

## **Consolidated or Standalone Earnings: Which do Investors React to?**

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### **Abstract:**

In India, firms provide annual financial statements at both the consolidated (parent and subsidiary) and standalone level (parent only). We exploit this unique financial reporting requirement to examine how the stock market incorporates consolidated and standalone earnings surprises in determining stock price. While it seems obvious that stock returns should respond more strongly to consolidated earnings, as the consolidated number is more comprehensive and subsumes the information in standalone earnings, our results show that this is not always true. We argue that the availability of standalone earnings information allows investors to decompose the overall consolidated earnings into parent and subsidiary components and price them differentially based on their quality. Accordingly, we find that on average the stock market places more weight on earnings surprise on a standalone basis, compared to the earnings surprise attributable of subsidiaries. These results are more pronounced in firms with (i) high levels of related party transactions, (ii) more subsidiaries, (iii) more earnings management in subsidiaries, and (iv) more leverage in subsidiaries.

**Keywords:** Consolidated financial statements, standalone financial statements, earnings surprise, market reaction, information disaggregation, earnings quality.

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## 1. Introduction

Accounting standards (both US GAAP and IFRS) typically require an entity (the parent) to present consolidated financial statements if it controls one or more other entities (subsidiaries). These consolidated statements present combined financial information of the parent and its subsidiaries as if they were a single economic entity. In contrast to the well-established standard of reporting only consolidated financial statements in an annual report prevalent in most countries (Walker [1976]), India has a unique reporting requirement that makes firms disclose both consolidated and standalone financial statements.<sup>1</sup> The presence of two sets of financial statements provides investors with two distinct measures of earnings: consolidated and standalone. This paper empirically examines how the stock market incorporates consolidated and standalone earnings surprises in determining stock prices.

To better understand our research question, consider the earnings performance of two companies—Mphasis Ltd. and HCL Technologies. Both belong to the same industry (information technology) and have similar financial characteristics in terms of profitability, growth, etc. In the 2019, Mphasis reported consolidated EPS of INR 56 per share, an improvement of INR 13 per share over the previous fiscal year. For the same year, HCL Technologies reported consolidated EPS of INR 73 per share, which was an improvement of INR 11 per share over the previous fiscal year. Since both these companies show a similar consolidated earnings surprise, it is natural to expect a similar market reaction at the time of their earnings announcements. In India, the presence of standalone financial statements, in addition to consolidated financial statements, provides information that investors can use to decompose the overall consolidated earnings into parent and subsidiary earnings, with some

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<sup>1</sup> According to Indian Accounting Standard 110 (Consolidated Financial statement), entities that control one or more subsidiary entities are considered “parents.” The financial statements of the parent are referred to as “standalone financial statements” in the annual financial reports presented by Indian companies.

degree of approximation. For instance, Mphasis reports a  $\Delta$ EPS of INR 2 per share on a standalone basis. Given its consolidated  $\Delta$ EPS is INR 13 per share, it can be imputed that  $\Delta$ EPS of INR 11 per share relates to all its subsidiaries combined. In contrast,  $\Delta$ EPS of INR 11 per share for HCL Technologies can be decomposed as  $\Delta$ EPS of INR 7 per share coming from the parent company (standalone) and INR 4 per share coming from all its subsidiaries. Thus, in the case of Mphasis, the improvement over the previous period's consolidated EPS is driven by the improvement in the subsidiary EPS, whereas the improvement over the previous period's consolidated EPS in the case of HCL technologies is driven by the change in the parent EPS.<sup>2</sup> Given this additional information, it is not obvious that the market reaction to earnings announcement for these two firms will be similar.

On one hand, standalone statements may have limited or no information role because the reported standalone earnings number as well as the imputed subsidiary earnings number (reported consolidated earnings less reported standalone earnings) are both subject to measurement error, due to intercompany transactions, but consolidation eliminates that error in reporting the consolidated earnings. There is also insufficient information available in the financial statements for the investors to perform the consolidation process on their own. Perhaps for these reasons, most nations do not require additional presentation of standalone financial statements; consolidated financial statements subsume all the information present in standalone statements. On the other hand, standalone financial statements may provide valuable information to investors because they may allow meaningful decomposition of the

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<sup>2</sup> The example discussed here is very simple, as it does not involve any intercompany transactions. Hence consolidated earnings can be exactly decomposed as parent and subsidiary earnings. However, in more realistic situations with intercompany transactions, the standalone earnings capture the parent's earnings unadjusted for intercompany transactions. Similarly, the consolidated earnings (which is adjusted for intercompany transactions) less standalone earnings (which is unadjusted for intercompany transactions) roughly measures subsidiary earnings performance. Thus conclusions drawn based on this example are not always true. We provide a more involved illustration of mechanics behind construction of consolidated and standalone statements as per the Indian Standards in Appendix A1.

consolidated earnings in two components—one attributable to the parent and the other to its subsidiaries. This information can enable investors to differentially price these components based on their respective quality. This hypothesis is consistent with theory that demonstrates that any process of information aggregation can lead to a loss of information (Demski [1973], Pendlebury [1980]), making disaggregated information useful. Given these opposing arguments, the usefulness of standalone earnings to investors is unclear.

To address our research question, we draw our sample from the Prowess database maintained by CMIE (Centre for Monitoring Indian Economy). This database is widely used in the literature on India's financial markets (Khanna and Palepu [2000], Bertrand, Mehta, and Mullainathan [2002], Gopalana, Nanda, and Seru [2007], Manchiraju and Rajgopal [2017], Li [2021]). Our sample period is 2003–2020, as the financial statement data is available for the consolidated entity as well as for the standalone parent during this period. Our final sample comprises of 8,760 firm-year observations relating to 1,362 unique firms. We impute the financial performance of the subsidiary as the difference between consolidated-level measure and the standalone measure. We find that on average a subsidiary constitutes 20% of the consolidated total assets, suggesting that the subsidiary can significantly affect the overall performance of the consolidated entity.<sup>3</sup>

Our research design builds on the extensive research that examines the stock market reaction to earnings surprises (Ball and Brown [1968], Bartov, Givoly, and Hayn [2002], etc.) and its components (Dechow [1994], Sloan [1996], Burgstahler, Jiambalvo, and Shevlin [2002], Hsu and Kross [2011], etc). We regress one-year market-adjusted buy-and-hold returns on the earnings surprise attributable to parent ( $ESUR_P$ ), earnings surprise attributable to subsidiaries ( $ESUR_S$ ), and an indicator variable for meeting or beating ( $MBE$ ) the prior year

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<sup>3</sup> This statistic is subject to measurement error, as the consolidated financial statements adjust for related-party transactions by posting elimination entries, but the subsidiaries' financials do not.

earnings target. Earnings surprise is defined as earnings (scaled by total assets) for the current year less earnings (scaled by total assets) for the previous year. An equal weight on  $ESUR_P$  and  $ESUR_S$  would indicate that market treats both these components the same and hence the standalone earnings do not provide information incremental to consolidated earnings. In contrast, different weights on  $ESUR_P$  and  $ESUR_S$  would indicate that markets use standalone earnings information to treat parent and subsidiary earnings components differently, thereby establishing the need for the standalone financial statements. On average, our results are consistent with the second possibility. We find that the market places a greater weight on the parent's earnings surprise, compared to subsidiaries' earnings surprise, suggesting that standalone financial statements do provide valuable information to investors.

We further drill down to the source of the market reward for  $MBE$  in the contemporaneous market reaction. In our setting,  $MBE$  can be achieved in three possible ways: (i) improvement in both the parent's and subsidiary's earnings, (ii) improvement in the parent's earnings alone, and (iii) improvement in the subsidiary's earnings alone. Similarly,  $MISS$  can also be achieved in three possible ways: (i) decline in both the parent's and subsidiary's earnings, (ii) decline in the parent's earnings alone, and (iii) decline in the subsidiary's earnings alone. We include separate indicator variables for each of the above scenarios in our regression model. We find that the reward for  $MBE$  that is achieved due to surprise in parent's earnings is greater than the reward for  $MBE$  that this achieved due to surprise in subsidiaries' earnings. When it comes to the penalty for  $MISS$ , we find that there is none if, at a consolidated level, the company misses the earnings benchmark but, at a standalone level,  $MBE$  is achieved. In fact, there is a reward in this case. Overall, we find that the stock market differentially treats parent's earnings surprise and subsidiary's earnings surprise, giving greater weight to the former. Our findings indicates that standalone financial statements are useful to investors, even in the presence of consolidated financial statements.

To better understand the economic significance of these results, we adopt the perfect foresight portfolio returns approach used by Francis and Schipper [1999]. Specifically, we compare the total return that could be earned from perfect foresight of earnings at the consolidated level and earnings at a disaggregated level. We find that a portfolio based on the foresight of consolidated, parent, and subsidiary earnings (35.12%) performs better than a portfolio formed on the foresight of consolidated earnings alone (26.07%). This reinforces our conclusion that there is value in standalone earnings, even in the presence of consolidated earnings and even though intercompany transactions can introduce measurement error into standalone earnings.

Our next set of analyses examines the cross-sectional variation in how the stock market differentially prices parent versus subsidiary earnings surprise. This analysis allows us to point out when consolidated financial statements alone are sufficient for investors and when there is an incremental value for standalone financial statements. We hypothesize that investors are likely to find standalone earnings useful in settings where they would want to better understand the financial performance of the parent alone, in addition to the overall performance of the consolidated entity. We argue that such a need to understand the financial performance of the parent might arise due to the potential for “tunnelling” (majority shareholders/promoters diverting funds from the publicly listed parent to privately held subsidiaries or themselves) and “propping-up” (the parent company receiving funds from subsidiaries to show better performance). Accordingly, we find that, while reacting to earnings information, the market assigns higher weight to the parent component of earnings surprise,  $ESUR_p$ , than the subsidiary component of earnings surprise,  $ESUR_s$ , in firms with (i) high levels of related party transactions, (ii) many subsidiaries, (iii) high levels of earnings management in the subsidiaries, and (iv) high leverage in the subsidiaries, consistent with our expectations.

In additional analysis, we rule out any possibility of market mispricing these two components of earnings surprise. We argue that the relationship between the earnings components and returns is driven by the expected persistence of the earnings components. Thus, to determine whether the market is efficiently pricing the parent's and subsidiaries' earnings surprise, we examine the extent to which the parent's versus subsidiaries' current period earnings predict one-year-ahead earnings. We find that the parent's earnings has greater explanatory power than the subsidiary's earnings in predicting consolidated earnings and cash flows. To further rule out any mispricing, we regress one-year-ahead stock returns on components of current year earnings surprise and indicator variables that represent various ways in which *MBE* or *MISS* can be achieved based on the earnings surprise at parent and subsidiary levels. Any over or underreactions to parent versus subsidiary earnings surprise in the current period is likely to reverse in the future. We do not find evidence of mispricing of the subsidiaries' earnings surprise being corrected in the future. These results indicate that the stock market finds the disaggregation of consolidated earnings into parent and subsidiary earnings useful, and it prices these two components efficiently.

Our work relates closely to the stream of research that examines the usefulness of segment reporting (Berger and Hann [2007], Ettredge, Kwon, Smith, & Zarowin [2005], Song [2021], etc.). Both segment reporting and standalone versus consolidated financial statements provide disaggregated information that can be useful to investors. Hence, we rule out the possibility that our results reflect the usefulness of segment reporting and not that of parent versus subsidiary earnings disaggregation. We argue that there are certain unique features of our setting that make it different from segment reporting. First, in the case of segment reporting, many of the disclosures are made at a very broad level, such as revenue, operating profits, total assets, etc., and not at the EPS level. Thus, it is impossible to examine the informativeness of earnings relating to each segment in the way that we examine the usefulness of parent versus

subsidiary earnings. Second, segments are internally demarcated by the firm based on geography, industry, and operating segments, whereas parents and subsidiaries are separate legal entities. Thus, unlike different segments, parents and subsidiaries are likely to differ on required levels of legal compliance and regulatory oversight. This in turn can have implications for the usefulness of earnings components. To provide empirical support for these arguments, we estimate model (1) in subsample of firms that are unlikely to have segments. We still find differential weights on the parent and subsidiary components of earnings surprise, suggesting that disaggregation by parent versus subsidiary is distinct from segment disaggregation.

