported earnings of a period correspond to the firm's genuine earnings. According to Enofe et al. (2017), earnings are more realistic and of higher quality when managers' opportunistic behavior is monitored and reduced by monitoring techniques like a well-diversified board. There have been allegations that the failure of businesses is mostly due to these opportunistic measures. Due to multiple financial scandals involving prestigious corporations in the past, such as Enron, WorldCom, Xerox, and the 2017 corporate collapse of General Electric in the US, corporate governance has grown to be a serious issue in the business world. There has been a global awakening and re-awakening, and research studies have been expanding toward designing and implementing corporate governance procedures to counteract opportunistic behaviors that jeopardize the profitability and survival of firms globally.

The board, which is the focus of corporate governance, is once more the subject of intense discussion. These actions are performed to manage the shareholders' resources, portray the company's financial performance honestly and truthfully, and lessen the negative effects of earning management. Experts propose that the board be set up with a balance of executive and non-executive directors, at least one independent director, and a variety of experience to guarantee that it meets its goals. As a result of unqualified boards and dishonest profit-management techniques, the majority of well-known companies have historically failed (Goncharov, 2015; Enofe, Eyafekhe & Eniola, 2017).

The claim is that board diversity benefits the company and that these benefits have a significant impact on the earnings of the firms because board members are more likely to bring varied viewpoints to bear when making decisions. Hoang (2014) asserts that these benefits include a rise in creativity and invention because attitudes, cognitive ability, and opinions frequently differ systematically across demographic factors including age, race, and gender. Despite the fact that heterogeneity may be thought to increase conflict during the decision-making process, it is also thought to improve problem-solving since it allows board members to consider a wider range of options and their implications.

Again, diversity improves corporate leadership effectiveness because it is thought that homogeneity among top managers results in a narrow perspective while diversity among top managers takes a broader view. The combined effect of these advantages of board diversity works to ensure, among other things, an increase in the firm's earnings. Nigeria, one of the world's developing economies, is still working to strengthen investor protection, company transparency, and corporate governance. How can this be made better? Within the field of accounting study, the phrase "earnings quality" is frequently employed. There is currently no agreement on what this phrase implies or how to assess it because it has taken on a variety of various forms (Schipper & Vincent 2003; Hoang, 2014).

According to Hoang (2014), reported earnings are deemed to suggest greater quality when they closely match fundamental earnings. This is consistent with the decision usefulness method in accounting research. Fundamental earnings are thought to accurately represent a company's economic performance. The market's uncertainty over the firm's terminal value is thus reduced as a result of the earnings report, which is how earnings quality is subsequently defined (Ewert and Wagenhofer, 2005). According to financial experts' viewpoints, Dechow and Schrand (2004) suggested that a reported high quality earnings will accurately annuitize the intrinsic worth of the company and reflect current operational performance. It will also serve as a good indicator of future operating performance. A high correlation with stock market data is interpreted as a sign that earnings are helpful in the context of equity valuation decisions, so when empirically tested, earnings would be considered to be of superior quality when they are strongly associated with returns (Lev 1989; Schipper and Vincent 2003; Francis et al., 2004). Dechow et al. (2010) asserted in their analysis of more than 300 papers on earnings quality that the word earnings quality only has value when it is used to describe a particular decision model.

2. LITERATURE REVIEW

Board diversity is defined as the variety inherent in the board's composition, and it can be measured in numerous dimensions (Campbel and Minguez-Vera 2008). It includes dissimilarities among firm boards in terms of board structure (Structural Diversity) and dissimilarities among directors within a board in terms of the demographic attributes of board members (Demographic Diversity).

This has to do with the diversity of the board in terms of demographic attributes such as gender, age, educational qualifications, and the nationality/ ethnicity, and/or cultural backgrounds of directors. Demographic diversity can benefit from cognitive conflict among board members because this should result in solutions that have been examined extensively. Furthermore, this heterogeneity can also lead to greater board independence because the differences in gender, age, ethnicity, and/or cultural backgrounds among directors can elicit questions that would not arise from directors with similar backgrounds or experience. Such diversity in attributes among board members can also increase creativity and innovation, and therefore, provides competitive advantage to the firm. Teams that are diverse can potentially be more creative than homogeneous teams and may lead to more alternative decisions being considered.

Diversity can also generate new criteria for evaluating alternative decisions. Additionally, diversity in boards is a necessary ethical obligation of the board of directors, and also a board of directors must not only be responsible for the interests of the owners but also represent the diversity of the owners, thus leading to a more diverse board of directors. Board diversity also calls for a more general responsibility towards the society in which a firm operates (Van der Walt & Ingle, 2003). However, diversity also has negative aspects. Heterogeneous groups are more likely to disagree, thereby weakening the team consensus. Diverse boards could also become divisive and conflict could stifle rather than encourage meaningful discussion in board meetings. There is, therefore, the potential for a poorer rather than richer information environment with diverse boards. In addition, Bryson (2004) found that the burden on the board of directors increases with diversity because the community expects the firm to be more responsive and accountable.

