

EARNINGS MANAGEMENT AROUND MERGERS AND ACQUISITIONS:  
EMPIRICAL EVIDENCE FROM BRICS NATIONS

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**by**

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**to the**



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**Dedicated to my parents**

for their endless love and support, and

**to my late aunt,**

whose memory has been a constant source of motivation in my journey.

## **Certificate**

This is to certify that the thesis titled “**Earning management around mergers and acquisitions: Empirical evidence from BRICS nations**”, submitted by **Diksha Lalwani** to the Indian Institute of Technology Delhi for the award of the degree of **Doctor of Philosophy**, is an authentic record of the original research work carried out under appropriate supervision and guidance. This thesis meets all the standards and requirements stipulated by the institute for the award of the degree.

Furthermore, to the best of my knowledge, the results presented in this thesis have not been submitted, in part or in full, to any other University or Institute for the award of any degree or diploma.

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Diksha Lalwani

## **Abstract**

Mergers and acquisitions (M&A) offer strategic growth opportunities but also introduce significant challenges and complexities, particularly through managerial opportunism such as earnings management. This behaviour can distort financial reporting and influence deal outcomes, raising concerns about transparency and post-deal value creation. Understanding the extent and implications of such practices is crucial for assessing the actual impact of M&A activities on firm performance. In light of this, the current study examines earnings management around M&A deals by acquiring firms from five major emerging economies, namely, Brazil, Russia, India, China, and South Africa (BRICS), over the period 2005-2023.

First, the study examines whether acquiring firms manage their earnings in the period leading up to M&A deal announcements. The analysis further explores whether the intensity of this behaviour differs between domestic and cross-border M&A (CBMA) deals and identifies country-level factors that influence such behaviour. Second, the study assesses the implications of pre-deal earnings management on deal outcomes, including the choice of payment method, market reaction around announcements, post-deal earnings management practices, and long-term firm performance. Further, it evaluates the evolution of earnings management practices by investigating this behaviour during the three years leading up to M&A deal announcements. The study also considers matching non-acquiring firms to study the specific incentives of firms related to M&A deals. Finally, the study looks into the role of managerial hubris and corporate governance mechanisms in driving that behaviour.

To achieve these objectives, the study applies various research techniques. First, the study measures earnings management using both accruals earnings management (AEM) and real earnings management (REM). It employs the performance-adjusted discretionary accrual

model by Kothari et al. (2005) to measure AEM, while REM is estimated following Roychowdhury (2006). The earnings management behaviour of the acquiring firms is investigated using pooled ordinary least squares (OLS) regressions. Additionally, to address the potential endogeneity issues related to M&A decisions, acquiring firms are compared with their matched non-acquiring firms, found using the propensity score matching (PSM) technique. The study assesses the country-level factors through four dimensions: developed market classification, institutional difference, cultural distance, and legal origin of the targets.

Next, the impact of earnings management on the payment method choice is analysed using logistic regression. To evaluate performance outcomes, an event study methodology is employed to estimate short-term market response as captured by Cumulative abnormal returns (CAR), while long-term performance is assessed through stock returns, proxies using buy-and-hold-abnormal returns (BHAR), and post-deal firm performance is measured using indicators, such as industry-adjusted ROA, ROE, and Tobin's Q. Lastly, to investigate the moderating role of corporate governance measures in influencing the relation between earnings management and M&A activity, the study considers both board characteristics and ownership structure as moderating variables. Board-related measures include board independence, busyness, diligence, and compensation, while ownership structure is captured through the shareholding of institutional investors, foreign institutional investors (FII), and promoters.

The findings suggest that M&As are a significant force driving firms to manage earnings before the deal announcement. This behaviour is more prominent in cross-border deals than in domestic deals, potentially attributed to higher information asymmetry arising from the institutional differences between the acquirer and the target countries. Specifically, the study finds that stronger institutional quality and higher development levels of target countries are

associated with reduced earnings management by BRICS acquirers, while cultural distance and differences in legal origin do not significantly moderate this behaviour.

In the short run, markets respond favourably to inflated earnings, as seen in the form of positive abnormal returns around the announcement date. However, this initial optimism does not translate into sustained value creation. Over the long run, market performance declines as investors gradually recognise the earnings management practices and adjust their expectations accordingly. Moreover, REM is associated with a decline in post-deal operating performance, while no significant relationship is observed between pre-deal earnings management and post-deal firm value measured by Tobin's Q. This suggests a disconnect between short-term market perceptions and long-term outcomes. The study also documents a notable decline in earnings management following the deal, reinforcing the idea that such behaviour is opportunistic and event-specific, rather than a persistent reporting practice.