We contribute to the literature on earnings informativeness by documenting the usefulness of disaggregated parent and subsidiary financial statements. In the context of debt contracting, Francis [1986] shows that disclosure of standalone as well as consolidated statements is incrementally valuable to creditors beyond the disclosure of only consolidated financial statements. Similarly, Beaver, Cascino, Correia, and McNichols [2019] show that subsidiary information improves the prediction of parents' defaults, possibly because the process of consolidation nets off the intragroup exposures relating to borrowing and lending. There is scant evidence on the usefulness of disaggregated parent and subsidiary information for equity investors. Our paper fills this gap in the literature. It is the first to examine how the market reacts to earnings surprises decomposed as parent and subsidiary components. Note that our decomposition of reported earnings into parent and subsidiary is possible only in countries such as India where regulation mandates the disclosure of both standalone and consolidated financial statements. The same decomposition would be impossible in, for example, the United States since US GAAP requires only consolidated financials. We also add to the literature that examines the market reaction to meeting or beating earnings benchmarks (e.g., Bartov, Givoly, and Hayn [2002]). We show that the market reaction to MBE varies, depending on whether the MBE is achieved based on parent or subsidiary earnings surprise.



The rest of the paper is structured as follows. Section 2 describes the institutional background. Section 3 reviews the literature and develops the hypotheses. Section 4 outlines our research design and describes the data. Section 5 presents our empirical analysis, and Section 6 concludes.

## **2. Institutional Background**

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When an entity (parent) controls one or more other entities (subsidiaries), many countries across the world require presentation of consolidated financial statements. For instance, the first reporting requirement for the preparation of a consolidated financial statement was issued by the New York Stock Exchange (NYSE) in 1919 (Walker and Mack [1998]). Consolidated statements have been required over parent-company reports in the United States since the early 1900s (Walker [1976]) and in the United Kingdom since the 1920s. The Australian Accounting Standard Board (AASB 1024) made the publication of consolidated statements mandatory for parent entities<sup>4</sup> in 1990. Regulators prefer a consolidated perspective, rather than the parent disclosing subsidiaries as equity investments in its balance sheet, because in essence parent and subsidiaries are single economic entity (even though they remain separate legally). Under this process (after making necessary adjustments), the consolidated balance sheet includes the gross assets and liabilities of both the parent and subsidiaries, and the income statement includes gross sales and expenses of the parent and subsidiaries, rather than just the parent's share of the subsidiaries' net assets or income. Consolidation provides the overview of the whole group of businesses under the parent company's control.

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<sup>4</sup> Australian stock exchanges had required consolidated financial statements as part of their listing obligations way before AASB 1024.

Historically, reporting requirements in India have differed from those in the rest of the world. The Companies Act of 1956, administered by the Ministry of Corporate Affairs (MCA) under the Government of India (GOI), provides the regulatory framework for reporting of financial statements. Section 212 of the Companies Act requires that the parent company should provide standalone financial statements where its investments in subsidiaries are reported under the equity method. In addition, the parent must separately provide the financial statements of subsidiaries as an attachment. The standard setters were of the view that the disclosure of consolidated financial statements was not needed because financial statements of subsidiaries provide all the required information and consolidated statements would not add any more information (Srinivasan and Narasimhan [2012]). However, a major drawback of this approach is that it imposes significant costs on the users of financial statements who want to consolidate the financial statements of a parent and subsidiaries on their own. Moreover, investors would not have access to necessary information, such as intercompany transactions, needed to post elimination entries during the process of consolidation.

However, post liberalization<sup>5</sup> (1992 onward), India opened its economy to foreign capital, and regulators sought to converge to international accounting standards because increased financial comparability and reporting quality was known to facilitate foreign investment (Li, Ng, and Saffar [2021]). Around that time, the requirement for consolidated financial statements was outlined in International Accounting Standard 27, *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*.<sup>6</sup> The IAS 27 mandated the consolidated financial statements of direct subsidiaries (> 50% of shareholding) and subsidiaries where the parent firm exercises influence. With the objective of improving the

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<sup>5</sup> Until 1991, India was closed economy. Starting in 1991 and 1992, India undertook economic reforms focused on liberalization and privatization.

<sup>6</sup> The International Accounting Standards Board (IASB), a London-based independent international standard-setting body, released the International Accounting Standards (IAS) in the past. In 2001, International Financial Reporting Standards took the place of the IAS.

comparability of Indian financial statements with those prepared in the rest of the world, the Institute of Chartered Accountants of India (ICAI) introduced Accounting Standard (AS) 21, *Consolidated Financial Statements*, effective April 1, 2001.<sup>7</sup> This accounting standard is broadly in line with the IAS 27. However, note that AS 21 does not mandate that companies should present consolidated financial statements but states that, if a company prepares consolidated financial statements to comply with some other statute or legislation, then it should be in accordance with AS 21. Taking this initiative a step further, the Securities Exchange Board of India (SEBI) modified its listing obligation and disclosure requirement (LODR) in 2002 and mandated consolidated financial statements for all listed companies.<sup>8</sup>

In 2013 India implemented a major policy reform by overhauling the Companies Act of 1956. The revised act requires all the firms, publicly listed and private, to prepare consolidated and standalone financial statements. Following this change, the ICAI developed IFRS converged Ind AS110, *Consolidated Financial Statements*. This Standard shows a parent's and subsidiary's financial statements as a unified economic entity. Ind AS 27, *Separate Financial Statements*, provides separately the parent's financial statements on a standalone basis.<sup>9</sup> Unlike AS 21, Ind AS 110 makes consolidated financial statements mandatory for parent firms without this being conditioned on any other statute.

We interviewed financial executives and analysts to understand their perspectives on the relative importance of the two sets of financials. Paritosh Basu, former CFO of Essar Group, said: “Both are required for any decision-making. The logic behind this is standalone

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<sup>7</sup> ICAI (equivalent to AICPA in the US) is statutory body that sets standards for accounting and auditing processes. The Ministry of Corporate Affairs under the Government of India then notifies [[this seems the wrong word—does it publish them? Notify users about them?]] these standards.

<sup>8</sup> SEBI is regulator of capital markets in India (equivalent to the SEC in the US), and specifically Regulation 33 mentions the preparation of consolidated financial statements.

<sup>9</sup> These Indian Accounting Standards (Ind AS) were adopted on April 1, 2016, initially for listed firms with a net worth of more than INR 5 billion. Moreover, companies with a net worth of INR 2.5 billion have been subject to the law since April 1, 2017. From April 1, 2019, the regulatory requirement applied to banks, insurers, and financial service companies.

financial statements are like the stem of a tree, and consolidated financial statements like full tree which includes various branches, fruits, flowers, etc.” Others, such as Dr S.R. Korivi of NIFM,<sup>10</sup> argue that information in the standalone statements may be more useful for assessment of profit, while information in the consolidated ones may be more useful for assessing leverage and the strength of the firm’s capital structure overall. In addition, executives suggest that both the relative size of the subsidiaries (S. Guntupalli, Kotak Mahindra Asset Management) or the extent of influence or control the parent has over the subsidiaries (Yadnaya Investment Academy) may determine the relative usefulness of standalone versus consolidated financial statement information. These differing views motivate our empirical analysis.

Compared to the standards they replaced; the new standards may provide useful information to investors. Standalone financial statements are incomplete and hence could be misleading. For example, in the year 2000, when consolidation was not required in India, the profit before tax for Zee Telefilms Ltd. (ZTL) increased from INR 806 million in 1999 to INR 2,882 million. With this improvement in profits, there was a significant positive stock price reaction. However, when the detailed annual reports of subsidiaries were later made available, it became obvious that the main driver of the profits was an intercompany transaction, where parent ZTL sold a part of its library to its subsidiary Asia Today. If consolidated statements had been in place, such intercompany transactions would have been eliminated, and the stock market reaction would have been more modest.

Even if detailed reports from subsidiaries were concurrently available, investors may still have had difficulty processing the information. Consider the example of Tata Steel Ltd., a company in our sample with 287 subsidiaries. In this case, investors would face the challenge of sifting through many sets of financial to identify the source of the gains at the standalone

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<sup>10</sup> NIFM refers to the National Institute of Financial management, a financial education organization.

level. The information processing problems only worsen if investors face bounded rationality [Simon 1990]. Indeed Lu [2019] demonstrates that, when investors' attention is limited, providing more data alters the nature of information extraction, which can cause information loss. Hence the combination of standalone and consolidated statements prevents information overload and information loss because investors can impute the overall financials for all subsidiaries by subtracting the standalone financials from the consolidated financials.

### **3. Hypothesis development**

In India, the regulations enacted in 2001 made two sets of financial statements available for the investors: a standalone financial statement for the parent company and a consolidated financial statement combining information of the parent and all subsidiaries. Given the presence of two sets of statements and the two earnings numbers contained within, we seek to develop hypotheses about the usefulness of these statements to investors. We identify reasons why standalone earnings may or may not be incrementally useful in the presence of consolidated financial earnings, and, if they are incrementally useful, what are the cross-sectional determinants of their usefulness.

Viewed as a problem of investors using earnings information to make inferences about the performance and ultimately the value of a firm, the presence of standalone and consolidated earnings suggests that investors should be better off with two sets of information than they would be with consolidated statements alone. Accounting theory on aggregation and information loss (e.g., Demski [1973], Pendlebury [1980]) argues that consolidation leads to information loss, and hence there are benefits to having disaggregated earnings information. However, the presence of intercompany transactions is a source of error in both standalone financials and the imputed financials of subsidiaries that can be developed by subtracting standalone from consolidated financials. Since these errors are eliminated in the process of

consolidating financial statements, the ultimate consolidated statements are free from potential errors due to related party transactions. Should the magnitude of errors in standalone financials be sufficiently large, the standalone financials may not be incrementally informative, given consolidated financials.

Nevertheless, standalone earnings (even if measured with error) can provide valuable information to investors. First, to prop up the consolidated entity's earnings, the parent entity can take advantage of fact that subsidiaries are often unlisted and do not need to provide detailed financial statements. For instance, Beuselinck, Cascino, Deloof, and Vanstraelen [2019] find that, in the absence of subsidiary-level information and when subsidiaries operate in a weak institutional setting, firms can manage subsidiary earnings to present favorable financials at the consolidated level. The presence of standalone financial statements is likely to provide useful information to investors to identify propping up behavior. Investors can decompose overall earnings as the parent and subsidiary components and price them accordingly based on their quality and persistence. Formally stated, we hypothesize in null and alternate forms respectively.

***H0: Standalone earnings is not incrementally informative to investors in the presence of consolidated earnings.***

***H1: Standalone earnings is incrementally informative to investors even in the presence of consolidated earnings.***

We expect the usefulness of standalone earnings to vary cross-sectionally. We posit that investors are likely to find standalone earnings information useful in settings where they would want to better understand the financial performance of the parent alone, in addition to the overall performance of the consolidated entity. Such a need to better understand the performance of the parent arises due to the potential for “tunnelling” and “propping-up”, which are characterized by concentrated ownership and complex group structures. In such firms, the

controlling shareholders have the incentive to transfer resources from the public companies to themselves. Such transfers can hurt firm value (La Porta, Lopez-de-Silanes, Shleifer, and Vishny [2002], Bertrand, Mehta, and Mullainathan [2002], Cheung, Rau, and Stouraitis [2006], Kohlbeck and Mayhew [2010]). In contrast, a firm can also receive support from other group companies or subsidiaries. This can be done to take advantage of internal capital markets and overcome difficulties in accessing external finance. It can prevent the failure of solvent entities that suffer the temporary cash flow shortages (Friedman, Johnson, and Mitton [2003], Khanna and Yafeh [2007], Gopalana, Nanda, and Seru [2007], Beaver, Cascino, Correia, and McNichols [2019]).

