Abstract

During the past five years, fourteen financial holding companies have been founded by stock for stock mergers corresponding to the policies and deregulations in Taiwan. Among these M&As transactions, the exchange ratio for each combination, which is determined by the reported earnings in both acquiring and acquired firms, affects the success of the merger most. Therefore, our research focuses on whether financial institutions manage their reported earnings in order to get more favorable price for maximizing their shareholders’ wealth.

From empirical results in Taiwan’s banking industry, we find (1) that the degree of earnings management is much higher in the period prior to M&As announcements given financial institutions in Taiwan are used to manipulating earnings at usual times, (2) that those financial institutions with higher degree of earnings management indeed get more favorable exchange ratios within M&As transactions relative to those with lower degree of earnings management for both acquiring and acquired companies. We also make an investigation for investors’ reactions toward behaviors of earnings management. By focusing on the sample of Taiwan’s financial holding companies, empirical results show that market investors will not punish those financial institutions obtaining better exchange ratios by manipulating reported earnings in the market since they can't see through managers’ tricks on reported earnings.