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Effect of Corporate Diversification on Earnings Management: Evidence From Pakistan

by

Iffat-un-Nisa

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This thesis is dedicated to my family.

CERTIFICATE OF APPROVAL

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Iffat-un-Nisa

(MMS151057)

THESIS EXAMINING COMMITTEE

S. No.	Examiner	Name	Organization
(a)	External Examiner	Dr. Sumayya Chughtai	IIU, Islamabad
(b)	Internal Examiner	Dr. Arshad Hassan	CUST, Islamabad
(c)	Supervisor	Dr. Jaleel Ahmed	CUST, Islamabad

Dr. Jaleel Ahmed
Thesis Supervisor
May, 2019

Dr. Sajid Bashir
Head
Dept. of Management Sciences
May, 2019

Dr. Arshad Hassan
Dean
Faculty of Management & Social Sciences
May, 2019

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(Iffat-un-Nisa)

Registration No: MMS151057

Abstract

The objective of the study is to investigate the impact of corporate diversification on earning management. Non-financial firms have been taken which are listed on Pakistan Stock Exchange. Data collected from 100 index firms. Panel data from the year 2009 to 2016 included. Firms which did not report the complete data have been excluded. Study uses earning management as a dependent variable and corporate diversification as an independent variable. To estimate the corporate diversification study used information asymmetry, agency conflict, operating risk, investment and firm size. Earning management measure by discretionary accruals and which is estimated through cross sectional Jones model. Discretionary accrual is a proxy for earning management. Results of the study shows that geographically and industrially diversified firms uses earning management more actively. According to results information asymmetry and firm size have a negative impact on earnings management. Therefore, Investment have positive and insignificant effect on earning management.

Keywords: Diversification, Earning, Information Asymmetric, Agency problem.

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Chapter 1

Introduction

1.1 Background of the Study

Current financial scandals which upset the financial societies, a number of researchers from academia and different controller had been attracted the focused by the earning management. During the previous era earnings management is full fledge fame in accounting literature. Many publish and unpublished documents examine hypothetically and empirically diverse hypotheses related to earning management. Many investigators deliver remarks of earning management (Nelson et al., 2002) others investigate its part in agency settings and its effect on financial markets and information asymmetry Tendeloo and Vanstraelen (2005).

The determination of this study is to find that diversification deliver a satisfactory atmosphere for earning management and whether executives of diversified business resort, more than others, to earnings management in their described presentation. Certainly, options of business plans are the accountable for the organizations act. But the earnings management is further possibility to depend on functional performance (Chung et al., 2005).

Furthermore, business plan options provide circumstances that can also satisfactory to earnings management (opportunistic behavior, values of self-fulfillment which leads short-term advantages at the expenditure of long-term steadiness and

behavior of selective and subjective revealed) or unsatisfactory. There is a requirement to compare the situations formed by diversification policy as different to a focused policy, and effects on earnings management. study recommend two challenging hypotheses that theoretically describe the relative among the earnings management and corporate diversification. As mentioned by agency conflict, capacity of managers to manipulate the information distort earnings depends on organizational complications and probable for agency advantages. Which show significant. Usually, large firms are diversified over more than one country which are complicated and have agency issues.

It is mostly reported that diversified firms are usually greater, their organizational forming is complicated and their procedures are not cleared. Their investors and analysts face problems Kim and Pantzalis (2003). Additionally, they are probable to show agency problems and information asymmetry issues, which are contemplate beneficial to the exercise of earnings management (Dye et al., 1988).

Furthermore, with respect to the literature of corporate diversification, many researches recommend that corporate diversification ends stakeholders wealth and sell the shares of diversified firm at a discount. Its claimed that executives can find out to diversify to Growth in their return authority and status Safe their place within the organization through executives-certain investments Shleifer and Vishny (1990). Decrease the risk of their own investment by decreasing the business risk Amihud and lev (1981).

The diversification doesnt induce executives to control the number of accounting, but may also generate a satisfactory condition to make it difficult to record management of earning. Thus, on the basis of these opinions, it can be assumed that companies operating in a only one industry (only one enterprises) and entirely in the internal market are possible to have fewer opportunities to manage profits than Industrial Diversification (Multi-segment enterprises) or geographically diversified (multinational) firms or both combined. Recently, the works on business diversification discovered the hypothesis of earnings volatility which claims that business diversification should lead to lower variability in earnings because revenues generated by various units of the company are less than faultlessly correlated.

As a result, managers have difficulty manipulating earnings through regularization accounts because accruals produced by diverse units that are poorly associated tend to cancel. Thus, the assumption of earnings instability expects an reverse relationship between earning management of and business diversification, such as diversification can decrease management of earning. The empirically data on the role of business diversification (industrial and geographical diversification) in reducing or worsening management of earning are scarce and inconclusive. In fact, only the literature of (Jiraporn et al., 2008) is attempting to talk about this problem. Thus, by linking two streams of research, management of earning and business diversification, this study contributes to the related literature in numerous ways. Firstly, in view of the two dimensions of diversification (industrial and geographical), they were trying to ascertain whether the diversification of companies has a positive or negative impact on management of earning. Secondly, they should also try to find out whether management of earning is being practiced very hardly in companies that are both geographically and industrially diversified.

The contribution of this thesis is that it employs a rather different approach to determine effectiveness diversification this research follows a slightly different approach to diversification. study test the diversification in the context of earning management.

The study was differing from (Jiraporn et al., 2008) in numerous important aspects. Firstly, that research takes to the unknown area of sources of variance in management of earning between diversified companies. By relating sample of diversified companies to their complements (carefully nominated portfolios of self-targeted companies, which corresponds to size and business to a diversified company), identifying the features of the circumstances created by the diversification favoring increased/diminished management of earning. Secondly, usage the different method to that of (Jiraporn et al., 2008) they deliver new and substantially diverse proof on the comparative roles of business change in management of earning. The outcome demonstrates that, while industrial diversification mitigates the management of earning as per the results of (Jiraporn et al., 2008) geographical diversification as alone or mutual with industrial diversification accentuates

this phenomenon unpredictable with the results of (Jiraporn et al., 2008).

1.2 Theoretical Support

This study is about the association between corporate diversification and earnings management. Four theories available, which explains understand about complications and benefits in the relationship of corporate diversification and earnings management. This analysis follows the cross-sectional John's model which she gave 1991 modified to detect revenue-based earning management delivers the very powerful test of earning management.

Diversification is a corporate strategy to enter into a new market or business in which the business doesn't presently work, while also making a new product for that new market. Diversification is an important factor for the more profit. Diversification is argued to be beneficial for companies due the following factors. Increased managerial economies of scale reduce the overall costs and makes the company more efficient Chandler (1997).

The hypothesis empowers the hazard reluctant financial specialists to improve their normal returns by improving portfolios for venture purposes Markowitz. H. (1952). In any case, in genuine terms, these speculation openings are not all that all around ok as it looks as a result of exceptional dimension of profit control. This hypothesis lies in the middle of the genuine rewards or returns and deliberate hazard looked by speculators. As per this hypothesis, broadened firms are increasingly reliable for speculation on the grounds that the money streams of various divisions are incompletely.

1.3 Problem Statement

There is a lot of literature available on corporate diversification and earning management. This study is going to investigate how corporate diversification impacts on earnings management.

When a business moves towards the expansion itself then it bear some awful issues as earnings management which have strong connection with corporate diversification.

This study can serve as a starting point and with the help of this study further research can be done. It may helpful for the investment decisions and could be help the researchers.

1.4 Research Question

- What is the impact of corporate diversification on earning management?

1.5 Research Objective

- To identify the relationship between earning management and corporate diversification.

1.6 Significance of Study

If we look specifically about significance of study, it can be divided in two parts again one is academic and other is practical conduct. If we talk about the academic purpose, we can say that this research will be very helpful for students of finance. It also helps to those who want to do more research.

If we look at the Practical perspective it is very useful again because most of the investor wants to know about performance of these firms that can help for forecast the future.

It presents guide line for those who are not performing very well. This study help investor to get the right information about the performance of these firms and this study will help investor to make correct decisions about investment so we can say that this study is fruitful for both investors and students as well.

1.7 Organizing of the Study

First chapter has 5 section. 1st of all it includes introduction of the study then discuss the research questions. This chapter also include problem statement, research objectives and significance of the study. Chapter number two contained a detailed literature review of corporate diversification including (information asymmetry, investment, cultural diversity) and earnings management. Third chapter comprises methodology.In this chapter defined detailed about data description and methods which has been used. In this study we use panel regression analysis, descriptive statistic and correlation analysis. Forth chapter is about the results and discussion of corporate diversification on earnings management. It has also discussed that how it would be helpful for the future researchers.

Chapter 2

Literature Review

A literature survey of corporate diversification and earning management has been discussed in detail. Many researchers investigated the corporate diversification with earnings management. In this segment, study discuss whether diversification make worse or weakens earnings management.

2.1 Corporate Diversification

Basically, for entering into new market the diversification is a commercial strategy in which the business or corporate doesn't currently work, while also generating a new invention for that new or innovative market. In the last few years, researchers have been examining the value of corporate diversification. Several U.S. based studies on corporate diversification suggest that there is significant evidence to assume that firms which are diversified, on normal, trade at a discount contrast to those firms which are not diversified Berger and Ofek (1995). There are a number of companies, observing for new methods of growth often diversify into different fields. In theory, if a company enter in a new business that can reduce the chances of their loss. However diversified business has to face many challenges for the growth purpose. Therefore, existing of diversification discount is dependent on the institutional setting of a country was discussed by Mazur and Zhang (2015).

Corporate diversification is affected by Change in the business cycle. The first economic recession, which occur due to increase in discount rate was investigated by (Campbell et al., 2013). Rudolph and Schwetzler (2013) described about the relationship between the corporate diversification and capital market development. They investigated that integration and legal system has been examined and found that diversification value is limited in mature markets, where firm can achieve external capital on the capital market. The diversification is affected due to changes in the business cycle. Diversified firms and non-diversified firms perform differently during the recession, which is suggested to be imputable to distinctions in access to credit. Due to two reasons the entrance to credit worsen during the recession period. First are non-diversified firms being more experience external finance premiums. Secondly the shortages of bank monetary reserves guide to high chance for non-diversified firms to be a credit constrained. Both effects are magnified because of an increased cash flow variability and poorer credit rating of nan diversified firms discussed by Dimitrov and Tice (2006).