We argue that tunnelling and propping-up are likely to happen in several settings. First, Li [2021] suggests firms often rely on related party transactions to enable wealth transfers (both tunnelling and propping up). Second, firms with many subsidiaries or where assets of subsidiaries comprise of a significant portion of consolidated assets have greater flexibility to transfer wealth. Third, Beuselinck, Cascino, Deloof, and Vanstraelen [2019] suggest that firms often manage subsidiary earnings, due to their low visibility, to present favorable financials at the consolidated level. Finally, Beaver, Cascino, Correia, and McNichols [2019] find that on average subsidiaries have more debt than parents. Such strategic placement of debt can make a parent entity appear much healthier than it truly is. We posit that, in all these settings, investors are more likely to find standalone earnings useful in accessing the relative performance of the parent entity vis-à-vis the performance of the consolidated entity. Based on this discussion, we hypothesize:

***H2: Standalone earnings is more informative in firms with (i) high levels of related party transactions, (ii) many subsidiaries, (iii) high levels of earnings management in the subsidiary, and (iv) high leverage in the subsidiary.***

## 4. Research Design and data

### 4.1. Regression model

Our research design builds on extensive the literature that examines the stock market reaction to earnings surprises (Ball and Brown [1968], Degeorge, Patel, and Zeckhauser [1999], Skinner and Sloan [2002]) and its components (Dechow [1994], Sloan [1996], Burgstahler, Jiambalvo, and Shevlin [2002], Hsu and Kross [2011]). We regress the stock market reaction on earnings surprise decomposed as earnings surprise attributable to the parent ( $ESUR_P$ ) and earnings surprise attributable to the subsidiaries ( $ESUR_S$ ) and an indicator variable to capture whether current year consolidated earnings meets or beats ( $MBE$ ) expectations. Our baseline model is as follows:

$$\begin{aligned} BHR_{i,t} = & \alpha_0 + \beta_1 * ESUR_{P_{i,t}} + \beta_2 * ESUR_{S_{i,t}} + \beta_3 * MBE_{i,t} + \beta_4 * Size_{i,t} \\ & + \beta_5 * Beta_{i,t} + \beta_6 * BM_{i,t} + \varepsilon_0, \end{aligned} \quad (1)$$

where  $BHR$  is contemporaneous one-year market-adjusted buy-and-hold returns for firm  $i$  during year  $t$ . For calculating BHR, compounding starts nine months before the fiscal year ends and three months after the fiscal year ends.  $ESUR_{P_{i,t}}$  is the earnings surprise for parent firm  $i$  in period  $t$ , defined as the difference between the profit after tax in period  $t$  and  $t-1$  as reported in the standalone financial statements, scaled by total assets reported in the consolidated balance sheet.  $ESUR_{S_{i,t}}$  is the earnings surprise for all subsidiaries of firm  $i$  in the period  $t$  and  $t-1$ , scaled by total assets as reported in consolidated financial statements, where subsidiaries' earnings is imputed as the difference between profit after tax reported in the consolidated income statement and profit after tax reported in the standalone (parent) statement in the period. This measure of subsidiary earnings is subject to some degree of measurement error.  $MBE_{i,t}$  is an indicator variable for meeting or beating prior year earnings; it takes a value of 1 if earnings improved over the previous period, i.e.,  $\Delta Earnings_{C_{i,t}} \geq 0$ , and otherwise 0. In our model,



we also control for variables known to affect stock prices. These include  $Size_{i,t}$ , which is the natural logarithm of the market value of equity, and  $Beta_{i,t}$ , a three-year market beta introduced to control for systematic risk.  $BM_{i,t}$  is calculated by dividing the company's book value of equity by its market value of equity at the end of period  $t$ . We use the Fama-MacBeth 1973 method with the Newey-West 1987 correction for serial correlation to estimate this equation. We expect positive signs on  $\beta_1$ ,  $\beta_2$ , and  $\beta_3$  coefficients, consistent with the stock market reacting positively to earnings surprise and there being a reward for MBE. To test our first hypothesis, we compare the relative magnitude of  $\beta_1$  and  $\beta_2$  coefficients. A finding of  $\beta_1 = \beta_2$  would indicate that the market gives equal weight to parent and subsidiary earnings surprise while determining stock price. The implication of such a finding is that the market finds consolidated earnings information sufficient and there is no further role of standalone earnings. In contrast, a finding of  $\beta_1 \neq \beta_2$  would suggest that the market differentially prices the parent and subsidiary components of earnings and hence standalone earnings is informative, even in the presence of consolidated earnings.

We further expand equation (1) to examine whether the stock market reward for *MBE* and penalty for *MISS* (missing the earnings target) varies, depending on the relative contribution of parent and subsidiary earnings surprise in achieving *MBE* or *MISS*. Specifically, we estimate the following equation:

$$\begin{aligned}
BHR_{i,t} = & \alpha_0 + \beta_1 * ESUR_{P_{i,t}} + \beta_2 * ESUR_{S_{i,t}} + \beta_3 * MBEP1S1_{i,t} + \beta_4 * MBEP1S0_{i,t} \\
& + \beta_5 * MBEP0S1_{i,t} + \beta_6 * MISSP1S0_{i,t} + \beta_7 * MISSP0S1_{i,t} + \beta_8 * Size_{i,t} \\
& + \beta_9 * Beta_{i,t} + \beta_{10} * BM_{i,t} \\
& + \varepsilon_0,
\end{aligned} \tag{2}$$

where *MBEP1S1* is an indicator variable that equals 1 if a firm achieves *MBE* at consolidated entity level and such *MBE* is achieved due to positive earnings surprise at both parent and subsidiary levels and zero otherwise. *MBEP1S0* is an indicator variable that equals 1 if a firm achieves *MBE* at the consolidated entity level and such *MBE* is achieved due to

positive earnings surprise at the parent level alone and the subsidiary reports negative earnings surprise and zero otherwise. *MBEPOS1* is an indicator variable that equals 1 if a firm achieves *MBE* at consolidated entity level and such *MBE* is achieved due to positive earnings surprise at the subsidiary level alone and the parent reports negative earnings surprise and zero otherwise. *MISSPIS0* is an indicator variable that equals 1 if a firm misses the earnings target at the consolidated level and the *MISS* is due to negative earnings surprise at the subsidiary level alone, with the parent reporting positive earnings surprise and zero otherwise. *MISSPOS1* is an indicator variable that equals 1 if a firm misses the earnings target at the consolidated entity level and the *MISS* is due to negative earnings surprise at the parent level alone with the subsidiary reporting positive earnings surprise and zero otherwise. All other variables are as previously defined for equation (1). If the stock market does not differentiate how *MBE* is achieved, i.e., whether it is driven by the earnings surprise of the parent or that of the subsidiary, then we expect  $\beta_4 = \beta_5$ . Similarly, if the market does not differentiate how a firm misses the earnings benchmark, then we expect  $\beta_6 = \beta_7$ . Depending on the values these coefficients take, we can draw conclusions about the usefulness of standalone earnings information.

#### ***4.2. Sample and data***

Our starting sample consists of 26,455 firm-year observations from 2000–2020. We use the Prowess database maintained by CMIE (Centre for Monitoring Indian Economy), which is widely accepted and used in academic research on Indian markets (Khanna and Palepu [2000], Bertrand, Mehta, and Mullainathan [2002], Gopalana, Nanda, and Seru [2007], Manchiraju and Rajgopal [2017], Li [2021]). We impose the following restrictions to arrive at our final sample. First, we retain only firms with March year-ends, which reduces our sample size by 1,449 firm-year observations. Second, to reduce the effect of extremely small firms, we discard firm-year observations with sales and total assets reported on a consolidated and parent basis of less than INR 1 million. In this step we lose 3,210 firm-year observations. Third, we eliminate

observations with total assets and sales at the consolidated level less than total assets at the parent level. Such observations are likely to reflect financials for holding companies or data quality issues. We lose 5,306 firm-year observations in this step. Fourth, we drop 299 observations with missing values of sales, total assets, net income, book value of equity, and cash flow from operations on both the consolidated and parent basis. Fifth, for our empirical analysis, we need earnings surprise, the difference between profit after tax in periods  $t$  and  $t-1$  scaled by total assets as reported in consolidated statements. Therefore, we drop 3,540 firm-year observations with a missing earnings surprise. An essential part of our analysis is the contemporaneous and future returns tests. Hence our final data filter requires the availability of stock price data. We drop unlisted firms. We then use stock prices from the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE), two of the country's major stock exchanges.<sup>11</sup> Since BSE has more listed firms, we primarily considered NSE stock prices and market capitalization and used BSE data wherever NSE data was missing values. For our returns test, we calculate BHR (buy-and-hold return), which is one-year market-adjusted buy-and-hold returns, where compounding starts nine months before the fiscal year-end and ends three months after the fiscal year-end (Hsu and Kross [2011]). Therefore, we need 12 months of data to calculate BHR; hence we eliminate all those values with less than 12 months of returns data. We use book-to-market and market beta as controls in our return test. Beta calculated is three-year market beta, and the benchmark index used is NIFTY 500.<sup>12</sup> We drop observations with missing values of stock returns, index returns, market capitalization, beta, and book-to-market ratio. We also eliminate observations with a beta value and book-to-market

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<sup>11</sup> Market cap of both the stock exchange is around \$3 trillion: <https://www.livemint.com/market/stock-market-news/after-bse-market-cap-of-nse-firms-hits-a-record-3-tn-as-stocks-rally-11622094856033.html>

<sup>12</sup> It reflects the top 500 firms in the eligible universe based on complete market capitalization: [https://www1.nseindia.com/products/content/equities/indices/nifty\\_500.htm](https://www1.nseindia.com/products/content/equities/indices/nifty_500.htm)

ratio of less than 0. Overall we lose 3,891 firm-year observations, and our final sample consists of 8,760 firm-year observations. Table 1 summarizes sample selection.

<<Insert Table 1>>

In Table 2, we describe the sample composition by year and industry. We find that the data availability increases with time. Our industry classification is based on industry divisions as specified in national industry classification 2008, by Central Statistical Organisation, Ministry of Statistics and Programme Implementation, Government of India. We find that manufacturing, information and communication, and construction are the top three industries in terms of sample data.

<<Insert Table 2>>

Table 3 provides descriptive statistics for our overall sample. In panel A, we report statistics relating to consolidated financials. On average a firm in our sample has 9.05 subsidiaries, and 46.7% of our observations consist of wholly owned subsidiaries, while 957 firm-year observations consist of at least one subsidiary. Mean consolidated total assets is 79.95 (INR billions). Subsidiary firms contribute, on average, around 20.01% of the total assets of the consolidated total assets, suggesting that they form an important component of the overall economic entity and can significantly affect performance at a consolidated level.<sup>13</sup> The average return on assets (ROA) for firms in our sample is 4%. In our sample, 45.8% firm-year observations show improvement in previous year ROA.

In panel B, we compare the mean and median values of certain key financial indicators at parent and subsidiary level. ROA is higher for the parent or standalone component of the consolidated entity compared to the subsidiary component. However, earning volatility

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<sup>13</sup> We need to be cautious in interpreting the statement, as the effect of related party transactions is adjusted at consolidated level but not at subsidiary level. Therefore subsidiary assets can be inflated.

measured as the standard deviation of ROA estimated over 5-year estimation period, is much higher for subsidiaries 31.6% than for parent (3.5%) and consolidated level (3.3%). The discretionary accruals of subsidiaries are also higher than the discretionary accruals of the parent entity. Another noteworthy statistic in this table relates to leverage, defined as the ratio of total liabilities to total assets. The average leverage at the parent level is 0.496, whereas the average leverage for subsidiaries is 0.809, suggesting that companies prefer to have more debt in their subsidiaries than in the parent company.

