Gender Diversity on audit and compensation committees The impact on company financial risk and risk management

Philip Mcilkenny*[1]

[1]Telfer School of Management, Ottawa IPAG BUsiness School, Paris – Canada

Abstract

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Bruce McConomy (Wilfrid Laurier University), Philip McIlkenny (University of Ottawa) and Anne-Marie Ward (Ulster University)

Extended abstract

Over the past few decades there have been increasing calls for companies to increase the participation of women on boards. Some countries have introduced mandatory quota regimes (Belgium, France, Netherlands, Italy, Norway and Spain), others encourage gender diversity as an indicator of good corporate governance (U.S., Australia, Canada) (Aldamen et al., 2018). There is a clear social argument for gender diversity in leadership positions, however, the literature is more conflicted when the business case for gender diversity is investigated. Most empirical studies examine the association between the proportion of women on the board and performance or risk measures (Hutchinson et al., 2015). However, there are calls for a more nuanced investigation of the association between gender diversity and performance and risk, as studies have highlighted that the relationship is complicated as financial decision-making behavior is situational (Radwan, et al., 2021) and influenced by board dynamics (Hillman et al., 2007; Kanter, 1977). In particular, studies have identified that inclusion of women on sub-committees improves the performance of the sub-committees (Srinidhi et al. (2011). Investigating how female directors participate on the board and its subgroups, such as the audit committee and the compensation committee, can provide more nuanced empirical evidence on the effectiveness of women on boards (Oradi and Izadi, 2020) and facilitate corporate governance improvement.(1)

In general, it is recognized that women on boards typically undertake a monitoring or advisory role and that women are more risk adverse relative to men (Karjalianen et al., (2018). Reducing excessive risk-taking is beneficial, however, excessive monitoring may be detrimental to board functioning (Adams, 2009; Adams and Ferrari, 2007). Studies suggest that women adapt their role depending on the environment: they focus on monitoring when governance and monitoring are weak; (Adams and Ferreira, 2009; Ward and Forker, 2021) and perform an advisory role when monitoring is strong (Jonsdottir et al., 2015). Governance mechanisms to control risk include the audit and compensation committees, respectively. Studies have identified an association between the gender on these committees

*Speaker

and decision making. For example, studies report an inverse association between women on the audit committee and audit restatements (Oradi and Izadi, 2020) and between women on the remuneration committee and CEO pay (García-Izquierdo, Fernández-Méndez, and Arrondo-García, 2018). However, no study has examined the moderating influence of both these committees on company risk.

These committees have distinct characteristics, roles and functions and the management literature on the effectiveness of governance mechanisms suggests that the monitoring effectiveness of each one is affected by the level of monitoring in the other (Rediker & Seth, 1995; Schepker & Oh, 2013). Therefore, financial risk is influenced by the efficiency of "bundled" combinations of monitoring mechanisms as opposed to one. Hence, focusing on the "independent" effects of a single monitoring mechanism can lead to incorrect conclusions about its effectiveness, as the mechanisms interactively influence financial risk decision-making in a complex way (Aguilera et al., 2008; Oh et al., 2018).

Therefore, to contribute to the literature we aim to provide a more nuanced understanding of the association between women on boards and company financial risk by investigating the effect of bundle combinations of different levels of the two monitoring mechanisms (gender on audit committees and gender on compensation committees) on financial risk indicators.

We will assess whether gender diversity on the compensation committee and audit committee act as complements or substitutes in terms of the joint effect on risk management. Our tests will consider both resource dependence theory (related to a reduction in information asymmetry) and agency theory (relating to the impact on monitoring by the board and board committees, and the firm's information environment).

(1) Some jurisdictions refer to a compensation committee, while others refer to a remuneration committee. We use the terms interchangeably. For example, when referring to prior literature we retain the authors' original terminology.