Post-IPO Earnings Management Driven by Insider Selling Motives: Using KOSDAQ IPOs

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May 2010

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Abstract

Prior literature reports positive discretionary accruals around initial public offerings (IPOs) and interprets these accruals as evidence of earnings overstatement. While a few studies examine the motives for earnings overstatement, they mainly focus on managers’ incentives to either boost IPO proceeds or maintain high post-IPO stock prices through earnings management. This study investigates another motive for earnings management in IPO firms. That is, we examine whether IPO managers overstate accruals before insider selling in order to gain profits from insider selling. This study also investigates whether accruals inflations that are motivated by insider selling are pronounced when the firm performs poorly and information asymmetry between managers and outsiders is high. The results reveal that discretionary accruals are significantly positive in the year of the IPO (year 0) and in the year immediately following the IPO (year +1), even after the methodological problems raised in prior literature are addressed. We also find that discretionary accruals in year 0 (year +1) are positively related to insider selling by CEOs in year +1 (year +2), suggesting that insider selling provides a motive for earnings inflation around IPOs. Furthermore, the results suggest that the CEOs of IPO firms have a tendency to inflate earnings only when the incentives for earnings overstatement are high and when it is hard for outsiders to detect earnings management due to information asymmetry.

Keywords: Initial Public Offerings; Discretionary Accruals; Insider selling; Firm Performance; Information Asymmetry

JEL Classification: M41