The role of conditional conservatism on acquirers' stock prices around M&A announcement

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Abstract

Purpose: This study investigates the relationship between conditional conservatism and the market reaction of firms' stock prices in Mergers and Acquisitions (M&A) operations.

Design/methodology/approach: Leveraging a sample of 224 U.S. listed companies and event study methodology, as well as regression models, this study analyses 735 M&A deals from 2010 to 2018.

Findings: We find that conditional conservatism is positively associated with cumulative abnormal returns of acquiring firms post-M&A announcement; moreover, one of the drivers of this result is the information asymmetry channel. Additional analysis also shows that while acquirers with high conditional conservatism experience a positive reaction to M&A announcements, there is no significant reaction for acquirers with low conditional conservatism.

Originality/value: Our main results provide evidence that a high conditional conservatism limits the reduction of acquiring firms' stock prices post-announcement of M&A. Our additional analyses show that low conditional conservatism does not exert a significant negative impact on acquiring firms' stock prices post-announcement of M&A, as would be expected.

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Practical implications: This paper may be useful for both investors and practitioners since it offers interesting insights on how to deal with accounting policies and benefit from M&A transactions. Indeed, if they are informed on how conditional conservatism exerts a role on stock prices, they are less likely to engage in value-destroying M&A transactions. In addition, our results may interest standard setters interested in the role of the conservatism principle under the Generally Accepted Accounting Principles.

Keywords: conditional conservatism, market reaction, stock prices, acquirer firms, M&A, event study

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1. Introduction

Accounting conservatism is generally defined as "*anticipating no profits but anticipating all losses*" (Bliss, 1924), and it is considered one of the most important principles of accounting valuation. For this reason, scholars have investigated several related issues of conservatism (e.g., Pae et al., 2005) such as news-dependent and news-independent conservatism (Chandra, 2011), discretionary and non-discretionary conservatism (Lawrence et al., 2013), as well as conditional and unconditional conservatism (Ball and Shivakumar, 2005; Basu, 2005; Beaver and Ryan, 2005).

The most common approach to accounting conservatism in the literature is conditional conservatism. Conditional conservatism is a news-dependent approach that refers to the asymmetric recognition of bad and good economic news. In particular, conditional conservatism labels when bad news as being recognized faster than good news (Basu, 1997).

Consistent with prior research (e.g., Cui et al., 2021; Tang et al., 2021), we focus on conditional conservatism because it is likely to influence a firm's risks, while unconditional conservatism is a news-independent approach that does not provide information relevant to decision making and is less relevant to contracting (Ball and Shivakumar, 2005).

Therefore, conditional conservatism exerts a significant positive influence on firms' stock returns (e.g., Balakrishnan et al., 2016; Francis and Martin, 2010; Kim and Pevzen, 2010; Kim et al., 2013) because it tends to limit managers' incentives to overstate performance and hide bad news from investors (Kim and Zhang, 2016). This beneficial effect may be of fundamental

importance in merger and acquisition (M&A) operations, as M&A deals affect agency conflicts between managers and shareholders (e.g., Jensen and Meckling, 1976). For example, empirical research investigating market reactions related to M&A operations (e.g., Adnan et al., 2016; Avallone and Roncagliolo; Giosi et al., 2016; Courteau, 2020; Ma et al., 2009; Tang et al., 2016) finds a negative trend in acquirers' long-term abnormal returns after the deal (e.g., Moeller et al., 2005; Savor and Lu, 2009). Despite the importance of accounting conservatism in investors' decisions and capital market valuation (Tang et al., 2021), little is known about whether conditional conservatism may influence acquiring firms' stock prices post-announcement of M&A deals.

Using the event study methodology on a sample of 224 US-listed companies involved in 735 M&A deals from 2010 to 2018, we provide evidence that conditional conservatism positively affects the cumulative abnormal returns of acquiring firms post-M&A announcement.

Additional analyses show that firms adopting high conditional conservatism generate different market reactions than those adopting low conditional conservatism. In particular, we confirm our main analysis, furnishing evidence of a positive reaction to M&A announcements when the acquirer adopts high conditional conservatism. We also demonstrate that this positive effect is not observed when the acquirer adopts low conditional conservatism. Finally, our results show that the differences between the two sub-samples emerge mainly after the event from "*Day 1*" to "*Day 5*".

Additional analyses also demonstrated that one of the drivers of our results is the information asymmetry channel. Hence, we show that conditional conservatism is positively associated with cumulative abnormal returns of acquiring firms post-M&A announcement since it reduces the information asymmetries between the firm and its investors.

This study contributes to the literature in several ways. First, it contributes to the international academic debate on the association between conditional conservatism and stock returns (Balakrishnan et al., 2016; Francis and Martin, 2010; Kim and Pevzen, 2010; Kim et al., 2013). Second, it offers fresh insights into market reaction to M&A announcements (e.g., Adnan et al., 2016; Jory et al., 2020; Ma et al., 2009; Tang et al., 2016) by adopting the perspective of how conditional conservatism influences acquirers' stock returns. Furthermore, this is the first study to investigate the effect of high and low conditional conservatism on acquiring firms' stock prices post-M&A announcement comparatively. In particular, the analysis suggests that high conditional conservatism can limit the reduction of acquiring firms' stock prices post-announcement of M&A. In contrast, a low conditional conserva-

tism does not exert a negative impact on acquiring firms' stock prices post-announcement of M&A. Finally, our results highlight the role of conditional conservatism as a mechanism able to mitigate information asymmetry and increase corporate transparency, enforcing studies supporting the desirability of the conditional conservatism in the financial market.

The remainder of this paper is organized as follows. Section 2 provides an overview of the literature and the development of the hypothesis. Section 3 details the methodology, sample, and data used in this study. Section 4 discusses the empirical results. Section 5 presents additional and robustness tests. Section 6 concludes.

