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Accounting conservatism and SEO announcement returns: the role of culture and institutions

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Resumo/Abstract

Using a sample of Seasoned Equity Offerings (SEOs) issued in 35 countries from 2002 to 2021, we examine the influence of institutions and culture on the relationship between accounting conservatism and SEO announcement returns. Specifically, we investigate two institutional factors (legal enforcement and legal system) and six cultural dimensions (individualism, uncertainty avoidance, power distance, masculinity, long-term orientation, and indulgence). Our findings reveal a moderating positive (negative) effect of rule of law and masculinity (long-term orientation) on the association between conservatism and SEO announcement returns. We also find that the previously observed positive effect of conservatism on market reaction to SEO is strongly contextual and dependent on culture and institutional arrangements. In fact, the relationship transitions from positive to negative when considering these country-level variables. Our results contribute to the existing literature on conservatism by addressing the information role of conservative practices for investors and to the equity issuance literature by highlighting the varying efficacy of financial reporting in reducing SEO costs.

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Abstract
Using a sample of Seasoned Equity Offerings (SEOs) issued in 35 countries from 2002 to 2021, we examine the influence of institutions and culture on the relationship between accounting conservatism and SEO announcement returns. Specifically, we investigate two institutional factors (legal enforcement and legal system) and six cultural dimensions (individualism, uncertainty avoidance, power distance, masculinity, long-term orientation, and indulgence). Our findings reveal a moderating positive (negative) effect of rule of law and masculinity (long-term orientation) on the association between conservatism and SEO announcement returns. We also find that the previously observed positive effect of conservatism on market reaction to SEO is strongly contextual and dependent on culture and institutional arrangements. In fact, the relationship transitions from positive to negative when considering these country-level variables. Our results contribute to the existing literature on conservatism by addressing the information role of conservative practices for investors and to the equity issuance literature by highlighting the varying efficacy of financial reporting in reducing SEO costs.

Keywords: international accounting; equity market; institutions; national culture; equity offering.

1. Introduction

Accounting conservatism plays a corporate governance function when it decreases information asymmetry between managers and shareholders (Kim et al., 2013; LaFond & Watts, 2008; Watts, 2003). Reporting bad news timely through conservative practices can be a signaling mechanism that optimizes financing decisions to the extent that it protects investors and creditors from wealth expropriation by managers or majority shareholders (Goh et al., 2017; X. Li, 2015; Ramalingegowda & Yu, 2021). This good signal potentially decreases the cost of capital and facilitates the access to equity capital (García Lara et al., 2011; Ramalingegowda & Yu, 2021). Nevertheless, the potential effect of conservative signals may depend on institutional arrangements and cultural background of financial reporting users. Thus, this study explores institutional and cultural factors that are associated with the information role of conservatism for the equity market.

Firms may adopt conservative practices due to the information role of accounting conservatism under the presence of information asymmetry (Watts, 2003). Being better informed by conservative financial reporting, shareholders can make timelier decisions when it comes to litigation. However, the efficiency of these decisions depends on the shareholder protection laws and the use of financial reports for litigation matters (Ball et al., 2000; Watts, 2003). Moreover, previous literature has documented that cultural characteristics may affect how the equity market reacts to financial reports (Gray et al., 2013; Pevzner et al., 2015). Some cultural values (e.g., power distance, individualism and social trust) are associated with investors' sentiment and behavior when it comes to assess future cash flows and investment risk, which ultimately drives investors' decisions (Chang & Lin, 2015; Pevzner et al., 2015).

Hence, it is expected that the informational function of conservatism is sensitive to institutional and cultural aspects.

The informativeness of conservative practices is particularly relevant when investors and managers trade directly in equity offerings due to the information asymmetry and adverse selection (Masulis & Korwar, 1986; Myers & Majluf, 1984). It is documented that due to the information asymmetry, investors tend to react negatively to Seasoned Equity Offering (SEO) announcements (Eckbo & Masulis, 1995; Lee & Masulis, 2009; Masulis & Korwar, 1986). Nevertheless, since conservative financial reporting may reduce information asymmetry consequences, investors tend to react less negatively to SEO announced by more conservative firms (Kim et al., 2013). However, due to the evidence regarding the differences in the role of conservatism in different institutional arrangements and cultures, we argue that the relationship between accounting conservatism and SEO announcement returns may vary according to those country-level variables. Specifically, we focus on studying the moderating effect of legal enforcement, legal systems, and six dimensions of national culture on this relationship.

We employed an event study to conduct this analysis. Event studies measure abnormal changes in stock returns that occur in conjunction with an event. Thus, the price impact of an event reveals the effect of that event on expected future cash flows. Because the event-study method is based on a direct reaction to an unanticipated event with a short window, it is a powerful tool for isolating the phenomenon and decreasing the risk of omitted variables (El Ghoul et al., 2022). Despite that, El Ghoul et al. (2022) state that this methodology has not been explored in international settings, which leaves opportunities to answer important research questions in finance literature.

Our results indicate that both institutions and culture are related to the information role of conservatism for investors. There is a robust positive (negative) moderating effect of legal enforcement and masculinity (long-term orientation) on the association between conservatism and SEO announcement returns. The other country-variables (i.e., legal system, power distance, individualism, uncertainty avoidance and indulgence) either are not statistically significant or are significant in only one market window. We also show that observed association between conservatism and SEO announcement returns in the US (Kim et al., 2013) is not only lower in other institutional and cultural environments but becomes negative. Using a score based on both cultural and institutional moderating variables, we find that the association between conservatism and SEO announcement returns is strongly dependent on the joint effect of institutions and culture.