<< Insert Table 3 >>

## **5. Empirical Analysis**

### ***5.1. Contemporaneous market reaction to earnings surprise***

We present the results from estimating equation (1) in Table 4. In column (1) we regress 12-month BHR on earnings surprise at a consolidated level and an indicator variable from meeting or beating earnings expectations. As shown in column (1), we find a positive and statistically significant coefficient of *ESUR<sub>C</sub>*. This is consistent with extensive prior literature starting Ball and Brown [1968] that documents a positive association between earnings and stock returns. The coefficient on *MBE* is positive and statistically significant at a 0.01 level. Controlling for earnings surprise and other determinants of stock returns, firms achieving MBE have 17.6% higher return compared to firms that do not achieve MBE. The finding is consistent with the premium for meeting or beating expectations documented in the prior literature (Bartov, Givoly, and Hayn [2002]). We find similar results in column (2) where we regress one-year contemporaneous stock returns on earnings surprise at a standalone level and an indicator variable from meeting or beating earnings expectations. We find a positive association between returns and standalone earnings surprise and there is a premium for MBE.

In column (3) we regress one- year contemporaneous stock returns on earnings surprise at a consolidated and standalone level and an indicator variable from meeting or beating earnings expectations. This test enables us to determine whether the stock market relies more on consolidated or standalone earnings in determining stock prices. We find the coefficient on both consolidated earnings surprise  $ESUR_{C_{i,t}}$  (coeff = 0.463 , p-value < 10%) and standalone earnings surprise  $ESUR_{p_{i,t}}$  (coeff = 1.09 p-value < 1%) are positive and significant, suggesting that stock market incorporates both components of earnings in determining stock prices. However, the coefficient on the standalone earnings surprise is statistically greater than the coefficient on the consolidated earnings surprise (F-stats = 4.83, p-value < 10% level), suggesting that standalone earnings surprise is more useful in determining stock prices. Since consolidated earnings comprises of both parent and subsidiary, the overall coefficient on parent earnings surprise can be considered as 1.553 (=1.09 + 0.463) and that on the subsidiary earnings surprise will be 0.463.

A similar result is shown in column (4), where we decompose the consolidated earnings surprise into  $ESUR_{p_{i,t}}$  (parent component) and  $ESUR_{s_{i,t}}$  (Subsidiary component). We find that positive and significant coefficients on both  $ESUR_{p_{i,t}}$  (coeff = 1.553, p-value < 1%) and  $ESUR_{s_{i,t}}$  (coeff = 0.463, p-value < 10%). However, the coefficient on the parent component of earnings surprise is statistically greater than the coefficient on the subsidiary component of earnings surprise (F-stats = 15.95, p-value < 1%). In column (5) we include additional variables to control for the level of profitability, sales growth and earnings volatility both at parent and subsidiary level. These variables are known as drivers of earnings persistence (Collins and Kothari[1989]). Despite controlling for these variables, we still find the coefficient on the parent component of earnings surprise to be statistically greater than the coefficient on the subsidiary component of earnings surprise (F-stats = 16.92, p-value < 1%). Overall, these

results indicate that the stock market differentially weighs the parent's and subsidiary's component of earnings surprise, and more weight is given to the parent's component.<sup>14</sup>

<< Insert Table 4 >>

In table 5, we present our analysis where we attempt to identify whether reward to *MBE* and penalty for *MISS* vary, depending on whether parent or subsidiary earnings surprise leads to such *MBE* or *MISS*. In panel A, we present the univariate results. We find that 46% of all our firm-year observations achieve *MBE* at the consolidated earnings level, whereas the remaining 54% do not show improvement over prior year's earnings and hence are classified as *MISS*. There is substantial variation in how *MBE* is achieved. In the subsample of firm-year observations that achieve *MBE* at the consolidated earnings level, there is improvement over previous year's earnings—at both the parent and subsidiary levels (*MBEPISI*), only at the parent level and not at the subsidiary level (*MBEPIS0*), and only at the subsidiary level and not at the parent level (*MBEPOS1*), in 51.1%, 30.1%, and 18.7% observations, respectively. The average one-year BHR (buy-and-hold return) for firms classified *MBEPISI*, *MBEPIS0*, and *MBEPOS1* is 23.3%, 16.1%, and 3.9%, respectively. This result suggests that the stock market performance of firms classified based on improvement in consolidated earnings varies based on the source of improvement; i.e., the market reward is greater if parent firms drive the improvement. We also examine the stock market penalty for not showing improvement in the previous year's earnings. In the subsample of firm-year observations classified as *MISS*, there is a decline over previous year's earnings—at both the parent and subsidiary levels (*MISSPOS0*), only at the parent level and not at the subsidiary level (*MISSPIS0*), and only at the subsidiary level and not at the parent level (*MISSPOS1*), in 51.1%, 14.7%, and 34%

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<sup>14</sup> We test the sensitivity of results by controlling for the level of related-party transactions (RPT) at the parent and subsidiaries level of earnings and earnings volatility. Our results remain consistent. Since we lose part of our sample by including these controls, we have not tabulated those results.

observations, respectively. The average one-year BHR (buy-and-hold return) for firms classified *MISSPOS0*, *MISSPIS0*, and *MISSP0SI* is -13.5%, -2.4%, and -10%, respectively. This finding suggests that the penalty for missing the earnings target is greater if the negative surprise is driven by a decline in the parent's earnings.

In panel B of Table 5, we present the results from estimating model (2). In this model, our coefficients of interest are *MBEPISI*, *MBEPIS0*, *MBEP0SI*, *MISSPIS0*, and *MISSP0SI*, which capture various ways of improvement or decline in the previous year's consolidated earnings. The intercept term, *MISSPOS0*, relates to firms that *MISS* the earnings target and the decline is driven by a negative earnings surprise at both the parent and subsidiary levels. Results of the regression analysis resemble those documented in the univariate analysis. The coefficient on *MBEPISI* is 0.247, statistically significant at a 0.01 level. This can be inferred as firms registering an improvement in consolidated earnings due to improvement in both parent and subsidiary earnings have a BHR of 24.7% higher than firms registered a decline in consolidated earnings due to a decline in both parent and subsidiary earnings. The coefficient of *MBEPIS0* (0.205) is statistically significant, greater, and different than the coefficient on *MBEP0SI* (0.108). This result validates that market underreacts to consolidated earnings improvement driven by the subsidiary. Additionally, in *MISSPIS0*, we find a reward indicated by 0.098 at 0.05 level significance, despite missing the target or declining consolidated earnings. Hence this result indicates that, despite a decline in consolidated earnings driven by subsidiary earnings, if the parent's earnings improve, the market responds favorably. Taken together, the results so far suggest that the stock market does not fixate at consolidated earnings and that it differentially reacts to the parent and subsidiary components of earnings surprise.

<< Insert Table 5 >>



To better understand the economic significance of these results, we adopt the perfect foresight portfolio returns approach used by Francis and Schipper [1999]. For each year in our sample, Table 6 shows the mean market-adjusted 12 month buy-and-hold return to each accounting hedge portfolio denoted by HP\_C and HP\_CPS. HP\_C represents a hedge portfolio formed based on the sign of change in consolidated earnings over the previous year; we take a long position when the change in consolidated earnings over the previous year is positive and a short position when the change in consolidated earnings is negative. HP\_CPS is a hedge portfolio formed based on the sign of change in consolidated, standalone, and subsidiary (consolidated minus standalone) earnings; we take a long position when all three earnings changes are positive and a short position when negative. The proportion of market-adjusted buy-and-hold return to the return-based portfolio explained by each accounting measure is denoted by %Mkt, which refers to the percentage of the perfect foresight return available to investors with foreknowledge of earnings change.

The average market-adjusted buy-and-hold returns across the entire sample period for the hedge portfolios formed based on only consolidated earnings (HP\_C) is 26.07%, compared to hedge portfolios formed based on consolidated, parent (standalone), and subsidiary earnings (HP\_CPS) is 35.12%. These results show that hedge portfolios formed based on consolidated, standalone, and subsidiary earnings yield greater returns (difference: 9.04% t-stat: 4.55). Secondly, % Mkt indicates that about 34.55% of total perfect foresight returns are available to investors with advanced knowledge of only the consolidated earnings change, compared to 42.91% when the consolidated, standalone and subsidiary earnings information is available. These results highlight the incremental value of the standalone earnings, even in the presence of consolidated earnings. Overall, the results in Table 6 highlight that standalone earnings have incremental value and consolidated earnings decomposition into parent and subsidiary

components (with a certain degree of measurement error) yields greater returns than using only consolidated earnings.

<<Insert Table 6>>

## ***5.2. Cross sectional variation***

In this section, we present results relating to our second hypothesis, which examines the cross-sectional variation in the market response to the decomposed components of earnings surprise (parent and subsidiary). These results are presented in Table 7. There are four panels in this table, with each panel corresponding to a particular setting where the hypothesized need for disaggregated information is greatest.

In panel A, we partition the sample based on high versus low RPT volume and estimate model (1) separately for each subsample. Consistent with our prediction, we find that, in the subsample of high RPT volume (defined as RPT volume being above the industry median RPT volume), the parent's earnings surprise is weighted higher by the market (coef: 1.629 p-value < 1%) and subsidiary component is statistically insignificant. No such differential pricing of earnings surprise components is seen in column (2), where volume of RPTs is low. We further classify RPTs as operating and financing and tone and business. Research (Li [2021]) suggests that financing RPTs, rather than operating RPTs, are more likely to be the devices of wealth transfers and (Kohlbeck and Mayhew [2017]) tone RPTs (tone RPTs refer to transactions with directors, officers, and shareholders) rather than business RPTs (transactions with subsidiaries, joint ventures, and unconsolidated company entities) are more likely to be channels for expropriation. Hence, we repeat the subsample analysis based on partitions formed on the above versus below annual industry median levels of financing and tone RPTs. We find that the market places greater weight on the parent's component of earnings surprise in firms with high levels of financing and tone RPTs.

Next, we examine the cross-sectional variation of our results based on the relative importance of subsidiaries. We document these results in panel B. We divide the sample based on number of subsidiaries in columns (1) and (2). In columns (3) and (4), we divide the sample based on the proportion of subsidiary assets to total assets. We find that market differentially prices parent and subsidiary surprises when the proportion of subsidiaries' assets and number of subsidiaries are above median, which is evident from F-test (p-value < 5%). Hence, we infer from these results that, if the subsidiaries are relatively important as measured by assets and number of subsidiaries, the market values disaggregated information.

In panel C, we partition the sample based on positive and negative discretionary accruals and estimate model (1) separately for each subsample. We use the modified Jones model (Dechow, Sloan, and Sweeney 1995) to estimate discretionary accruals.<sup>15</sup> Columns (1) and (2) relate to the subsamples where discretionary accruals at subsidiary level are positive and negative, respectively. In column (1), the coefficient on the parent's earnings surprise is positive and significant (coef: 1.974, p-value < 1%) whereas the coefficient on the subsidiary's earnings surprise is statistically insignificant. This finding suggests that, when subsidiary earnings quality is poor, the market places a lower weight on its earnings surprise. No such differential pricing of earnings surprise components is seen in column (2), where discretionary accruals are negative and hence less indicative of poor earnings quality. In columns (3) and (4), we partition the sample based on the level of the absolute value of discretionary accruals. Similar to the results documented in columns (1) and (2), we find that the market places lower weight on the subsidiary's earnings surprise when the absolute value of the discretionary accruals of the subsidiary is high (above the sample median). However, no such differential

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<sup>15</sup> Estimation details are described in Appendix A2.

weight is assigned to parent and subsidiary earnings surprise when the absolute value of the discretionary accruals of the subsidiary is low (below the sample median).

