

The Bright Side of Discretionary Accruals: Evidence from Finance and Innovation

(Grace) Qing Hao , Keming Li 

First published: 09 September 2015

<https://doi.org/10.1111/eufm.12068>

Accessibility issue? [Request accessibility update.](#)

The authors are grateful to three anonymous referees, John Doukas (the Editor), Jay Ritter and Dave Diltz for helpful comments and suggestions. The authors also thank Wendy Jennings for editorial assistance. Grace Hao would like to acknowledge financial support from the College of Business Administration at the University of Texas at Arlington.



ABSTRACT

We find cross-sectional evidence that a financially constrained firm with patentable innovation opportunities can use discretionary accruals to reveal information about the firm's prospects and facilitate its financing activities. Specifically, using firms with patents in the National Bureau of Economic Research (NBER) patent database, we find that among financially constrained firms, higher discretionary accruals are associated with more capital being raised, greater research and development (R&D) expenditures, more patents, more patent citations, and better operating performance in the future. These positive relationships are driven by firms that raise equity capital, especially those that raise equity capital from employees.

References

Aghion, P., Bloom, N., Blundell, R., Griffith, R. and Howitt, P., 'Competition and innovation: an inverted U relationship', *Quarterly Journal of Economics*, Vol. 120, 2005, pp. 701-28.

[Web of Science®](#) 

[Google Scholar](#) 

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

[Google Scholar](#) 

Arya, A., Glover, J. and Sunder, S., ' Are unmanaged earnings always better for shareholders?' *Accounting Horizons*, Vol. 17, 2003, pp. 111-16.

[Google Scholar](#) 

Atanassov, J., ' Do hostile takeovers stifle innovation? Evidence from anti-takeover legislation and corporate patenting', *Journal of Finance*, Vol. 68, 2013, pp. 1097-131.

[Web of Science®](#)  | [Google Scholar](#) 

Bhattacharya, S. and Ritter, J., ' Innovation and communication: Signalling with partial disclosure', *Review of Economic Studies*, Vol. 50, 1983, pp. 331-46.

[Web of Science®](#)  | [Google Scholar](#) 

Bradley, M., Gregg, J. and Han, K., ' On the existence of an optimal capital structure: Theory and evidence', *Journal of Finance*, Vol. 39, 1984, pp. 857-80.

[Web of Science®](#)  | [Google Scholar](#) 

Bradshaw, M., Richardson, S. and Sloan, R., ' The relationship between corporate financing activities, analysts' forecasts and stock returns', *Journal of Accounting and Economics*, Vol. 42, 2006, pp. 53-85.

[Web of Science®](#)  | [Google Scholar](#) 

Brown, J., Martinsson, G. and Peterson, B., ' Do financing constraints matter for R&D?' *European Economic Review*, Vol. 56, 2012, pp. 1512-29.

[Web of Science®](#)  | [Google Scholar](#) 

Brown, J., Fazari, S. and Peterson, B., ' Financing innovation and growth: Cash flow, external equity, and the 1990s R&D boom', *Journal of Finance*, Vol. 64, 2009, pp. 151-85.

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

Chaney, P. and Lewis, C., ' Earnings management and firm valuation under asymmetric information', *Journal of Corporate Finance*, Vol. 1, 1995, pp. 319-45.

[Google Scholar](#) 

Chou, D., Gombola, M. and Liu, F., ' Earnings management and stock performance of reverse leveraged buyouts', *Journal of Financial and Quantitative Analysis*, Vol. 41, 2006, pp. 407-38.

[Web of Science®](#)  | [Google Scholar](#) 

Chung, R., Firth, M. and Kim, J., ' Institutional monitoring and opportunistic earnings management', *Journal of Corporate Finance*, Vol. 8, 2002, pp. 29-48.

[Web of Science®](#)  | [Google Scholar](#) 

Cohen, D., Dey, A. and Lys, T., ' Real and accrual based earnings management in the pre- and post-Sarbanes-Oxley periods', *The Accounting Review*, Vol. 83, 2008, pp. 757-87.

[Web of Science®](#)  | [Google Scholar](#) 

Collins, D. and Hribar, P., ' Errors in estimating accruals: implications for empirical research', *Journal of Accounting Research*, Vol. 40, 2002, pp. 105-34.

[Web of Science®](#)  | [Google Scholar](#) 

Cornell, B. and Shapiro, A., ' Financing corporate growth', *Journal of Applied Corporate Finance*, Vol. 1, 1988, pp. 6-22.

[Google Scholar](#) 

Daniel, N., Denis, D. and Naveen, L., ' Do firms manage earnings to meet dividend thresholds?' *Journal of Accounting and Economics*, Vol. 45, 2008, pp. 2-26.

[Web of Science®](#)  | [Google Scholar](#) 

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

[Web of Science®](#) | [Google Scholar](#)

Dechow, P., Sloan, R. and Sweeney, A., ' Detecting earnings management', *The Accounting Review*, Vol. 70, 1995, pp. 193-225.