Additionally, the findings suggest that the acquirers' earnings management behaviour intensifies as they approach M&A deals, particularly evidenced by high discretionary accruals in the financial year immediately preceding the announcement compared to previous years. The findings show that acquiring firms exhibit higher abnormal accruals than their matched non-acquirers, indicating distinct incentives for earnings management behaviour associated with M&A. The analysis also highlights that acquiring firms demonstrate a preference for AEM over REM compared to matched counterparts. The choice of any earnings management technique may be driven by the potential costs and outcomes of manipulation (Schipper, 1989). Firms may prefer to engage in AEM to meet the short-term objectives of an M&A deal, considering the complexity and cost of engaging in REM.

Further, it finds that governance mechanisms, especially independent boards and institutional investors, play a critical role in constraining opportunistic financial reporting

before M&A deals. Overall, the study finds evidence that acquiring firms are inclined to manage earnings before strategic events like M&A to benefit from better negotiations and favourable deals. The urge to portray a strong financial position and execute the deals may induce myopic behaviour among managers. In addition, manipulation by acquiring firms may stem from hubristic tendencies of managers who aim to signal superior performance to further validate their decisions related to M&A deals.

By uncovering how earnings management is strategically employed by firms in the period leading up to M&A announcements, especially in cross-border contexts, this study makes several important contributions. Given their growing significance in the global M&A landscape, this study offers international insights from one of the most influential groups of emerging economies. It highlights the role of country-level institutional environments in shaping corporate behaviour and underscores the risks of short-termism and overconfidence in deal-making. The study underlines the potential of strong internal and external governance mechanisms in enhancing financial reporting integrity during M&A.

These findings are particularly relevant in emerging markets, where investor protection and regulatory enforcement remain weak. As investors heavily rely on available information, understanding the potential for earnings management practices by firms can help investors make informed investment decisions. The findings can aid practitioners in identifying manipulative practices during due diligence and assisting their clients. These insights may also encourage regulators to implement stronger oversight of M&A transactions, thereby enhancing transparency, supporting market efficiency, and strengthening the resilience of emerging economies in international capital markets.

**Keywords:** Earnings management, Mergers and acquisitions (M&A), Acquirers, Emerging economies, Discretionary accruals, Institutional differences, Performance

## सार

विलय और अधिग्रहण (एम एंड ए) रणनीतिक विकास के अवसर प्रदान करते हैं, लेकिन महत्वपूर्ण चुनौतियों और जटिलताओं को भी पेश करते हैं, विशेष रूप से आय प्रबंधन जैसे प्रबंधकीय अवसरवाद के माध्यम से। यह व्यवहार वित्तीय रिपोर्टिंग को विकृत कर सकता है और सौदे के परिणामों को प्रभावित कर सकता है, जिससे पारदर्शिता और सौदे के बाद मूल्य सृजन के बारे में चिंताएं बढ़ सकती हैं। ऐसी प्रथाओं की सीमा और निहितार्थों को समझना, फर्म के प्रदर्शन पर एम एंड ए गतिविधियों के वास्तविक प्रभाव का आकलन करने के लिए महत्वपूर्ण है। वर्तमान अध्ययन 2005-2023 की अवधि में पांच प्रमुख उभरती अर्थव्यवस्थाओं, अर्थात्, ब्राजील, रूस, भारत, चीन और दक्षिण अफ्रीका (ब्रिक्स) से फर्मों का अधिग्रहण करके एम एंड ए सौदों के आसपास आय प्रबंधन की जांच करता है।

सबसे पहले, अध्ययन यह जांचता है कि क्या अधिग्रहण करने वाली फर्म एम एंड ए सौदे की घोषणाओं से पहले की अवधि में अपनी कमाई का प्रबंधन करती हैं। विश्लेषण आगे यह पता लगाता है कि क्या इस व्यवहार की तीव्रता घरेलू और सीमा पार एम एंड ए (सीबीएमए) सौदों के बीच भिन्न है इसके अलावा, एमएंडए डील की घोषणाओं से पहले तीन वर्षों के दौरान हेरफेर करने वाले व्यवहार की जांच करके आय प्रबंधन प्रथाओं के विकास का मूल्यांकन करता है। अध्ययन एमएंडए सौदों से संबंधित फर्मों के विशिष्ट प्रोत्साहनों का अध्ययन करने के लिए गैर-अधिग्रहण करने वाली फर्मों के मिलान पर भी विचार करता है। अंत में, अध्ययन उस व्यवहार को संचालित करने में प्रबंधकीय अभिमान और कॉर्पोरेट प्रशासन तंत्र की भूमिका पर भी गौर करता है।

