International Mergers and Earnings Management

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Abstract

In this paper we investigate patterns of earnings management by U.S. bidders in cross-border mergers. We argue that to reduce the cost associated with a foreign merger financed by stock, the U.S. bidder has strong incentives to engage in aggressive earnings management, particularly when it faces greater information asymmetries in the host country. Consistent with this argument, we find that among U.S. acquirers, those whose target home countries do not share a common language and a similar culture with the U.S. and those that acquire targets in non-Christian countries are more likely to report income-increasing abnormal accruals. Bidder abnormal accruals are also higher when the targets are from countries with less freedom of press, less political stability, less government effectiveness, a lower level of rule of law, or more government corruption. Finally, we find that for bidders acquiring high information asymmetry targets in stock swap transactions, announcement returns and post-merger long-term stock returns are negatively related to the abnormal accruals, suggesting that investors do not fully undo bidder accrual management at the time of the merger announcement.