MITIGATING EARNINGS MANAGEMENT IN TIMES OF ECONOMIC UNCERTAINTY: THE IMPACT OF ANALYSTS' COVERAGE

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ABSTRACT

This study investigates the interplay between analysts' coverage, environmental uncertainty, and earnings management, including accrual management and real earnings management. It focuses on stocks traded on the Shanghai and Shenzhen Stock Exchanges (A-shares) in China between 2010 and 2018. The research reveals a positive relationship between elevated environmental uncertainty and increased levels of earnings management, particularly in the field of real earnings management. Importantly, analysts' coverage emerges as a potent external oversight mechanism, effectively curbing the extent of earnings manipulation, particularly in real earnings management activities. Moreover, analysts' coverage serves to dampen the impact of environmental uncertainty on earnings management, particularly within the realm of real earnings management.

Keywords: *Economic Uncertainty; Analysts' Coverage; Accrual Management; Real Earnings Management*

1. INTRODUCTION

In today's global business arena, achieving and maintaining consistent firm performance to impress the market is increasingly challenging. To manipulate earnings, managers often employ accounting techniques to create financial statements with inflated or smoothed earnings. This practice, known as earnings management, can enhance a company's financial image, creating unfair competition for market participants, including investors. Detecting and disclosing a firm's earnings management activities in a timely manner is crucial to maintain fairness and transparency. Analysts possess the knowledge and skills required to uncover hidden and distorted information within financial statements, shedding light on a company's true financial condition, regardless of its complexity (Dyck, 2010). Thus, analysts' coverage serves as an effective mechanism to mitigate the impact of earnings management. Furthermore, a stable business environment enables management to make more informed strategic decisions, ultimately leading to improved firm performance. Therefore, reducing environmental uncertainty is another viable solution to address the issue of earnings management and its associated consequences. However, accomplishing this in today's competitive global market is unquestionably more challenging than it sounds.

A question arises: Can analysts' coverage effectively curb earnings management in such a complex and uncertain environment? The existing literature does not offer explicit answers to this question. In this study, we aim to bridge this gap by comparing the influence of environmental uncertainty on earnings manipulation, incorporating both accrual management and real earnings management. Additionally, we investigate the role of analysts' coverage in mitigating earnings management within a competitive business environment. Our focus is on companies listed on the Shanghai and Shenzhen Stock Exchanges for A-shares during the period from 2010 to 2018. To achieve this, we employ a two-way fixed effect approach and a group regression method.

Our study contributes to the literature in several ways. First, we integrate analysts' coverage into the unified framework of environmental uncertainty and earnings management, shedding light on a topic that has been somewhat neglected in prior research. Second, while previous studies primarily concentrated on accrual management, we examine both accrual and real earnings management, offering fresh insights into how to curtail management's earnings manipulation practices. Lastly, we explore the regulatory impact of analysts'