

Firm's management of systematic risk: one source and two strategies

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Abstract

This thesis develops several aspects of systematic risk management within the firm. Initially identifies one source (earnings manipulation) that generates this risk, followed by two strategies (internationalization and acquisitions) that under certain circumstances can help to mitigate it, trying to answer the following three main questions: is the manipulation of earnings detected by the market and properly reflected in the audit reports? Has the internationalization a beneficial effect on systematic risk management? Do the acquisitions add value to shareholders? The first chapter is motivated by the 21st century first decade's well-known financial scandals that, besides causing devastating effects on the economy, have undermined investors' confidence and casted doubt on the auditor's role. Using a sample of Spanish listed companies, for the period 2004-2008, the direct effect of earnings manipulation on systematic risk is measured, as well as its indirect effect on this risk mediated by the auditor's qualified reports. Chapters two and three are inspired by the increasing relevance of the internationalizing and acquiring activity within the firm. Here it is investigated under which circumstances internationalization and acquisitions can help the firm to diminish its systematic risk. In both cases it is used a sample of listed companies from 10 developed countries classified as more or less stable, considering a period (2000-2010) characterized by a continuous market integration (globalization) and the impact of the last global financial crisis following a previous prosperity period. The three chapters are supported by empirical analyses using secondary information from diverse data bases. A market variable, as is the systematic risk, is forecasted as a function of several accounting variables that measure earnings management, as well as various dimensions of internationalizing and acquiring activity. After running a set of different regressions that help to address the most frequent statistical problems (collinearity, autocorrelation, heteroskedasticity and endogeneity), in all the cases are obtained robust and consistent results that allow concluding that: 1. Earnings management increases risk aversion (increasing systematic risk) and also increases the firm's probability of receiving an unfavorable audit report, 2. Even during times of strong market integration when a positive relation between internationalization and systematic risk is expected, the origin and destination country's relative stability makes it possible for the opposite to occur. For instance, firms from less stable countries, due to their greater potential to internationalize to more stable ones, are better perceived by the market having, in turn, a lesser systematic risk mainly during prosperity times, and 3. The global economic context (prosperity versus crisis) as the origin and destination country's relative stability are factors that determine the relation between acquisitions and systematic risk. For example, in times of crisis related acquisitions can help to diminish the systematic risk regardless the country's relative stability, while during prosperity firms from less stable countries can take advantage of cross border acquisitions. It is also important to highlight that in all the cases the acquisitions supported by an increase in tangible assets help to diminish acquiring firm's systematic risk.