According to Lewellen (1971) diversified firms have lower cash flow volatility. Caves was the man who gave the idea that diversification is useful if it will create more benefits in collaboration but in the presence of all assets, which are useful for the firms. It is not easy to sell in market, these information-based assets own economies of scale, it is best for the firm sell these assets in internal market. Global diversification enhances the worth of the firm by making elasticity within a firm to answer the comparative price change, distinction in a countrys nominal earnings and other corporate differences.

Diversified enterprises have significant access to the external source of capital Lewellen (1971) have an advantage in the capital change between the sections in the internal capital market Alchian (1969). Consequently, empirical evidence according to many different studies that do not demonstrate that diversified firms benefit from these benefits, Commentary and Jarrell (1995) Berger and Ofek (1995). Another researcher introduced that coporate diversification report may meaningfully decrease liquidity demand in business. Further they have shown in their study that it is an importance gradually risky environment business, in which financially

flexibility is the higher priority for manager of finance and where management of financial has become a main issue in the company policy (Almeida et al., 2004). Business diversification becomes significant when the costs associated with transactions of carrying out in companies with more than one industry within their borders are affected. Alchian (1969) academically suggested that diversification of business generates value as the allocations of capital within the internal capital of market in enterprises diversified are more effective (implying lower transaction costs) than those in external markets of capital.

Williamson (1986) argue that "internal communications costs are normally lower than those that would be incurred in making proposal of investment for the external capital market". In addition, the headquarters of diversified business is widely designated as reliable and appropriate people to effectively assign capital between segments within companies. As a result of this argument, the recent theoretical analysis (such as., Gertner, Scharfstein and Stein (1994) emphases on the differences in incentives, between diversified business managers and external financial providers. According to (Gertner et al., 1994) survey of diversified business managers, which they assign capital, while on the external financial capital market providers, like debtors or banks, are not normally the owners of the companies they are lending money to. Although the theoretical reports Joehnk and Nielsen (1974) debated portfolio theory, that business diversification increases value of firm as it decreases risk. Amihud and Lev (1981) were studied on the adoption of agency theory see diversification as an ineffective strategy solely motivated by the manager's own objectives.

(Mackey et al., 2017) indicate that the ability to accomplish diversification is a heterogeneous distribution of industry crosses. Some of the industries have been more successful than others industries in handling a specific degree of diversification. According to (Barney et al., 1991) result of other firm characteristics or as a capacity. In the previous empirical research reported that empirical study is consistent with idea that industries fluctuate significantly in terms of capacity to handling diversification Amit and Livnat (1988). There are some very diversified industries overperform their targeted but otherwise similar competitors opponents

Campa and Kedia (2002). Other researchers identified a series number of factors that affect the optimum degree of diversification of a business, also including the ownership George and Kabir (2012) and industrial structure Klein and Saidenberg (2009).

A researcher He (2009), suggested that strategy of optimum diversification will be determined endogenously. Industries were select the types and level of diversification which is the best fits their capabilities, their resources and other factors of specific business, thereby producing better performance results compared to strategies of alternative diversification Gomes and Livdan (2004). However, the efficiency of this mechanism is liable on strength of the environments selection where industries work McKelvey and Aldrich (1983).

The weak environments selection can allow industries to "diversify" Markides (1992), such as to follow strategies of diversification in which incompatible with maximization of profit. On the other hand, increasing the pressure on capital market Hoskisson and Turk (1990) and increased competition in the product market Hoskisson and Hitt, (1994) will require industries to choose best level and type of diversification with optimum performance. For example, according to Sandalo and Becerra (2008) have shown that with the growth of competition among specialized industries, diversified industries have lost their previous performance advantage. As a result, with the growth competition, industries will adapt strategies of their diversification to optimum performance levels.

Therefore, argue that the pressures of environmental mentioned above have affected not only the overall diversification points, but also the connection between industry performance and diversification, as outcome of negative and as well as positive selection procedures. Compare industry with a given diversification level, but heterogeneous endowments of resources and capabilities Barney (1991), the pressure to reduce their diversification level should have been the solidest for industries that were least able to handle their diversification in a rewarding way. According to (Hitt et al., 1996) for corporate control given an active market, industries with particularly destructive value strategies of diversification will have been enforced to diversify; Otherwise, they may have left the business population

by subsequent recovery and rupture, or by declining and exiting (Daley et al., 1997).

On the other hand, industries with better capacity to handle diversification with success, and also with well performance, should have had better possibility of survival (Pennings et al., 1994). The increase burdens in environment therefore implies that the impact of industry with diversification greater than their optimum levels of yield will have decreased. On the theoretical framework of these assumptions discussed above (such as our cash flow free hypothesis and the asymmetry of information and the offsetting of the regularization assumptions), we built two hypothesis to explore specifically on the relationship between diversification of the industries and the management of real profits and accumulation. More precisely, at the small diversification levels, while the demand to manipulate gains may be low as expected hypothesis by free cash flow, leaders just need to operate the actual activities as they real prefer to manage accumulation gains (Graham et al., 2005).

When industries become more mature and diversified, their cash flow can still grow to the higher side, but their development chances are limited. Stulz (1990) says that diversified industry will tend to participate too much in segmentation in which opportunities of investment are low. Another researcher Jensen (1986) states that industry leaders with large cash flows are more probable to undertake net investments with negative discounted value. Jensen's state that diversified industries will participate more in projects that diminish value, as their segments have accesses to cash flows as part of industrial diversified. Ineffective cross-subsidization in the internal markets of capital of diversified enterprises is broadly documented (Lamont, 1997; Ozbas and Scharfstein, 2010; Shin and Stulz, 1998).

The evidence of empirical research shows that ineffective investments in internal markets of capital have a positive relationship with the diversification level Berger and Ofek (199). Therefore, it is probable that more diversified industry leaders should increase the scope of management of earnings to cover the low earnings of these ineffective investments. No doubt, this influence has drawn the devotion of leaders to sustainability strategies for continually developing and thriving in the

midst of the unforeseen economic situation as well as emerging commercial competition. The most common strategies are diversification, either geographically or industrially, because they are both supposed to decrease the level of risks of the industry Harto (2005). The literature rash shows that strategies of diversification may be improve the profitability performance in the industry (Farooqi, 2014; Satoto, 2007). However, this diversification, despite its capability to generate multiple revenue streams by expanding the firms business line, segmentation and share of market, requires a higher degree of industrial complexity that can create another condition unfavorable El Mehdi and Sebuoi (2011).

Furthermore, El Mehdi and Sebuoi (2011) reported that the management of earnings rises with the geographic diversification levels. They show that, for multinational industries, that they operate in one or more segments of activity, they also find provisions for increased income. The discovery of this finding is dependable with the other view that geographic costs of diversification compensate the benefit. They also propose that aggressive management in diversified global enterprises is inspire by more volatility in operating cash flows, more asymmetry of information and increased risk of exploitation. Other comparable study is conducted on Taiwanese industry by (Chin et al., 2009).

They agreed that greater internationalization of the industry is related with an advanced level of management of earnings through greater asymmetry of information and decrement transparency. Instead, numerous studies provide dissimilar conclusions that are inconsistent with the aforementioned elements. The study of (Jiraporn et al., 2008), such as, provides evidence of empirical that geographically diversification does not seem to have an impact on profit management. Other researchers that geographically diversification can support mitigate the practice of management of earnings (Farooqi et al., 2014).

The panic and compatible market imperfection relating to emerging economies which is associated with diversification and it plays an important role to increase the costs of potential agency. The managers and as well as shareholders can easily exploit a firm to achieve their own benefits and objectives by using the information relating to higher asymmetric. The result of these types of exploitation

can be exacerbated if there would weakness in law enforcement, which leads the implication of policies in difficult ways, if the standards relating to accounting would be poor and there would be less power to use right for shareholders. These types of deficiencies make it difficult for a diversified firm to make its position in the emerging market to face all the potential challenges Jensen (1986).

Internal checks and balance process play an important role for an industry in an emerging market rather than hostile takeover and for internal evaluation discipline, inside management plays a key role. It has been published in a search, relating to a country report which had been published by The Economist Unit during the period 1993-1996, was this in that period there was no hostile takeover activity had been happened. Hostile takeover was banned illegally in India till January 1998, before a change in the law effective policies. It had been also assessed by the EIA that in South Korea the culture was going to be accepted more forwardly relating to hostile takeover. By the EIA analysis it has been also assessed by, (La Porta et al., 1999) that concentrated ownership matter in emerging market was more intensive rather than laws relating to weak investor protection.

Concentrated ownership can be beneficial as well as detrimental especially by a specific management group in diversified culture. The convergence relating to interest hypothesis Jensen and Meckling (1976). It has been revealed that the managers who also leading their business as owner they prefer to implement poor diversification application and have less stamina to lose their corporate wealth.

In the recent study the phenomenon to study the causality effects relating diversification and its impact on performance has been analyzed. There are only a few researchers who have analyzed the relationship to express the causal reasoning between diversification and its effect on performance relating matters. (Grant et al., 1988) had analyzed a causal effect relating to profitability in the presence by using a large sample about 304 companies from a manufacturing side of British during 1972-1984. The result of this causal effect was weak in terms of both above stated directions.

Hall (1995) the study, relating organizational performance and its diversification on the bases of its causality by using an unbalance panel data had been conducted

in 1988-1993 in US but its results were different as per unbalanced data panel from 86-134. Different results had been analyzed in consistent studies relating to diversification and its effects on performance. It had been also analyzed that the firms which were getting high profit they were applying less diversified applications.

Campa and Kedia (2002) in US a sample of 8,815 firms had been taken during 1978-1996 to take over the control decision relating to endogeneity in diversification matters. And by this study it had been analyzed that no causal relationship exists between relating to firm values due to diversification. In this regard, it had been also suggested the diversification should be discounted, because it was not playing an effective impact on the performances of a firm values.

Lamont and Polk (2002) it had been reported that even when endogeneity and biases relating to self-selections were applied, then diversification was discounted. Villalonga (2002) it had been revealed that when selection bias was being controlled then the diversification discount had been disappeared. Stowe and Xing (2006) had analyzed the possible happening of diversification discount by using a sample of 230 relating to Us diversifying firms during 1981-1997 in firms to show relation between diversified firms and single-segment firms.

