EARNINGS MANAGEMENT BY FIRMS GOING PUBLIC: ESSAYS FROM AN INDIAN PERSPECTIVE

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Abstract

The extant literature on earnings management has provided several instances where the motivation to manage earnings is strong (Perry & Williams, 1994; Erickson et al., 1999; DeAngelo, 1986; Zhou et al., 2004; Teoh et al., 1998). One such crucial event is initial public offerings (IPOs). There are several aspects that make IPOs vulnerable to earnings management. Primarily, IPOs are made by firms with limited operating histories. There is very little publicly available information before the IPO other than the information presented in the prospectus. The prospectus also contains financial information only for a maximum period of three years prior to an IPO, making it difficult for investors to estimate their future prospects (DuCharme, 2001). This thesis contributes to the existing literature by examining the presence of earnings management by firms going public in an emerging economy. The study critically examines the existing techniques of measuring earnings management, analyses the factors that can restrain such practices and also highlights the consequences of managing earnings in the post-issue periods. Each issue comprises of one essay based on Indian data samples.

The first essay discusses and empirically examines some of the most widely used earnings management measures. The essay proposes a new model based on the existing misspecifications of the commonly used models. The results demonstrate that the new model does fairly well in detecting earnings management in the Indian IPO context and highlight the fact that scholars need to revisit the existing models to obtain unbiased results.

The second essay examines the impact of corporate governance on real and accrual earnings management. It specifically inspects whether corporate governance limits managers’ opportunity in managing earnings while going public. Our results indicate that auditor quality and promoter shareholding are the only corporate governance variables that appear to have an impact on earnings management. However, they fail to restrain all kinds of earnings
management. While auditors and promoters succeed to restrain managers from engaging in accrual earnings management, they on the other hand provide opportunity to engage in sales-based manipulations.

The third essay examines the impact of earnings management on post-IPO firm performance. The study examines both operating and financial performance to obtain a holistic view of earnings management’s impact. The results indicate that earnings management negatively impacts post-issue firm performance. Moreover, it is evident that aggressive earnings management practicing firms are the ones that suffer more in their post-issue performances.

**Keywords:** accrual earnings management, real earnings management, initial public offerings, operating performance, financial performance.