[Web of Science®](#) | [Google Scholar](#)

Demski, J., ' Performance measure manipulation', *Contemporary Accounting Research*, Vol. 15, 1998, pp. 261-85.

[Google Scholar](#)

Edmans, A., Goldstein, I. and Jiang, W., ' The real effects of financial markets: the impact of prices on takeovers', *Journal of Finance*, Vol. 67, 2012, pp. 933-71.

[Web of Science®](#) | [Google Scholar](#)

Erickson, M. and Wang, S., ' Earnings management by acquiring firms in stock for stock mergers', *Journal of Accounting and Economics*, Vol. 27, 1999, pp. 149-76.

[Web of Science®](#) | [Google Scholar](#)

Fama, E. and French, K., ' Common risk factors in the returns on stocks and bonds', *Journal of Financial Economics*, Vol. 33, 1993, pp. 3-56.

[Web of Science®](#) | [Google Scholar](#)

Fama, E. and French, K., ' Financing decisions: Who issues stock?' *Journal of Financial Economics*, Vol. 76, 2005, pp. 549-82.

[Web of Science®](#) | [Google Scholar](#)

Franklin, B., 'Raising capital from employees has its positives and negatives', *Jian Small Business Blog*, 2010, <http://blog.jian.com/raising-capital-from-employees-has-its-positives-and-negatives/>.

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

Gerakos, J., ' Discussion of detecting earnings management: a new approach', *Journal of Accounting Research*, Vol. 50, 2012, pp. 335–47.

[Web of Science®](#) [Google Scholar](#)

Gong, G., Louis, H. and Sun, A., ' Earnings management and firm performance following open-market repurchases', *Journal of Finance*, Vol. 63, 2008, pp. 947–86.

[Web of Science®](#) [Google Scholar](#)

Gorodnichenko, Y. and Schnitzer, M., ' Financial constraints and innovation: Why poor countries don't catch up', *Journal of the European Economic Association*, Vol. 11, 2013, pp. 1115–52.

[Web of Science®](#) [Google Scholar](#)

Guay, W., Kothari, S. and Watts, R., ' A market-based evaluation of discretionary accruals models', *Journal of Accounting Research*, Vol. 34, 1996, pp. 83–105.

[Web of Science®](#) [Google Scholar](#)

Hadlock, C. and Pierce, J., ' New evidence on measuring financial constraints: Moving beyond the KZ Index', *Review of Financial Studies*, Vol. 23, 2010, pp. 1909–40.

[Web of Science®](#) [Google Scholar](#)

Hall, B. and Ziedonis, R., 'The patent paradox revisited: an empirical study of patenting in the US semiconductor industry, 1979-1995', *RAND Journal of Economics*, Vol. 32, 2001, pp. 101–28.

[Web of Science®](#) [Google Scholar](#)

Hall, B. and Lerner, J., ' The financing of R&D and innovation', in: B., H. and N. Rosenberg, eds., *Handbook of the Economics of Innovation* (Elsevier-North Holland, 2010).

[Web of Science®](#) [Google Scholar](#)

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

Hao, G., 'Institutional shareholder investment horizons and seasoned equity offerings', *Financial Management*, Vol. 43, 2014, pp. 87-111.

[Web of Science®](#) | [Google Scholar](#)

Hazarika, S., Karpoff, J. and Nahata, R., 'Internal corporate governance, CEO turnover, and earnings management', *Journal of Financial Economics*, Vol. 104, 2012, pp. 44-69.

[Web of Science®](#) | [Google Scholar](#)

He, J. and Tian, X., 'The dark side of analyst coverage: the case of innovation', *Journal of Financial Economics*, Vol. 109, 2013, pp. 858-78.

[Web of Science®](#) | [Google Scholar](#)

Hirshleifer, D., Low, A. and Teoh, S., 'Are overconfident CEOs better innovators?' *Journal of Finance*, Vol. 67, 2012, pp. 1457-98.

[Web of Science®](#) | [Google Scholar](#)

Hirshleifer, D., Hsu, P. and Li, D., 'Innovation efficiency and stock returns', *Journal of Financial Economics*, Vol. 107, 2013, pp. 632-54.

[Web of Science®](#) | [Google Scholar](#)

Hsu, P., Tian, X. and Xu, Y., 'Financial development and innovation: Cross country evidence', *Journal of Financial Economics*, Vol. 112, 2014, pp. 116-35.

[Web of Science®](#) | [Google Scholar](#)

Huberman, G., 'Familiarity breeds investment', *Review of Financial Studies*, Vol. 14, 2001, pp. 659-80.

[Web of Science®](#) | [Google Scholar](#)

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

[Web of Science®](#) | [Google Scholar](#)

Joos, P. and Plesko, G., 'Valuing loss firms', *The Accounting Review*, Vol. **80**, 2005, pp. 847-70.

[Web of Science®](#) | [Google Scholar](#)

Kaplan, S. and Zingales, L., 'Do financial constraints explain why investment is correlated with cash flow?' *Quarterly Journal of Economics*, Vol. **112**, 1997, pp. 169-216.