इन उद्देश्यों को प्राप्त करने के लिए, अध्ययन विभिन्न शोध तकनीकों को लागू करता है। सबसे पहले, अध्ययन प्रोद्भव आय प्रबंधन (AEM) और वास्तविक आय प्रबंधन (REM) दोनों

का उपयोग करके आय प्रबंधन को मापता है। यह AEM को मापने के लिए कोठारी एट अल. (2005) द्वारा प्रदर्शन-समायोजित विवेकाधीन प्रोद्भव मॉडल का उपयोग करता है, जबकि REM का अनुमान रॉयचौधरी (2006) के अनुसार लगाया जाता है। अधिग्रहण करने वाली फर्मों के आय प्रबंधन व्यवहार की जांच पूल किए गए साधारण न्यूनतम वर्ग (OLS) प्रतिगमन का उपयोग करके की जाती है। इसके अतिरिक्त, M&A निर्णयों से संबंधित संभावित अंतर्जात मुद्दों को संबोधित करने के लिए, अधिग्रहण करने वाली फर्मों की तुलना उनकी मिलान की गई गैर-अधिग्रहण करने वाली फर्मों से की जाती है, जो प्रवृत्ति स्कोर मिलान (PSM) तकनीक का उपयोग करके पाई जाती हैं। देश-स्तरीय कारकों को चार आयामों के माध्यम से कैप्चर किया जाता है: MSCI मानकों के आधार पर विकसित बाजार वर्गीकरण, विश्व बैंक के विश्वव्यापी शासन संकेतकों के प्रमुख घटक विश्लेषण का उपयोग करके निर्मित संस्थागत दूरी, हॉफस्टेड के सांस्कृतिक आयामों के आधार पर कोगुट और सिंह सूचकांक के माध्यम से मापी गई सांस्कृतिक दूरी, और विश्व जनसंख्या समीक्षा के अनुसार वर्गीकृत कानूनी उत्पत्ति।

लॉजिस्टिक रिग्रेशन का उपयोग करके भुगतान विधि के चयन पर आय प्रबंधन के प्रभाव का विश्लेषण किया जाता है। प्रदर्शन परिणामों का मूल्यांकन करने के लिए, एक इवेंट स्टडी पद्धति अल्पकालिक और दीर्घकालिक बाजार प्रतिक्रियाओं का अनुमान लगाती है, जबकि उद्योग-समायोजित आरओए, आरओई और टोबिन के क्यू का उपयोग सौदे के बाद के प्रदर्शन का आकलन करने के लिए किया जाता है। अंत में, आय प्रबंधन और विलय एवं अधिग्रहण गतिविधि के बीच संबंध को प्रभावित करने में कॉर्पोरेट प्रशासन उपायों की मध्यस्थ भूमिका की जाँच करने के लिए, अध्ययन में बोर्ड की विशेषताओं और स्वामित्व संरचना, दोनों को मध्यस्थ चर के रूप में माना गया है। बोर्ड से संबंधित उपायों में बोर्ड की स्वतंत्रता, व्यस्तता, परिश्रम और मुआवज़ा शामिल हैं, जबकि स्वामित्व संरचना को संस्थागत निवेशकों, विदेशी

संस्थागत निवेशकों (एफआईआई) और प्रवर्तकों की शेयरधारिता के माध्यम से समझा जाता है।

निष्कर्ष बताते हैं कि विलय और अधिग्रहण एक महत्वपूर्ण शक्ति है जो सौदे की घोषणा से पहले फर्मों को आय में हेरफेर करने के लिए प्रेरित करती है। यह व्यवहार घरेलू सौदों की तुलना में सीमा पार सौदों में अधिक प्रमुख है, जो संभावित रूप से अधिग्रहणकर्ता और लक्ष्य देशों के बीच संस्थागत अंतर से उत्पन्न होने वाली उच्च सूचना विषमता के कारण है। विशेष रूप से, अध्ययन में पाया गया है कि मजबूत संस्थागत गुणवत्ता और लक्ष्य देशों के उच्च विकास स्तर ब्रिक्स अधिग्रहणकर्ताओं द्वारा आय में हेरफेर को कम करने से जुड़े हैं, जबकि सांस्कृतिक दूरी और कानूनी मूल में अंतर इस व्यवहार को महत्वपूर्ण रूप से नियंत्रित नहीं करते हैं।