Although there has been mixed evidence and constant debate in empirical research regarding board diversity (e.g. Dulewicz & Herbert, 2004; De Andres et al., 2005), based on the evidence gathered so far, a diversity of board membership is desirable for the following reasons. First, it can enhance the exchange of ideas among board members in making informed decisions (Schippers et al., 2003; Knippenberg et al., 2004) on how to increase organizational economic value and financial performance. Second, diversity can ensure that the interests of stakeholders are been served through the business. In this context, Van der Walt and Ingle (2003) argued that diversity in boards can also increase the breadth of ethical obligations that the boards of directors believe should be served by firms. Their argument is based on a notion of legitimacy where a firm should respond to the norms and values of society. Third, the premise of equal opportunities implies that capacities and abilities are distributed equitably among people, and thus management and directors should also be drawn from and represent an equitable labor pool.

This equity refers to equal possibilities of representation regardless of discriminative features (such as gender, age or ethnicity), but rather on the basis of merit. Additionally, in support of Van der Walt and Ingle (2003) views, Brammer et al. (2007) stated that women and ethnic minorities should be represented on corporate boards in the same proportions as they are in society (Hoang, 2014). Relevant research has covered issues regarding the way that director's demographic attributes such as gender, age, educational qualifications, and the nationality of directors affect organizational performance and effectiveness.

Customers, employees, and investors are key stakeholders that have demanded greater diversity in board representation relating to gender. Customers believe that boards with gender diversity bring direct benefits by promoting and communicating the preferences, aspirations, and concerns that enhance relations with customers (Hoang, 2014). Also, firms that have a board that reflects gender diversity may reap improvements in workforce motivation and loyalty. The

economic benefits of greater equality of representation may also be derived indirectly through improved relationships with external institutions, principal institutional investors, equal opportunity pressure groups, and regulators of employment law. Many institutional investors have publicly expressed a preference for an increased representation of females and minority groups at board-level. (Brammer et al. 2007). It could be argued that it is unethical and immoral to exclude women from boards based on gender. In order to fulfill the moral imperative about fairness and equity, firms should promote gender diversity in order to encourage economic empowerment and positive outcomes for society.

Even though fulfilling the moral obligation could be seen as a socially responsible act in itself, further arguments point out that female representation is associated with better firm performance. So if firms ignore the female talent pool, the economic argument suggests they fail to access the best candidates to support firm performance and gain a competitive advantage (Campbell and Mínguez-Vera 2008). The OECD (2008) has reported that women are generally more educated than men: indeed more than one half of all university degrees are awarded to women. According to Hoang (2014), Francoeur et al. (2008) also document a positive relationship between gender diversity and financial performance when firms operate in riskier environments because women on boards appear to be able to deal with more complex strategic issues. In addition to those moral and economic arguments, studies also show that women can provide boards with unique resources. Daily and Dalton (2003) show that female directors are more likely to provide unusual perspectives and experiences than their male counterparts (Hoang, 2014). Studies also have shown that female directors can be more valuable in industries where females constitute majority customers because they are more likely to empathize more insightfully with market place dynamics and contribute to a firm's competitive advantage (Daily and Dalton 2003; Campbell and Mínguez-Vera 2008).

Directors' age may be indicative of their business experience and maturity and it can also influence how they perceive events and the decisions they are more likely to make. As directors advance in age, their flexibility to change decreases and their resistance to change increases (Rosen and Jerdee 1976). Studies show that directors who are younger are likely to support less stable and more volatile strategies (Hambrick and Mason 1984), although these strategies may result in superior firm performance. Studies have also shown that firms with younger directors are more likely to pursue innovation or growth strategies than their older counterparts, and they are also more likely to possess contemporary technical knowledge. Vroom and Pahl (1971) however, disagreed with the 'volatile', 'changeable' actions of younger directors, and believe that such actions can lead firms into taking decisions that can contribute to a more volatile firm performance. Some researchers state that older directors are likely to make more conservative and morally balanced judgments (Hoang, 2014). These studies assign such conduct to older director's aspiration to lead financially stable careers. Given that younger and older directors can bring variations in thinking that can translate into corporate decisions, some authors point out that having directors of varying age's means corporate boards can consider a range of decisions, and this allows the board to make the best choice for firms (Hoang, 2014).