[Web of Science®](#) | [Google Scholar](#)

Kau, J., Linck, J. and Rubin, P., 'Do managers listen to the market?' *Journal of Corporate Finance*, Vol. **14**, 2008, pp. 347-62.

[Web of Science®](#) | [Google Scholar](#)

Kothari, S., Leone, A. and Wasley, C., 'Performance matched discretionary accrual measures', *Journal of Accounting and Economics*, Vol. **39**, 2005, pp. 163-97.

[Web of Science®](#) | [Google Scholar](#)

Lerner, J., Sorensen, M. and Stromberg, P., 'Private equity and long-run investment: the case of innovation', *Journal of Finance*, Vol. **66**, 2011, pp. 445-77.

[Web of Science®](#) | [Google Scholar](#)

Levine, R., 'Finance and growth: Theory and evidence', in P. Aghion and S. Durlauf eds., *Handbook of Economic Growth* (North-Holland Elsevier Publishers, Amsterdam, 2005).

[Google Scholar](#)

Linck, J., Netter, J. and Shu, T., 'Can managers use discretionary accruals to ease financial constraints? Evidence from discretionary accruals prior to investment', *The Accounting Review*, Vol. **88**, 2013, pp. 2117-43.

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

Louis, H. and Robinson, D., ' Do managers credibly use accruals to signal private information? Evidence from the pricing of discretionary accruals around stock splits', *Journal of Accounting and Economics*, Vol. 39, 2005, pp. 361-80.

[Web of Science®](#) | [Google Scholar](#)

McKeon, S., 'Firm-initiated versus investor-initiated equity issues', Working paper, University of Oregon (2013).

[Google Scholar](#)

Myers, S. and Majluf, N., ' Corporate financing and investment decisions when firms have information that investors do not have', *Journal of Financial Economics*, Vol. 13, 1984, pp. 187-221.

[PubMed](#) | [Web of Science®](#) | [Google Scholar](#)

McNichols, M. and Stubben, S., ' Does earnings management affect firms' investment decisions?' *The Accounting Review*, Vol. 83, 2008, pp. 1571-603.

[Web of Science®](#) | [Google Scholar](#)

O'Connor, M. and Rafferty, M., ' Corporate governance and innovation', *Journal of Financial and Quantitative Analysis*, Vol. 47, 2012, pp. 397-413.

[Web of Science®](#) | [Google Scholar](#)

Petersen, M., ' Estimating standard errors in finance panel data sets: Comparing approaches', *Review of Financial Studies*, Vol. 22, 2009, pp. 435-80.

[Web of Science®](#) | [Google Scholar](#)

Perry, S. and Williams, T., ' Earnings management preceding management buyout offers', *Journal of Accounting and Economics*, Vol. 18, 1994, pp. 157-79.

[Web of Science®](#) | [Google Scholar](#)

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)

Manage Preferences

Accept All

Reject Non-Essential

[Web of Science®](#) | [Google Scholar](#)

Subramanyam, K., ' The pricing of discretionary accruals', *Journal of Accounting and Economics*, Vol. 22, 1996, pp. 249-81.

[Web of Science®](#) | [Google Scholar](#)

Teoh, S., Welch, I. and Wong, T., ' Earnings management and the long-run market performance of initial public offerings', *Journal of Finance*, Vol. 53, 1998a, pp. 1935-74.

[Web of Science®](#) | [Google Scholar](#)

Teoh, S., Welch, I. and Wong, T., ' Earnings management and the post-issue underperformance in seasoned equity offerings', *Journal of Financial Economics*, Vol. 50, 1998b, pp. 63-99.

[Web of Science®](#) | [Google Scholar](#)

Teoh, S., Wong, T. and Rao, G., ' Are accruals during initial public offerings opportunistic?' *Review of Accounting Studies*, Vol. 3, 1998, pp. 175-208.

[CAS](#) | [Google Scholar](#)

Whited, T. and Wu, G. ' Financial constraints risk', *Review of Financial Studies*, Vol. 19, 2006, pp. 531-59.

[Web of Science®](#) | [Google Scholar](#)

Yu, F., ' Analyst coverage and earnings management', *Journal of Financial Economics*, Vol. 88, 2008, pp. 245-71.

[Web of Science®](#) | [Google Scholar](#)

Citing Literature



This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)



Manage Preferences

Accept All

Reject Non-Essential

About Cookies

Manage Cookies

Accessibility

Wiley Research DE&I Statement and Publishing Policies

HELP & SUPPORT

Contact Us

Training and Support

DMCA & Reporting Piracy

Sitemap

OPPORTUNITIES

Subscription Agents

Advertisers & Corporate Partners

CONNECT WITH WILEY

The Wiley Network

Wiley Press Room

Copyright © 1999-2026 John Wiley & Sons, Inc or related companies. All rights reserved, including rights for text and data mining and training of artificial intelligence technologies or similar technologies.

WILEY

This website utilizes technologies such as cookies to enable essential site functionality, as well as for analytics, personalization, and targeted advertising. You may change your settings at any time or accept the default settings. You may close this banner to continue with only essential cookies. [Privacy Policy](#)



Manage Preferences

Accept All

Reject Non-Essential