2.1.1 Information Asymmetry

According to Burch and Nanda (2003) literature advice that corporate diversification has higher asymmetric information issues than focused firm because corporate diversification lead towards the agency relationship between stakeholders and managers. There is source of Distinction in asymmetry that diversified firms are not much clear as compare to those firms which are focused Van Hemmen (2010). It supposes, executives of diversified firms can notice fractional cash flow while stranger can notice only simple estimation of cash flow. Therefore, account translation and combination problems make not much clear reports of company for strangers and earnings which is reported convey not appropriate information. Mostly, focused firms are clear rather than diversified firms, to identify the earnings management they offer a huge incentive.

Furthermore, many studies about accounting variation have specified that presence of information asymmetry is necessary between management of the firm and stakeholders due to exercise of earnings management (Dye et al., 1988). Therefore, shareholders dont have the relevant information when information asymmetry is high, due to this reason they cannot change the earnings. Shareholders in extremely diversified firms, have inadequate capital, motivations, or approach to related information to control management which boost the exercise of earnings management (Warfield et al., 1995).

Agreeing to the to the microstructure writing, data asymmetry (or antagonistic determination hazard) in the share trading system emerges when there are brokers with better data who attempt than get benefits by exchanging based on their educational leverage Bagehot (1971). In every one of these models there are two kinds of merchants in the market, educated and clueless, exchanging a benefit of questionable esteem. Though clueless dealers consult in money related markets for liquidity reasons and get no unique data, educated merchants have a spot in the market dependent on data about the benefit's actual esteem. The instructive favorable circumstances of educated market members originate from two witnesses. Premier, the educated speculators may get permission to private data about firm esteem that isn't. Available to unaware stockholders (insider transaction). Second, dealers who have knowledge a more skill to treat and explain community information become informed dealers because they can produce greater valuations of the implications of this information for business performance or value Kim and Verrecchia (1994). The information asymmetries between market contributors make an adverse selection issues, which is generally established in high transaction costs and decrease levels of stock liquidity, because when liquidity providers perceive increases in the adverse selection risk, they protect themselves by widening the bid-ask spread, thereby decreasing liquidity, and higher the cost of capital Easley and OHara (2004).

Although literature recommends that profit quality influences the data condition of the firm, most research to date has utilized collections-based profit the executives as an intermediary for income quality, finding that poor income quality is

altogether connected with higher data asymmetry (Bhattacharya et al., 2013). Be that as it may, as far as anyone is concerned, just two papers have broken down the impact of REM on the firm data condition, and they give indistinct proof. For an example of New York Stock Exchange firms, (Ascioglu et al., 2012) find blended outcomes and powerless proof for the relationship among REM and liquidity. Their outcomes rely upon the intermediaries utilized: in a few relapses they locate a huge relationship between anomalous optional costs and liquidity, yet with the contrary sign to that normal; when they utilize irregular income, nonetheless, the relationship with liquidity intermediaries is, in general, not factually huge.

2.1.2 Investment

Goldman (2005) explains that diversified firms have to suffer risks during investment decisions. First risk is opportunity to invest in best projects Literature theme suggest that firms which are diversified mismanage their funds of investment due to poor performance of contribution. Many Authors explains that decrease in firm worth linked with corporate diversification Tong (2009). According to Berger and Ofek (1995) firms which are diversified are suffer to cross contribution investment. In parts with imperfect development chances. Correspondingly, Scharfstein and Stein (2000) demonstrate that local managers of rent seeking can destabilize the decision of inside capital division. According to study diversified firms distract resources towards the weaker from stronger and misdirect their capital of investment. The second risk is that purposes of earnings management can take satisfaction through investment and court order and expose of wanted retributions.

(Dranikoff et al., 2002) claim that result to divest is almost always in reply to burden as the pattern of the disposed company that suffers heavy losses, the parent having a stifling burden of debt, or the analysts of Wall Street negative turning. They also suggested that fifty of the biggest projects over a four-year period, further three quarters were completed in the burden, and most of them only after long delays, when issues became so clear that the action was inevitable. Also (Haynes et al., 2003) investigates that divestiture is a one-time response to financial, governance of corporate and strategic variables and, as like, seems to be

largely compatible with the theoretical and strategic viewpoints of the agency. In part, by reacting to this rule, poor and standard anticipated its standard operating number: "Basic benefits".

The investment public frequently contemplates R&D as a significant driver for something new corporate that can generate the economic fees satisfactory for economic growth. R&D intensity measures the ratio of expenses by a firm on its research and growth to its sales, and prior research recommends that R&D intensity is positively connected to the firms value of market Cockburn and Griliches (1988).

The overinvestment hypothesis claims that self-centered executives always invest in the net cash flows from outside funding actions in investment strategies with negative attainable value. Therefore, (Bradshaw et al, 2006) indicate a funding business with negative earnings mostly reflects the decrease in value caused by such more investment. The governor of Chinese Central Bank has stated that several investments do not meet our industrial strategy necessities for Outward investment.

They are not of outstanding benefit to China and experience led to complaints abroad. Thusly, we remember a sure point of policy guidance is necessary and efficient Feng (2017). Thus, managers in these firms will be motivate to involve in value-generating policies, and maybe, concentrate on their central business to recover the national security mandate. Also, foreign investments might require access to capital and chances of Chinese businesses to long-term debt is highly selective as it is provided by the Chinese state bank Xu, Xu, and Yuan (2013) and is strictly controlled by the state Bai, Lu, & Tao (2006).

2.1.3 Agency Conflict

Basically, culture tells about the values of an organization which is different in everywhere and creates agency problem. Values are dominant element of an organization and support the attitudes, behavior and decisions. Number of organizations which are successful they manage their culture very effectively. Values of the

employee can be supported through the principle of honesty, clarity, respect and fineness. Indirectly, a firm can make profit in any case, its leading and exceptional worth Arnold and Lange (2004).

Firms which are diversified have many companies and each company have a specific culture that can separate from each other company. Cultural diversity is worse issue when firms which are diversified industrially and also diversified geographically. Definitely, process is very tough to control because they try to put their firms to other cultures and shareholders unable to control actions of agents. So, the cultural problems appear to emphasize additional agency issues and earnings management in firms which are diversified Sambharya (1996). According to the Lang and Stulz (1994) investigate that shareholders wealth ends due to corporate diversification a fact that guide towards the diversification discount puzzle.

Most of the researchers feature the existence of diversification discount to agency problem between shareholders and managers (Amihud et al., 1981). In the previous literature (Hitt et al., 1997) suggests that factors such as product diversification the size of the company and opportunities of investment can be useful to explain the variation in diversification performance. The process of diversifying businesses, through internal growth or acquisitions, involves interdependent step decisions and collaboration with other parties, generating more probable for achieving learning the repetitive experience Hoskisson and Hitt (1990).

Therefore, a firm that follows repetitive diversification, acquires the learning of the recognition and assimilation of new experiences emerging from the repetition of these processes was discussed by (Bergh et al., 2008). Therefore, at low diversification level, while demand to manipulate gains may be low as predicted by the free flow of cash hypothesis, the managers may just need to operate actual activities as they real prefer to manage accumulation gains Gunny (2010). A design of this concept is the reversed U-shape association between the diversification degree and the performance of business widely described by Fryxell and Barton, (1990) Licher, Cardinal, and Miller (2000) among other things. They suggested that business diversification mitigates the management of accumulation gains, which is reliable with the outcomes of Jirapon (2008).

The diversified industries have lower correlation between the divisions in opportunities of investment and higher correlation between opportunities of investment and cash flows than non-diversified firms, which corresponds to a lower level of cash Chin (2010). Large companies are on regular, more established, more expectable and have more constant incomes than small businesses. Chan and Chen (1991) suggested this view by investigative the structural and return characteristics of the small and large enterprises and conclude that there is a relationship between company size and performance.

2.1.4 Firm Size

There are two opposing opinions on the role of the size of the industry in the management of profits, as shown below. The larger size of the industry, the less the management of earnings can be achievable. Firstly, the industrial size is associated to its interior control system. Large industries can have more cultured internal systems of control and have more capable internal auditors related to small industries.

An active control of internal scheme donates to the dependability of the financial information revealed into public. Furthermore, the governance of corporate mitigates the degree of management of earnings and improves the financial reporting quality (Warfield, et al., 195 and Bestiley et al., 2000). As a result, large industry is more probable to strategize and maintain more cultured and efficient control of internal systems compared to small businesses, reducing the probability of manipulate earnings.

Second, big industries are mostly checked by auditors from five large accounting industries that have more experienced listeners who might help prevent false tax returns. Thither is a differentiation of quality in the control of aggressive and opportunistic gains among large international accounting industry, domestic companies and local businesses (Francis, et al., 1999). Definitely, industries controlled by big five tend to declare lower discretionary levels of the regularization even if

they possess a high level of accruals. Additionally, industries audit report lesser levels of discretionary accruals (Becker et al., 1998).

According to (Gore et al., 2001) indicate that non-large auditors 5 allow better management of earnings than large 5 auditors. Another study by Lennox (1999) also suggested that the report of audit issued by the major auditors are more useful, demonstrating that the size of the listener is positively related to the accuracy of the audit. Heninger (2001) posited that positive relationship between the risk of litigation audit and abnormal interest charges.

These research's show that large industry in size tend to receive better auditing services from audit firms established due to bigger budgets operating industry. Third, large industries take reputation costs into account when they engage in profit management. These industries can have a better appreciation of the environmental market, better to control of their operations and a better kind of their activities compared to small industries.

Large industries may also have reputable their trustworthiness in the community at industry and social accountability, including the reliability of financial evidence because they are more able to use the best skills and modern way of information technologies in reliable and timely information compared to small industries. As a result, the cost of commitment to managing gains will be bigger for large industries than small industry. Consequently, their concern about reputations can prevent large sized industry from earnings of manipulation.

Finally, large industries may be less expected to handle earnings compared to smaller counterparties because they are tracked by other financial analysts. On the other hand, an opposite view indicate that large industry is more likely to manage earnings than small industries. Barton and Simko (2002) state that large industry faces more burden to meet or beat analysts' expectations. Myers and Skinner (2000) establish empirical data demonstrating that large industry does not report about earnings accurately after they have studied their growth of earnings for at least 14 quarters. Another research Rangan (1998) also suggested that the industries in its study manipulate current provisions to over-report revenues in the year before to the seasoned stock offerings are larger and older.

