EARNINGS MANAGEMENT IN ANTICIPATION OF PRIVATIZATION OF LISTED STATE-OWNED-ENTERPRISES IN THE CHINESE MARKET

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ABSTRACT

This study examines whether bureaucrats of Chinese-listed state-owned-enterprises (SOEs) manipulate earnings immediately before governments relinquish their control to private hands. It is very hard for private businesses to issue equity in the Chinese stock market. A typical way for a private entrepreneur to access the market is to acquire a listed SOE’s controlling shares, which are non-tradable in the market but can be transferred among institutions. In this situation, the floor of the transfer price is based on accounting numbers. I find that SOEs realize abnormally large income-decreasing earnings management compared with benchmark samples one year prior to privatization. This difference vanishes in other years around the privatization event. In addition, the negative earnings management preceding privatization reduces governments’ revenues and is negatively associated with earnings changes in subsequent years. These findings provide empirical support for the rent-seeking model of Shleifer and Vishny (1992, 1993) and suggest that earnings management should be considered in studies examining the effects of privatization programs.

Keywords: Earnings management; Privatization; Rent-seeking
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