Earnings Management and the Long-Run Underperformance of Private Placements of Equity

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Abstract

We investigate whether, like IPOs and SEOs, managers of firms issuing equity privately manage earnings and whether the earnings management explanation for poor long-run stock performance of public issues also holds for private issues of equity. Due to limited information asymmetry between managers and private placement investors, managers of firms issuing equity privately should have limited opportunity to manage earnings.
Consistent with this notion, we find no evidence of earnings management for the overall sample, except for the subset of firms in the most "aggressive" earnings management quartile. Only for the most "aggressive" quartile, do we find persistent evidence of underperformance. We do not find a monotonic pattern in stock performance across quartiles. Our results suggest that aggressive earnings management by managers of firms issuing equity privately can lead to subsequent poor stock performance, like IPOs and SEOs. Unlike public issues, our results show that underperformance following private placements of equity is concentrated only in the subset of firms practicing aggressive earnings management.
Keywords: Earnings Management; Private Equity Issues; Long-Run Performance.