2.1.5 Operating Risk

One of the most significant inspirations in the management of earnings is wish to impact the perception of the financial market of industry risk. In fact, an increase in the risk level could be connected with high management of earnings. On the other hand, a mechanism about any governance that decreases accounting practices is negatively associated with the level of risk. Furthermore, these financial choices differ to the degree of aversion risk, in which generates problems for agency: the bondholders seek the protection of their investment strategies, while the stockholders pursue a big dividend through investments in project of risk (Games et al., 2003). The agency's problems can be resolved by a governance system that gives controller to bondholders through decisions of financial and control to shareholders through effective decisions Bernanke and Gilchrist (1996). However, a reduction in financial debt is connected with a rise in payment when the industry makes decisions about risky investment. A positive shock in the economy reduces the risk of aversion and leads investors to invest and adjust their business portfolios to involve small as well as medium sized speculative businesses. Then, stockholders demand a bigger return in exchange for a bigger risk according the theory of portfolio Harrison and Zhang (1999).

The leaders are encouraged to handle earnings by seeking a balance among the different kinds of risk binding-related activities undertaken by the industry Jensen (2002). In previous study by Chung (1993) portray that when the opportunities for high growth and high level of risk occurred simultaneously in an enterprise business, management tended to grow the debt, which led to the loss of business growth opportunities for prevent bankruptcy. The cases of fraud in the financial statements mentioned above reveal that management has not applied conventional financial strategies. They unfairly improved the income figures in the bushiness financial reports and disappeared the financial shortcomings of the industry.

Lastly, all sorts of risks can seem to have a significant influence on the management of earnings. As the risk increases, the leaders will be motivated to manage the earnings. With a bigger level of risk, the leaders want to show his abilities by filling various opinions and fascinating for the new investors. A high level of risk also

causes pressure on the manager, imposing it to manage the outcomes as expected (2015). Lastly, all forms of risk appear positive effect on earning management. Further risk will high, the managers motivation also high towards the earnings management. Executives try to display their skills to attract the new stockholders with a high degree of risk. More risk outcomes in a burden on the executives, imposing them to maintain the probable outcomes (Amira Neffati et al., 2011).

2.2 Earnings Management

In literature, earning management is discussed by the author in two different ways, according to Beidleman (1973) unpredictability of earning decreased by the earning management procedure, thats why it become the main reason to improve the shareholders benefits. It is also helpful to estimate the earnings in future and at the same time to improve the earnings multiples. In the previous research, earnings management can be described by managers, meanwhile it is exclusive for related to conclusion makers to see concluded the earnings management Watts and Zimmerman (1978).

In the literature the primary focus of earnings management was to know about the smooth technique in term of income on accruals Dye (1988) pointed about the analytical models of the earnings management. Investor always concerned and try make sure that company must have reserve to pay the accruals with the passage of time. Discretionary accruals are the elementary tool of earning management.

According to (Dechow et al., 1995) identifies the presentation of relative challenging models for calculating discretionary accrual. There are all these models are good for measuring accruals discretionary but johns model which contributed in 1991, revised to notice income-based provides powerful earning management to fixed the fewest mistakes and also test the earning management. A lot of the literature describes phenomenon of earning management.

In previous study Deangelo (1988) discusses that manager uses earning management mostly in merger and acquisitions. Teoh, Welch and Wong (1988) found that managers manage earning management for initial public offerings. On the

other hand, the firms are managing to earning which meet the analytical financial forecasting Burgstahler and Eames (1998).

Many definitions have been made available to define profit management. There are most well-known and most famous definition about the earning management given by Healy and Whalen. A researcher Pual Healy (1985) was published his paper in the journal of Accounting and Economic.

The analysis of earnings management exposes that it is universal and that there are many incentives for the company's executives to use their discretion including businesses as they increase capital are the most probable to manageable their earnings, or when they must meet expectations of analyst or the objectives related to the bonus plan of executive compensation plans.

Furthermore, managers of business are trying sometimes to minimize earning for reduce tax obligations and sometimes also avoid costs of dogmatic when the business is having good time. Earning managements are used to operate previous stock prices to granting of stock decisions since the stock decision encourages management to depress the stock price before the date of award (Balsam et al., 2007).

Another researcher Beatty (1998) reported that more businesses were displaying a short-term increase in earnings compared to a larger number of firms showing low-earning decreases. According to ANH and Linh (2016), when managers are using good decision role in financial reporting then at this point the earning management was occurring and in constructing transactions to modify financially reports to mis-inform certain parties on the underlying performance of economically in the company or to impact the contractual outcome that depend on the accounting figures of reporting.

Dechow and Schrand (2004) investigated that earnings are made up of cash flow and accruals, and manipulation of any of the items will affect the number of earnings. A manager may can take actual economic actions which effect on cash flows. Earnings management is an effort by corporate managers to step in or affect information in financial statements with the intention of deceiving the stakeholders who desire to experience the performance & condition of the society.

A researcher Stolowy and Breton (2004) suggested that management of earnings as the use of discretion managements to decide on choices of accounting or to designing the transactions so as to influence the chances of transfer wealth between business, managers or fund providers. In the study by Fischer and Rosenzweiz (1995) reported further concise meaningful definition about management of earnings, where they specified that there are the actions of manager that increase or decrease the current earning reporting of a financial business without an increase or decrease of the economic long-term gain in the business.

(Christensen et al., 1999) analyses that if stockholders are to trusted on the earnings of the company, it would be ambiguous for them that opportunistic management of earnings and as well as higher incentives to operate earnings diminish the information value due to the business of earnings movement. There are huge number of literatures has focused on the manipulation of accruals in industrial firms: as taken evidence of income management a simple of model departures from statistical modelling Lys (2008).

According to Healy (1985) reported that managers can use optional requirements to operate premium income. Another researcher Sloan (1996) suggested that the marketplace looks not to entirely identify the content of the accruals account about information. In the previous study of described about earning management that there are clear differences in earnings vehicle management industry firms use when industrial firms manage earning in diverse directions. Specifically, they found in their study that industrial firms increase income frequently use non-monetary income, including gains in asset disposal. Businesses that decrease income use non-cash expenditures, including doubtful debts Miller and Jiraporn (2006).

On the basis of theoretical and empirical evidence managers, accounting practice policies of accounting choice are affected by cultural and social values (Ball et al., 2000). In earlier studies (Chung et al., 2005) on the association amongst cash free surplus and generally earning of management did not include the aspect of culture. According to (Han et al., 2010) found that culture dimensions may help to describe the discretion of managers earning at the country level.

Extensive research has shown the effect the culture on the choices of accounting business leaders for declared earnings in businesses with a high level of cash flow as well as low level of growth opportunities. In previous research observe the high-quality role of auditors, as the four major countries do to discourage the management of opportunistic managerial earns. This study thus contributes to the emergence of literature on earning management and as well as practices of financial reporting in companies that have excessive cash flows. According to later on discussed theoretical aspects, the manager (CFO or CEO) uses earnings management to increase his own wealth Healy and Wahlen (1999).

(Chung et al., 2005) investigated that the use by managers of accounting techniques and practices of earnings management faced with excess liquidity. Managers or leaders of industrial have no obligation to reveal to their investors the justification of decisions of investment or the feasibility of investment. Similarly, the cash flow projections of an investment and assumptions which are not underlying in the public domain, which will increase the opportunities for managers or leaders to divert the company's earning resource an advantage. This type is myopic because the earnings of the business would replicate decisions about poor investments.

A researcher Habib (2011) indicated that non-maximizing investment ultimately decrease earns and outcome in lower level of prices stock. These situations may induce stockholders to withdraw executives and directors. However, financial statement preparers may be use account techniques that higher the revenues reported. The managers of the company can practice the management of the profits by the creative accounting by managing the DAC.

Earnings are the big phenomenon that is largely treated in the academic accounting literature. The literature provides a number of different definitions that were used in the past. A definition of management of earnings is the manager choice about the accounting policies, or actions which can effects on earnings, so as well as to accomplish some precise earnings reported. Thus, earnings management is about the choices of a manager in order to drive the earnings towards a predetermined direction.

According to Scott (2009) directions in which earnings could be managed towards are: taking a bath, minimization of income, maximization of income, and income of smooth. Taking a bath is the situation that a firm reports a loss, and therefore increases the loss in the current year by incurring future accrual costs, so that future periods have a higher probability of reporting profits. Income minimization (maximization) makes sure that the profits reported in the current period are lower (higher) at the expense of future periods. With income smoothing the manager ensures that the reporting earnings are yearly on the same level, or increase steadily, which makes the firm look like a stable firm.

The literature also distinguishes other definitions on earnings management, like the definition which is rephrased in a more common definition by (Leuz et al., 2003) the firms alteration about economically performance report by insiders to either mis-inform some shareholders or to impact of contractual outcomes. Where the definition by Scott (2009) is more neutral and allows room for both good and bad interpretation of earnings management, the definition by Healy and Wahlen (1999) is more negative using words like mislead and thus more focused on the opportunistic or negative effects of earnings management.

For the past decades earning management is still a largely discussed topic in the academic accounting society. Studies like for example Jones (1991) provided evidence of empirically that managers do manage earnings within organizations. Also, outside the academic society there has been attention for earnings management. According to Sloan and Sweeney (1996) earnings management influences the information which the market receives. The study suggested that large number of discretionary accruals models may use to perceive management of earnings.

(Cohen et al., 2008) find that nonstandard accruals to be tend more important when compensation management is more closely related to the value of the stock. In addition to mitigating fluctuations in the company's performance, insiders can use their discretion to erroneously report the economic performance of their business. For example, insiders may surety the declared earnings to achieve certain compensation objectives or declare extraordinary performances in particular cases, such as a share issue Dechow and Skinner (2000).

A researcher Stolowy and Breton (2004) suggested that earnings management as the use of discretion management to decide on choices of accounting or to designing transactions so as to influence the chances to transfer of wealth between business, managers or fund providers. In the study by Fischer and Rosenzweiz (1995) concluded the definition about management of earnings, where they specified that there are actions of managers that increase/decrease the current earnings report of a financial business without an increase/decrease economic gain in the business. According to Liu and Lu (2007) reported that in earning management there are systematic documents that listed in China companies at 1999-2000, and have empirically established that companies with higher governance corporate levels have lower earning management.