Director's educational qualifications are indicative of their knowledge, cognitive orientation, and skill base (Hambrick & Mason 1984). Research shows that directors who are more formally educated are likely to adopt new ideas, accept innovations and entertain a broader view of ideas (Hoang, 2014). Board members with diverse educational qualifications can therefore evaluate a range of solutions to a given problem before making decisions. However, there is a downside to having board members with diversity in education. It leads to greater turnover, and higher coordination and integration costs stemming from conflicts that can arise from this diversity (Milliken and Martins, 1996).

As globalization has increased, firms tend to modify their governance structures by having more foreigners on their boards (Carpenter 1998; Oxelheim et al., 2013). This is based on an implicit assumption that foreign directors are better able to understand the international business environment and can bring alternative investment and operating decisions that might otherwise not be considered by domestic board members. Foreign directors help a firm to access resources internationally with sources and contacts known to them, and also help to open up new business opportunities (Hoang, 2014). Based on those factors, the nationally diverse directors can bring competitive advantages because firms that embrace this diversity are more likely to attract more productive human capital. The diverse knowledge base of those directors means they can make decisions where they respond more favorably to changes in the business environment. However, not all studies have found positive effects on having diverse boards based on nationality. For example, Milliken and Martins (1996) have shown that diversity in national background may reduce a Board's initial effectiveness and performance but it can become more efficient and productive later.

Structural diversity of board has to do with the diversity of the board in terms of structural attributes such as separation of the CEO/chairperson, non-executive directors owning more than 5 per cent of a firm's equity (block holders), representative directors' ownership and promoters. This section discusses the independence of the chairperson (in the light of the chairperson also acting as the chief executive officer involved in the operations of the firm), and the

independence of directors (in the light of whether they are an independent directors who are also block holders), promoters, and representative directors' ownership.

The chief executive officer (CEO) duality in a firm exists when the CEO is also the chairperson of the board of directors. Holding this highly symbolic position of board chair provides the CEO with a wider power base and more control over decisions made by the board. While some organizational scholars advocate combining both positions into one as a dual position, others propose separating the two positions to increase the effectiveness of the board. Supporters of the dual role argue that it not only removes any incomplete communication between the CEO and chairperson, but also reduces any conflicts that may arise between the two (Brickley et al., 1997). They also point out that the CEO's knowledge of the business allows for timely and optimal decisions not only at the operational level but also at the strategic level, which results in better short and long term performance. Klein (1998) supports the dual role, and states that a CEO becoming the chairperson means appointing an inside director into key decision making on the board because the CEO has more knowledge and expertise of the firm's activities than outside directors. Accordingly, this dual role allows the CEO/chairperson to utilize the information and increase the effectiveness of the board. Daily and Dalton (2003) refer to CEO duality as a joint structure, and suggest that joint leadership provides a positive signal that the firm have a strong leadership, and it is considered to be an effective form of governance in that context.

Due to recent financial scandals, regulators and reformers are increasingly demanding that the role of the CEO be separated from that of the chairperson (Lorsch and Zelleke, 2005) because the combination of these roles could make the board ineffective at monitoring managerial opportunism. In reality, CEO duality increases their decision-making power while reducing board independence, and thus a board cannot perform its monitoring role effectively (Finkelstein and D'Aveni 1994, Barako et al., 2006). The dual role may impair board effectiveness because the CEO can control board meetings by selecting agendas and board members. Finally, combining the two roles also makes it difficult for the board to replace a poorly performing CEO. Prior studies also reported no relationship between CEO duality and specific organizational actions such as earnings management firm performance (Boyd et al., 2011), and corporate social responsibility (Said et al., 2009; Khan et al., 2013).

An independent director who is also a shareholder is one who is not a current or a past executive of the firm, and does not have a business relationship with the firm, e.g., as a supplier or customer but has an ownership relationship with the firm. He is expected to own more than five per cent of a firm's ordinary shares (Kim et al., 2009). Such independent directors have a strong incentive to monitor management because they have invested private wealth into those firms.

Large shareholdings may offer an Independent Director direct voting power, the ability to form coalitions with other large shareholders, and exercise greater influence on the board relative to other independent directors, who typically have negligible stockholdings. Independent directors are perceived to be a tool for monitoring the behavior of management. Fama and Jensen (1983) argue that a higher proportion of independent directors increases board effectiveness in monitoring managerial opportunism, and as a consequence, increases the voluntary information reported. Furthermore, independent directors may show more objectivity and may consider the needs of diverse stakeholders in making their deliberations and recommendations as they have sufficient incentive to align their personal economic interests with the firm's economic interests (Jensen and Meckling, 1976; Elson, 1996). Accordingly, they provide outside perspectives, including the propensity to provide transparent information to a wide range of stakeholders. Also, independent directors have strong incentives to perform their decision making functions so as to maintain their personal and firm reputation. Agrawal and Nasser (2012), examined the role of Independent Directors and found that the presence of such directors on the board leads to better contracting with and monitoring of the CEO, and consequently leads to higher firm valuation. Their findings imply that by making it easier for block holders to obtain a board seat, benefits shareholders as shareholders common interest become their self-interest. This also improves corporate governance because they are more likely to have a higher level of commitment to the firm's long term goals and financial returns.