Finally, in panel D, we divide the sample into above- and below-industry-median leverage at the subsidiary level. We estimate equation (1) separately in each of these subsamples. In columns (1) and (2), we show results relating to subsamples based on above- and below-median leverage at the subsidiary level. We find that, in the subsample of firms with above-median leverage, the stock market places greater weight on parent earnings surprise (coeff = 1.832, p-value < 1%) and on the subsidiary earnings surprise (coeff = 0.512, p-value < 10%) in determining stock prices. However, in the below-median group, the market does not differentially weight parent (coeff = 1.705, p-value < 1%) and subsidiary (coeff = 0.924, p-value < 5%) components of earnings surprise in determining stock prices. Overall these results suggest that investors find disaggregated information useful in highly levered firms.

<<Insert Table 7>>

### ***5.3. Ruling out alternate explanations***

Our results so far indicate that, in determining stock prices, the market assigns higher weight to the parent's component of the earnings surprise and a lower weight to the subsidiary's component. In this section, we rule out alternate explanations for our main result. First, we rule out the possibility that the differential weighing of earnings components is because of mispricing. *Ceteris paribus*, in determining stock prices, the market will place greater weight on the component of earnings that has higher persistence. Hence we compare the earnings persistence of the parent's component of earnings vis-a-vis the subsidiary's component of earnings. To test the persistence of parent and subsidiary earnings, we regress one-year-ahead earnings on current year earnings (Dechow, Ge, and Schrand [2010]). Specifically, we estimate the following model:

$$\begin{aligned}
EARN_{C_{i,t+1}} = & \alpha_0 + \gamma_1 * EARN_{P_{i,t}} + \gamma_2 * EARN_{S_{i,t}} + \gamma_3 * Size_{i,t} \\
& + \gamma_4 * Beta_{i,t} + \gamma_5 * BM_{i,t} + \varepsilon_0,
\end{aligned}
\tag{3}$$

where *EARN* is profit after tax scaled by total assets and subscripts C, P and S refer to consolidated, parent, and subsidiary, respectively. All the other variables are the same as described in model (1) and in Appendix A2. A finding of coefficient  $\gamma_1 > \gamma_2$  will indicate that parent's earnings is more persistent than the subsidiary's earnings. Any finding contrary to this would indicate mispricing.

We present the results from estimating model (3) in panel A of Table 8. The ability of current year parent and subsidiary earnings in predicting one-year-ahead parent, subsidiary and consolidated earnings is shown in columns (1)–(3), respectively. In column (1), the coefficient on the parent's earnings is positive and significant (coeff = 0.683, p-value <1%). This shows that 68.3% of current year parent earnings map into future parent earnings. In column (2), the coefficient on the subsidiary's earnings is also positive and significant (coeff = 0.539, p-value <1%), indicating that 53.9% current year subsidiary earnings map into future subsidiary earnings. These results suggest that both parent and subsidiary earnings are persistent. To evaluate which of these two components are more persistent, in column (3), we examine the predictive ability of parent and subsidiary earnings for future consolidated earnings. The coefficients on both the parent and subsidiary components are positive and significant. However, both coefficients are statistically different, and the coefficient on the parent component (0.697) is greater than that on the subsidiary component (0.584). An F-test rejects the hypothesis of equality of these coefficients (p-value < 10%). The nature of the results is similar in columns (4)–(6), where we document the ability of current year parent and subsidiary earnings in predicting one-year-ahead parent, subsidiary, and consolidated cash flows, respectively.

As an additional check, we examine the association of current year disaggregated earnings surprise and one-year-ahead returns. To the extent there is any over- or underreaction to parent versus subsidiary earnings surprise in the current year, the mispricing is likely to be corrected in subsequent years. We use a modified version of model (2) to check this possibility. We regress future *BHR* (one-year market-adjusted buy-and-hold returns for a firm *i* during year  $t+1$ ) on both current year earnings surprise components and indicator variables for various ways in which improvement or decline over previous year earnings is achieved. The results are tabulated in panel B of Table 8. We find the coefficients on  $ESUR_{P_{i,t}}$  and  $ESUR_{S_{i,t}}$  to be statistically insignificant, indicating that investors having fully incorporated the information contained in the parent and subsidiary earnings surprise in the contemporaneous stock returns itself, leaving no need for a future correction. The coefficient on *MBEPISI* is positive and significant, which indicates that post-earnings announcement drift (Bernard and Thomas [1989]) reverses in the last quarter of the year.

We also rule out the possibility that our results capture the information contained in segment reporting—one of the most widely followed practices of financial information disaggregation. Therefore, to rule out the possibility that differential market response we observe is due to segment reporting and not that of disaggregation at the parent and subsidiary levels, we undertake a subsample analysis, as shown in Table 8 Panel C. We obtain segment information from *prolessdx* maintained by CMIE.<sup>16</sup> We divide the sample based on availability of segment information (at least one segment). In column (1), we find the coefficient on  $ESUR_{P_{i,t}}$  is statistically significant (coef: 2.092\* , p-value < 10%) and that on  $ESUR_{S_{i,t}}$  is statistically insignificant. In column (2), we consider the firm year observation devoid of segment information, and, in that case  $ESUR_{P_{i,t}}$  and  $ESUR_{S_{i,t}}$ , are statistically

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<sup>16</sup> Segment information is sparsely populated in the Prowess database. Therefore we have only 506 firm-year observations with segment information.

significant, and the parent component is weighted higher. Therefore, we conclude that informativeness of standalone statements is not sensitive to availability of segment information.

<< Insert Table 8 >>

#### **5.4. Robustness tests**

In this section, we perform several sensitivity tests to ascertain the robustness of our results. This analysis is tabulated in the internet appendix to the main paper. First, we establish that our results are not sensitive to the regression specification we employed in the estimating equation (1). Rather than estimating Fama-McBeth regressions, we use panel regressions with year and industry fixed effects as an alternative specification. These results are documented in Table OA1 of the internet appendix. Consistent with our main results, as documented in Table 4, we find that stock market gives higher weight on the parent component of earnings surprises, compared to the subsidiary component (F-test: 20.86 p-value < 1%), in determining stock prices.

Second, we check the sensitivity of our results to the way we measure earnings surprise. In our main analysis, we use prior year earnings to calculate earnings surprise, because data for analyst estimates (the more frequently used proxy for expected earnings in the literature) is available only for around 10% of the sample. We rule out the possibility that our results are driven by the way we measure earnings surprise by estimating model (1) for only the subsample that has analyst earnings forecasts. We obtain analyst EPS estimates from I/B/E/S database. To make the analysis comparable to the main analysis, we multiply the difference between actual and estimated EPS with shares outstanding at the end of the year and divide this by consolidated total assets. The resulting metric resembles ROA. Due to limited number of observations, we use panel regression with industry and year fixed effects. Results tabulated in Table OA2 of

the internet appendix show that, in column (1), earnings at the consolidated level is positively associated with returns. This confirms our earlier finding of the stock market differentially pricing parent and subsidiary earnings surprise (F-test: 7.86 p-value < 1%).

Third, we examine how the stock market reacts to earnings surprise over a much shorter three-day event window around the earnings announcement date, rather than over a one-year horizon. We calculate a three-day cumulative abnormal return (CAR) around the quarterly earnings announcement. This CAR is adjusted for Fama-French factors like SMB (small minus big), HML (high minus low value), WML (winners minus losers), and market risk.<sup>17</sup> Results from estimating model (1) by using the three-day CAR as the dependent variable are shown in Table OA3 of the internet appendix. Like the results documented in Table 4, we find that the market places a higher weight on the parent's earnings surprise than the subsidiary's earnings surprise. We do not use the analysis based on three-day CAR as the main analysis because the available earnings announcement date in the Prowess database is inconsistent.<sup>18</sup>

Finally, we verify that our results are not driven by changes in accounting standards. In 2016, India adopted Indian Accounting Standards (Ind As),<sup>19</sup> which are more in line with IFRS. The adoption of Ind AS is likely to have an impact on how stock prices incorporate accounting information. Hence, we estimate equation (1) in subsamples relating to pre and post implementation of Ind AS. We find that, in both the pre- and post-period, the stock market assigns greater weight to the parent's component of earnings surprise, as compared to the subsidiary's component. This result is documented in Table OA4 of the internet appendix.

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<sup>17</sup> <https://faculty.iima.ac.in/~iffm/Indian-Fama-French-Momentum/> data source for India based Fama-French factors.

<sup>18</sup> In Compustat, there is an RDQ variable, which reflects the earnings announcement date. In contrast, there is no data item from earnings announcement date in Prowess. We extract the date from board meetings dates and the description of meetings as approving quarterly financial results.

<sup>19</sup> Indian Accounting Standards (Ind AS) were implemented in a staggered manner. They have been voluntarily applicable since 2015 but mandatory for firms with net worth INR 5 Billion or more since 2016. Hence, we use pre and post 2016.



Similarly, we also estimate equation (1) in subsamples relating to wholly and partially owned subsidiaries in Table OA5. We find, in both the samples, that the market differentially prices parent and subsidiary earnings surprise components and that the parent component is weighted more.

## **6. Conclusion**

Unlike countries where a firm must present only its consolidated financial statements, India has a unique financial reporting requirement: firms disclose both standalone (parent only) and consolidated financial statements. The availability of two sets of financial statements raises the question of whether standalone statements are useful at all. On one hand, it can be argued that, since consolidated financial statements subsume all the information present in the standalone statement, standalone statements have limited or no information role. However, on the other hand, the availability of standalone earnings allows investors to impute a subsidiary earnings number (reported consolidated earnings less reported standalone earnings), thereby enabling investors to decompose earnings into two components and price them according to their relative quality. Our results show that the stock market reacts differentially to the parent and subsidiary components of earnings surprise. The coefficient on the parent component is weighted more than the subsidiary's earnings surprise. We rule out any possibility of mispricing and find that the parent's component of earnings and cash flows has higher persistence than the subsidiary's component. Overall, our results indicate that standalone financial statements have an informative role, even in the presence of consolidated financial statements. We note that intercompany transactions can introduce error into the earnings of both standalone and subsidiary entities but that this does not affect overall consolidated earnings. The potential for error in standalone earnings should, *ceteris paribus*, decrease the informativeness in the market, but surprisingly we find that standalone earnings is incrementally informative, nonetheless.

Further we note that the informativeness of standalone earnings is higher when concerns over earnings management and propping up of consolidated earnings in the subsidiaries are higher.

Our paper adds to the literature on earnings informativeness in equity markets by documenting the usefulness of disaggregated standalone (parent) earnings and subsidiary earnings. Research (Francis [1986], Beaver, Cascina, Correia, and McNichols [2019]) examines the role of disaggregation in debt markets and debt contraction, but, to the best of our knowledge, this disaggregated information has not been examined in equity markets. We thus document results that may be relevant to academics, practitioners, and potentially regulators. While our results may be relevant in regulatory debates on ways to augment financial reporting to include information that disaggregates consolidated earnings, our paper was not explicitly focused on addressing a regulatory question. Hence we urge caution in the use of our results in these debates, as further research would be required to address or support changes in regulation.

