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Does Earnings Management Explain the Long-Term Performance of Capital Reduction Firms?

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Abstract: In Taiwan, firms can implement capital reduction under either the Company Act or the Securities Exchange Act. This study examines whether earnings management associated with different forms of capital reduction can partially explain long term share price underperformance. The results indicate that firms reducing their capital under the Company Act engage in earnings management for longer than those engaging in a capital reduction under the Securities Exchange Act. Furthermore, stock performance reduces with increasing aggression of accruals. The analytical results imply that managers engage in earnings management by reducing capital to boost stock prices without improving firm solvency.

Keywords: Earnings management; Capital reduction; Long-term performance.

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