2. Literature review and hypothesis development

Conditional conservatism plays a crucial role in market reaction studies because information asymmetry is positively associated with required equilibrium returns (Easley and O'Hara, 2004). This is because conditional conservatism refers to the tendency to require a higher degree of decision to recognize good news as gains rather than bad news as losses (Basu, 1997). Thus, it mitigates information asymmetry. These arguments are supported by agency theory, which assumes that the principal (i.e., shareholder) and the agent (i.e., manager) have different interests, which, if not adequately managed, can favor opportunistic behavior (Jensen and Meckling, 1976). Conditional conservatism may facilitate monitoring managers' investment decisions, limiting the pursuit of personal benefits (Ball and Shivakumar, 2005). Hence, conditional conservatism policies can reduce agency conflicts between shareholders and managers by reducing information asymmetry, thus aligning their interests (Francis and Martin, 2010). In this regard, LaFond and Roychowdhury (2008) argue that firms with agency problems demand more conservative accounting than other firms and that hard information encourages investors to adopt soft information from different resources to evaluate firms' current and future performance. It has also been stated that conditional conservatism reduces managers' incentives to hide bad news, forcing them to provide hard information to outsiders. Therefore, conditional conservatism plays an informational role in the capital market, which may lead to an increase in firms 'stock prices (LaFond and Watts, 2008).

Several studies have investigated the positive impact of conditional conservatism on investment efficiency (e.g., García Lara et al., 2016), on risk-averse policies (e.g., Biddle and Hilary, 2006) as well as on stock returns

(e.g., Ahmed et al., 2023; Francis and Martin, 2010; Kim and Pevzner, 2010; Kim et al., 2013; Kim and Zhang, 2016).

All of these studies confirm that conditional conservatism positively impacts the market by reducing the negative consequences of information asymmetries. This is particularly significant in the context of M&A deals, as M&As tend to increase agency conflicts between managers and shareholders (e.g., Jensen and Meckling, 1976).

Francis and Martin (2010) show that acquirers adopting a higher degree of timely incorporation of economic losses into earnings have larger acquisition announcement returns. Kim and Pevzner (2010) find that the stock market reacts more strongly to the good earnings news of more conservative firms than to the good earnings news of less conservative firms. Later, Kim et al. (2013) examined the impact of conditional conservatism on the equity market and found that more conservative firms suffer from fewer negative returns during announcements of seasoned equity offerings by mitigating the adverse effects of information asymmetry. Consistently with these studies, Kravet (2014) finds that managers make less risky acquisitions under more conservative accounting practices and that firms with accounting-based debt covenants drive this association. Recently, Ahmed et al. (2023) showed that conditional and unconditional conservatism benefits both sellers and buyers of equity in M&A transactions. In particular, they argue that targets' use of conservatism minimizes acquirers' risk and enhances the production of verifiable information, facilitating more accurate estimation and realization of synergies in the combined firm. In addition, Tang et al. (2021) examined the role of accounting conservatism in M&A target selection, finding that when the M&A control is transferred, and the acquirer exhibits high long-term debt and low manager power, conditional conservatism reduces M&A risks while increasing M&A performance. However, previous studies mainly adopted a partial view of conditional conservatism accounting policies on M&A, or they looked at the effect of conditional conservatism on investors to earnings announcements not related to M&A deals (e.g., Balakrishnan et al., 2016; Kim and Pevzner, 2010; Kim et al., 2013). Therefore, scholars claim that the role of accounting conservatism in the M&A process has not been explored in-depth and requires further investigation (Ahmed et al., 2023; Tang et al., 2021).

Relying on the agency theory, we argue that conditional conservatism can help acquirers' firms increase stock prices following the announcement of the M&A deals. In particular, we expect conditional conservatism to positively impact the market by reducing the information asymmetries between managers and shareholders. Indeed, by ensuring that financial statements reflect a firm's financial health more accurately, conditional conservatism pro-

vides shareholders with clearer and more reliable information. This transparency reduces the uncertainty surrounding a firm's value and managerial actions, increasing investor confidence. As a result, the market is likely to respond positively to M&A announcements by firms practicing conditional conservatism. Investors perceive these firms as less risky and more trustworthy, anticipating that the acquisition decisions will be made with greater diligence and prudence. Therefore, conditional conservatism not only enhances the credibility of financial reporting but also aligns the interests of managers and shareholders, ultimately boosting stock prices post-M&A announcements.

Although information asymmetries may be significant in explaining the positive association between conditional conservatism and market reactions, it is probably not the only one. Indeed, considering that earlier recognition of losses can provide a timely signal to the market on poorly performing acquisitions, it may discourage managers from investing in risky projects and encourage them to make quicker abandonment decisions by referring to losing investments. Hence, conditional conservatism may create incentives for managers to make better acquisition decisions, thus generating a beneficial effect on the acquirer's stock return after the M&A announcement.

All the above arguments lead to formulate and test the following hypothesis:

H1: *Conditional conservatism positively influences the acquiring firm's stock prices post-announcement of M&A deals*

3. Research design

3.1. Sample selection

The sample consists of non-financial firms listed on the New York Stock Exchange (NYSE) involved in M&A deals as acquirers from 2010 to 2018. We exclude financial firms from our sample because their accounting policies differ from those of other firms (García Lara et al., 2016)[1].

We collect and merge data from different data sources. We obtain accounting data from Compustat North America, stock market data from the Center for Research in Security Prices (CRSP), and M&A data from Zephyr for nine years from 2010 to 2018. The choice of this period is motivated by

[1] We consider the following to be financial firms: banks, insurance firms, broker/dealers, real estate, and other financial services. We used the "Industry Format" variable on Compustat to exclude these firms.

the need to exclude the years before 2010, which are closely associated with the global financial crisis in the United States (following Biddle et al., 2022) and the effects of the COVID-19 pandemic, manifested after 2018.

We start our sample selection process by choosing from Compustat North America all non-financial firms listed on the New York Stock Exchange (NYSE). Then, we merged this list of firms (1,327 firms) with the list of M&A events completed between 2010 and 2018 collected by Zephyr. In particular, the deals included in our sample respond to the following criteria:

- To ensure that all acquirers in our sample aim for full control of their targets, we select only acquisitions involving at least 50% of the target equity.
- Following Lipson and Mortal (2007), we include in our sample only M&A operations in which the ratio of the deal value to the bidder's market value of equity (relative deal value) is not less than 10%;
- To avoid sample bias from a heavily debt-financed sample, following Novialdi and Wardhani (2019), we exclude acquisitions with funding sources coming from debt, which is categorized as leverage buy-outs.
- Following Tidbury et al. (2022), for firms with more than one acquisition, we only include deals for which the event periods do not overlap with the pre-acquisition period.