अल्पावधि में, बाजार बड़ी हुई आय पर अनुकूल प्रतिक्रिया देते हैं, जैसा कि घोषणा तिथि के आसपास सकारात्मक असामान्य रिटर्न के रूप में देखा जाता है। हालाँकि, यह प्रारंभिक आशावाद निरंतर मूल्य सृजन में तब्दील नहीं होता है। दीर्घावधि में, बाजार प्रदर्शन में गिरावट आती है क्योंकि निवेशक धीरे-धीरे आय प्रबंधन प्रथाओं को पहचानते हैं और अपनी अपेक्षाओं को तदनुसार समायोजित करते हैं। इसके अलावा, वास्तविक आय प्रबंधन सौदे के बाद परिचालन प्रदर्शन में गिरावट के साथ जुड़ा हुआ है, जबकि टोबिन के क्यू द्वारा मापी गई सौदे से पहले की आय प्रबंधन और सौदे के बाद की फर्म मूल्य के बीच कोई महत्वपूर्ण संबंध नहीं देखा गया है। यह अल्पकालिक बाजार धारणाओं और दीर्घकालिक परिणामों के बीच एक वियोग का सुझाव देता है। अध्ययन में इस सौदे के बाद आय प्रबंधन में उल्लेखनीय गिरावट का भी उल्लेख किया गया है, जो इस विचार को पुष्ट करता है कि ऐसा व्यवहार अवसरवादी और घटना-विशिष्ट है, न कि सतत रिपोर्टिंग अभ्यास।

इसके अलावा, निष्कर्ष बताते हैं कि M&A सौदों के करीब पहुंचने पर उनका व्यवहार तीव्र हो जाता है, विशेष रूप से पिछले वर्षों की तुलना में घोषणा से ठीक पहले के वित्तीय वर्ष में उच्च विवेकाधीन उपार्जन द्वारा इसका प्रमाण मिलता है। निष्कर्ष बताते हैं कि अधिग्रहण करने वाली फर्म अपने मिलान किए गए गैर-अधिग्रहणकर्ताओं की तुलना में उच्च असामान्य उपार्जन प्रदर्शित करती हैं, जो M&A से जुड़े आय प्रबंधन व्यवहार के लिए अलग-अलग प्रोत्साहनों को दर्शाता है। विश्लेषण इस बात पर प्रकाश डालता है कि अधिग्रहण करने वाली फर्म मिलान किए गए समकक्षों की तुलना में REM के बजाय AEM को प्राथमिकता देती हैं। किसी भी EM तकनीक का चुनाव हेरफेर की संभावित लागतों और परिणामों से प्रेरित हो सकता है (शिपर, 1989)। REM में संलग्न होने की जटिलता और लागत को देखते हुए, फर्म M&A सौदे के अल्पकालिक उद्देश्यों को पूरा करने के लिए AEM में संलग्न होना पसंद कर सकती हैं।

इसके अलावा, यह पाया गया कि शासन तंत्र, विशेष रूप से स्वतंत्र बोर्ड और संस्थागत निवेशक, एम एंड ए सौदों से पहले अवसरवादी वित्तीय रिपोर्टिंग को बाधित करने में महत्वपूर्ण भूमिका निभाते हैं। कुल मिलाकर, अध्ययन में इस बात के प्रमाण मिलते हैं कि अधिग्रहण करने वाली फर्म बेहतर बातचीत और अनुकूल सौदों से लाभ उठाने के लिए M&A जैसी रणनीतिक घटनाओं से पहले आय का प्रबंधन करने के लिए इच्छुक हैं। एक मजबूत वित्तीय स्थिति को दर्शाने और सौदों को निष्पादित करने की इच्छा प्रबंधकों के बीच मायोपिक व्यवहार को प्रेरित कर सकती है। इसके अतिरिक्त, अधिग्रहण करने वाली फर्मों द्वारा हेरफेर, प्रबंधकों की अहंकारी प्रवृत्ति से उत्पन्न हो सकता है, जो M&A सौदों से संबंधित अपने निर्णयों को और अधिक वैध बनाने के लिए बेहतर प्रदर्शन का संकेत देने का लक्ष्य रखते हैं।