Promoters are controlling shareholders who also serve on the board of directors as inside directors (Hoang, 2014). Inside directors are those who hold managerial positions within a firm as well as being directors (De Andres et al., 2005). These directors act as executive directors who manage and organize daily operations in the firm. Because promoters are controlling shareholders, they lead key strategic decisions of firms using the board and management. Studies have shown that promoters, because of their controlling ability, can reduce agency costs, and increase firm performance. These findings support Jensen and Meckling (1976), who state that high ownership concentration leads to more of an alignment effect which may provide incentives for promoters to maximize firm values (Hoang, 2014). It is believed that a board dominated by promoters who are also inside directors can have ready access to details about the operational activities of the firm (Hoang, 2014). Similarly, inside directors possess more knowledge and expertise about firms activities which outside directors might lack and therefore, they might be better in making strategic planning decisions (Hoang, 2014).

Fama and Jensen (1983) and Stulz (1988) also argue that greater ownership control by insiders give them enough power over external owners to influence firm performance.

Representative Director's ownership is common with firms in large and strategically important industries or sectors such as electricity production, telecom, infrastructure, mineral exploration, and water supply which were privatized former State Owned Enterprises (Hoang, 2014). Instead of having government bureaucrats directly supervising the State Owned Enterprises (SOEs) as before, the government now formally exercises its rights as a major shareholder by appointing representative directors to boards. Some are executive directors and others are non-executive

Directors in the board. The role of representative directors is to align decisions made by firms they represent, with government objectives. Since these firms are large in terms of asset values, numbers of staff employed, and have a government presence, they are visible to stakeholders who tend to demand greater accountability for their actions (Hoang, 2014). State ownership in a firm can be called representative directors' ownership, if there are assigned representative directors. Representative Directors' ownership is the ownership which belong to the state and represented by the directors so appointed.

The term 'earnings quality' has been widely used within accounting research. This term has evolved into numerous different shapes and today there is no consensus on what earnings quality means or how to measure it (Schipper & Vincent, 2003; Hoang, 2014).

Consistent with the decision usefulness approach in accounting research, reported earnings are considered to signal superior quality when they correspond to fundamental earnings as closely as possible (Hoang, 2014). Fundamental earnings are considered to reflect the true economic performance of a firm. Earnings quality can then be defined as the reduction of the Market's uncertainty about the firm's terminal value due to the earnings report (Ewert and Wagenhofer, 2005). Based on a the perspective of financial analysts, Dechow and Schrand (2004) argued that a reported high quality earnings will reflect current operating performance, present a good indicator of future operating performance; and accurately annuitize the intrinsic value of the company.

Accruals quality is a measure of earnings quality. It measures the extent to which reported accruals represent the actual accruals of the firm for the period being reported. Accruals are an attractive way for managers to manage earnings because they generally do not require disclosure and often will not be questioned by an auditor (Islam, 2011). This is made all the more easier for them by the fact that at any point in time, some of the firm's future revenues and costs are genuinely uncertain. While there are no set of hard and fast rules that can help to solve the problem, inevitably, instances exist where managers exercise judgment and thus have room to manage earnings. In particular, without violating accounting rules, managers can accelerate the recognition of revenues and defer the recognition of certain expenses.

In measuring accruals quality, researchers have identified two components that make up the total accruals. These are the non-discretionary accruals and discretionary accruals. The non-discretionary component reflects business conditions such as growth and length of the operating cycle that naturally create and destroy accruals. The discretionary component reflects accruals that are due to management choices alone; that there appears to be no business reason for their inclusion in the financial report.

3. CONCLUSION AND RECOMMENDATION

Earnings persistence is the extent to which current period earnings reflect future period earnings. Persistent earnings are recurring or sustainable, and therefore are more desirable than transitory earnings. There conclude that persistence indicates the sustainability or recurrence of earnings. This is in line with the study of Francis et al. (2004), Leuz et al. (2003), Boonlert-U-Thai et al. (2006) Hoang (2014), and Lipe (1990) who describe persistence as the time-series relationship between the current period unexpected earnings and future earnings. The study covered the scope of 1971 -2023 period. The study also recommend that the companies should strive for persistence earning as it indicates the sustainability or recurrence of earnings.

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