This sample selection procedure leads to a sample of non-financial firms listed on the NYSE from 2010 to 2018 who were acquirers in M&A operations (512 firms). Finally, we excluded firms with missing data (288 firms). Following this procedure, we identify 735 M&A deals in which the selected 224 firms are acquirers.

Table 1 presents the distribution of observations by announcement year.

Table 1 – Event distribution

By Announcement Year		
Year	**N. Events**	**% Events**
2010	237	32,2%
2011	83	11,3%
2012	54	7,3%
2013	62	8,4%
2014	54	7,3%
2015	53	7,2%
2016	68	9,3%
2017	50	6,8%
2018	74	10,1%
Total	735	100%

Note. Table 1 reports the sample distribution by M&A announcement year. The sample consists of 735 US deals from 2010 to 2018. % Events refers to the proportion of the number of acquisitions each year relative to the total number of acquisitions over the sample period.

3.2. Event study

To examine market reactions to announcements of M&A deals, we adopt the standard event study methodology (e.g., Wang et al., 2022; Yong and Laing, 2021). The assumption underlying this methodology is that, given market rationality, the effect of an M&A announcement is immediately reflected in stock prices (Ma et al., 2009).

The event study is designed to evaluate the abnormal returns in the market value of a firm when a specific event occurs (e.g., MacKinlay, 1997). We adopt the market model defined according to the Capital Asset Pricing Model (CAPM) to estimate abnormal returns. The market model ensures a predictive power (Brenner, 1979) and is straightforward to implement and replicable (Binder, 1998).

The normal rate of return is calculated as follow:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \qquad \text{Eq. (1)}$$

Where:

- R_{it} is the return of stock "*i*" on day "*t*"
- R_{mt} is the market return on day "*t*"
- α_i is the intercept of the relationship for stock "*i*"
- β_i measures the sensitivity of stock's return to the market return

Following prior research (e.g., Wang et al., 2022), we chose to estimate $\hat{\alpha}_i$and $\hat{\beta}_i$ over an estimation period of 100 trading days preceding the announcement of the M&A deal. The estimation period excludes the 50 days before the event since information leakage in that period might have affected stock prices. To estimate abnormal returns, firms must have a minimum of 70 stock returns during the 100-day estimation period[2].

We considered the announcement day of an M&A deal as the event day and defined it as "*Day 0*"[3].

The parameters obtained from the regression (Eq. 1) are then used to derive abnormal returns for firm "*i*" on day "*t*" (AR_{it}) by the following equation:

$$AR_{it} = R_{it} - (\hat{\alpha}_i + \hat{\beta}_i R_{mt}) \qquad \text{Eq. (2)}$$

[2] We adopted a minimum of 70 days of return data to estimate the market model parameters to reduce the non-synchronicity bias deriving from daily data with irregular returns.

[3] An event day is the first day when the outbreak of the event is released to the public through media.

Where $(\hat{\alpha}_i + \hat{\beta}_i R_{mt})$ is the estimated expected return for firm "*i*" on day "*t*".

Cumulative abnormal return (CAR) of stock "*i*" in the event period $(t_1 - t_2)$ is computed by:

$$CAR_i(t_1 - t_2) = \sum_{t=t_1}^{t_2} AR_{it} \quad \text{Eq. (3)}$$

Aït-Sahalia *et al.* (2012) argue that limiting the event window reduces the influence of confounding events, while Brown and Warner (1980) highlight that short event windows do not necessarily lead to a better estimation of abnormal returns. Therefore, we provide a series of robustness tests for both event windows and consider potentially confounding events that might affect our results[4].

The events window investigated consists of eleven days (-5,+5). The trading days before the event are denoted as "*Day -1*", "*Day -2*", "*Day -3*", "*Day -4*", and "*Day -5*", while the trading days following the event are denoted as "*Day +1*", "*Day +2*", "*Day +3*", "*Day +4*", "*Day +5*". Considering that the accuracy will be higher when fewer days are included in the event window (MacKinlay, 1997), we also considered shorter windows (-1,+1; -3,+3).

3.3. Cross-sectional analysis of CARs

The model adopted to develop our empirical analysis is as follows:

$$CAR_{i,t} = \delta_1 COND_{i,t-1} + \sum \delta_j Controls_{i,t} + \ Year_{FE} + \ Industry_{FE} + \varepsilon_{i,t} \quad \text{Eq. (4)}$$

Where CARs are calculated as in paragraph 3.2, and CONDt-1 represents the conditional conservatism proxy calculated by adopting the measure proposed by Khan and Watts (2009), which represents an extension of Basu's (1997) model[5]. This measure is based on the intuition that conditional conservatism is influenced by three variables – size, MTB ratio, and leverage –

[4] In this regard Hines et al. (1999) assert that the event study methodology is "*statistically robust except in the case that confounding events are correlated cross sectionally with the event under investigation*" (Hines et al., 1999, p. 66-67).

[5] Previous studies supported the effectiveness of Basu-based metrics in capturing variation in conservatism (Jayaraman and Shivakumar, 2013; García Lara et al., 2020); however, they are not exempt from criticisms (Badia et al., 2021; Dietrich et al., 2023; Harakeh et al., 2024). Hence, we adopted also an alternative proxy for conditional conservatism in order to validate the results in our robustness tests.

that capture the four factors that drive conservatism: contracting, litigation, taxation, and regulation (Watts, 2003). Following Biddle et al. (2022), we calculated the conditional conservatism proxy as the ratio of the sum of the C-Score and G-Score to the G-Score. We considered a one-year lag in the independent variable COND to control endogeneity issues.

We also include a vector of variables in the regression model to control for various firm-specific and deal characteristics that are known to be correlated with conditional conservatism or stock return performance. The former group of control variables, according to the main literature (e.g. Ahmed and Duellman, 2011; Cui et al., 2021; García Lara et al., 2016) includes firm size, firm performance measured by market-to-book ratio (MTB) and by return on assets (ROA), leverage, bankruptcy risk (Z-Score), the proportion of tangible assets (tangibility), operating cash flow to sales (CFO sales), financial slack (slack), dividend payout ratio (dividend), frequency of losses (loss), cash flow ratio (cash ratio). The latter group of control variables, according to the main literature (Lipson and Mortal, 2007; Monaco et al., 2022), includes deal value, deal stock, cross-border acquisition (CBA), cross-sector acquisition (CSA), and types of payment (PAY). A detailed description of the control variables is presented in Table 2.

