EARNINGS MANAGEMENT AND MARKET PERFORMANCE - A STUDY OF PHARMA AND CONSTRUCTION COMPANIES IN INDIA

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Abstract
In this study, we have examined the impact of earnings management on the market performance of pharmaceutical and construction companies which are listed on BSE. The study was carried out for 10 years. The total of 182 listed companies which consist of pharmaceutical and construction companies have been taken as the sample for the study. The data were analysed with the help of EViews and multiple regression was implied. Earnings management was estimated by using the modified Jones model. The result of the study reveals that the market performance of the select companies is negatively affected by earnings management.

Key words: *Earnings Management, Market Performance, Discretionary Accruals, Non-discretionary Accruals.*

1. Introduction

Earnings management is a form of earnings manipulation that is likely to obtain some desired objectives. Schipper (1989) defines earnings management as "a purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain."

Earnings management occurs when managers use decision in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence predetermined outcomes that depend on reported accounting numbers. Earnings management is taking advantages of the flexibility in the choice of accounting treatment to signal the manager's private information on future cash flows. Earning management is also choosing an accounting treatment that is either devious or economically efficient. Sometimes earnings management can also be used or tricked to misrepresent or reduce the transparency of the financial reports. Earnings management arises when managers exercise their discretion over the accounting numbers with or without restrictions. Such discretion can be either firm value-maximizing or opportunistic (field, Lys, and Vincent 2001). Earnings management could be a purposeful intervention in the external financial reporting process. The purpose or the intention may or may not be of obtaining some private gain. It could be a collection of managerial decision that results in not reporting short term value-maximizing earnings as known to management. The practice of earnings management could be beneficial, perennials or neutral. This practice involves reporting earnings that are higher than the truth and reporting earnings less than the truth. Earnings management is the choice of a manager of accounting policies to accomplish the specific objectives (Scott, 2003).

The general conception of earnings management is that it equals to misrepresentation. It is usually the firm attempts to bide poor performance and mislead the investors. Regardless of the purpose or tactics, the truth about the managing earnings is always known to management. Earnings management is the choice by a manager of accounting policies to achieve a specific objective (Seats, 2003).

2.Need for the Study

Earnings management comes about when managers of a firm use judgment in communicating financial reporting and organizing transactions to misrepresent financial reports to misguide the stakeholders about the performance of the firm or to influence the contractual outcome. Therefore there is a need to understand the relationship between earnings management and market performance.

3.Review of Literature

Sara W Bassiouny (2016) examined the impact of firm characteristics on earnings management of 50 firms in the Egyptian stock market. The finding revealed that there was a significant positive relationship between the firm's financial leverage and earnings management and insignificant relationship between firm size, firm age and firm audit quality with earnings management.

Sinan S. Abbadi et.al (2016) investigated the effect of corporate governance quality on earnings management in Jordan. The study found that corporate governance quality is negatively affected the earnings management.

Brad A. Badertscher (2011) examined the degree and duration of overvaluation affect management use of alternative earnings management. The finding reveals that the longer the firm was overvalued and the grater is the amount of total earnings management and managers engage in accruals management in the early stage of overvaluation before moving to real transaction management to sustain their overvalued equity.

Lakshmanan Shivakumar (2010) discussed an aggregate market reaction to earnings announcement and stated that a negative relationship between aggregate earnings news and daily market returns.

Gregory S. Miller, (2002) examined 3071 firms earnings performance and discretionary disclosure. The study found that there is a strong positive relationship between types of disclosure and earnings management.

Sunil Dutta and Frank Gigler (2002) had analyzed the association between earnings management and voluntary management forecasts in an agency setting. The analysis stated that earnings management is a model as window dressing system that can increases the firms reported accounting earnings but there is no impact on real cash flows. The shareholders may not find it optimal to prohibit earnings management.

Patricia M. Dechow et.all (1995) evaluated alternative accrual-based models for detecting earnings management and highlighted the importance of controlling for financial performance when investigating earnings management stimuli that are correlated with financial performance. The study found that the modified version of Jones (1991) model is most powerful in detecting earnings management.

4.Research Gap

From the review of literature, it is found that there are few studies on the determination of earnings management and corporate governance and earnings management in the Indian context. No studies have concentrated on the impact of the firm's earnings management on market performance. Therefore, the present study is focusing on the impact of earnings management on market performance.