Our results contribute to literature in several ways. First, it provides insights into the relation between conservatism and cost of equity capital, which has shown mixed results (Ruch & Taylor, 2015). On one hand accounting conservatism may decrease information asymmetry between managers and outside investors which is associated with a lower cost of capital (Guay & Verrecchia, 2018; LaFond & Watts, 2008). On the other hand, conservatism introduces biases into financial statements that decrease analysts' ability to predict future earnings, which implies a higher cost of capital for conservative firms (Helbok & Walker, 2004; Mensah, Song & Ho, 2004). By using an international sample, we add to this literature examining contexts where benefits and costs of conservatism may change due to institutional incentives and national culture and showing that conservatism can be costly or beneficial (from the investors' perspective), which corroborates the notion that the mentioned perspectives toward the relevance of conservatism for investors are complementary. Moreover, most studies about conservatism and cost of equity rely on asset-pricing models, which may suffer from misspecification and introduce measurement errors (Easton & Monahan, 2005). Thus, our study contributes to this literature in two directions: (1) examining Kim et al. (2013) evidence in an

international view and (2) addressing the international evidence of the relationship between conservatism and cost of equity capital through SEOs instead of asset-pricing models.

Second, our study contributes to understanding one of the mechanisms behind the well-documented determinants of accounting conservatism across countries. Many studies address institutional factors that are associated with conservatism (e.g., Ball et al., 2008; Bushman & Piotroski, 2006). However, the previous evidence may be explained by a set of demands for conservatism (e.g., regulation, taxation, equity and debt market). Our study focuses on a specific role of conservatism (i.e., effect on equity offering costs) and how it varies across different institutions. The role of institutions on the quality of financial reporting is relevant for regulators and standard setters that need to consider how earnings properties may be less or more useful according to country-specific contexts.

Third, we contribute to the national culture literature providing evidence of the consequences of culture on the equity market. Equity market is an environment particularly challenging to test national culture consequences since stock price movements are relatively well-explained by standard finance theory, which is based on a rational perspective of individuals. Nevertheless, we investigate whether national culture can explain stock prices in a way that differs from the notion of rationality and incorporates behavioral aspects that come from the cultural values of individuals trading on the equity market. Being aware of the possible biases that comes from cultural values or other personal characteristics may help investors to create defaults, nudges and choice architecture in order to improve financial decisions (Cai, 2020; García & Vila, 2020).

Fourth, we contribute to the literature about information asymmetry and SEO costs. Lee and Masulis (2009) argues that flotation costs (e.g., negative market reaction to SEO) represent a significant loss of capital to firms and are positively related to information asymmetry, which can be decreased by disclosure mechanisms. According to Eckbo et al. (2007) survey, information asymmetry between issuers and outside investors explains the negative effect of SEO announcement, a type of flotation cost, that ranges between -2% and -3% among different studies. Kim et al. (2013) evidence suggests that conservatism may decrease this cost making investors react more favorably around SEO announcements of conservative firms. We show that the positive association between conservatism and SEO announcement returns is only present in countries where institutional and cultural aspects lead to it. In other contexts, this association tends to zero or becomes negative, which means that conservatism is not only less capable of reducing flotation costs in some countries, but it can increase it.

2. Related Literature

2.1. Institutions and accounting conservatism

A link between institutions and accounting conservatism has been documented in several studies (Ball et al., 2000; Bushman & Piotroski, 2006). This link is supported by a set of explanations usually related to how conservatism improves the efficiency of different contract settings and how this contract setting efficiency depends on institutional characteristics. Guay and Verrecchia (2006) provide a valuable framework of the role of conservatism in different types of contracts that is useful to explain the influence of institutional factors. They separate three features of conservatism that can be demanded and incentivized by institutional mechanisms in different contract setting: (1) Imposing downward bias in earnings, (2) increasing the marginal cost of manipulating difficult-to-verify gains and losses, and (3)

excluding difficult to verify information about gains. The three features and their relationship with the contracting setting is presented in Table 1.

Table 1 – The relation between contracting costs and three features of conservative accounting

Contracting setting	Feature of conservative accounting		
	Would imposing a downward bias in earnings or net assets lower contracting costs?	Would increasing the marginal cost of manipulating difficult-to-verify gains and losses lower contracting costs?	Would excluding difficult-to-verify information about gains lower contracting costs?
Debt Contracts	Unlikely	Likely	Possibly
Political costs	Possibly	Likely	Possibly
Litigation	Possibly	Likely	Possibly
Taxes	Possibly	Likely	Unlikely
Political economy	Indeterminate	Likely	Unlikely
Compensation contracts	Unlikely	Likely	Unlikely

Guay and Verrecchia (2006)

When it comes to the information role of conservatism two contracting settings described in Table 1 may be particularly relevant for investors: compensation contracts and litigation. Executive compensation contracts induce managerial incentives to bias reported earnings upward, which is explained by the agency conflict between managers and shareholders (Jensen & Meckling, 1976). However, this notion does not imply that managerial contracts would be more efficient excluding difficult-to-verify gains, but instead timely recognition of both gain and losses are relevant to managerial contracts as long as they are not subject to managerial manipulation (Guay & Verrecchia, 2006). Nevertheless, the main accounting standards (IFRS and US-GAAP) are conservative since it accepts the recognition of difficult-to-verify losses more often than gains (Lawrence, Sloan & Sun, 2013). Supposing a scenario where accounting standards does not allow the recognition of difficult-to-verify gain but allows the recognition of difficult-to-verify losses and managers cannot manipulate earnings, earnings would be conservative since they would recognize losses timelier. However, as the ability of managers to manipulate difficult-to-verify information increases they would avoid the recognition of difficult-to-verify losses and/or overestimate losses recognition opportunistically (D'Arcy & Tarca, 2018; Riedl, 2004). As a result, conservatism would not come from timeliness and the managerial contract would be less efficient. In other words, as costs to manipulate difficult-to-verify information increases, the costs of conservatism would also increase (i.e., opportunism) and the benefits of conservatism would decrease (i.e., contract efficiency).

Several studies show that countries with institutional arrangements that increase the protection of investors' rights also experience lower manipulation of financial statements by managers (Haw, Hu, Hwang & Wu, 2004; Leuz, Nanda & Wysocki, 2003). Thus, these countries have higher quality of financial reporting and more efficient contract settings based on accounting numbers. Hence, investors may react more favorably to conservatism in countries with institutions that promote a more efficient application of conservative reporting.