Table 2 – Control Variables

Variable	Description
Acquirer variables	
Size	The log of the market value of equity
MTB	The ratio of the market value of total assets to the book value of total assets
ROA	The ratio of pretax income divided by total asset
Leverage	A measure of solvency calculated as short-term plus long-term debt scaled by the market value of equity
Tangibility	The ratio of property, plant, and equipment to total assets
CFO sales	The ratio of CFO to sales
Slack	The ratio of cash to net property, plant, and equipment
Dividend	A dummy variable that takes the value of 1 if the firm paid dividends and 0 otherwise
Loss	A dummy variable that takes the value of 1 if net income before extraordinary items is negative and 0 otherwise
Cash ratio	The ratio of cash to total assets
Z-Score	Bankruptcy risk defined in Biddle and Hilary (2006), and based on the methodology of Altman (1968)
Deal variables	
Deal Value	The log of the deal value
Deal stock	A dummy variable that takes value 1 for deals where consideration is 100% stock and 0 otherwise
CBA	A dummy variable that takes value 1 if the target is from a different country with the acquirer and 0 otherwise
CSA	A dummy variable that takes value 1 if the target is from a different sector with the acquirer and 0 otherwise
PAY	A dummy variable that takes value 1 if the deal involves a payment in cash and 0 otherwise

4. Results

4.1. Descriptive statistics

Table 3 presents the descriptive statistics. The results show that the mean value of CARs increases from the shorter to the longer windows, highlighting, on average, a better market reaction after M&A deals for the longer window (-5; +5).

Table 3 – Descriptive statistics

Variable	Obs.	Mean	Std. Dev	Min	Max
CAR (-1, +1)	735	-0.02	0.03	-0.21	0.10
CAR (-3, +3)	735	0.00	0.05	-0.24	0.16
CAR (-5, +5)	735	0.01	0.07	-0.34	0.17
$COND_{t-1}$	735	-0.00	0.01	-0.07	0.06
Size	735	-0.01	0.53	-2.7	1.2
MTB ratio	735	-0.01	0.45	-3.47	4.32
ROA	735	0.00	0.01	-0.02	0.11
Leverage	735	0.00	0.02	-0.25	0.07
Tangibility	735	-0.00	0.02	-0.20	0.07
CFO sales	735	0.16	0.19	-0.92	1.7
Slack	735	0.01	0.24	-0.95	2.82
Dividend	735	0.69	0.46	0	1
Loss	735	0.11	0.32	0	1
Cash ratio	735	-0.00	0.02	-0.22	0.14
Z-score	735	0.00	0.28	-2.55	1.30
Deal Value	735	5.88	0.53	4.15	7.52
Deal stock	735	0.89	0.31	0	1
CBA	735	0.76	0.43	0	1
CSA	735	0.82	0.38	0	1
PAY	735	0.72	0.45	0	1

Note. Table 3 reports the descriptive statistics (mean, standard deviation, minimum and maximum) of the main variables. All continuous variables were winsorized at the 1st and 9th percentiles.

Table 4 presents the Pearson correlations. The only variables with a significantly high correlation are CARs, which are used alternatively in regression models. However, to discard any potential multicollinearity problem, we also performed variance inflation factor (VIF) in the regression analysis. Furthermore, Table 4 shows that the correlation between the conditional conservatism proxy and CARs is negative and significant at 1%, consistent with our expectation of a positive association between conditional conservatism and stock market returns after an M&A deal.

Table 4 – Correlation matrix

	1	2	3	4	5	6	7	8	9	10
CAR (-1, +1)	[a]1.00									
CAR (-3, +3)	[a]0.89***	[a]1.00								
CAR (-5, +5)	[a]0.89***	[a]0.91***	[a]1.00							
$COND_{t-1}$	[a]0.15***	[a]0.11***	[a]0.15***	[a]1.00						
Size	[a]0.33***	[a]0.32***	[a]0.35***	[a]-0.58***	[a]1.00					
MTB	[a]-0.00	[a]0.01	[a]0.01	[a]-0.21	[a]0.32***	[a]1.00				
ROA	[a]-0.39***	[a]-0.33***	[a]-0.37***	[a]0.34***	[a]-0.32***	[a]0.04	[a]1.00			
Leverage	[a]0.42***	[a]0.37***	[a]0.42***	[a]-0.59***	[a]0.73***	[a]0.18	[a]-0.75***	[a]1.00		
Tangibility	[a]0.45***	[a]0.37***	[a]0.46***	[a]-0.49***	[a]0.79***	[a]0.19***	[a]-0.59***	[a]0.67***	[a]1.00	
CFO sales	[a]0.32***	[a]0.25***	[a]0.33***	[a]-0.36***	[a]0.75***	[a]0.25***	[a]-0.09***	[a]0.53***	[a]0.71***	[a]1.00
Slack	[a]0.02	[a]0.04	[a]0.03	[a]-0.17***	[a]0.31***	[a]0.60***	[a]0.08**	[a]0.17***	[a]0.05	[a]0.29***
Dividend	[b]0.01	[b]-0.04	[b]0.00	[b]-0.07**	[b]-0.07*	[b]-0.11***	[b]0.01	[b]-0.04	[b]-0.00	[b]0.02
Loss	[b]-0.07**	[b]-0.01	[b]-0.07**	[b]-0.02	[b]0.08**	[b]0.00	[b]-0.03	[b]0.04	[b]-0.07**	[b]-0.04
Cash ratio	[a]0.00	[a]0.02	[a]0.01	[a]-0.17***	[a]0.31***	[a]0.73***	[a]0.09***	[a]0.14***	[a]0.14***	[a]0.22***
Z-score	[a]0.15***	[a]0.21***	[a]0.17***	[a]-0.41***	[a]0.75***	[a]0.63***	[a]-0.10***	[a]0.54***	[a]0.47***	[a]0.44***
Deal Value	[a]0.02	[a]0.00	[a]0.01	[a]0.05	[a]-0.05	[a]-0.04	[a]-0.07**	[a]0.01	[a]-0.04	[a]-0.04
Deal stock	[b]0.05	[b]0.04	[b]0.05	[b]0.05	[b]-0.01	[b]-0.07**	[b]-0.00	[b]-0.03	[b]0.03	[c]0.10**
CBA	[b]-0.02	[b]-0.01	[b]-0.01	[b]0.17***	[b]-0.12***	[b]-0.08**	[b]0.04	[b]-0.11***	[b]-0.12***	[c]-0.04
CSA	[b]-0.05	[b]-0.04	[b]-0.05	[b]0.18***	[b]-0.08**	[b]-0.18***	[b]0.04	[b]-0.08**	[b]-0.02	[c]0.01
PAY	[b]-0.04	[b]-0.03	[b]-0.05	[b]-0.11***	[b]0.04	[b]0.04	[b]0.04	[b]0.02	[b]0.05	[c]0.05