In this research, further examine about companies use their reasonable value for reporting decisions to achieve two objectives of management earnings in the previous literature: these two objectives are such as to smooth the earning and to reach the benchmark of earnings Trueman and Titman (1988). On the other hand, results show there has been a significant increase in the relevance value of earnings following the convergence, especially for firms located in less developed regions (Lee et al., 2013). According to (Fields et al., 2001) deliberate about these important features that lead to account choices (cost of agency, asymmetry of information and non-contracting party affects).

Industrial firm and as well as investment can affect costs of agency and asymmetry of information through monitor by investor. For investment belongings, the impact of the site is particularly tangible as the effectiveness of local estate of real market influences how these resources are measured on financially statements. So far, the localization factor has been largely neglected by accounting researchers.

In this study, measure firms earnings management motive using their past earnings management activity for two reasons: the first is, managers' behaviour tends to persist over time; the second is, firms that had large earnings management in the past will face higher earnings management constraints in the future Barton and Simko (2002). The management of earning, although it can rise temporary earnings targets, is doubtful to rise the long-term value of firm (Alhadab et al., 2015).

The outcome suggest that companies can use accrual accounting and real earnings as substitutes for each other although for the establishment the evidence may be not sufficient how the Business diversification influences business manipulation activities Zang (2012).

Previous research has established that family property reduces management of earning Wang (2006). In addition, Dyer and Whetten (2006) given initial evidence that family businesses in Standard and Poor's (S&P) 500 have fewer concerns about of CSR than their non-family counterparts. Numerous studies have explored the issues related to the management of the agency's earning (Khan et al., 2011; Wysocki et al., 2003) for family businesses or firms, the conflict between owners of the family and smaller shareholders is part of the majority agency - minority shareholder.

Rashid and Shawtari (2012) reveal that the corporate governance has a guideline to protect the interest of shareholders and minimize the possibility of managements to manipulate the earnings. According to Cohen and Zarowin (2010) demonstrate that the underperformance of the company as a result of the seasoned equity offer (SEOs) is partly attributable to the effects of business decisions related to profit management. They also described that these effects of REM are simpler than the effects of accrual-based profit management.

In the studies of Browns and Merchant (1990) analyse the managers showed a better willingness to use the actual activity rather than accruals to manipulate the reported gains. This idea supported by recent research, and showing that confidence about performance in future can lead leaders to manage earnings because they overvalue their ability to offset the management of current-period earns through strong performance in future Schrand and Zechman (2012). Moreover, although companies can effectively filter or monitor hopeful leaders as reported by Schrand and Zechman (2012) this approach cannot decrease the optimism that varies systematically according to the factors Environmental. Understanding that how the important attributes of the account parameters disturb the optimism is significant step in identify to other interferences that might be more effectively.

In both instances, the optimism generated by the horizon could put managers on a "slippery slope" where comparatively benign management of earning is intensified over time Schrand and Zechman (2012).

Previous research which is related to the work of accounting suggested that increases in optimism of propensity is the problem for the managers positive estimates Libby and Rennekamp (2012). In the other cases, managers could turn to real earnings management when they may expect that earnings from the current period will not be covered by a compensation objective (Graham et al., 2005). Because in future if performance periods are enough to reward for future inversions then the net benefits for management of earning are likely to be higher horizon-induced the optimism could extend both kind of management of earning by managers leading to overrate these net benefits (Myers et al., 2007).

In the study of Healy and Wahlen (1999) management of earning arises when managers usage discretionary power for financial report to misinform stakeholders about the fundamental performance or influence contract results that depend on the accounting performance. The motivations for the management of profits can be derived from 1) the expectations of the capital market and 2) the written contracts in relations of accounting performance. For private companies, the final latter is obviously the main motivation. According to another study literature displays that companies can use both accrual accounting and real management of earnings to improve performance of accounting Badertscher (2011).

Unlikely accrual-based management of earning, which purpose to obscure economic performance by changing methods of accounting, real management of earnings modifies the implementation of real business transactions for achieve short-term objectives performance Roychowdhury (2006).

Research also studied whether companies are more engage in management of earning when they are close to violating debt restrictive agreements like payment of dividend constraints and new issuance debt limitations DeAngelo and Skinner (1994). According to (Chaney et al., 2011) indicated that politically related companies have low quality of accounts, and they conjecturing that political ties can be used to protect businesses from penalization for low-quality declared incomes.

The possibility of receiving political safety when engaged in management earning could be stronger when managers themselves are politicians, because they have power as a political and as well as prestige.

Additionally, a research by (Braam et al., 2015) political related companies are likely more to use real management earnings because the manipulation of actual activities is not under the inspection of audit rules. In the previous literature mention that there are three main tools to observe the magnitude of management earning through actual activities: abnormal cash flows, abnormal costs of production and abnormal expenses of discretionary Cohen and Zarowin (2010).

It also demonstrations that industrial mixture and global change helps alleviate management of earning by 2.5% and that global change does not effect on management of earning. On the other hand, Farooqi Harris (2014) point out that diversified global enterprises mitigate manipulated activities while industrial modification and industrial mixture and global changing exacerbate it. The results of this research shown that real management earnings are a reduction in value and that globally diversified enterprises have fewer pips than diversified industrial enterprises.

Roychowdhury (2006) carefully considered that managers manipulated financial statistics to avoid losses of annual report by provisionally increasing sales and lowering the cost of sold goods. According to his study, the reality of receivables, debts and inventories, and opportunities for growth are undoubtedly linked to the manipulation of real events. Another study shows that the strength information of asymmetric has bigger through diversification and then increase in debt and asymmetry information inspires managers to impact on earnings. A researcher found that differentiated companies had more expected values rather than single-segment enterprises Servaes (1996).

Despite the fact that (Fields et al., 2001) audit bookkeeping decision inquire about articles, their characterization is additionally valuable for profit the executives contemplates. "In spite of the fact that not all bookkeeping decisions include income the executives, and the term profit the board reaches out past bookkeeping decision, the ramifications of bookkeeping decision to accomplish an objective

are predictable with the possibility of profit the executives". They sorted out the bookkeeping decision writing into three gatherings dependent on the same number of market blemishes: office costs, data asymmetries and externalities influencing non-contracting parties. By and by, the thought processes in profit the executives were made obvious. Administrators need to impact the result of agreements (for example pay assentions and obligation pledges), stock costs and approaches of outsiders (for example charges, industry explicit directions). They contended that advancement in the field of bookkeeping decision has impeded. They characterized three fields for further research: estimating the ramifications of elective bookkeeping strategies, building diagnostic models that give direction to empiricists, planning all the more dominant factual procedures and enhancing research structures.

This last issue is the primary subject of the survey paper by McNichols (2000). She talked about the qualities of the three most ordinarily connected plans in the income the executives writing: total accumulations models, explicit collections models and the recurrence dispersion approach. One of the principle contentions against utilizing total gatherings models is that we don't have enough learning on how these accumulations act without income the executives. That is one reason why McNichols contended that advancement in profit the executives research would originate from explicit gatherings look into. The recurrence circulations (of various income measurements) approach presented by Burgstahler and Dichev (1997) is another frequently utilized strategy to recognize organizations who are believed to deal with their profit and those organizations who are likely not. This strategy, albeit very simple to incorporate, is likewise being censured.

The examination uncovers that income the executives is decidedly identified with the measure of the directorate. This backing the view that bigger sheets give off an impression of being insufficient in their oversight obligations with respect to littler sheets. A conceivable clarification for the irrelevant connection between other corporate administration systems (freedom of board and review council) and income the board is that the governing body is viewed as incapable in releasing their observing obligations because of the executives strength over board matters.

The evident purpose behind this wonder is credited to the governing body relative absence of learning in organization's undertakings. The investigation likewise discovered that ethnicity (race) has no impact in relieving profit the board, perhaps because of the more individualistic conduct of the Bumiputra chiefs. The modernization of Malaysia and furthermore the expansion in Bumiputra responsibility for riches may have made the Malays be increasingly individualistic, like their Chinese partner. Rashidah Abdul Rahman (2006) before tending to such quirks, we have to characterize privately-owned companies. The writing proposes a few distinct definitions, in light of various criteria, for example, level of possession, key control, inclusion of the family in the everyday exercises Astrachan and Shanker (2003).

Family firms are normally described by a cozy connection among directors and controlling family. This component can be breaking down from both hypothesis points of view. The organization related writing stresses that in family firms chiefs are picked more based on close to home connections than on a look for the best competitor (Brunello et al., 2003).

A second imperative component of family firms is that the controlling investors typically go for keeping their interest in the long term. "Founding families are a one of a kind class of financial specialists. The mix of undiversified family possessions, the craving to pass the firm onto consequent ages, and worries over family and firm notoriety recommend that family investors are more probable than different investors to esteem firm survival over strict adherence to riches augmentation" (Anderson et al., 2003).

We additionally locate that transient stocks alternatives held by non-official advisory group individuals are related with salary expanding income the board. Salary diminishing income the executives is contrarily connected with the nearness of something like a part with money related ability and an unmistakable order for administering both the fiscal summaries and the outside review.

For the directorate, we find less pay expanding income the board in firms whose outside board individuals have understanding as board individuals with the firm and with different firms. We likewise locate that bigger board, the significance of the proprietorship stakes in the firm held by non-official chiefs, and experience

as board individuals appears to lessen pay diminishing profit management Sonda (2001). Corporate administration (CG) components ensure financial specialists that they will get sufficient profit for their venture Shleifer and Vishny (1986). Accordingly, it legitimizes the need for this investigation to push into the capacity of the CG systems in beating income the board (EM) with the goal that solid budget reports could be created. EM happens when chiefs use judgment in money related announcing and in organizing exchanges to modify monetary reports to either misdirect some partner about the hidden financial execution of the organization, or to impact legally binding results that rely upon revealed bookkeeping numbers Healy and Wahlen, (1999).

Likewise, control factors that have noteworthy effect on an organization's capacity and penchant to take part in EM are additionally included. These incorporate; right off the bat benefit. (Saleh et al., 2005) express that organization which is making misfortunes would tend to be engaged with EM exercises. Also is the organization measure. Che-Ahmad and Mansor (2009) find that littler size organizations tend to be associated with salary smoothing exercises as their activities would not be examined. Thirdly is the obligation. Organizations that utilization elevated amounts of obligation are presented to expand dimensions of institutional checking, which would diminish the organization's capacity to deal with its profit (Becker et al., 1998). The principle expectations are that in contrast with the last mentioned, family firms are less delicate to income smoothing inspirations, while they are comparably spurred to oversee profit for obligation agreement reasons. The closer connections among officials and the controlling family (Brunello et al., 2003).