Another contract setting of Guay and Verrechia (2006) framework that matters for investors is litigation. Litigation is also an alternative for shareholders to monitor managerial misconduct when the primary governance mechanisms (e.g., board of directors and executive compensation) fails in their monitoring efforts (Romano, 1991). Previous studies support this view showing that firms with greater agency conflicts have more incidence of shareholder derivative lawsuits and that after lawsuits firms improve their corporate governance

mechanisms (Cheng, Huang, Li & Lobo, 2010; Ferris, Jandik, Lawless & Makhija, 2007). Similarly, auditors learn from their past experiences of litigation and improve audit quality after suffering litigation (Lennox & Li, 2014). Nevertheless, according to Watts (2003), investors initiate lawsuits for overstatement more often than understatement. In this sense, Donelson, McInnis, Mergenthaler and Yu (2012) find that early revelation of bad earnings news lowers the likelihood of litigation. Moreover, Ettredge et al. (2016) show that conservative reporting is associated with favorable consequences on five dimensions of litigations: initiation of lawsuits, market reaction to lawsuits, duration of lawsuits, dismissals of lawsuits, and penalties approved by courts.

This evidence corroborates that the information role of conservatism is amplified by litigation. However, this impact of shareholders' litigation on financial reporting may decrease since shareholders' legal protection decreases and the institutional arrangement relies on other factors to deal with information asymmetry instead of public financial statements. A relevant institutional aspect to explain investors' rights and, for that reason, also explain the association between litigation and financial reporting, is legal origins/families (common law and code law). Common law countries usually provide more protection to investors than code law countries, which may be explained by the way in which laws are generated in each legal setting (La Porta et al., 2000). This consequence may affect a set of corporate governance mechanisms and how these mechanisms interact with disclosure and stock market development. Ball et al (2000) argue that common law countries rely on public financial statements to resolve information asymmetry, and this creates a demand for accounting conservatism that is resolved by other means in code law countries (e.g., closer relations between investors and managers).

Since conservatism may work as a corporate governance mechanism that is more used for litigation matters in common law countries and that is also more efficient in this institutional context since it is more costly to manipulate difficult-to-verify information, we expect that the conservative reporting will be differently priced by investors from different legal origins. Therefore, the information role of accounting conservatism on equity offerings documented by Kim et al. (2013) will be less pronounced depending on this country-level aspect. Thus, our first hypothesis is formulated as follows:

Hypothesis 1. There is a positive moderating effect of the common law system on the association between accounting conservatism and SEO announcement returns.

The creation of laws that protect shareholders, mainly the minority ones, is relevant to improving the efficiency of conservatism. However, laws by themselves are not enough to guarantee shareholders' protection. Legal enforcement is a fundamental dimension of the role of institutions on accounting. Modigliani and Perotti (2000) argue that the income rights promised by market-traded securities to non-controlling investors are based on legal content, not a relationship. Thus, their value is strongly dependent on the quality of securities law and their proper enforcement. Whether conservatism may signal wealth expropriation of minority shareholders, the legal value of this signal will reflect in investors' assessment of firms' value (X. Li, 2015). Hence, the effect of conservative reporting on shareholders litigation also depends on legal enforcement. Thus, the second hypothesis is formulated as follows:

Hypothesis 2. There is a positive moderating effect of legal enforcement on the association between accounting conservatism and SEO announcement returns.

2.2. Culture, conservatism, and equity market

Hofstede (2001) proposes that culture manifests through layers. Similar to an onion, culture is formed by deep and shallow layers that represent the manifestation of culture in societies. Cultural values transmitted among generations from the same nation have consequences to a series of components of society, such as organizations, politics, laws, institutions and economy (Herrmann et al., 2008; Licht et al., 2007). The documented evidence of the influence of culture on people's behavior has challenged the standard finance theory since national culture may impact investors decisions and the market.

In standard finance theory, when it comes to the stock market, economic decisions are driven by rationality. Any irrationality among market participants is erased by arbitrageurs and the stock prices always reflect the discounted value of future cash flows. However, previous literature evidences that irrationality also drives stock prices. Grinblatt and Keloharju (2001) find that investors are more likely to hold, buy, and sell the stocks of firms that are located close to the investors, that communicate in the investor's native tongue, and that have chief executives of the same cultural background. They claim that investors exhibit a preference for familiar companies and that this preference refutes the implications about investors behavior developed in many standard asset-pricing models. Moreover, Pevzner et al. (2015) document that a cultural aspect named societal trust is relevant for the efficiency of disclosure mechanisms. They argue that societal trust increases, *ex ante*, the investors' acceptance of the transmitted information by managers through corporate financial reporting. Pevzner et al. (2015) corroborate the mentioned argument showing that countries with higher societal trust exhibit higher earnings announcement returns. Moreover, national culture also explains herding behavior (i.e., stock market irrationality) (Schmeling, 2009).

We argue that national culture explains how investors assess accounting conservatism. In general, conservative practices may represent a good signal for equity market participants in terms of decreasing information asymmetry and alleviating agency conflicts (LaFond & Watts, 2008; Watts, 2003). However, since the acceptance of corporate disclosure by investors depends on cultural aspects, we expect that culture affect how investors assess accounting conservatism and, as a result, it moderates the relationship between accounting conservatism and SEO announcement returns.

National culture is a complex concept with numerous facets that can be simplified into a few dimensions. The purpose of reducing national culture into a couple of dimensions is to capture the most prominent features, integrate multiple cultural features, and relate meaningfully to social-historical variables (Schwartz and Ros, 1995). National culture is classified by Hofstede (2001) in six main dimensions: power distance, uncertainty avoidance, individualism (versus collectivism), masculinity (versus femininity), long versus short-term orientation and indulgence.