	11	12	13	14	15	16	17	18	19	20
CFO sales										
Slack	[a]1.00									
Dividend	[b]-0.11**	[c]1.00								
Loss	[b]0.05	[c]-0.26***	[c]1.00							
Cash ratio	[a]0.58***	[b]-0.01	[b]0.06	[a]1.00						
Z-score	[a]0.44***	[b]-0.09***	[b]0.09***	[a]0.69***	[a]1.00					
IA	[a]0.32***	[b]-0.07**	[b]0.09***	[a]0.34***	[a]0.078***					
Deal Value	[a]-0.02	[b]0.18***	[b]-0.05	[a]-0.00	[a]-0.06	[a]1.00				
Deal stock	[c]-0.16***	[c]0.05	[c]-0.11***	[b]-0.08**	[b]-0.09***	[b]0.05	[c]1.00			
CBA	[c]0.03	[c]0.01	[c]-0.06	[b]-0.08**	[b]-0.10***	[b]0.09***	[c]-0.01	[c]1.00		
CSA	[c]-0.13***	[c]0.02	[c]-0.12***	[b]-0.13***	[b]-0.14***	[b]-0.04	[c]0.11***	[c]0.35**	[c]1.00	
PAY	[c]0.03	[c]0.01	[c]-0.10***	[b]0.00	[b]-0.00	[b]-0.00	[c]0.21***	[c]-0.06	[c]-0.03	[c]1.00

Note. Table 4 presents the Pearson correlations among the selected variables. Variables are coded with numbers from 1 to 16, in the following order: CAR (-1, +1) (1), CAR (-3, +3) (2), CAR (-5, +5) (3), $COND_{t-1}$ (4), Size (5), MTB (6), ROA (7), Leverage (8), Tangibility (9), CFO sales (10), Slack (11), Dividend (12), Loss (13), Cash ratio (14), Z-Score (15), Deal Value (16), Deal stock (17), CBA (18), CSA (19), PAY (20). The symbols ***, **, and * denote two-sided significance at the 1%, 5%, and 10% levels, respectively. ([a])Pearson correlation coefficient indicating the level of association between two continuous variables. ([b])Point-biserial correlation coefficient indicating the level of association between one continuous variable and one dichotomous variable. ([c])Chi-square coefficient indicating the level of association between two dichotomous variables.

4.2. Cross-sectional analysis results and discussion

Table 5 reports the results of the cross-sectional analysis of cumulative abnormal returns for three event windows (-1, +1; -3, +3; -5,+5).

Table 5 – Main results: Cross-sectional analysis of CARs

	CAR (-1,+1)		CAR (-3,+3)		CAR (-5,+5)	
	Coeff.	**P>|t|**	**Coeff.**	**P>|t|**	**Coeff.**	**P>|t|**
$COND_{t-1}$	0.01	0.01***	0.01	0.00***	0.01	0.01***
Controls						
Size	0.02	0.00***	0.00	0.15	0.00	0.01***
MTB ratio	-0.00	0.03**	-0.00	0.02**	-0.01	0.03**
ROA	-0.37	0.00***	-0.19	0.00***	-0.29	0.00***
Leverage	-0.10	0.04**	-0.05	0.15	-0.11	0.02**
Tangibility	0.11	0.00***	0.04	0.09*	0.13	0.01***
CFO sales	0.08	0.13	0.02	0.57	0.09	0.21
Slack	0.00	0.06**	0.00	0.08*	0.02	0.03**
Dividend	0.00	0.85	-0.00	0.65	0.00	0.87
Loss	-0.00	0.28	-0.00	0.69	-0.00	0.33
Cash ratio	-0.03	0.45	-0.07	0.11	-0.03	0.42
Z-Score	0.02	0.06*	0.02	0.00***	0.01	0.11
Deal Value	0.00	0.08*	0.03	0.17	0.00	0.06*
Deal stock	0.00	0.53	0.00	0.82	0.00	0.60
CBA	-0.00	0.04**	-0.00	0.03**	-0.02	0.25
CSA	-0.02	0.42	-0.02	0.23	-0.04	0.44
PAY	-0.04	0.23	-0.00	0.42	-0.01	0.13
Year FE	Yes		Yes		YES	
Industry FE	Yes		Yes		YES	
R^2	0,282		0,212		0,268	
Prob>F	0,00		0,000		0,000	
N. Obs	735		735		735	

Note. Table 5 reports the results of regression estimated according to Eq. (4). The dependent variable is CAR calculated according to Eq. (3), while the independent variable is COND, measured as the accruals/cash flow relation by Ball and Shivakumar (2005). The results presented refer to three event windows: -1,+1 (first column), -3,+3 (second column), -5,+5 (third column). The description of the control variables is presented in table 2. All continuous variables are winsorized at the 1st and 99th percentiles. Year FE and Industry FE refer to year-fixed effects and industry-fixed effects dummies, respectively. The symbols ***, **, and * denote two-sided significance at the 1%, 5%, and 10% levels, respectively.

Table 5 shows that the coefficient of COND (δ_1) is positive and statistically significant at 1% in each of the three event windows. This means that conditional conservatism positively influences the acquiring firm's stock prices post-announcement of M&A deals, which is consistent with our hypothesis. According to agency theory, results suggest that conditional conservatism may help acquirer firms to increase stock prices post the announcement of the M&A deals because the earlier recognition of losses can reduce information asymmetries, providing a timely signal to the market on poorly performing acquisitions. This may discourage firms from investing in risky projects and encourage them to abandon losing investments. In this sense, findings reveal that conditional conservatism creates incentives for managers to experience better acquisition decisions, thus generating a beneficial effect on the acquirer's stock return after the M&A announcement. These results are consistent with Ahmed et al. (2023), who recently emphasized the beneficial impact of accounting conservatism in M&A transactions, although they focused on target companies, whereas we focused on acquirers.

