Cluster characteristics, business strategy and earnings management
Mei-Sen Pak
Jalan Lagoon Selatan, Selangor Darul Ehsan, Malaysia

This study, using a sample of US companies for the years 2000 to 2011, shows that both cluster characteristics, cluster size and cluster knowledge, are associated with higher earnings management. This suggests that agglomeration brings negative effect as clusters become larger. Cluster size is proxied by the natural logarithm of number of firms operating in related industry within the cluster while cluster knowledge is proxied by the natural logarithm of total research and development expenses of firms operating in the related industry in a cluster. This study also shows that defender firms are associated with higher earnings management, as compared to prospector firms. This result indicates that defender firms are likely to manage earnings within the bound of GAAP due to competitors-oriented behavior and short term focus on financial performance. In addition, defender firms, who face higher competition as a result of increasing size of cluster, may even manage more earnings to beat the performance of their proximate competitors. The more interesting finding is that, the defender firms are less likely to manage earnings if they locate themselves in a knowledge cluster as they can benefit from knowledge inflows.

Keywords: geographical cluster, business strategy, earnings management, agglomeration theory