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# Does founding family control affect earnings management?

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# Notes

- <sup>1</sup> This is analogous to the literature on the board of directors. There is mixed evidence on the association between boards and firm performance. Thus, several studies focus on specific situations rather than on the overall firm performance. For examples, research has been conducted on the impact of boards on CEO turnover (Weisbach, [1988](#); Perry, [2000](#)), on earnings management (Xie et al., 2002) and on executive compensation (Hallock, [1997](#); Core et al., [1999](#)).
- <sup>2</sup> To the extent that shareholders make poor decisions based on managed accounting numbers, earnings management can be classified as an agency cost (Davidson et al., [2004](#)).
- <sup>3</sup> This proportion of family-owned firms is remarkably consistent with Anderson and Reeb ([2003a,b](#); [2004](#)). They find that one-third of their sample is family owned.
- <sup>4</sup> Anderson and Reeb ([2003a,b](#), [2004](#)) make their classification of family firms available to the public. More detailed discussions about the classification can be found in their studies.
- <sup>5</sup> For instance, the Ablon family is perceived as controlling the Ogden Corporation as if they were majority owners but, in actuality, they hold merely 2% of the outstanding shares. (Coughlan and Schmidt, 1985, p. 104) to maintain control.
- <sup>6</sup> We emphasize that the results are not found to be sensitive to the choice of models (see Davidson et al., [1995](#)). In addition, the results are not sensitive to the choice of accruals.' Davidson et al. (1995) model are found to be sensitive to the choice of accruals.
- <sup>7</sup> This approach is used in Davidson et al. (1995) and in Davidson et al. (1998a, b; 1998b).
- <sup>8</sup> Other studies have found that the effect of income-inequality on the growth rate of income-inequality is positive (Becker et al., 1995;

- <sup>9</sup> In a separate regression (data not shown), the raw DCA (not the absolute value) is used. The family firm dummy does not produce a significant coefficient.
- <sup>10</sup> As in Anderson and Reeb ([2003a,b](#), [2004](#)), the magnitude of the reduction in earnings management is computed as the coefficient of the family dummy divided by the average  $|DCA|$  for the sample  $= 0.017/0.047 = 0.36$ .
- <sup>11</sup> Although the  $R^2$ s appear to be low, this should not be particularly problematic for Lev ([1989](#)) finds that a majority of earnings studies exhibit low  $R^2$ s. The  $R^2$ s in this study are comparable to those in other earnings studies. We also make sure that multicollinearity is not a problem. We examine the variance inflation factors (VIF) and find that none of them are higher than 2.
- <sup>12</sup> The fixed-effect approach helps reduce the possibility that the documented relation is caused by unobservable omitted variables, i.e. the fact that the firm is family owned and the extent of earnings management may be driven by some unobservable variables that are not included in the model. The fixed-effects analysis has been found to resolve this potential problem.

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Earnings management and the underperformance of seasoned equity offerings<sup>11</sup>We thank Brad Barber (the referee), Randy Beatty, Vic Bernard, K.C. Chan, Kent Daniel, M. DeFond, Laura Field, David Heike, Chuan Yang Hwang, Jonathan Karpoff, S.P. Kothari, Charles Lee, Wayne Mikkelson (the editor), Tim Opler, Krishna Palepu, K. Ramesh, Jay Ritter, Terry Shevlin, Doug Skinner, Sheridan Titman, Ross Watts, Jerry Zimmerman, and seminar participants at the University of California Finance and Accounting Conference (Davis, March 1995), the NBER Corporate Finance Conference (Boston, August 1995), the Center for Research in Security Prices Conference (Chicago, October 1995), and the American Accounting Association meeting (San Francisco, November 1995).

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