Regarding the control variables, we find that some are statistically significant in each of the three event windows considered. These variables are market-to-book ratio (coefficient < 0), return on assets (coefficient < 0), proportion of tangible assets (coefficient > 0), and financial slack (coefficient > 0). Other control variables included in Equation 3 are statistically significant only in some event windows: size, leverage, bankruptcy risk, deal value, and cross-border acquisition. Finally, the only variables that are ultimately not statistically significant are frequency of losses, operating cash flow to sales, dividend payout ratio, cash flow ratio, deal stock, cross-sector acquisition, and payment types.

5. Additional analyses and robustness tests

5.1. Additional analyses: High versus Low Conditional Conservatism

We further investigated the influence of conditional conservatism on acquiring firms' stock prices post-M&A announcement, analyzing how market reaction changes between a sample of firms with high conditional conservatism and a sample of firms with low conditional conservatism.

In particular, we divided observations for the level of conditional conservatism. We selected the top and bottom groups to identify the two sub-

samples representing M&A acquirers with high conditional conservatism and low conditional conservatism, respectively (following Lys and Sabino, 1992)[6]. Consequently, we investigated 396 events, of which 198 fall in the sample with high conditional conservatism and 198 fall in the sample with low conditional conservatism.

Table 6 shows the mean values of abnormal returns and cumulative abnormal returns for the two panels (high conditional conservatism and low conditional conservatism) on the event date and each trading day before and after the event.

Results show that the abnormal returns depicted in panel A (high conditional conservatism) have mean values higher than panel B (low conditional conservatism). This is particularly evident when looking at the CARs. Indeed, the values of panel B with low conditional conservatism are negative after the event. These results are consistent with our hypothesis, suggesting that the high conditional conservatism of the acquirer limits the adverse reaction of the post-M&A announcement market.

Table 6 – Panel A versus Panel B

	Panel A: High Conditional conservatism			Panel B: Low Conditional conservatism		
Day	**N**	**AR**	**CAR**	**N**	**AR**	**CAR**
-5	177	-0.001	-0.001	167	0.001	0.001
-4	177	0.002	0.001	167	0.001	0.001
-3	177	0.000	0.001	167	0.000	0.001
-2	177	0.000	0.002	167	0.001	0.002
-1	177	0.001	0.002	167	0.001	0.002
0	177	0.005	0.005	167	0.002	0.002
1	177	0.009	0.013	167	-0.011	-0.009
2	177	0.004	0.018	167	0.002	-0.007
3	177	0.002	0.020	167	0.003	-0.004
4	177	0.001	0.021	167	0.000	-0.004
5	177	0.001	0.022	167	0.002	-0.002

		AR		CAR			AR		CAR	
Days	**N**	**Mean**	**T**	**Mean**	**T**	**N**	**Mean**	**T**	**Mean**	**T**
(-1,1)	177	0.005	3.86***	0.009	2.35*	167	-0.005	-0.69	-0.003	-0.94
(-3,3)	177	0.004	2.67**	0.014	3.17**	167	-0.002	-0.66	-0.004	-1.12
(-5,5)	177	0.003	2.02**	0.017	3.49**	167	-0.001	-0.19	-0.003	-0.96

Note. Table 6 presents the mean value of abnormal return (ARs) and cumulative abnormal return (CARs) for the panel A and panel B for the following days: "Day -5", "Day -4", "Day -3", "Day -2", "Day -1", "Day 0", "Day 1", "Day 2", "Day 3", "Day 4", "Day 5". ARs are

6 The groupings method proposed by Lys and Sabino (1992) was widely adopted in literature (e.g. Miller, 2010).

calculated according to Eq. (2), CARs are calculated according to Eq. (3). Table 6 also presents the results of the event study using an estimating window of 100 trading days preceding the announcement of the M&A deals. The table presents results for three event windows (-1,1; -3,+3; -5,+5). ARs are calculated according to Eq. (2), CARs are calculated according to Eq. (3). The symbols ***, **, and * denote two-sided significance at the 1%, 5%, and 10% levels, respectively. Panel A reports observations with high conditional conservatism (top 27%), while Panel B reports observations with low conditional conservatism (bottom 27%).

To provide robustness on the differences between the means of cumulative abnormal returns, we conduct a t-test (mean comparison test)[7]. The results, illustrated in Table 7, show that the differences between the means are not statistically significant before the event (from "*Day -5*" to "*Day 0*"). Differently, the mean values show differences statistically significant after the event, from "*Day +1*" to "*Day +5*". This finding confirms that the influence of conditional conservatism on cumulative abnormal returns is manifested especially after the announcement date.

Table 7 – Differences in Cumulative Abnormal return between Panel A and Panel B

Panel A – Panel B			
Day	**Mean**	**Std. Err.**	**T**
-5	-0.003	0.003	-1.066
-4	-0.001	0.005	-0.361
-3	-0.001	0.004	-0.250
-2	-0.002	0.005	-0.500
-1	-0.002	0.005	-0.419
0	0.003	0.002	1.462
1	0.023	0.005	4.417***
2	0.025	0.006	4.356***
3	0.026	0.006	4.016***
4	0.024	0.006	3.798***
5	0.023	0.006	3.669***

Note. Table 7 presents the results of the t-test (mean comparison test) of cumulative abnormal return between Panel A (observations with high conditional conservatism, top 27%) and Panel B (observations with low conditional conservatism, bottom 27%). The symbols ***, **, and * denote two-sided significance at the 1%, 5%, and 10% levels, respectively.

We then analyzed the sign and significance of the abnormal and cumulative abnormal returns for three event windows (-1,+1; -3,+3; -5,+5). We found that for panel A (high conditional conservatism), there is a positive

[7] The mean comparison test has been previously adopted in literature to test whether the results significantly differ between two categories of firms (e.g. Erdem, 2020).

and significant market reaction at all three event windows. Unlike for panel B (sample with a low conditional conservatism), there is a negative and insignificant market reaction in all three event windows. These results, in Table 8, corroborate the argument that acquirer firms with a high conditional conservatism recognize a positive market reaction post-M&A announcement, unlike the less conservative ones. These results are consistent with previous studies suggesting that the ability of conditional conservatism to alleviate information asymmetry mitigates negative market reactions to economic events (e.g., Kim et al., 2013).