5.Objective of the Study

1. To study the effect of earnings management on market performance.

6.Hypothesis of the Study

H_{01}: There is no significant effect of earnings management on market performance.

H_{a1}: There is a significant effect of earnings management on market performance.

7.Research Methodology

The research methodology adopted for the study is presented as follows:

7.1.Source of the Data

For the present study, only secondary data is used. Required variables were collected from the online database that is Center for Monitoring Indian Economy (CMIE) ProwessIQ and Websites like BSE.

7.2.Sample Selection

The present study used a sample size of 182 Pharmaceutical and Construction companies in India. All the 182 sample companies in the study are categorized into 2 sectors. They are the pharmaceutical industry and the construction industry in India. A convenience sampling method was used in selecting the sample companies for the study.

7.3.Period of the Study

The period of the study has been covered for a period of 10 years that is from the financial year 2009 to 2018.

7.4.Tools used

For the present study, we have taken the modified version of the Jones Model (1991) for the empirical analysis. The modification was designed to eliminate the conjectured tendency of the Jones Model to measure discretionary accruals with an error when discretion is exercised over revenues. In the modified Jones model, nondiscretionary accruals are estimated during the study period.

$\alpha 1: coefficient\ of\ \dfrac{1}{Assets_{i-1}}$

$\beta 1: coefficient\ of\ \dfrac{\Delta Revenue - \Delta Receivables}{Assets_{i-1}}$

$\beta 2: coefficient\ of\ \dfrac{PPE}{Assets_{i-1}}$

For calculation of Discretionary accruals

$$TA_{it} / A_{it-1} = \alpha 1_i (1 / A_{it-1}) + \beta 1_i (\Delta Rev_{it} - \Delta Rec_{it}) / A_{it-1} + \beta 2_i (PPE_{it} / A_{it-1}) + \varepsilon_{it}$$

TA= Total Accruals

A_{it-1} =Lagged Value of Total Assets

ΔRev_{it} = Change in Revenue

ΔRec_{it} = Change in Receivable

PPE_{it} = Gross Property Plant Equipment

ε_{it} = Error term

8.Analytical Framework of the Study

To analyse the impact of one by total assets, change in revenue minus change in receivable and gross fixed assets to total assets on the discretionary accruals.

Table-1 Method: Panel EGLS (Cross-section weights (Dependent variable = Discretionary accruals)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.007660	0.003622	2.114972	0.0346
1/TOTAL_ASSETS	-0.712270	0.270199	-2.636094	0.0085
(CHANGE_IN_REVENUE-CHANGE_IN_RECEIVABLE)/TOTAL_ASSETS(-1)	0.009745	0.005104	1.909266	0.0564
GROSS_FIXED_ASSETS/TOTAL_ASSETS(-1)	-0.053549	0.004899	-10.93073	0.0000

Weighted Statistics			
R-squared	0.067819	Mean dependent var	-0.066697
Adjusted R-squared	0.066279	S.D. dependent var	0.161896
S.E. of regression	0.152846	Sum squared resid	42.42512
F-statistic	44.04010	Durbin-Watson stat	1.574095
Prob(F-statistic)	0.000000		
Unweighted Statistics			
R-squared	-0.013827	Mean dependent var	-0.029051
Sum squared resid	46.80518	Durbin-Watson stat	1.361373

Source: computed from compiled data

able-1 reveals that the coefficient value of 1 by total assets is -0.007 and value of P is 0.034 which indicates the one by total assets has significant negative impact on discretionary accruals and gross fixed assets to total asset coefficient value is -0.05 and the value of P is 0.00 which indicates gross fixed assets have significant negative impact on market performance. Change in revenue and change in receivable coefficient value is 0.009 and P-value is 0.056 which indicates a change in revenue minus change in receivable has a positively insignificant impact. R-squared value is 0.067 which represent 6.7 percent of variation on market performance and adjusted R-squared value is 0.066 which represent 6.6 percent which is representing small variation. Durbin-Watson statistic value is 1.57 which indicates the presence of positive autocorrelation in the residuals. Probability of F-statistic is significant (0.00).

9.Conclusions

The study was set out to examine the impact of earnings management on market performance among select Indian listed companies. The study found that market performance has a negatively significant impact on market performance. The other studies have proved that earnings management has influenced by corporate governance disclosures. Cready and Gurun have found that negative relationship between market performance and earnings management due to aggregate earnings conveying the discount rate to the market. This present study contributes to the literature by examining the impact of earnings management on market performance.

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