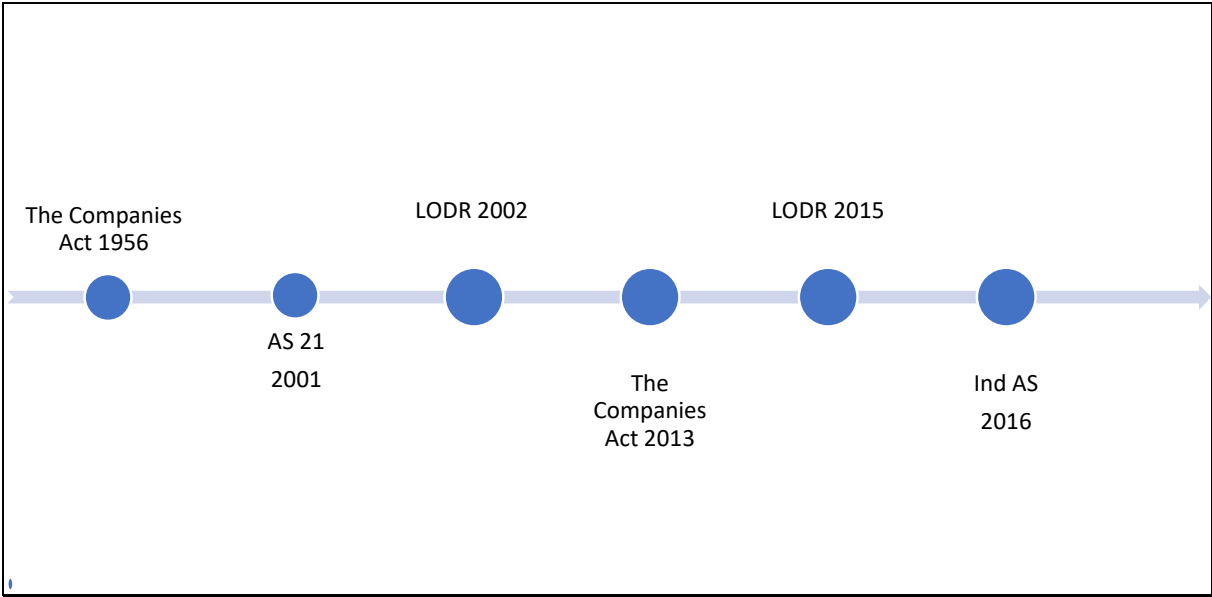
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**Figure 1: Timeline of important regulations related to consolidated and standalone financial statements**



## Appendix A1: Illustration of mechanics behind construction of Consolidated and Standalone statements

At the beginning of the year, the balance sheet of two entities P and S is as follows -

(INR)	P	S
Cash	500	50
Investments	0	0
Other assets	1,700	550
<b>Total assets</b>	<b>2,200</b>	<b>600</b>
Liabilities	1,500	400
Shareholders' equity	700	200
<b>Total Liabilities &amp; Shareholders' equity</b>	<b>2,200</b>	<b>600</b>

### Scenario 1:

Let us assume that at the beginning of year 1, P pays INR200 to buy 100% shares of S.<sup>20</sup> Since both P and S are separate legal entities, both will prepare their separate financial statements. In addition to the standalone financial statements, P also needs to provide consolidated financial statements where the financial statements of P and S are combined as if they are a single economic entity. The separate financial statements of P and S as well as consolidated financial statements of the combined entity at the end of the year are given below-

	Scenario 1			Scenario 2		
	P	S	C	P	S	C
<b><u>Income statement</u></b>						
Sales	1,000	200	1200	1,000	200	1200
Other Income				20		
Cost	800	120	920	800	120	920
PBT	200	80	280	220	80	280
Tax @ 25%	50	20	70	55	20	75
<b>PAT</b>	<b>150</b>	<b>60</b>	<b>210</b>	<b>165</b>	<b>60</b>	<b>205</b>
<b>Dividend paid</b>				<b>0</b>	<b>20</b>	
Balance at end of the year				165	40	205
<b><u>Balance sheet</u></b>						
Cash	300	50	350	300	50	350
Investments	200	0	0	200	0	0
Other assets	1,700	550	2250	1,700	550	2250
Dividend Receivable				20		
<b>Total assets</b>	<b>2,200</b>	<b>600</b>	<b>2,600</b>	<b>2,220</b>	<b>600</b>	<b>2,600</b>
Liabilities	1,350	340	1,690	1,355	340	1,690
Dividend Payable					20	
Shareholders' equity	850	260	910	865	240	910
<b>Total Liabilities &amp; Shareholders' equity</b>	<b>2,200</b>	<b>600</b>	<b>2,600</b>	<b>2,220</b>	<b>600</b>	<b>2,600</b>

<sup>20</sup> For the sake of simplicity, we assume that the price paid by P to acquire 100% shares of S is exactly equal to the book value of S at the time of purchase. If the price paid is different that the book value of S then goodwill (or gain on bargain purchase) is recognized during the consolidation following the purchase method of accounting for consolidation.

Ind AS 27 *Separate Financial Statements* (paragraph 10) requires that the parent entity should account for an investment in its subsidiary at cost.<sup>21</sup> In appendix 1, the standard clearly disallows the use of equity method to account for subsidiaries. If P were to use equity method to account for its subsidiaries, the net income of P would be equal to the consolidated net income as equity method is often called as single line consolidation. But since P records its investment in S at cost, the consolidated income statement is obtained by simply adding all the line items of P and S.<sup>22</sup> The standalone income statement in addition to consolidated income statement thus gives a valuable piece of information to investors about how well the parent company is performing on its own without combining the performance of its subsidiaries.

Similarly, the consolidated balance sheet is obtained by adding all the assets and liabilities of P and S, respectively. The investment of P cancels out the shareholders' equity of S. While we do not consider more several elements of the consolidation process such as the difference between purchase price and the book value of S, intercompany transactions, revaluation of S' assets and liabilities in scenario 1, the process of consolidation in the Indian accounting standards is broadly like the process outlined in US GAAP and IFRS. In addition to the consolidated financial statement, the parent entity P also provides it separate balance sheet where it shows its investment in S at cost.

## **Scenario 2:**

Let us assume that subsidiary S declares dividend of INR20 yet to be paid. Therefore, we assume an intercompany transaction in this scenario between P and S, in addition to the earlier assumptions made in Scenario 1.

To present financial statements in consolidated form for the group, the effect of intra group transactions should be eliminated. According to AS 21 and Ind AS 110, intragroup balances and intragroup transactions should be eliminated. Therefore, dividend INR 20 increases total income of P to 1020 and total income of S is 200. Hence in C according to line-by-line aggregation and eliminating intercompany transactions the total income is INR 1200 (1020 + 200 – 20 (Intercompany transactions)). The effect of this intercompany transactions is that it increases net income of P and reduces retained earnings of S. Rest of the line items in income statement like cost and tax are aggregated on line-by-line basis. In the balance sheet, according to Ind AS 110 and AS 21 in case of intercompany transactions liabilities in one group firm is set off against the corresponding assets in another group firm. In the current example S declares dividend of INR 20. Hence it creates an asset dividend receivable for P and liability dividend payable for S in their respective separate financial statements. The dividend receivable of P Ltd. is set off against dividend payable of S in consolidated financial statement.

Unlike Scenario 1, due to intercompany transactions P + S earnings may not be equal to C earnings. In our illustration 165 + 60 is not equal to 205. Hence the imputed measure for subsidiary earnings is subject to measurement error. In our illustration we consider only one intercompany transaction, however firms have several transactions within complex group structures which makes accurate measurement of S component very difficult.

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<sup>21</sup> Ind AS 27 allows the parent company to select fair value option to account for its subsidiary. Further, the parent entity can opt for equity method when accounting for joint ventures and /or associates.

<sup>22</sup> If intercompany transactions are present, P and S still record them as P and S are separate legal entities. However, such intercompany transactions are eliminated during the process of consolidation.



## Appendix A2: Variable Description

Variable	Variable Name	Description
$EARN_{C,i,t}$ , $EARN_{P,i,t}$ , $EARN_{S,i,t}$	ROA	Profit after tax divided by total assets at the end of year $t$ . Further the subscripts $C$ , $P$ , and $S$ relate to consolidated, parent (or standalone), and subsidiary, respectively.
$ESUR_{C,i,t}$ , $ESUR_{P,i,t}$ , $ESUR_{S,i,t}$	Earnings Surprise	Difference between the profit after tax (pat) in period $t$ scaled by total assets reported in the period $t$ and profit after tax (pat) in $t-1$ , scaled by total assets as reported in period $t-1$ . Further the subscripts $C$ , $P$ , and $S$ relate to consolidated, parent (or standalone), and subsidiary, respectively.
$BHR_{i,t}$	Buy Hold Return	One-year market adjusted buy hold returns where compounding starts 9 months prior to the fiscal year end and ends 3 months after the fiscal year end, company's stock return for the month minus market return (NSE500 index)
$SIZE_{i,t}$	Firm Size	Natural log of the market value of equity
$BETA_{i,t}$	Market Beta	Market adjusted (Nifty 500 index) beta, with estimation window of 36 months
$BM_{i,t}$	Book to Market Ratio	It is the ratio of Book value of equity to the market value of equity
$MBE_{i,t}$	Dummy for Meeting or beating expectation	Indicator variable that receives a value of 1 if earnings improved over the previous period i.e., $ESUR_{C,i,t} \geq 0$ , otherwise 0.
MBEP1S1	Dummy for Source of Meeting or beating expectation	There is an improvement in consolidated earnings that is driven by improvement in Earnings of both parent and subsidiaries
MBEP1S0	Dummy for Source of Meeting or beating expectation	There is an improvement in consolidated earnings that is driven by the improvement in earnings of the only parent
MBEP0S1	Dummy for Source of Meeting or beating expectation	There is an improvement in consolidated earnings that is driven by improvement in Earnings of only subsidiaries
MISSP1S0	Dummy for Source of Missing expectation	There is a decline in consolidated Earnings that is driven by the decline in Earnings of only subsidiaries
MISSP0S1	Dummy for Source of Missing expectation	There is a decline in consolidated Earnings that is driven by a decline in Earnings of the only parent
MISSP0S0	Dummy for Source of Missing expectation	There is a decline in consolidated Earnings that is driven by the decline in Earnings of both parent and subsidiaries

$CFO_{C,i,t}$ $CFO_{P,i,t}$ $CFO_{S,i,t}$	Cash flow from Operations	Cash flow from a firms' operating activities during a year t scaled by consolidated total assets. Further the subscripts <i>C</i> , <i>P</i> , and <i>S</i> relate to consolidated, parent (or standalone), and subsidiary, respectively.
$ACCRUALS_{C,i,t}$ $ACCRUALS_{P,i,t}$ $ACCRUALS_{S,i,t}$	Accruals	Profit after tax minus Cash flow from operations for year t scaled by consolidated total assets. Further the subscripts <i>C</i> , <i>P</i> , and <i>S</i> relate to consolidated, parent (or standalone), and subsidiary, respectively.
<i>DACC</i>	Discretionary Accruals	<p>The level of discretionary accruals calculated following modified Jones model (1991) suggested by Dechow, Sloan, and Sweeney (1995), as the residuals from the following industry-year regression:</p> $ACCRUALS_t/A_{t-1} = \alpha_0 + \alpha_1[1/A_{t-1}] + \alpha_2[(\Delta SALE_t - \Delta TR_t)/A_{t-1}] + \alpha_3[PPE_{t-1}/A_{t-1}] + \varepsilon_{i,t}$ <p>Where <math>ACCRUALS_t</math> is computed as change in current assets from <i>t-1</i> year to year <i>t</i> (<math>\Delta Current\_Assets_t</math>) minus change in current liabilities from <i>t-1</i> year to year <i>t</i> (<math>\Delta Current\_Liabilities_t</math>) minus change in cash and cash equivalent from <i>t-1</i> year to year <i>t</i> (<math>\Delta Cash_t</math>) plus change in debt included in current liabilities from <i>t-1</i> year to year <i>t</i> (<math>\Delta Short\_term\_borrowing_t</math>) minus depreciation expense in year <i>t</i> (<math>Depreciation_t</math>); <math>\Delta SALE_t</math> is change in net sales from year <i>t-1</i> to year <i>t</i>; <math>\Delta TR_t</math> is change in trade receivable from year <i>t-1</i> to year <i>t</i>; and <math>PPE_t</math> is property, plant, and equipment in year <i>t</i>. We estimate the above regression cross-sectionally for industry-years with at least 10 observations. The estimated residuals (<i>DACC</i>), capturing discretionary accruals, are our proxy for accrual-based earnings management. <i>DACC</i> is calculated separately at parent and subsidiary level.</p>
Earnings volatility	Earnings volatility	The standard deviation of profit after tax scaled by total assets (ROA) estimated over 5-year estimation period.
Sales Growth	Sales Growth	Sales growth defined as $(sales_t - sales_{t-1}) / sales_{t-1}$
Leverage	Leverage	The total liabilities are divided by total assets for the year t on consolidated, Standalone, and subsidiary basis

RPT Volume		The sum of all RPTs (excluding director/manager compensation) with all related parties carried out during the fiscal year, divided. by consolidated total assets
Financing RPT		Financing RPTs with all related parties during the fiscal year, scaled by total assets. The following items are labelled as financing: loans and guarantees received during the year, loans and guarantees made during the year, purchase/sale of fixed assets and investments, and capital issued during the year.
Tone RPT		Tone refers to transactions with directors, officers, and shareholders scaled by total consolidated assets.