यह अध्ययन यह उजागर करके कि M&A घोषणाओं से पहले की अवधि में, विशेष रूप से सीमा-पार संदर्भों में, फर्मों द्वारा किस तरह से आय प्रबंधन को रणनीतिक रूप से नियोजित किया जाता है, कई महत्वपूर्ण योगदान देता है। वैश्विक M&A परिदृश्य में उनके बढ़ते महत्व

को देखते हुए, यह अध्ययन उभरती अर्थव्यवस्थाओं के सबसे प्रभावशाली समूहों में से एक से अंतर्राष्ट्रीय अंतर्दृष्टि प्रदान करता है। यह कॉर्पोरेट व्यवहार को आकार देने में देश-स्तरीय संस्थागत वातावरण की भूमिका पर प्रकाश डालता है और सौदेबाजी में अल्पकालिकता और अति आत्मविश्वास के जोखिमों को रेखांकित करता है। अध्ययन में विलय एवं अधिग्रहण के दौरान वित्तीय रिपोर्टिंग अखंडता को बढ़ाने में मजबूत आंतरिक और बाह्य शासन तंत्र की क्षमता को रेखांकित किया गया है।

ये निष्कर्ष उभरते बाजारों में विशेष रूप से प्रासंगिक हैं, जहां निवेशक संरक्षण और नियामक प्रवर्तन कमजोर बने हुए हैं। चूंकि निवेशक उपलब्ध जानकारी पर बहुत अधिक निर्भर करते हैं, इसलिए फर्मों द्वारा आय प्रबंधन प्रथाओं की क्षमता को समझना निवेशकों को सूचित निवेश निर्णय लेने में मदद कर सकता है। निष्कर्ष उचित परिश्रम के दौरान हेरफेर करने वाली प्रथाओं की पहचान करने और अपने ग्राहकों की सहायता करने में चिकित्सकों की सहायता कर सकते हैं। ये अंतर्दृष्टि विनियामकों को M&A लेनदेन की अधिक मजबूत निगरानी लागू करने के लिए भी प्रोत्साहित कर सकती हैं, जिससे पारदर्शिता बढ़ेगी, बाजार दक्षता का समर्थन होगा और अंतरराष्ट्रीय पूंजी बाजारों में उभरती अर्थव्यवस्थाओं की लचीलापन मजबूत होगा।

**कीवर्ड:** आय प्रबंधन, विलय और अधिग्रहण (M&A), अधिग्रहणकर्ता, उभरती अर्थव्यवस्थाएँ, विवेकाधीन परिलब्धियाँ, संस्थागत भिन्नताएँ, प्रदर्शन

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## **List of Abbreviations**

|         |                                                  |
|---------|--------------------------------------------------|
| AEM     | Accruals Earnings Management                     |
| BHAR    | Buy-and-hold Abnormal Return                     |
| BRICS   | Brazil, Russia, India, China, and South Africa   |
| BSE     | Bombay Stock Exchange                            |
| CAR     | Cumulative Abnormal Return                       |
| CBMA    | Cross-border Mergers and Acquisitions            |
| CFO     | Cash Flow from Operations                        |
| CMIE    | Centre for Monitoring Indian Economy             |
| DA      | Discretionary Accruals                           |
| EM      | Earnings Management                              |
| ISIN    | International Securities Identification Number   |
| LEV     | Leverage                                         |
| LIQ     | Liquidity                                        |
| M&A     | Mergers and Acquisitions                         |
| NSE     | National Stock Exchange                          |
| OLS     | Ordinary Least Squares                           |
| PB      | Price-to-Book                                    |
| PSM     | Propensity Score Matching                        |
| R&D     | Research and Development                         |
| REM     | Real Earnings Management                         |
| RLPP    | Real Investment in Property, Plant and Equipment |
| ROA     | Return on Assets                                 |
| ROE     | Return on Equity                                 |
| SGR     | Sales Growth Rate                                |
| SIC     | Standard Industrial Classification               |
| SSE     | Shanghai Stock Exchange                          |
| STD DEV | Standard Deviation                               |
| UK      | United Kingdom                                   |
| US      | United States                                    |
| VIF     | Variance Inflation Factor                        |