Direct CEO introduction to the stock costs of their organizations expanded significantly amid the 1990s. Corridor and Liebman (1998) demonstrate that the middle presentation of CEO riches to firm esteem tripled somewhere in the range of 1980 and 1994. This change came in light of the conviction that chiefs were under-boosted, just as to changes in the duty code that expanded the appeal of

execution-based pay, for example, stipends of stock and options. These progressions may have disheartened specific sorts of inefficient 'realm building, for example, those recorded by Jensen (1993). This paper presents proof, in any case, that very boosted CEOs additionally occupied with larger amounts of profit control.

Collins and Hribar (2002) recommend that a support portfolio system abusing the overvaluation of accumulations earned unusual two-quarter holding period returns of roughly 6 percent over the period somewhere in the range of 1988 and 1997.

There is additionally proof that chiefs control income amid periods when they or their organizations are pitching offers to capital markets. Beneish and Vargus (2002) break down collections, insider deals, and consequent profit. They find that times of exceptionally high gatherings are related with offers of offers by insiders, and they locate that low profit and stock returns pursue the times of high collections that are joined by insider deals. Bergstresser, Desai and Rauh (2004) demonstrate that organizations with characterized advantage annuity designs make especially forceful suspicions about these plans' profits amid periods where their officials are practicing investment opportunities. A lot of papers from Teoh, Welch, and Wong (1998a, 1998b), demonstrate that underlying and auxiliary open contributions of offers by firms that seem to have controlled income around the offering year see significantly more terrible execution than different contributions. At last, Burns and Kedia (2003) find that income repetitions are increasingly normal at firms where CEOs have bigger choices portfolios. This paper presents proof that accumulations-based proportions of profit the board are higher at firms with more elevated amounts of stock-based motivators. This outcome supplements the current writing, specifically the papers by Burns and Kedia and Beneish and Vargus. Consumes and Kedia center around profit repetitions; our paper supplements theirs by concentrating on collections-based proportions of income the executives. Likewise, the finding that times of high accumulations harmonize with abnormal amounts of CEO alternative exercise and more elevated amounts of CEO and insider share deal broadens and supplements Beneish and Vargus (2001).

This paper expands one a player in their outcomes by concentrating on an assortment of proportions of insider alternative exercise and offer deals, and by displaying an examination of insider deals that controls unequivocally for firm qualities. An outcome is that directors may just utilize gathering income the executives as a possibility plan despite the fact that the counterbalancing accumulation speculation proposes that low-expanded firms are in a superior position to oversee collection gaining. Likewise, as clarified in the free income speculation, venture openings are bounteous at the low dimensions of expansion, so it might be simpler for administrators to legitimize their cut in genuine exercises spending, for example, promoting or R&D. The data asymmetry theory additionally proposes that uninformed asymmetry at a low dimension of broadening may make gathering control simpler to distinguish, given that such chiefs might not have any desire to utilize optional collections to oversee income. The balancing accumulation theory by and large is increasingly applicable to clarify the gathering gaining the executives. As needs be, when dimensions of expansion increment, the effect of counterbalancing collection expands which prompts lower dimension of gathering procuring the board. At low 8 dimensions of broadening, chiefs may depend more on genuine income the board than accumulation profit the executives.

Strangely, we find that income declarations in 2008 reduction data asymmetry in respect to prior periods and that this decline exists just for banks and not for modern firms. Specifically, we find that bank profit declarations decrease spreads by around 11% in 2008 with respect to different periods. In consequent tests, we find that these reductions are driven by huge banks which are bound to be the focal point of administrative intercession. Interestingly, little banks experience increments in offer ask spreads in 2008. We locate that extensive banks perceive increasingly undiscovered misfortunes on securities accessible available to be purchased, acknowledge misfortunes on securities accessible available to be purchased and have more elevated amounts of credit misfortune arrangements. These outcomes are reliable with the political cost speculation of Watts and Zimmerman (1978, 1986), and recommend that administrative enthusiasm for bank budget reports in 2008 is related with more prominent misfortune acknowledgment and

higher misfortune arrangements which result in lower data asymmetry after profit declarations.

Recently investigators (Dechow et al., 2012) reviewed accrual-based management earning by introducing a new method that simultaneously increases power of test and provisions. According to their research, the management of remuneration based on accrual accounting of a period must reverse in another period and if the inspector has perfectly foreseen the period during which management of earning takes place and opposites, the test ability to the management of earnings will be increased by more than 40% by incorporating recoveries. Again, according to them, examined value in industrial and globally diversified enterprises. They found a surplus value which reduced by increasing in globally changing and vice versa. They found diversification in industry with destructive farm value while geographic diversifications positively add value to the business. They concluded at the end that the strong link between value, productivity and capital expenses has had a positive impact on geographically diversified companies. In the end, there is no link between diversification and the value of degree diversification, whereas; diversification according to geographic is definitely related to global diversification.

Studies over the past two decades have provided important information about diversification is negatively connected with ownership of equity, but that they have a positive relationship with the size of the firm. They were founded that outside block operators had no influence on the value of diversification, but that they created an alarming situation as to the level of diversification. As a result, the agency's problems diminished the diversification value in companies with incompetent management property while block holders had no role to play in reducing problems of agency in these companies (Yeo et al., 2002).

In this study, Chen and Steiner (2000) investigation that, increasing the cash flow of discretionary and property of management leads to greater diversification in businesses. They summarizing that risk aversion, increases in managerial ownership and wealth transfer are declining. Furthermore, managers of business are trying sometimes to minimize earning for reduce tax obligations and sometimes

also avoid costs of dogmatic when the business is having good time. Earning managements are used to operate previous stock prices to granting of stock decisions since the stock decision encourages management to depress the stock price before the date of award (Balsam et al., 2007).

Another researcher Beatty (1998) reported that more businesses were displaying a short-term increase in earnings compared to a larger number of firms showing low-earning decreases. According to ANH and Linh (2016) when managers are using good decision role in financial reporting then at this point the earning management was occurring and in constructing transactions to modify financially reports to misinform certain parties on the underlying performance of economically (company or to impact the contractual outcome that depend on the accounting figures of reporting.

According to Clarke, Fee and Thomas (2004) suggested that firms concentrated have a less severe asymmetry problem than the diversified average enterprise. They summarizing that the information of asymmetry is very comparable in individual diversified and concentrated enterprises. Therefore Richardson (2000) discover in his study that managers or leaders were proactive in keeping personal information about the company's cash flows that the owners did not simply because of the information existence between stockholders and leaders or managers, which allowed for the management of earnings.

2.3 Hypothesis

H_1. There is a positive impact of corporate diversification on earnings management.

H_2. There is a negative impact of corporate diversification on earnings management.

Chapter 3

Data and Methodology

The Data and Methodology of present research work entitled Impact of Corporate Diversification and Earnings Management Evidence from Pakistan. This section of study represents the source from which data has been collected and how the results are derived. Study focused that which methodology suits on the data available in hand.

3.1 Data Description

Data for this study is Pakistani stock exchange. Study uses data for eight years from the year 2009-2016. The study aims to explore the effect of corporate diversification on earnings management.

3.2 Sample

The sample has been selected from the PSX 100 index. Only non-financial companies have been selected. Study excludes all companies which are:

1. Financial companies (because their capital structure is different).
2. Companies for which the data could not be found.

Data has been collected from the annual reports, for each firm year. Other data taken from the financial reports (balance sheets, income statements, statements of cash flows) accessible on the firms official websites. Stock market data are collected from PSX, Website. While data is also collected from the State Bank website.

3.3 Variable Construction

Topic of this study suggests that to estimate the corporate diversification study used Information asymmetry, agency conflict, operating risk, Investment and firm Size. Earning management measure through cross sectional jones model.

3.3.1 Dependent Variable

Dependent variable is Earning management to evaluate the impact of corporate diversification. There are two opinions which discussed earnings management. Lipe (1990) described earning management practices decrease the variability of earnings and, therefore that abnormal accruals over time tend to inverse and are readily detected by investors.

The second view Schipper and Vincent (2003) is here, stockholders advantage because the decrease uncertainty and better probability of upcoming earnings support in enhancing price earnings multiples.

3.3.2 Independent Variable

The idea of corporate diversification is based on how a firm invest in diverse business. Diversification is not only encouraging managers to invest and create manipulating accounting environment. Empirical evidence on the role of corporate diversification in easing or exacerbating earnings management is sparse and inconclusive. In fact, to knowledge, only the work attempts to describe this issue (Jiraporn et al., 2008).

3.3.3 Measurement of Dependent Variable

Accruals used as a proxy for earnings management. These accruals can be measured through balance sheet approach. Numerous methodologies have been developed to measure earnings management properly. The model recommended by Jones (1991) is contemplate a milestone in the accrual approaches.

3.3.4 Variables Measurement

TABLE 3.1: Variables Measurement

		Variable Name	Measurement
DV	**Earning Management**	Discretionary Accruals	Cross Sectional Jones model
IV	**Corporate Diversification**	Information Asymmetry	$MBR = \frac{market\ capitalization}{Total\ book\ value}$
		Operating Risk	Risk= $\frac{Sd\ of\ Net\ Income}{Total\ Sales}$
		Investment	CAPEX= $\frac{Capital\ Expence}{Total\ Assets}$
		Firm Size	LNASSETS
		Agency Conflict	$FCF = \frac{income\ before\ DEP - Interest\ exp - T.Taxes - Div}{Total\ Assets}$

3.3.5 List of Abbreviation

- Discretionary Accruals (DiscAcc)
- Market to book ratio (MB Ratio)
- Standard deviation (SD)
- Capital expenditures (Capex)
- Logarithm of total assets (LNASSETS)
- Free cash flow (FCF)

- Interest expense (Interest exp)
- Total taxes (T.Taxes)
- Dividend (Div)

3.3.6 Measurement of Independent Variables

Information asymmetry deals with the research of decisions in proceedings where one party receives more or better information than the other. The first is information asymmetry. Information asymmetry is estimated by market-to book ratio.