Power distance is defined as the difference between the ability of individuals of different hierarchical positions to influence each other's behavior (Hofstede, 2001). The concept of power distance is closely connected to inequality and hierarchy. A culture is power distant when its culture values lead individuals to deal with inequality by strengthening hierarchy schemes that increase the ability of a boss to influence a subordinate's behavior and decrease the ability of a subordinate to influence a boss's behavior (Hofstede, 2001). In other words, the power distance dimension captures the acceptance of power inequality by societies.

Power-distant cultures often exhibit a greater aversion to risk and uncertainty. This explains Aggarwal et al. (2012) finding that power distance impacts negatively on cross-border holding of both debt and equity. Accounting conservatism, with its focus on recognizing

potential losses and risks, may be seen as a more cautious approach to financial reporting. Investors in these cultures may appreciate conservative practices because they provide a sense of security and minimize the chances of unexpected negative surprises. Thus, we establish the following hypothesis:

Hypothesis 3. There is a positive moderating effect of power distance on the association between accounting conservatism and SEO announcement returns.

Uncertainty avoidance refers to how individuals react to uncertainty or ambiguity. Hofstede (2001) states that uncertainty avoidance is a natural reaction to human conditions, and it relates to fundamental aspects of traditional and modern human societies. He points out that technologies, laws, and religions are ways that human societies developed to deal with the anxiety that stems from uncertainty about nature, other people and the unknown, respectively. However, some societies are more tolerant or feel less anxious with uncertainty than others. This tolerance to uncertainty tends to affect the way that societies organize in terms of social rules, religion, and institutions. Uncertainty-avoiding cultures look for structures in their organizations, institutions, and relationships, which makes events clearly interpretable and predictable (Hofstede, 2001).

K. Li et al. (2013) document that uncertainty avoidance and corporate risk-taking are negatively related since societies with high scores on uncertainty avoidance shun ambiguous situations and prefer clear rules of conduct, whereas societies with low uncertainty avoidance enjoy novel events and value innovation. Kanagaretnam et al. (2014) find that the negative relation between uncertainty avoidance and risk-taking decisions explain accounting conservatism in the banking industry. They also find that banks from cultures low on uncertainty avoidance (i.e., cultures that encourage high risk-taking) experienced more bank failures and bank troubles during the 2007-2008 financial crisis. When it comes to the capital market, Dou et al. (2016) find that investors from uncertainty-avoiding cultures incorporate earnings news faster because they exhibit a higher sense of urgency in ambiguous situations. Thus, we expect that investors from more uncertainty-avoiding cultural background tend to assess conservative practice more favorably, which leads to the following hypothesis:

Hypothesis 4. There is a positive moderating effect of uncertainty avoidance on the association between accounting conservatism and SEO announcement returns.

Individualism, as opposed to collectivism, is described as "the relationship between the individual and the collectivity that prevails in a given society. It is reflected in the way people live together – for example, in nuclear families, extended families, or tribes – and it has many implications for values and behavior" (Hofstede, 2001, p. 209). In individualistic culture, the individual forms the basic functional unit, and self-identity is based on one's personal rather than the group; thus, personal autonomy, independence, self-fulfillment, and personal accomplishments are prioritized over group harmony (Dang et al., 2019; Hofstede, 2001).

Individualism (versus collectivism) is also associated with risk-taking since more individualistic societies emphasize individual freedom, autonomy and self-interest competition, which leads individuals from these societies to be more self-confident and more inclined to risky decisions (K. Li et al., 2013). Managers from individualistic countries are more likely to engage in risky investments since they are motivated to stand out from other managers to demonstrate their autonomy (Kreiser, Marino, Dickson & Weaver, 2010; K. Li et al., 2013). When it comes to the equity market, Dang et al. (2019) find that individualism is positively

associated with stock price crash risk. Moreover, Dou et al. (2016) and Chui et al. (2010) argue that the overconfidence and overoptimism of investors from individualistic societies lead them to rely on private information instead of public disclosure, which explains the negative association between individualism and the speed of stock prices to incorporate earnings news. Thus, we argue that investors from more individualistic societies tend to be less impacted by conservative practices that come from public disclosure, which leads to the following hypothesis.

Hypothesis 5. There is a negative moderating effect of individualism on the association between accounting conservatism and SEO announcement returns.

In societies characterized by high masculinity, there is often a strong emphasis on assertiveness, competition, and achievement (Hofstede, 2001). This focus on success and ambition may create a cultural environment where investors prioritize maximizing gains and pursuing aggressive investment strategies. Consistent with this notion, Galariotis and Karagiannis (2021) find that masculinity is related to investors strategies to the extent that stock market momentum is positively associated with masculinity. Under such circumstances, investors in highly masculinity cultures may view accounting conservatism as overly cautious and restrictive. They may perceive conservative accounting practices as hindering their ability to achieve high returns and capitalize on opportunities. These investors might prefer financial reporting practices that emphasize optimism, risk-taking, and the recognition of gains. Thus, we propose the following:

Hypothesis 6: There is a positive moderating effect of masculinity on the association between accounting conservatism and SEO announcement returns.

In cultures characterized by a high degree of long-term orientation, there is typically a strong emphasis on persistence, tradition, and planning. While this focus on long-term goals and delayed gratification may have many positive implications, it can also impact how investors perceive accounting conservatism.

Investors in high long-term orientation cultures may prioritize growth and seize opportunities for long-term gains. They may perceive accounting conservatism as overly cautious and conservative, hindering their ability to capitalize on favorable market conditions and maximize their returns. The emphasis on tradition and adherence to conservative financial practices may be seen as a barrier to seizing opportunities for growth and innovation. Additionally, the focus on long-term planning in these cultures may lead investors to value future-oriented financial reporting practices. They may prefer financial statements that reflect the potential upside of investments and provide a more optimistic outlook, rather than conservative practices that prioritize risk mitigation and prudence. Investors with a strong long-term orientation may prioritize long-term growth potential over short-term risk mitigation.

