

# Private Equity, Earnings Management and Financial Disclosure

## The Case of Venture-backed Firms in Italy

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### Abstract

Recently, private equity (henceforth PE) investments feature for an ongoing and, at the same time, intriguing debate about the effects generated both for venture backed-firms (henceforth VBFs) and for national economic system. On one side, several scholars fuel the research stream into which PE investments exert a positive influence on VBFs' growth, in terms of performance, managerial "fertilization" and networking capabilities. On the other side, nonetheless, some scholars highlight the negative effects caused by PE investors. In their point of view, PE investor can be assimilated to a "locust" as, in a short-term, he often tends to achieve a huge value creation through the stake owned in the VBF's equity. To this end, he could put in place some strategic choices very risky for VBF's survival (i.e. stripping firm non value-added assets, high recourse to the leverage, etc.).

Nevertheless, it is worthwhile to note that PE investment represents a further alternative for VBF to intercept financial resources useful for the fulfilment of specific strategic goals (i.e. entry in foreign markets, replacement of the management team, etc.). With specific reference to small and medium enterprises (henceforth SMEs) and to some economic contexts of the European Union (henceforth UE) usually defined "bank-centered" systems, PE investments could reveal another opportunity to limit the dependence from the banking "universe".

From the theoretical standpoint, our empirical study draws upon a literature framework amenable to the former research stream above mentioned. In particular, in the managerial "fertilization" vein, we focus our attention on VBFs' financial disclosure policy. Indeed, after having identified that the main literature gap is the scant amount of empirical researches based on Italian context, we aim to investigate the following research question i.e., whether and to what extent, the PE investors affect VBFs' financial disclosure policy. Building on the literature review centered on earnings management, we measure the VBFs' financial disclosure policy through the calculation of the accruals. In more detail, the empirical analysis considers specific determinants, such as the stake percentage owned by the PE investors in the VBF's equity, the PE's nationality, the PE's ownership structure type, the industry into which the VBF works, the deal type and the Italian region where the VBF is located.

To explore the foregoing research question, we posit seven hypotheses into which the key independent variables are the aforementioned determinants, whilst the dependent one is ascribable to the accruals. Moreover, we verified these hypotheses, thanks to a longitudinal panel dataset into which, for each observation, we gathered the accounting data for a time lapse of three years after the deal closing. In other words, our dataset cover the period: 2009-2011, as 2008 is the financial year we selected for the deal closing. Indeed, in Italy, this financial year represented the “hearth” of the economic downturn. Hence, it appeared interesting to examine in depth the role played by the PE investors. Overall, the sample is made up of 237 observations, inherent to 79 Italian VBFs.

From the adoption of bivariate and multivariate analyses, our findings give interesting food for thought, notwithstanding some caveats mostly due to the sample and the time series size. In particular, the empirical evidence of the present study point out that the PE’s ownership structure type is able to influence the VBFs’ financial disclosure policy. In this regard, some vigilance bodies, probably coupled with the standard setters, could put in place effective actions to stimulate the PE investors owned by corporates to enhance the VBFs’ financial disclosure policy. Indeed, these actions could contribute to decrease the information asymmetries and, therefore, to improve the financial context into which the management team should make suitable decisions for the achievement of strategic goals depicted in the corporate strategy.