In the second analysis, they shape on their empirical model of EPU (Economic policy Uncertainty) and information asymmetry by testing how EPU affects investors response to earnings surprises. They find decreased quarterly earnings announcement returns for the same earnings surprise during periods of increased EPU Pastor and Stambaugh (2003).

The second variable is agency conflict measured by free cash-flow (FCF), Doukas and Pantzalis (2003) apply these two measures to check the effect of agency problems on capital structure of expanded companies. This statement is consistent with family controller, decreasing the representation problem (Problems between executives and shareholders). Therefore, earnings management is highly existing in those countries where business is family oriented and there is very weak protection for investors. There is another issue common stakeholders dominant to smaller investors Fan and Wong (2002).

The other is operating risk (RISK). According to Kim and Pantzalis (2003), operating risk is calculated through "standard deviation of the ratio of net income before extra-ordinary items to sales over the preceding four years". Research also mix the instability of operating cash-flows, estimated by "standard deviation of the ratio of operating cash-flows to total asset over the preceding four years". The operating cash-flows volatility (OCFV) is often used as a proxy for business risk.

In this study OCFV has been used as a proxy of business risk. While OCFV has been taken from annual report of each company.

Bush (1998) described that some managers manipulate research and development investment to take on short-term earnings target; hence, these managers are actively affected investors through their narrow-minded investment action in research and development. However, research and development investment are also a tool for firms to smooth their earnings, or firms may raise their profits by reducing research and development expenses. Previous literature suggests a negative relationship between CSR and earnings management Gary A. Patterson (2018).

The last is the firm size. The size is computed through a log of total asset (LNASSET). In other words, size is one of the elements that bear on the managerial organization of a firm, which in bend causes an impact on efficiency (Lin et al., 2005).

3.4 Model Specification

Judgment of this method total accruals can be calculated by applying the following pattern: Healey (1985) and Jones (1991).

$$TA = \alpha + \beta_1(\Delta Sales_{it} - 1(1-k)\Delta REC_{it}) + \beta_2 PPE_{it} + \beta_3 logTA_{it} + \beta_4 GRSales_{it} + \varepsilon_{it} \;..\; 3.1$$

3.4.1 Abbreviation List

- Total Accrual (TA)
- Receivables (REC)
- Property Plan Equipment (PPE)
- Growth Sales (GRSALES)

(ΔSales-(1-K)ΔREC) is the change between the variation in total sales (ΔSales: the variation in total sales from the earlier year to the existing year) and predictable variation in accounts receivable (ΔREC is the change in accounts receivable from the start to the end of the year). This expected variation is determined via the slope coefficient (k) from this regression.

$$\Delta REC_{it} = \alpha + K\Delta Sales_{it} + \varepsilon_{it} \quad \text{3.2}$$

3.5 Econometric Approach

Our empirical methodology consists of two stages aimed at determining the above hypothesis. To measure the independent variables, we used panel regression including dummy variables which is focused domestic, focused multinational, domestic diversified and diversified multinational. Univariate and multivariate has been used in this study.

$$(\text{Discacc})_i = \sum_{\alpha=1}^{4} \alpha\,(\text{Diversification Variables: FD, FM, DD, DM}) + \beta_1 \text{MB}_\text{i} + \beta_2 \text{FCF}_\text{i} + \beta_3 \text{OCFV}_\text{i} + \beta_4 \text{Risk}_\text{i} + \beta_5 \text{Capex}_i + \beta_6 \text{LNAssest}_\text{i} + \epsilon_\text{i}$$

3.5.1 Abbreviation List

(DISACC) the absolute value of discretionary accruals.

FD	1 if the firm is focused and domestic, then 0
FM	1 if the firm is focused and multinational, then 0
DD	1 if the firm is diversified and domestic, then 0
DM	1 if the firm is diversified and multinational, then 0

Chapter 4

Results and Discussion

The result and discussion of the present research work entitled "Corporate Diversification and Earnings Management Evidence from Pakistan." Is as follows:

4.1 Descriptive Statistics

The following table 4.1 describes the data behavior of this research for the time period of 2009 to 2016. Data's behavior is conducted to ensure that data is accurate and study can use this data for other tests to measure all the models. Descriptive statistics show the complete pattern of data including the dependent and all independent variables. The descriptive statistics have the mean and standard deviation. The value of mean shows the average behavior of all variables. Standard deviation indicates deviation of data from the mean. The descriptive statistics of this study are given below in table 4.1.

Table comprises of different descriptive results which shows that average return of Firm Size (LNASSET) is 10.39 percent during the period at average risk 1.01 Standard deviation shows how far observations are from the sample average the maximum value of LNASSET is 12.81 while its minimum value is 7.16. in the table 4.1 information asymmetry (MB) ratio shows that average return for the period is 12.84 percent and its standard deviation 2.165 which shows that how much risk is involved during the period.

TABLE 4.1: Descriptive Statistics

	DISCACC	LNASSET	MB	FCF	OCFV	RISK	CAPEX
Mean	0.143	10.39	12.849	7.334	14.497	13.373	-4.462
Median	0.08	10.55	12.93	7.55	14.65	13.565	-4.105
Maximum	1.85	12.81	18.57	13.06	22.2	16.96	-2.05
Minimum	0	7.16	6.95	2.37	7.19	7.754	-10.56
Std. Dev.	0.244	1.01	2.165	1.553	2.164	1.667	1.517
Skewness	5.044	-0.445	-0.12	-0.294	-0.612	-0.518	-1.135
Kurtosis	31.521	3.376	2.72	4.196	5.324	3.555	4.24

Its minimum value is 6.9 percent while maximum return is 18.57 percent. Mean value of agency problem (FCF) is 7.33 percent which tells us about the average return for a specific time period. Minimum return of FCF is 2.37 percent while its maximum return is 13.06 percent. Risk associated with FCF during the period is 1.55 percent. Risk involve in Operating cash flow volatility (OCFV) is 2.16 percent its average return 14.49 percent and minimum return is 7.19 percent while maximum return is 22.2 percent. Value of standard deviation 1.66 percent for the risk and its average return 13.37 percent for the time period. Minimum and maximum return in case of risk is 7.75 percent and 16.96 percent consecutively. Risk associated with Investment (CAPEX) is 1.15 percent with average return -4.46 percent. Its middle value is -4.10.

4.2 Correlation Analysis

Correlation analysis uses to investigate the relation between dependent and independent variable that includes in this study. Results of correlation reports in table 4.2.

The range of the correlation is -1 to +1 which shows the correlation between variables. Below 0 value shows the negative relation and positive values shows positive relation.

TABLE 4.2: Correlation Analysis

	DISCACC	LNASSET	MB	FCF	OCF	RISK	CAPEX
DISCACC	1						
LNASSET	-0.275	1					
MB	0.153	0.231	1				
FCF	0.062	0.665	0.281	1			
OCF	0.099	0.022	0.092	0.081	1		
RISK	0.155	0.204	0.415	0.092	0.215	1	
CAPEX	0.02	0.159	0.219	0.034	0.1	0.143	1

All the variables are positively corelated with one another while discretionary accruals and LNASSET have negatively correlated. Highest correlation exists between LNASSET and FCF which is 0.66 percent.

4.3 Regression Model 1

TABLE 4.3: Regression of the Absolute Value of DISCACC on Corporate Diversification (Model 1)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.744	0.28	2.659	0.008
FD	-0.116	0.046	-2.5	0.013
LNASSET	-0.149	0.025	-5.842	0
MB	0.013	0.01	1.367	0.173
FCF	0.063	0.016	3.755	0
OCFV	0.003	0.008	0.351	0.725
RISK	0.027	0.012	2.196	0.029
CAPEX	0.003	0.012	0.275	0.783
R-squared	0.286			
Adjusted R-squared	0.246			
F-statistic	7.123			
Prob(F-statistic)	0			

The study uses five models for regression analysis. It is a set of statistical procedure for measuring the relationship among variable regression includes many techniques for modeling and analyzing several variables. Regression analysis helps one understand how the typical value of dependent variable changes when one of the independent variables varied. Model 1 includes discretionary accruals as dependent variable. Results from model 1 are above in table 4.3.

Table 4.3 reports, statistical results for model 1. In model 1 study use FD as a dummy variable. FD is negative but significant at -0.116**. Which is negatively impact on earnings management. While looking at coefficient values we can see that LNASSET (Firm Size) has a negative but significant at -0.149***. Its means there is a negative impact on the earning management. Results shows that Firm Size decreases the earning management. That means discretionary accruals have t444a significant relationship with LNASSET. On the other hand, MB (Information asymmetry) is insignificant value 0.013. its mean there is no effect on dependent variable. While free cash flow has a positive and significant value 0.063***. According to this study FCF (Agency Problem) positively impact on the dependent variable that shows agency problem increases the earnings management. OCFV has a coefficient of 0.003 that shows it is positively insignificant with dependent variable it is aligned with previous studies (Trueman and Titan 1988). Risk has a positive and significant coefficient value 0.027**. Results show that risk positively impact on earnings management. Risk increases the earnings management. On the other hand, Capex (Investment) has a positive and insignificant coefficient value 0.003. Capex has no impact on earnings management.

F statistic predict the impact of the whole model. R- Square shows that how much change in explained in dependent variable due to independent variables. Modification or adjustment in other factors are shown by the adjusted R square. Statistics shows all about the appropriateness of the hypothesis. R- Square shows that 0.286 percent change in dependent variable due to independent variables.

4.4 Regression Model 2

Model 2 use FM as a dummy variable. FM (1 if firms are focused and multinational otherwise 0). While discretionary accruals are used as the dependent variable. Table 4.4 reports the result of model 2.

TABLE 4.4: Regression of the absolute value of DISCACC on corporate diversification dummy (Model 2)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.742	0.286	2.589	0.01
FM	-0.026	0.062	-0.427	0.67
LNASSET	-0.154	0.026	-5.912	0.000
MB	0.008	0.01	0.793	0.428
FCF	0.07	0.017	4.119	0.000
OCFV	0.003	0.009	0.352	0.725
RISK	0.028	0.013	2.211	0.028
CAPEX	0.01	0.013	0.776	0.438
R-squared	0.251			
Adjusted R-squared	0.209			
F-statistic	5.965			
Prob(F-statistic)	0			

Table 4.4 reports result for model 2 as discussed earlier study uses dummy variables and in model 2 study uses FM (focused and multinational) firms. Result for these firms are not positively aligned. Coefficient for FM is -0.026 that shows it is insignificant and will not affect to dependent variable. LNASSETS have -0.154*** coefficient that is significant relation with dependent variable. It shows that size decreases the earnings management. MB ratio is positive but insignificant 0.008. so, there is no impact on earnings management. Therefore, FCF is positive and significant value 0.07***. Its mean that FCF (agency problem) increases the earnings management. OCFV value 0.003 is positive but insignificant relationship with discretionary accruals. There is no impact on earnings management. Risk

is positive and significantly effect on earnings management. Risk coefficient value is 0.028***. Risk increases the earnings management. Capex coefficient value is positive 0.01 but insignificant. Its means there is no effect on dependent variable.

