**Cross-effects of Size and Diversification on Earnings Management and Tobin’s Q**

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**ABSTRACT**

According to previous studies, two competing hypotheses exist in explaining the relation between size and diversification and earnings management, namely, the “information asymmetry hypothesis” and the “offsetting accrual hypothesis.” In the current paper, we discuss the cross effect of size and diversification on earnings management and market valuation. The effect of size or diversification on earnings management is consistent with the “information asymmetry hypothesis” and the “offsetting accrual hypothesis.” In addition, when combining the cross effect of size and diversification, the “information asymmetry hypothesis” apparently dominates the “offsetting accrual hypothesis.” Still further, “diversified and big” firms are less likely to manipulate accounting earnings and acquiring positive valuation from the market. Hence, we use the Granger causality test to prove that the explanation of the association between earnings management and market valuation can only be determined by combining the cross effect size and diversification.

*Key words:* Earnings management; Size; Diversification