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

Azhar Mughal*, Abdul Haque†, Zohaib Zahid‡, Furman Ali§ and Zheng Li**

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

* Dr. Azhar Mughal, Assistant Professor, The Institute of Management Sciences, Lahore Pakistan, Postcode 54000, and Researcher, Southwestern University of Finance and Economics, Chengdu, China Postcode 611130, +86 137 39499643, +92 320 4511678, m_azhar786@hotmail.com
† Dr. Abdul Haque, Associate Professor, COMSATS University Islamabad Lahore Campus, Lahore Pakistan, Postcode 54000, +92 333 4203330, ahaque@cuilahore.edu.pk
‡ Zohaib Zahid, Southwestern University of Finance and Economics, Chengdu, China Postcode 611130, +86 137 39499247, mzohaibzahid@yahoo.com
§ Furman Ali, Southwestern University of Finance and Economics, Chengdu, China Postcode 611130, +86 155 28384305, faarmaanali@gmail.com
** Zheng Li (Corresponding Author), Sichuan Industrial Revitalization Development Investment Fund Co. Ltd, Chengdu, China, Postcode 610095, +86 28 85323231, 939307317@qq.com