Furthermore, the emphasis on tradition in high long-term orientation cultures may lead investors to view conservative accounting practices as outdated or overly cautious. They may favor financial reporting practices that embrace a more aggressive and optimistic approach, aligning with their long-term goals and aspirations. Thus, we propose the sixth hypothesis as follows:

Hypothesis 7. There is a positive moderating effect of long-term orientation on the association between accounting conservatism and SEO announcement returns.

According to Hofstede et al. (2010), indulgence refers to a cultural dimension that reflects the extent to which a society allows and encourages gratification of basic human desires and needs, particularly related to enjoying life and having fun. Societies that score high on the indulgence dimension tend to be more relaxed, lenient, and tolerant of individual behaviors that bring pleasure and enjoyment. They value personal freedom, self-expression, and happiness. Conservative accounting is often associated with prudence and responsible financial management. Investors from cultures with high Indulgence may appreciate these values as they provide a sense of accountability and discipline. They may view conservative accounting practices as a responsible approach to financial reporting that ensures the accurate representation of a company's financial position, aligning with their cultural emphasis on self-control and discipline. Thus, our last hypothesis is:

Hypothesis 8. There is a positive moderating effect of indulgence on the association between accounting conservatism and SEO announcement returns.

3.   Methodology

3.1. Sample and model specification

Our sample is drawn from the Refinitiv database. We collect data of equity offerings and financial reporting information from 2002 to 2021. We also collect the country-level variables from the World Bank database (Rule of Law Index), La Porta et al. (1998) (Legal System) and Hofstede et al. (2010) (Cultural Dimensions). Following Kim et al. (2013), we exclude private placements and right offers. The initial filing date is used as a proxy for the announcement date. Kim et al. (2013) use this proxy in the US market and argue that most firms announce at the same day of the filing date, as evidenced by Purnanandam & Swaminathan (2006). However, we use an international sample and firms from other countries may not exhibit the same pattern. Thus, we deal with this issue by using a larger event window to capture the announcement date when it is some days before the filing date. Table 2 shows the initial sample collected from Refinitiv, the exclusions and the final sample used in the main analyses.

Table 2 – Sample

Description	Number of observations	Number of countries
SEOs from Refinitiv excluded rights and private placement	20,710	66
After excluding countries where institutional and/or cultural variables are not available	15,772	48
After excluding CAR missing values	13,890	47
After excluding Conservatism missing values	8,592	47
After excluding other variables' missing values	7,245	46
After excluding countries with less than 10 SEOs	7,208	35

To measure the market reaction to the SEO announcements, we estimate the abnormal returns (AR) for a 7-day window around SEO announcement (-3,+3), which is calculated as the difference between the stock return and its expected value based on the market model. We use the Morgan Stanley Capital International (MSCI) index as the market portfolio since it is available for all countries in our sample. A 200-days window of daily returns is used to estimate

the coefficients of the market model and the cumulative abnormal returns (CAR) over the 7 days is used as the dependent variable of the following model:

$$
\begin{aligned}
CAR_{ij} = {}& \beta_1 Cons_{ij} + \beta_2 Common_{jl} + \beta_3 Cons_i * Common_j + \beta_4 Ruleof Law_j \\
& + \beta_5 Cons_i * Ruleof Law_j + \beta_6 PDI_j + \beta_7 Cons_i * PDI_j + \beta_8 IDV_j \\
& + \beta_9 Cons_i * IDV_j + \beta_{10} MAS_j + \beta_{11} Cons_i * MAS_j + \beta_{12} UAI_j \\
& + \beta_{13} Cons_i * UAI_j + \beta_{14} LTOWVS_j + \beta_{15} Cons_i * LTOWVS_j \\
& + \beta_{16} IVR_j + \beta_{17} Cons_i * IVR_j + \sum_{k=1}^{6} \delta_k Control_{ki} + \varepsilon_i
\end{aligned}
\tag{1}
$$

Where i and j index the event and the country respectively. *CAR* is the cumulative abnormal returns. *Cons* is the conservatism measure of the previous year financial statement. *Common* is a dummy variable equal 1 if the country's legal system is common law based on La Porta et al. (1998) and zero otherwise. *RuleofLaw* is the proxy for legal enforcement based on the Rule of Law index measured by the World Bank. *PDI*, *IDV*, *MAS*, *UAI*, *LTOWVS* and *IVR* represent Hofstede's (2001) cultural dimensions, which are Power Distance, Individualism, Masculinity, Uncertainty Avoidance, Long-term Orientation and Indulgence, respectively. *Control* represents a set of control variables related to SEO announcement returns and conservatism, and it includes the offer size (*OfferSize*), the relative number of secondary shares offered (*Secondary*), the standard deviation of the market returns over 60 days prior to the announcement date (*MktRunup*), the standard deviation of the idiosyncratic stock returns over 60 days prior to the announcement date (*Runup*), book value of assets (*FirmSize*), book leverage ratio (*Leverage*).

3.2. Conservatism measures

The first measure of conservatism is based on Givoly and Hayn (2000) and it is adopted in several studies (A. S. Ahmed & Duellman, 2013; Beatty et al., 2008; Haider et al., 2021). They propose that the accumulation of nonoperating accruals can be used as a measure of conservatism. Nonoperating accruals is measures as the difference between total accruals and operating accruals, where total accruals and operating accruals is calculated as follows:

$$
\begin{aligned}
Total\ Accruals = {}& (Net\ Income + Depreciation) \\
& - Cash\ flow\ from\ operations
\end{aligned}
\tag{2}
$$

$$
\begin{aligned}
Operating\ Accruals = {}& Accounts\ Receivable + Inventories + \\
& Prepaid\ Expenses - Accounts\ Payable - Taxes\ Payable
\end{aligned}
\tag{3}
$$

Following Kim et al. (2013) and Beatty et al. (2008), we calculate the conservatism variable as the average of the nonoperating accruals scaled by total assets over the five-year period ending in the year prior to the SEO announcement. We also multiply the variable by -1, then the greater its value the greater conservatism.