However, while it appears that a high level of conditional conservatism mitigates information asymmetries, leading to a beneficial effect on market reaction, it is not verified that a low level of conditional conservatism amplifies information asymmetries, generating a damaging impact on market reaction. In fact, sample B has negative results, but they are not significant, so it cannot be inferred that market reaction worsens with low conditional conservatism.

Table 8 – Market reaction to M&A announcement: Panel A and Panel B

Panel A: High Conditional conservatism					
		Abnormal Return		Cumulative Abnormal Return	
Event Window	N	Mean	T	Mean	T
(-1,1)	177	0.005	3.86***	0.009	2.35*
(-3,3)	177	0.004	2.67**	0.014	3.17**
(-5,5)	177	0.003	2.02**	0.017	3.49**

Panel B: Low Conditional conservatism					
		Abnormal Return		Cumulative Abnormal Return	
Event Window	N	Mean	T	Mean	T
(-1,1)	167	-0.005	-0.69	-0.003	-0.94
(-3,3)	167	-0.002	-0.66	-0.004	-1.12
(-5,5)	167	-0.001	-0.19	-0.003	-0.96

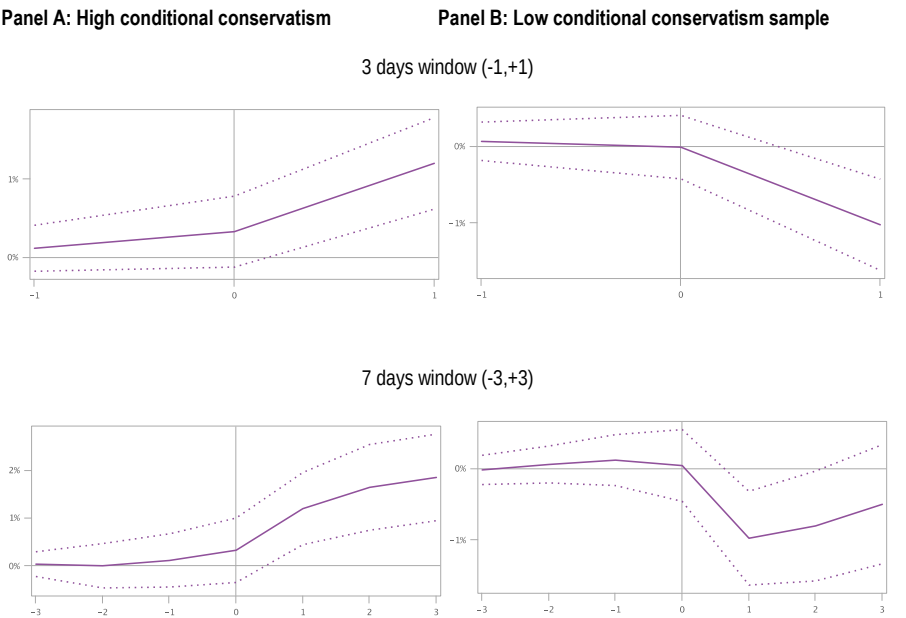
Note. Table 8 presents the results of the event study using an estimating window of 100 trading days preceding the announcement of the M&A deals. The first section of the table refers to panel A and the second section to panel B. Panel A reports observations with high conditional conservatism (top 27%), while Panel B reports observations with low conditional conservatism (bottom 27%). The table presents results for three event windows (-1,1; -3,+3; -5,+5). ARs are calculated according to Eq. (2), CARs are calculated according to Eq. (3). The symbols ***, **, and * denote two-sided significance at the 1%, 5%, and 10% levels, respectively.

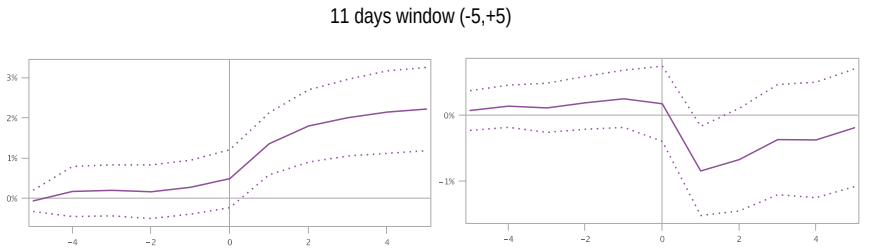
Figure 1 shows the trends of CARs post-announcement of M&A deals for panel A (sample with high conditional conservatism) and for panel B (sample with low conditional conservatism) for three event windows (-1, +1; -3, +3; -5,+5).

Looking at the 3-day window (-1, +1), it is evident that the effects of sample A and sample B are opposite since, in the sample with high conditional conservatism, CARs increase after the event. In contrast, in the sample with low conditional conservatism, CARs decrease after the event. However, the 7-day window (-3, +3) and 1-day window (-5, +5) graphs show that CARs in sample A continue to increase on "*Day +2"* and tend to stabilize thereafter, while in sample B, after the initial downward peaks on "*Day +1"* CARs tend to rise again. Differently, before the event, the figures do not show significant differences between Panel A and Panel B at each of the three event windows investigated.

These trends are consistent with the results shown in Table 7 on the difference between the averages of cumulative abnormal returns.

Figure 1 – Cumulative abnormal return post- announcement of M&A deals





Note. Figure 1 shows the trends of CARs post- announcement of M&A deals for panel A and panel B for three event windows (-1,+1; -3,+3; -5,+5). Panel A reports observations with high conditional conservatism (top 27%), while Panel B reports observations with low conditional conservatism (bottom 27%).

5.2. Additional analyses: Information Asymmetry Channel

We developed an additional analysis to test whether the information asymmetry channel may explain the positive association between the adoption of conditional conservatism policies and the cumulative abnormal returns of acquiring firms post-M&A announcement. Hence, we intend to demonstrate that conditional conservatism is positively associated with cumulative abnormal returns of acquiring firms post-M&A announcement since it reduces the information asymmetries between the firm and its investors. Following Biddle et al. (2022), we use a seemingly unrelated regression (SUR) approach to estimate equations 5 and 6 to account for potential cross-equational covariance of error terms, thus proceeding in two steps. Step one is to estimate Equation 5 to test whether conditional conservatism explains the level of information asymmetry (the channel). Then, Equation 6 is estimated to test whether the channel explains the cumulative abnormal returns. Thus, we rely on the following regression models:

$$IA_{i,t+1} = a_0 + a_1 COND_{i,t} + \gamma Controls_{i,t} + \varepsilon_{i,t} \quad \text{Eq. (5)}$$

$$CAR_{i,t+1} = b_0 + b_1 IA_{i,t+1} + \gamma Controls_{i,t} + \varepsilon_{i,t} \quad \text{Eq. (6)}$$

Regarding IAs measurement, following Armstrong et al. (2011), we adopt the annual average of the ratio of the daily closing bid-ask spread to the closing price to measure IAs.