F statistic predict the impact of the whole model. R- Square shows that how much change in explained in dependent variable due to independent variables. Modification or adjustment in other factors are shown by the adjusted R square. Statistics shows all about the appropriateness of the hypothesis. R- Square shows that 0.251 percent change in dependent variable due to independent variables.

4.5 Model 3

Model 3 includes DD as dummy variable (Diversified domestic) (if firms is domestic 1 and diversified otherwise 0). Discretionary accruals are used as dependent variable. Table 4.5 reports results for model 3.

TABLE 4.5: Regression of the absolute value of DISCACC on corporate diversification dummies (Model 3)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.763	0.277	2.756	0.006
DD	0.128	0.042	3.022	0.003
LNASSET	-0.151	0.025	-5.993	0.000
MB	0.006	0.009	0.672	0.502
FCF	0.066	0.016	4.040	0.000
OCF	0.000	0.008	0.044	0.964
RISK	0.024	0.012	1.949	0.053
CAPEX	-0.000	0.013	-0.058	0.953
R-squared	0.302			
Adjusted R-squared	0.262			
F-statistic	7.672			
Prob(F-statistic)	0.000			

Table 4.5 reports results for model 3. In model 3 study uses dummy variable DD (domestic and diversified) firms. Results for dummy variable is positively significant. It has 0.128 coefficient that explains model 3 has significant relationship with earnings management. DD dummy variable shows that industrial diversification increases the earnings management. While looking at other variables LNASSETS have -0.151*** coefficient that is significant. It shows that firm size decrease earnings management. While MB ratio is positive but insignificant 0.006, There is no effect on earnings management. FCF have a positive coefficient value 0.066*** and significant. Results shows that FCF (agency problem) increase the earnings management. OCF is positive but insignificant value 0.000. There is no impact on earnings management. RISK is positive and significant value 0.024**. There is a positive effect on earnings management its mean risk increases the earnings management. CAPEX is negative but insignificant value -0.000 there is no effect on dependent variable.

F statistic predict the impact of the whole model. R- Square shows that how much change in explained in dependent variable due to independent variables. Modification or adjustment in other factors are shown by the adjusted R square. Statistics shows all about the appropriateness of the hypothesis. R- Square shows that 0.302 percent change in dependent variable due to independent variables.

4.6 Model 4

Model 4 include DM (diversified and multinational) as a dummy variable (1 if firm is diversified and multinational than 0). Discretionary accruals used as dependent variable. Table 4.6 reports results for model 4.

Table 4.6 reports results for model 4. Study uses DM (diversified multinational) as a dummy variable for this model and other variable. DM has -0.026 that has insignificant relation with dependent variable. If we look at the LNASSET which is negative and significant -0.154***. Its means that LNASSET (firm size) decreases the earnings management. According to other researchers While The size of the board is negatively associated with earning management. The survey

TABLE 4.6: Regression of the absolute value of DISCACC on corporate diversification dummy

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.742	0.286	2.589	0.010
DM	-0.026	0.062	-0.427	0.67
LNASSET	-0.154	0.026	-5.912	0.000
MB	0.008	0.010	0.793	0.428
FCF	0.070	0.017	4.119	0.000
OCFV	0.003	0.009	0.352	0.725
RISK	0.028	0.013	2.211	0.028
CAPEX	0.010	0.013	0.776	0.438
R-squared	0.251			
Adjusted R-squared	0.209			
F-statistic	5.965			
Prob(F-statistic)	0.000			

also concluded that firm size has the opposite influence on earnings management in food and beverage companies in Indonesia Stock Exchange (Usman Ali., 2015).

MB ratio (Asymmetry information) is positive but insignificant coefficient value 0.008. There is no effect on earnings management due to insignificance value. FCF has positive coefficient value and highly significant at 0.070***. FCF (agency problem) increases the earnings management. OCF coefficient value is positive but insignificant 0.003. So, there is no effect on earnings management. Risk has a positively and significantly effect on earnings management because their coefficient value is positive 0.028**. Risk increase the earnings management. Capex has positive but insignificant value 0.010. There is no impact on earnings management.

F statistic predict the impact of the whole model. R- Square shows that how much change in explained in dependent variable due to independent variables. Modification or adjustment in other factors are shown by the adjusted R square.

Statistics shows all about the appropriateness of the hypothesis. R- Square shows that 0.251 percent change in dependent variable due to independent variables.

4.7 Model 5

Model 5 includes 3 dummy variables FD, FM and DD and Discretionary accruals as dependent variables. Table 4.7 reports results of model 5.

TABLE 4.7: Regression of the absolute value of DISCACC on corporate diversification dummies

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.760	0.278	2.729	0.007
FD	-0.058	0.066	-0.877	0.382
FM	-0.036	0.066	-0.544	0.587
DD	0.090	0.059	1.525	0.129
LNASSET	-0.149	0.025	-5.865	0.000
MB	0.008	0.010	0.840	0.402
FCF	0.065	0.016	3.886	0.000
OCFV	0.002	0.009	0.262	0.793
RISK	0.024	0.012	1.956	0.052
CAPEX	0.002	0.013	0.020	0.983
R-squared	0.306			
Adjusted R-squared	0.255			
F-statistic	6.001			
Prob(F-statistic)	0.000			

Table 4.7 reports model fives results. Study uses three dummy variables for this model. FD (focused Domestic), DD (Diversified domestic) and FM (Focused multinational). Results are FD dummy variable is negative but insignificant -0.058. FM is negative but insignificant -0.036. There is no effect on dependent variable. DD is positive and insignificant at 0.090. LNASSET (firm size) has negative and significant at -0.149***. Firm size decreases the earnings management. The other study results show level of earning regression variation in earnings. Firm

size measure through probit and its negatively impact on earnings management at significant level 0.005. Z value shows firms which are small lead to more possibility of positive earnings (Yangseon Kim et al., 2003). MB ratio (information asymmetry) has positive coefficient but insignificant 0.008. FCF (agency problem) has positive but significant at 0.065***. Its mean that FCF increase the earnings management. However, (Vince Ratnawati et al., 2015) finding of this study did not display that agency conflict high then exercise of earnings management low due positive beta. Shleifer and Vishny (1997) describe that stockholders which are from large firms they perform and control better than those stockholders which from small firms.

OCFV (operating cashflow volatility) has a positive but insignificant value 0.002. OCFV has no effect on earnings management. The value of Risk is positive and significant at level of 0.024**. Its mean that there is a positive relation with independent variable. So, risk increase the earnings management. Lastly, all forms of risk appear positive effect on earning management. Further risk will high, the managers motivation also high towards the earnings management. Executives try to display their skills to attract the new stockholders with a high degree of risk. More risk outcomes in a burden on the executives, imposing them to maintain the probable outcomes (Neffati et al., 2011). Capex has a positive value but insignificant 0.002 there is no impact on earnings management.

The other study results show level of earning regression variation in earnings. Firm size measure through probit and its negatively impact on earnings management at significant level 0.005. Z value shows firms which are small lead to more possibility of positive earnings (Yangseon Kim et al., 2003).

According to other researchers While The size of the board is negatively associated with earning management. The survey also concluded that firm size has the opposite influence on earnings management in food and beverage companies in Indonesia Stock Exchange Usman Ali (2015).

The researchers find out through their negative results it shows that the information asymmetry negatively significant impact on earnings management. Therefore, when information asymmetry is increase then earning management also high. It

means, as increase the information asymmetry possible to decrease earnings management (Pabelan Surakarta et al., 2009).

However, (Vince Ratnawati et al., 2015) finding of this study did not display that agency conflict high then exercise of earnings management low due positive beta. Shleifer and Vishny (1997) describe that stockholders which are from large firms they perform and control better than those stockholders which from small firms.

Lastly, all forms of risk appear positive effect on earning management. Further risk will high, the managers motivation also high towards the earnings management. Executives try to display their skills to attract the new stockholders with a high degree of risk. More risk outcomes in a burden on the executives, imposing them to maintain the probable outcomes (Neffati et al., 2011).

F statistic predict the impact of the whole model. R- Square shows that how much change in explained in dependent variable due to independent variables. Modification or adjustment in other factors are shown by the adjusted R square. Statistics shows all about the appropriateness of the hypothesis. R- Square shows that 0.306 percent change in dependent variable due to independent variables.

Chapter 5

Conclusion and Recommendations

5.1 Conclusion

This study is intended to measure the effect of corporate diversification on earnings management. This study uses 8 years data annually for the period of 2009 to 2016 to find the relationship of corporate diversification and earnings management. The sample consists of 100 index, Non-financial companies. The estimation technique involves panel data model a combination of cross section and time series of data.

As previous research has somewhat overlooked the impact of corporate diversification on earnings management and most of the studies are conducted for impact of corporate Governance on earning management on financial firms. But this study is conducted to investigate the impact of corporate diversification on earning management, evidence from Pakistan. Earning management can boost the level of investment.

Results of this study are aligning with the previous results. But some of the results are in contradictory. In the 1st model focused domestic (FD) shows negative and significant relation with earning management. It shows that geographically and industrially diversification decrease earning management. In the 3rd model domestic and diversified (DD) shows positive and significant relation with earnings

management. It shows that industrial diversification increases earnings management. Firm Size (LNASSET) has a negative impact on earnings management in all models its mean that firm size mitigates the earnings management in all models. Agency Problem (FCF) has a positive and significant effect on dependent variable which indicates that agency problems increase the earnings management. . Study is an investigation for identifying how eciently and successfully managed earnings through diversification.

5.2 Future Recommendations

This research can also be done on a broader set for future research. This study can serve as a starting point and with the help of this study further research can be done.

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