The second measure of conservatism is proposed by Beaver and Ryan (2000) and adopted in several other following studies (K. Ahmed & Henry, 2012; Beatty et al., 2008; Haider et al., 2021). It is based on the notion that the variations of the book-to-market ratio can be distinguished in bias and lags in book value. While lags capture the temporary differences between economic gains/losses and the recognized amounts into book value, bias is the

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persistent component of the book-to-market ratio, which is used as a proxy for accounting conservatism. Thus, to measure the accounting conservatism, we use the following model:

$$BTM_{it} = \alpha_t + \alpha_i + \sum_{j=0}^{6} \beta_j R_{it-j} + \varepsilon_{it} \tag{2}$$

Where i and t index firm and year, respectively. *BTM* is the book-to-market ratio, α_t and α_i are the year and firm fixed effect, respectively. *R* is stock returns. 6 lags of stock returns are used to eliminate the lag component of book-to-market and α_i captures the persistent bias in book-to-market value (i.e, accounting conservatism). We also multiply the variable by -1, then the greater its value the greater conservatism.

Similarly to Kim et al. (2013), we use a third measure of conservatism that is the average rank of the above two measures of conservatism (*ConsRank*). By merging the previous measures, we aim to capture different aspects of accounting conservatism.

4. Results

4.1. Descriptive analysis

Table 3 presents the number and percentage of equity offerings by offering techniques. SEOs are sold through a greater variety of flotation methods in comparison to IPOs due to the presence of an active secondary market where current prices for the stock are easily obtained, and the bigger number of current stockholders (Eckbo & Masulis, 1995). The most common offering technique in our sample is Firm Commitment, that involves underwriters guaranteeing to purchase all the shares from the company, followed by Accelerated Bookbuilt, in which offering price is based on investor demand, while the third most used technique is Block Trade, which involves the direct sale of a large block of shares by a major shareholder rather than the company itself. Moreover, most SEOs adopt more than one offering technique in the same offering.

Table 3 – Number of SEO by offering techniques

Offering Technique	Number	%
Firm Commitment	4305	60%
Accelerated Bookbuilt	2856	40%
Block Trade	1896	26%
Offer for Sale	1327	18%
Bought Deal	717	10%
Others	2388	33%
Total	7208	

Table 4 shows average values of CAR(-3,+3), and the three measures of conservatism by country. For the whole sample, the average CAR is -2.12 %, which is consistent with Eckbo and Masulis' (1995) review. Only 6 countries (17%) exhibit a non-significant market reaction around SEO announcements[2], all other 29 countries (83%) have a negative market reaction around SEO announcements, which indicates that the negative market reaction toward SEOs is not only a US phenomenon.

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[2] The lack of significance, at least for some of those countries, may be a result of the low number of observations associated with a low market reaction toward SEOs.

Table 4 – Average CAR and Conservatism Variables by Country

Country	Obs.	CAR(-3,+3)	ConsAcc	ConsBeaver	ConsRank
Australia	758	**-0.0084***	0.0649	-1.0450	0.5222
Austria	25	-0.0138	0.0376	-1.2614	0.4120
Belgium	42	**-0.0237***	0.0316	-0.5415	0.6318
Brazil	107	**-0.0180***	0.0221	-2.7427	0.2646
Canada	744	**-0.0250***	0.0436	-1.1117	0.4899
Chile	40	-0.0116	0.0117	-2.7628	0.2185
China	33	-0.0069	0.0363	-0.1639	0.7721
Denmark	63	**-0.0163***	0.0174	-0.7088	0.5825
Finland	58	**-0.0235***	0.0180	-1.2751	0.4229
France	248	**-0.0240***	0.0194	-0.6601	0.5861
Germany	314	**-0.0244***	0.0229	-0.8426	0.5525
Greece	25	**-0.0500***	-0.0011	-1.0240	0.4656
India	642	**-0.0139***	-0.0041	-1.6800	0.2862
Indonesia	106	**-0.0264***	0.0273	-0.6313	0.5926
Ireland	21	0.0182	0.0230	-1.0987	0.4174
Italy	143	**-0.0273***	0.0246	-0.6011	0.6253
Japan	1381	**-0.0169***	0.0544	-1.2114	0.5352
Malaysia	107	**-0.0191***	-0.0015	-0.5888	0.5503
Netherlands	36	**-0.0269***	0.0596	-0.6970	0.6316
New Zealand	81	**-0.0273***	0.0363	-0.9975	0.4899
Norway	162	**-0.0232***	0.0435	-1.1171	0.5096
Philippines	82	**-0.0442***	0.0297	-3.4414	0.2235
Poland	114	**-0.0273***	-0.0001	-0.5450	0.5715
Portugal	31	**-0.0286***	0.0001	-0.7737	0.4920
Romania	10	**-0.0362***	0.0302	-2.7664	0.2901
Singapore	54	0.0054	0.0195	-0.8604	0.5323
South Korea	184	**-0.0210***	0.0173	-2.1547	0.2865
Spain	114	**-0.0135**	0.0263	-0.8282	0.5499
Switzerland	108	**-0.0245***	0.0242	-0.6972	0.5888
Taiwan	57	-0.0101	0.0218	-1.4889	0.3686
Thailand	69	**-0.0358***	0.0001	-1.5421	0.2966
Turkey	22	**-0.0582***	0.0135	-0.3938	0.6152
United Kingdom	567	**-0.0215***	0.0198	-0.7635	0.5495
United States	646	**-0.0404***	0.0547	-0.8668	0.6089
Vietnam	14	**-0.0446***	0.0101	-0.3313	0.6505

*, **, *** denote the significance level at 10, 5 and 1%, respectively.

ConsAcc captures conservatism through the negative non operating accruals. In most countries, the average non operating accruals is negative (*ConsAcc* is the result of the non operating accruals multiplied by -1), which indicates that firms that issue equity are, on average, conservative in the year before the SEO announcement. The average size of SEOs varies

considerably across countries, representing, on average, less than 4% of shares outstanding in China and more than 34% in Australia.