The untabulated results indicate that conditional conservatism is negatively associated with IA ($a_1 < 0$), meaning that adopting conditional con-

servatism alleviates information asymmetries. In addition, the results highlight that information asymmetry is negatively associated with cumulative abnormal return of acquiring firms post M&A announcement ($b_1 < 0$). Overall, these findings demonstrate that the information asymmetry channel may explain the positive association between conditional conservatism and the market reaction post-M&A announcement.

Finally, consistent with Biddle et al. (2022), we conducted the Sobel Test (Sobel, 1982), confirming the channel validity.

5.3. Robustness tests

We provide a series of additional tests to increase the robustness of our main results. First, we used an alternative proxy of conditional conservatism ($COND_2$) developed by Givoly and Hayn (2000). This measure consists of the accumulated non-operating accruals deflated by accumulated total assets[8]. To make the direction of this measure consistent with the other adopted measure, we multiplied the accumulated non-operating accruals by -1 so that a larger value of $COND_2$ indicates more conservative financial reporting.

We also adopted two alternative methods for estimating abnormal returns. Namely, we calculated the abnormal returns as the excess of CRSP value-weighted market return following the market-adjusted model. In addition, we estimated the abnormal returns using Fama and French three-factor model (Fama et al., 1969). The results of this analysis are qualitatively similar to our main results.

Moreover, we have scoured major international outlets for possible confounding events that might affect the estimation of AR during the sample period using the LEXIS/NEXIS database (Onali and Ginesti 2014). We have identified two critical confounding events: S&P announcement on US sovereign debt that is being held down by rising deficits and policies focused too much on the short-term on 26 June 2018 (two days after an event); lastly, the great dollar dump and Russia liquidates US treasury holdings on 20 July 2018 (two days after an event). Our results are robust to excluding observations for which there may be confounding events.

[8] Following Givoly and Hayn (2000) non-operating accrual are defined as follows: Net Income + Depreciation – Cash Flow from operations - ΔInventory + ΔAccounts receivable - ΔPrepaid Expenses + ΔAccounts payable + ΔTaxes Payable.

Finally, since conditional conservatism could be endogenously determined and bias the regression results, we addressed this potential issue using an instrumental variable in the two-stage least squares (2-SLS) regression.

This approach requires that such an instrument should be correlated with COND (relevance condition) and uncorrelated with error terms of Eq. (4) (exclusion restriction). Under the 2-SLS analysis, we assume that COND might be influenced by acquiring firms' size and economic and financial performance (Keane and Neal, 2023; Jaggi et al., 2018). Thus, we run a first-stage regression explaining the potential endogenous variable in function of its determinants, in particular, Size, Leverage, ROA, the volatility of ROA, and P/B:

$$COND_{i,t-1} = \alpha + \delta_1 Size_{i,t} + \delta_2 LEV_{i,t} + \delta_3 ROA_{i,t} + \delta_4 ROAVOL_{i,t} + \delta_5 P/BV_{i,t} + \varepsilon_{i,t} \quad \text{Eq. (7)}$$

In the second stage, we use as an instrumented variable the absolute value of the residuals of the first-stage regression, obtaining the following model:

$$CAR_{i,t} = \delta_1 \widehat{COND}_{i,t-1} + \sum \delta_j Controls_{i,t} + Year_{FE} + Industry_{FE} + \varepsilon_{i,t} \text{ Eq. (8)}$$

These regression results (untabulated) confirm those obtained in the main analysis (in Table 5).

6. Conclusion

This study investigated the relationship between conditional conservatism and the market reaction of firms' stock prices involved in Merger and Acquisition (M&A) operations. We find that conditional conservatism is positively associated with the cumulative abnormal returns of acquiring firms post-M&A announcement. Furthermore, one of the drivers of this result is the information asymmetry channel. Our results also highlight that while acquirers with high conditional conservatism experience a positive reaction to M&A announcements, there is no significant reaction for acquirers with low conditional conservatism. Hence, although there is a beneficial effect of high levels of conditional conservatism on market reaction, this does not imply in the opposite case (low levels of conditional conservatism) that there is a harmful effect on market reaction.

The results of this study have several practical implications. First, as investors reap the financial benefits associated with M&A deals, they could be interested in understanding whether and how accounting policies, such as

conditional conservatism, may influence stock prices to M&A announcements. If they know the extent to which the company adopts conservative policies, they may better predict what the market response will be in the presence of an M&A deal. Second, our results may be useful for acquirer firms' preparers because they may learn how to deal with (and take advantage of) accounting policies and benefit from the M&A transactions. Indeed, if they are informed of how conditional conservatism affects stock prices, they are less likely to engage in value-destroying M&A transactions. Third, our results may be of interest to standard setters, providing insight into the debate on the role of the conservatism principle in the Generally Accepted Accounting Principles (GAAP). Indeed, several studies have highlighted the contradiction and critical aspects of the IASB's position towards the conservatism principle in the Conceptual Framework (e.g., Pelger, 2020; Fiondella, 2014), which reveals only a superficial understanding of the implications of this principle. In this regard, our study may help clarify the implications of adopting conservative policies in terms of market reactions.

However, interpreting our results requires some caution. First, we acknowledge that the event study methodology may be affected by potentially confounding events and to the extent to which the market perceptions are correct. Moreover, this study empirically tested the validity of the information asymmetry channel. Still, there may be other channels through which conditional conservatism can serve to enhance positive market reactions, for example, by improving acquisition decisions. Future studies could empirically investigate these different channels to enrich the evidence on this topic.

Lastly, we cannot exclude the possibility that some variables not considered in this study, such as corporate governance, may influence the association between conditional conservatism and the cumulative abnormal returns of acquirers' post-M&A announcement. Hence, future research may investigate the role of specific corporate governance variables (e.g., audit committee, independent board members, board size) in the relationship between conditional conservatism and market reactions after an M&A announcement.

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