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Firm's Motives behind SEOs, Earnings Management, and Performance

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Abstract

This study hypothesizes that financial constraints and financial distress risk can drive firms to report greater earnings around seasoned equity offerings (SEOs) but result in different performance in the long run. We confirm this argument and show that aggressively earnings-managing firms with financial constraints and high distress risk perform well and poorly after SEOs, respectively. These results imply that financially constrained firms fairly signal their post-issue profitability due to the release of operational inflexibility, while those with high distress risk inflate earnings to benefit from greater proceeds. We contribute to the literature by showing that firms with different characteristics convey distinct information in reported earnings around SEOs. This finding reminds auditors to watch firms with defective reporting intention and helps long-run investors select right targets.

Keywords: Seasoned Equity Offerings (SEOs); Earnings Management; Financial Constraints, Financial Distress

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