4.2. Main results

Table 6 shows the coefficient of the empirical model for all three measures of accounting conservatism with and without interaction terms. We run the model with and without *IVR* and the main results are consistent. Thus, we report the results with all variables. The results without interaction terms show that, on average, accounting conservatism is not associated with SEO announcements returns. When it comes to country-level variables, there is evidence that *CAR* is positively associated with RuleofLaw and *PDI*.

Table 6 - Conservatism and CAR moderated by institutions and culture

Variable	7-day window			7-day window		
	ConsAcc	**ConsBeaver**	**ConsRank**	**ConsAcc**	**ConsBeaver**	**ConsRank**
Cons	-0.0016	0.0012	-0.0032	-0.0005	0.0046	0.0229
Cons*Common				-0.0021	-0.0061	**-0.0505****
Cons*RuleofLaw				0.0045	**0.0061****	**0.0346*****
Cons*PDI				-0.0017	0.0043	**0.0196*****
Cons*IDV				**-0.0085*****	-0.0023	**-0.0170***
Cons*MAS				-0.0001	**0.0069*****	**0.0228*****
Cons*UAI				0.0013	0.0006	-0.0050
Cons*LTOWVS				**-0.0115*****	-0.0033	**-0.0362*****
Cons*IVR				-0.0059	0.0005	-0.0095
Common	0.0000	0.0005	-0.0003	0.0012	**-0.0097***	**0.0171****
RuleofLaw	**0.0068***	**0.0065***	**0.0068***	**0.0072****	**0.0072****	**-0.0105****
PDI	**0.0032***	0.0030	**0.0034***	**0.0030****	**0.0038****	-0.0053
IDV	-0.0037	-0.0044	-0.0035	-0.0052	-0.0041	0.0057
MAS	-0.0009	-0.0009	-0.0009	**-0.0010****	0.0020	**-0.0108***
UAI	-0.0020	-0.0019	-0.0022	-0.0010	**-0.0050*****	-0.0017
LTOWVS	0.0008	0.0005	0.0008	-0.0008	-0.0016	**0.0175****
IVR	-0.0036	-0.0037	-0.0036	-0.0044	-0.0019	0.0036
OfferSize	**0.0053*****	0.0054	**0.0051*****	0.0050	0.0052	0.0051
Secondary	**-0.0098****	**-0.0102****	**-0.0096****	**-0.0094***	**-0.0101****	**-0.0089***
MktRunup	0.0060	0.0057	0.0060	0.0058	0.0053	0.0055
Runup	**0.0243***	**0.0243***	**0.0242***	**0.0247***	**0.0242***	**0.0250***
FirmSize	-0.0031	-0.0028	-0.0030	-0.0031	-0.0026	-0.0028
Leverage	**0.0121*****	**0.0118****	**0.0121*****	**0.0128****	0.0090	**0.0108***
Year FE	yes	yes	yes	yes	yes	yes
Industry FE	yes	yes	yes	yes	yes	yes
Countries	35	35	35	35	35	35
Observations	7208	7208	7208	7208	7208	7208

*, **, *** denote the significance level at 10, 5 and 1%, respectively. *Cons* is one of the three measures of accounting conservatism (*ConsAcc*, *ConsBeaver* and *ConsRank*). *Common* is the common law dummy variable. *RuleofLaw* is the Rule of Law index. *PDI*, *IDV*, *MAS*, *UAI*, *LTOWVS*, and *IVR* are the 6 cultural dimensions: Power Distance, Individualism, Masculinity, Uncertainty Avoidance, Long-Term Orientation, and Indulgence,

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respectively. *OfferSize* is the relative offer size. *Secondary* is the proportion of secondary shares offered. *MktRunup* and *Runup* are the market return and the stock idiosyncratic return 60 days prior to SEO announcement. *FirmSize* is the book value of assets. *Leverage* is the book leverage. *FE* denotes Fixed Effect.

Results with interaction terms corroborate some of our research hypotheses. First, the coefficient on *Cons*RuleofLaw* is positive and supports the notion that the benefits of conservatism depend on institutional aspects. Specifically, in two of the three measures of conservatism, the association between accounting conservatism and *CAR* is higher in countries with stronger legal enforcement. An increase of 1 standard deviation in *RuleofLaw* increases the association of *ConsRank* and *CAR* in 0.0346, which is a substantial effect since the coefficient on *ConsRank* documented in Kim et al. (2013) is 0.016 and in our subsample of US SEOs is 0.052. There is no evidence of the difference between common and code law countries when it comes to the association between *Cons* and *CAR*. The interaction term *Cons*Common* is only significant for one measure of conservatism and this result does not remain in the robustness analysis presented in the next topic.

When it comes to culture, *Cons*UAI*, *Cons*IVR* have no significant coefficients in any of the models, while *Cons*PDI* is statistically significant in only one model. Coefficients on *Cons*IDV* and *Cons*LTOWVS* is negative in at least two of the three models, which suggests that investors from more individualistic and long-term oriented culture exhibit a more unfavorable reaction to SEOs announced by more conservative firms than the less conservative ones. On the other hand, coefficients on *Cons*MAS* is positive, indicating that more masculine societies tend to react more favorably to SEOs announced by more conservative firms.

To interpret the magnitude of the moderating effects of culture and institutions jointly, we created a score based on the coefficients of all moderation effects and plot the association of *ConsRank* and *CAR* by clustering countries based on this score.

