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Commitment to IT Investment Plans: The Interplay of Real Earnings Management, IT Decentralization, and Corporate Governance

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Abstract

How does real earnings management (REM) influence the extent to which firms realize their IT investment plans? To answer this question, we study the association between firms' engagement in REM and the extent of commitment to planned investments in IT infrastructure. We also study the extent to which this association is moderated by IT decentralization and, in turn, how such a moderating relationship is influenced by other corporate governance mechanisms such as institutional ownership and takeover threats. We document three important findings based on our analyses of data on 2,884 U.S. firms over the period 1998–2009. First, we find a negative association between engagement in REM and IT infrastructure investment commitment suggesting potentially negative consequences of REM for realizing IT investment plans. Second, we find that IT decentralization weakens the negative association between REM and IT investment commitment (ITIC), implying that decentralized IT governance mechanisms can serve as a potential antidote to negative effects of REM on IT investments. Finally, we find evidence that other corporate governance mechanisms, such as institutional ownership and takeover threats, can complement IT decentralization to further mitigate the negative association between REM and ITIC. Together, these findings provide new insights on how REM, IT decentralization, and other corporate governance mechanisms influence actual IT investments of firms. Our work here, which focuses on deviations from one's own IT investment plans, makes a novel contribution by extending prior work that has so far focused only on deviations from the industry norm in IT investments.

Keywords: IT investments, earnings management, IT governance, corporate governance, decentralization, institutional ownership, board independence, takeover threats