**Table 1: Sample Selection**

<b>Sample Operations</b>	<b>Number of observations</b>
Initial Sample	26455
Year-end other than March	-1449
Eliminating Small Firms	-3210
Holding Companies	-5306
Eliminating Missing Earnings Surprise	-3540
Eliminate Missing values	-299
Missing Market data	-3891
<b>Final Sample</b>	<b>8760</b>

Note: Removing small firms discard firm-year observations with sales and total assets reported on a consolidated and parent basis of less than INR 1 million. Holding companies are the firms with consolidated sales and assets were lesser than standalone sales and assets. We retain non-missing values of an earnings surprise, sales, total assets, net income, the book value of equity, and cash flow from operations on both consolidated and parent basis. We retain stock return data with non-missing values of Beta and Buy hold return (BHR).

**Table 2: Distribution of sample across years and industries****Panel A: Year-wise Sample distribution**

<b>Year</b>	<b>Frequency</b>	<b>Percent</b>
2003	130	1.48
2004	158	1.8
2005	179	2.04
2006	204	2.33
2007	258	2.95
2008	328	3.74
2009	408	4.66
2010	476	5.43
2011	531	6.06
2012	569	6.5
2013	598	6.83
2014	616	7.03
2015	629	7.18
2016	673	7.68
2017	732	8.36
2018	748	8.54
2019	769	8.78
2020	754	8.61
<b>Total</b>	<b>8,760</b>	<b>100</b>

**Panel B: Industry - Wise sample distribution**

<b>Industry group</b>	<b>Freq.</b>	<b>Percent</b>
Manufacturing	4,496	51.32
Information and communication	896	10.23
Construction	863	9.85
Financial and insurance activities	647	7.39
Wholesale and retail trade; repair of motor vehicles and motorcycles	623	7.11
Diversifies	241	2.75
Transportation and storage	226	2.58
Accommodation and Food service activities	141	1.61
Electricity, gas, steam, and air conditioning supply	128	1.46
Mining and quarrying	99	1.13
Administrative and support service activities	96	1.10
Others	304	3.47
<b>Total</b>	<b>8,760</b>	<b>100</b>

Note: Our sample consists of 8760 firm year observations. In Panel A of this table, we present year-wise distribution of the sample. In Panel B we present industry-wise distribution of the sample. Industry classification is based on industry divisions as specified in National industry classification 2008, by Central Statistical Organisation, Ministry of Statistics and programme implementation, Government of India.

**Table 3: Descriptive Statistics****Panel A: Summary statistics at consolidated level**

Variables	N	Mean	Median	SD	P25	P75
# Of Subsidiaries	8410	9.050	4.000	19.569	2.000	8.000
wholly owned	8760	0.467	0.000	0.499	0.000	1.000
# Of Listed Subsidiaries	957	1.368	1.000	0.871	1.000	1.000
Total Assets (INR Billion)	8760	79.950	10.786	243.409	3.176	38.230
Sub Assets/ Consolidated Assets	8760	0.201	0.127	0.210	0.034	0.308
ROA	8760	0.040	0.035	0.071	0.006	0.073
CFO	8760	0.062	0.063	0.088	0.014	0.111
Accrual	8760	-0.023	-0.024	0.090	-0.068	0.020
DACC	4840	0.000	0.000	0.000	0.000	0.000
ESURP	8760	-0.004	-0.002	0.059	-0.021	0.014
MBE	8760	0.458	0.000	0.498	0.000	1.000
Earnings Volatility	7811	0.033	0.023	0.033	0.013	0.041
ESURP (Analyst Estimate)	930	0.110	0.020	0.529	-0.153	0.341
RPT Volume	7601	0.127	0.063	0.178	0.016	0.164
Financing RPT	7601	0.038	0.010	0.071	0.001	0.041
Tone RPT	7601	0.006	0.000	0.023	0.000	0.001
Leverage	8760	0.552	0.577	0.213	0.407	0.711

**Panel B: Summary statistics at parent and subsidiary level**

Variable	Parent				Subsidiary				Difference	
	N	Mean	Median	SD	N	Mean	Med	SD	Mean	Median
ROA	8760	0.044	0.036	0.069	8760	-0.024	0.012	0.395	0.068***	0.024***
ESURP	8760	-0.004	-0.001	0.049	8760	-0.001	0.000	0.032	-0.003***	-0.001***
Earnings Volatility	7811	0.035	0.023	0.040	7811	0.316	0.072	0.967	-0.280***	-0.049***
Leverage	8760	0.496	0.519	0.221	8760	0.809	0.756	0.794	-0.314***	-0.237***
DACC	4840	-0.002	0.000	0.028	4840	0.000	0.000	0.005	-0.002***	-0.000***
Sales Growth	8760	0.129	0.080	0.467	7674	0.216	0.108	0.636	-0.0875***	-0.028***
ESURP (Analyst)	912	0.005	0.003	0.219	923	0.095	0.021	0.462	-0.090***	-0.017***

Note: In Panel A of this table, we report the descriptive statistics at of various firm characteristics at consolidated level: mean, median, standard deviation, 25<sup>th</sup> percentile and 75<sup>th</sup> Percentile. It comprises of 8,760 firm-year observations for 1,362 unique firms. In Panel B we report the mean, median and standard deviation of various firm characteristics at the parent (standalone) and subsidiary level (consolidated – standalone). The significance of differences in means and medians are evaluated based on the t-test and Wilcoxon test, respectively (p-values for the t-statistics and Z-statistics are two-tailed). \*\*\*, \*\* and \* denote significance at 1%, 5%, and 10% level, respectively. The detailed variable description is provided in Appendix A2. To adjust for outliers, we winsorize continuous variables at 1<sup>st</sup> and 99<sup>th</sup> percentile.

**Table 4: Contemporaneous market reaction to earnings surprise**

Dependent Variables →	(1)	(2)	(3)	(4)	(5)
	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$
$ESUR_{C_{i,t}}$	1.221*** (7.161)		0.463* (2.195)		
$ESUR_{P_{i,t}}$		1.510*** (9.212)	1.090*** (5.692)	1.553*** (8.992)	1.763*** (5.312)
$ESUR_{S_{i,t}}$				0.463* (2.195)	0.039 (0.152)
$MBE_{i,t}$	0.176*** (8.021)	0.185*** (8.381)	0.175*** (7.910)	0.175*** (7.910)	0.142*** (8.311)
$SIZE$	-0.014 (-1.122)	-0.015 (-1.126)	-0.015 (-1.128)	-0.015 (-1.128)	-0.022 (-1.718)
$BM$	-0.046** (-2.779)	-0.047** (-2.748)	-0.047** (-2.721)	-0.047** (-2.721)	-0.051* (-2.701)
$BETA$	0.004 (0.145)	0.002 (0.096)	0.003 (0.109)	0.003 (0.109)	0.012 (0.374)
<i>Sales Growth (Parent)</i>					0.104*** (6.062)
<i>Sales Growth (Subsidiary)</i>					0.002 (1.337)
$EARN_{P_{i,t}}$					0.084 (0.181)
$EARN_{S_{i,t}}$					1.039** (3.277)
<i>Earnings Volatility (P)</i>					0.082 (0.153)
<i>Earnings Volatility (S)</i>					-0.362 (-0.871)
<b>F-Test</b>					
$ESUR_C = ESUR_P$			4.83*		
$ESUR_P = ESUR_S$				15.95***	16.92**
Observations	8,760	8,760	8,760	8,760	6,983
Adjusted R-squared	0.132	0.132	0.133	0.133	0.161

Note: In this table we present the results on the contemporaneous returns test; In column 1 we regress 12-month Buy hold return ( $BHR_{i,t}$ ) on consolidated earning change over the previous year scaled by end of the year consolidated total assets ( $ESUR_{C_{i,t}}$ ). In column 2 we regress 12-month BHR on parent earning change over the previous year scaled by end of the year consolidated total assets ( $ESUR_{P_{i,t}}$ ), In column 3 we regress 12-month BHR on both parent and consolidated earnings change scaled by end of the year consolidated total assets. In column 4 we decompose earning change over the previous year (earnings surprise) into parent earning change ( $ESUR_{P_{i,t}}$ ) and subsidiary earnings change ( $ESUR_{S_{i,t}}$ ).  $MBE_{i,t}$  is indicator variable for meeting or beating prior year earnings at a consolidated level. We control for  $SIZE$  natural log of market value of equity;  $BM$  is book to market ratio and  $BETA$  is 3-year market beta. In column 5 we additionally control for sales growth at parent and subsidiary level. Level of earnings scaled by end of the year consolidated total assets and earnings volatility at parent and subsidiary level. We test equality of coefficients using F-test. We estimate regressions using the Fama-MacBeth [1973] method, with the Newey-West [1987] correction. For a detailed variable description, refer to Appendix A2. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.

**Table 5: Rewards to MBE conditioned on parent vs sub. earnings surprise.**

**Panel A – Univariate analysis**

	MBEP1S1	MBEP1S0	MBEP0S1	MISSP1S0	MISSP0S1	MISSP0S0	Total
N	2049	1208	751	703	1617	2432	8760
Mean	0.233	0.161	0.039	-0.024	-0.100	-0.135	0.022
Median	0.049	0.023	-0.062	-0.120	-0.179	-0.208	-0.099

**Panel B – Regression analysis**

Dependent variables	(1) $BHR_{i,t}$
$ESUR_{P_{i,t}}$	1.263*** (7.315)
$ESUR_{S_{i,t}}$	0.718** (3.272)
$SIZE$	-0.014 (-1.101)
$BM$	-0.047** (-2.776)
$BETA$	0.003 (0.105)
$MBEP1S1$	0.247*** (7.131)
$MBEP1S0$	0.205*** (6.547)
$MBEP0S1$	0.108*** (4.939)
$MISSP1S0$	0.098** (3.220)
$MISSP0S1$	0.032 (1.839)
$Constant$	0.098 (0.798)
<b>F-test</b>	
$ESUR_P = ESUR_S$	3.80*
$MBEP1S1 = MBEP0S1$	11.48**
$MBEP0S1 = MISSP1S0$	0.07
Observations	8760
Adjusted R-squared	0.134

Note: In this table Panel A represents BHR (Buy-Hold return), a one-year market-adjusted buy-hold return where compounding starts 9 months before the fiscal year-end and ends 3 months after the fiscal year-end. we divide firm-year observation on the basis of meeting or beating (missing) i.e MBE(MISS) at consolidated level driven by improvement (decline) in parent and subsidiary earnings. Panel B represents regression analysis in which we decompose earning change over the previous year (earnings surprise) into parent earning change ( $ESUR_{P_{i,t}}$ ) and subsidiary earnings change ( $ESUR_{S_{i,t}}$ ) and regress it on 12-month BHR. We control for  $SIZE$  natural log of market value of equity;  $BM$  is book to market ratio and  $BETA$  is 3-year market beta. MBE indicator variable for meeting or beating expectations in Table 4 is decomposed into 5 indicator variables as defined in Appendix A2. We test equality of coefficients using F-test. We estimate regressions using the Fama-MacBeth [1973]



method, with the Newey-West [1987] correction. For a detailed variable description, refer to Appendix A2. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.