Figure 1 – *Cons* and *CAR* association by Culture and Institutions Score
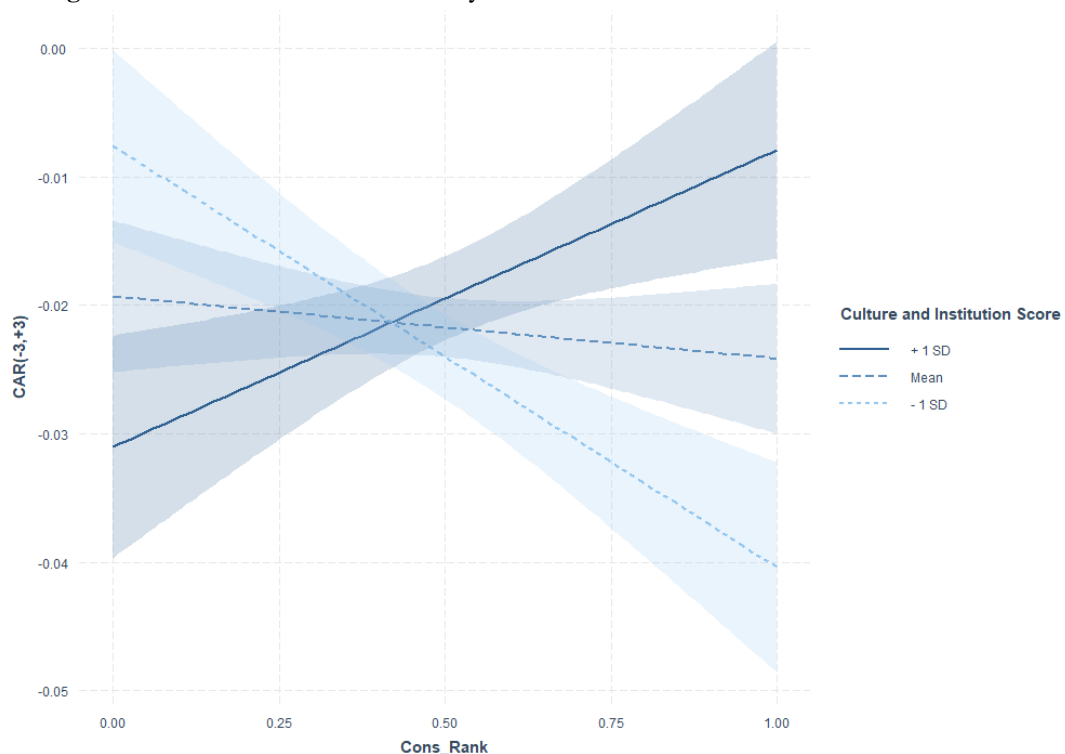
Figure 1 shows that the relation between *Cons* and *CAR* varies considerably by culture and institutional arrangements, when both culture and institutions promote an environment in which conservatism is positively assessed by investors (+1 SD, coef. 0.0462), more conservatism firms tend to face more favorable reactions. However, in other cultural and institutional environments, the same relation is close to zero (Mean, -0.0117) and negative (-1SD, coef. -0.0350). In other words, the joint effect of culture and institutions not only decrease the potential positive benefits of conservatism to investors but may make conservatism costly (i.e., negative relationship).

4.3. Robustness analyses

4.3.1. Market reaction window

Event study involves a careful choice about the size of the market reaction window. Small windows mitigate the risk of other events influencing the average CAR, i.e., events unrelated to the SEO announcement. Since the event date (filing date) is a proxy for the real event date, we adopted a 7-day window in order to capture small differences between the filing date and the real announcement date. Nevertheless, we run an additional test with the CAR calculated over a 3-day event window to mitigate the large window problem.

Table 7 - Conservatism and CAR moderated by institutions and culture

Variable	3-day window			3-day window		
	ConsAcc	ConsBeaver	ConsRank	ConsAcc	ConsBeaver	ConsRank
Cons	0.0003	**0.0046**	0.0083	0.0004	0.0060	0.0335
Cons*Common				-0.0023	0.0007	-0.0449
Cons*RuleoLaw				0.0081	**0.0093***	**0.0539***
Cons*PDI				0.0023	**0.0106**	**0.0468***
Cons*IDV				-0.0088	0.0006	-0.0126
Cons*MAS				**0.0051***	**0.0061**	**0.0334**
Cons*UAI				**0.0052**	0.0019	0.0059
Cons*LTOWVS				**-0.0185***	0.0019	**-0.0412**
Cons*IVR				-0.0077	0.0026	-0.0026
Controls	yes	yes	yes	yes	yes	yes
Year FE	yes	yes	yes	yes	yes	yes
Industry FE	yes	yes	yes	yes	yes	yes
Countries	35	35	35	35	35	35
Observations	7208	7208	7208	7208	7208	7208

*, **, *** denote the significance level at 10, 5 and 1%, respectively. *Cons* is one of the three measures of accounting conservatism (*ConsAcc*, *ConsBeaver* and *ConsRank*). *Common* is the common law dummy variable. *RuleofLaw* is the Rule of Law index. *PDI*, *IDV*, *MAS*, *UAI*, *LTOWVS*, and *IVR* are the 6 cultural dimensions: Power Distance, Individualism, Masculinity, Uncertainty Avoidance, Long-Term Orientation, and Indulgence, respectively. *Controls* comprises all variables included in Table 6 and omitted in this table.

Results for interaction terms are consistent with the previous analysis except for the coefficients on *Cons*PDI*, which is positive (non-significant in Table 6), and *Cons*IDV*, which is non-significant (negative in Table 6).

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5. Conclusion

This study aimed to examine the role of accounting conservatism in reducing information asymmetry and its interaction with institutional and cultural factors in the context of equity markets. The findings shed light on the information role of conservatism for investors and its implications for the cost of equity capital through the market reaction to SEO.

Our analysis revealed that both institutions and culture play a significant role in shaping the information role of conservatism. Specifically, legal enforcement and masculinity were found to have a robust positive moderating effect, indicating that stronger legal enforcement and a more masculine culture increase (decrease) the positive (negative) association between conservatism and SEO announcement returns. On the other hand, there is a negative moderating effect of long-term orientation on the information role of conservatism for investors, which suggests that investors from more long-term oriented societies react less favorably to conservative practices. In general, our results suggest that the relationship between conservatism and SEO announcement returns varies between positive, zero and negative according to institutional and cultural environments, highlighting the contextual nature of this association.

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