Does Target Firm's Earnings Management Affect Shareholder's Gains? Evidence from China

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Abstract

This study tests the hypothesis that the target firms are involved in earnings management activities in quarters leading to a takeover announcement. Using a sample of 3,455 Chinese listed firms that are targets of successful acquisitions over the period 2007 - 2020, and for a matched sample of non-targets, we find that target firms manipulate earnings in quarters leading to the announcement date. Further, we find evidence of a negative relationship between earnings management and short-term gains to shareholders. Our result remains robust after controlling for various deal characteristics. The study also suggests that pre-merger earnings management in target firms is not fully anticipated by the market before the takeover announcement. We find no evidence of earnings management immediately after the announcement quarter.

Keywords: Earnings Management; Takeovers; Short-Term Gains

JEL Classification: G14, G34, M41

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