**Table 6: Perfect Foresight Test**

Year	HP_C	%Mkt	HP_CPS	%Mkt
2003	23.16%	36.91%	26.15%	39.05%
2004	28.20%	47.59%	36.37%	58.86%
2005	35.69%	27.28%	72.91%	49.60%
2006	22.74%	26.83%	37.05%	36.28%
2007	21.85%	26.66%	21.68%	25.07%
2008	21.58%	29.96%	23.90%	31.75%
2009	16.74%	30.07%	20.23%	37.36%
2010	21.86%	26.89%	37.87%	45.49%
2011	20.13%	30.86%	27.19%	37.43%
2012	16.13%	27.76%	22.43%	36.71%
2013	21.37%	29.44%	30.10%	36.04%
2014	41.07%	43.05%	56.85%	55.79%
2015	42.70%	43.65%	53.85%	52.48%
2016	35.34%	50.66%	40.31%	59.84%
2017	27.76%	38.00%	35.84%	47.55%
2018	27.71%	38.18%	35.13%	47.13%
2019	13.19%	22.30%	14.78%	24.77%
2020	32.07%	45.82%	39.43%	51.23%
Average	26.07%	34.55%	35.12%	42.91%
Difference in Means HP_CPS – HP_C			9.04%	8.36%
T-stat			4.550	6.163

Note: In Table 6 we present for each year market adjusted buy hold return to hedge portfolio formed on the basis of sign of change in consolidated, and consolidated, standalone, and subsidiary earnings over the previous year. HP\_C represents a hedge portfolio formed on the basis of sign of change in consolidated earnings over the previous year; we take a long position when the change in consolidated earnings over the previous year is positive and a short position when the change in consolidated earnings is negative. HP\_CPS is a hedge portfolio formed on the basis of sign of change in consolidated, standalone, and subsidiary (Consolidated minus standalone) earnings; we take a long position when all three earnings change are positive and a short position when negative. The proportion of market-adjusted buy-hold return to the return-based portfolio explained by each accounting measure (only consolidated earnings and all consolidated, standalone and subsidiary earnings) is denoted by %Mkt. We conduct a t-test to report the difference in means of HP\_C and HP\_CPS.

**Table 7: Cross sectional variation**

**Panel A – Related party transactions**

	(1)	(2)	(3)	(4)	(5)	(6)
Dependent Variables →	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$
Subsample Criteria	Total RPT Volume		Financing RPT		Tone RPT	
	Above Median	Below Median	Above Median	Below Median	Above Median	Below Median
$ESUR_{P_{i,t}}$	1.629*** (4.597)	1.766*** (6.796)	1.609*** (4.466)	1.640*** (6.683)	2.030*** (5.358)	1.186*** (5.511)
$ESUR_{S_{i,t}}$	0.384 (1.510)	0.924* (2.133)	0.486 (1.707)	0.772 (1.532)	0.397 (0.823)	0.512 (1.572)
$MBE_{i,t}$	0.189*** (7.422)	0.142*** (3.627)	0.166*** (7.666)	0.179*** (5.490)	0.167*** (3.583)	0.175*** (9.835)
$SIZE$	-0.017 (-1.245)	-0.020 (-1.325)	-0.017 (-1.200)	-0.019 (-1.400)	-0.013 (-0.748)	-0.019 (-1.376)
$BM$	-0.057** (-2.683)	-0.045** (-2.985)	-0.056** (-2.820)	-0.051** (-2.779)	-0.069** (-2.219)	-0.047** (-2.621)
$BETA$	0.016 (0.643)	-0.017 (-0.687)	0.010 (0.417)	-0.006 (-0.205)	0.013 (0.523)	-0.015 (-0.479)
<u>F-test</u> $ESUR_P = ESUR_S$	8.16**	2.78	5.99**	2.4	7.09**	2.98
Observations	4,854	3,906	4,789	3,971	3,772	4,987
Adjusted R-squared	0.124	0.153	0.124	0.152	0.150	0.133

**Panel B – Number of subsidiaries**

	(1)	(2)	(3)	(4)
Dependent Variables →	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$
Subsample Criteria	Number of Subsidiaries		$\frac{\text{Subsidiary Assets}}{\text{Consolidated Assets}}$	
	Above Median	Below Median	Above Median	Below Median
$ESUR_{P_{i,t}}$	1.603*** (5.314)	1.594*** (6.898)	1.857*** (4.312)	1.605*** (4.078)
$ESUR_{S_{i,t}}$	-0.096 (-0.181)	1.020** (2.857)	0.551 (1.451)	0.846* (1.911)
$MBE_{i,t}$	0.171*** (6.263)	0.180*** (5.531)	0.135*** (5.548)	0.190*** (5.924)
$SIZE$	-0.023 (-1.362)	-0.015 (-1.025)	-0.018 (-1.281)	-0.014 (-0.978)
$BM$	-0.063*** (-3.230)	-0.051** (-2.419)	-0.053** (-2.747)	-0.045** (-2.694)
$BETA$	0.005 (0.169)	0.009 (0.314)	0.003 (0.091)	0.006 (0.267)
$\frac{F\text{-test}}{ESUR_P = ESUR_S}$	7.75**	1.82	5.17**	1.64
Observations	4,118	4,642	4,300	4,460
Adjusted R-squared	0.138	0.137	0.134	0.143

**Panel C – Earnings management at subsidiary level**

	(1)	(2)	(3)	(4)
Dependent Variables →	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$
Subsample Criteria →	Discretionary Accrual		Discretionary Accrual	
	Positive	Negative	Above Median	Below Median
$ESUR_{P_{i,t}}$	1.974*** (6.711)	1.415* (2.548)	1.571** (5.081)	2.026** (3.688)
$ESUR_{S_{i,t}}$	0.516 (1.234)	0.660 (1.836)	0.309 (0.722)	1.279** (3.320)
$MBE_{i,t}$	0.174** (4.549)	0.192*** (8.765)	0.188** (5.373)	0.158** (4.762)
$SIZE$	-0.004 (-0.400)	-0.012 (-1.034)	-0.008 (-0.792)	-0.007 (-0.595)
$BM$	-0.026** (-5.110)	-0.045* (-2.595)	-0.034*** (-6.317)	-0.037* (-2.749)
$BETA$	0.003 (0.112)	-0.062 (-2.335)	-0.014 (-0.452)	-0.032 (-0.967)
<u>F-test</u> $ESUR_P = ESUR_S$	8.12*	1.30	5.71*	1.24
Observations	2,497	2,342	2,385	2,453
Adjusted R-squared	0.159	0.145	0.145	0.158

**Panel D – Leverage at subsidiary level**

	(1)	(2)
Dependent Variable →	$BHR_{i,t}$	$BHR_{i,t}$
Subsample Criteria	Subsidiary Leverage	
	Above Median	Below Median
$ESUR_{p_{i,t}}$	1.832*** (4.372)	1.705*** (5.928)
$ESUR_{s_{i,t}}$	0.512** (3.081)	0.924** (2.417)
$MBE_{i,t}$	0.161*** (4.410)	0.163*** (4.083)
$SIZE$	-0.015 (-0.957)	-0.020 (-1.536)
$BM$	-0.074** (-2.203)	-0.039** (-2.867)
$BETA$	0.003 (0.124)	-0.007 (-0.350)
<u>F-test</u>		
ESUR <sub>p</sub> = ESUR <sub>s</sub>	8.57**	2.67
Observations	4,300	4,460
Adjusted R-squared	0.141	0.139

Note: In this table we present cross-sectional variation in the market response to the decomposed components of earnings surprise (parent and subsidiary). In Panel A we present cross-sectional variation in market response based on related party transactions. In column 1-2 We divide sample based on above and below annual industry median of total RPT volume. In column 3-4 We divide the sample based on above and below annual industry median of Financing RPT volume. In column 5-6 We divide the sample based on above and below annual industry median of Tone RPT volume. Then we estimate equation (1) on the subsamples using the Fama-MacBeth [1973] method, with the Newey-West 1987 correction for serial correlation. In Panel B we present cross-sectional variation based on the relative importance of subsidiaries. In column 1-2 we divide sample based on above and below annual industry median of number of subsidiaries in a firm. In column 3-4 we divide sample on the basis of above and below annual industry median proportion of subsidiary assets to total assets. Then we estimate equation (1) on the subsamples using the Fama-MacBeth [1973] method, with the Newey-West 1987 correction for serial correlation. In Panel C we present cross-sectional variation based on discretionary accruals we partition the sample on the basis of positive and negative discretionary accruals and estimate model (1). We use the modified Jones model (Dechow, Sloan, and Sweeney 1995) to estimate discretionary accruals. In columns (3) and (4) we partition the sample based on the level of the absolute value of discretionary accruals. Then we estimate equation (1) on the subsamples using the Fama-MacBeth [1973] method, with the Newey-West 1987 correction for serial correlation. In Panel D, we divide sample above and below industry median leverage at subsidiary level. Then we estimate equation (1) on the subsamples using the Fama-MacBeth [1973] method, with the Newey-West 1987 correction for serial correlation. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.

**Table 8: Ruling out alternate explanations**

**Panel A: Persistence of standalone and subsidiary earnings**

	(1)	(2)	(3)	(4)	(5)	(6)
Dependent Variable →	$EARN_{p_{i,t+1}}$	$EARN_{s_{i,t+1}}$	$EARN_{c_{i,t+1}}$	$CFO_{p_{i,t+1}}$	$CFO_{s_{i,t+1}}$	$CFO_{c_{i,t+1}}$
$EARN_{p_{i,t}}$	0.683*** (26.779)		0.697*** (21.143)			
$EARN_{s_{i,t}}$		0.539*** (9.453)	0.584*** (11.318)			
$CFO_{p_{i,t}}$				0.353*** (8.778)		0.363*** (9.211)
$CFO_{s_{i,t}}$					0.247*** (12.211)	0.275*** (12.102)
$SIZE$	0.002*** (6.815)	0.000 (1.133)	0.002*** (5.249)	0.003*** (6.755)	0.001 (1.258)	0.004*** (7.043)
$BM$	-0.003** (-2.892)	-0.001 (-1.195)	-0.003** (-3.056)	-0.002*** (-4.852)	0.000 (0.074)	-0.002 (-1.754)
$BETA$	-0.004** (-2.810)	-0.002 (-1.745)	-0.005** (-2.710)	-0.008*** (-4.768)	-0.002*** (-3.619)	-0.010*** (-4.995)
F-Test						
$EARN_{p_{i,t}} = EARN_{s_{i,t}}$			3.38*			
$CFO_{p_{i,t}} = CFO_{s_{i,t}}$						3.72*
Observations	6,900	6,900	6,896	6,900	6,900	6,899
Adjusted R-squared	0.506	0.234	0.475	0.177	0.067	0.169

**Panel B: Future Returns Test**

Dependent Variable →	(1)	(2)	(3)
	<i>BHR<sub>t+1</sub></i>	<i>BHR<sub>t+1</sub></i>	<i>BHR<sub>t+1</sub></i>
<i>ESUR<sub>C<sub>i,t</sub></sub></i>	-0.044 (-0.224)		
<i>ESUR<sub>p<sub>i,t</sub></sub></i>		-0.035 (-0.146)	-0.125 (-0.458)
<i>ESUR<sub>s<sub>i,t</sub></sub></i>		0.093 (0.502)	0.035 (0.162)
<i>SIZE</i>	-0.027** (-2.304)	-0.027** (-2.279)	-0.028* (-2.268)
<i>BM</i>	0.017 (1.670)	0.017 (1.690)	0.017 (1.715)
<i>BETA</i>	-0.043* (-1.855)	-0.043* (-1.849)	-0.045 (-1.840)
<i>MBE</i>	0.035 (1.663)	0.033 (1.559)	
<i>MBEPI<sub>SI</sub></i>			0.066* (2.066)
<i>MBEPI<sub>S0</sub></i>			0.044 (1.245)
<i>MBEPO<sub>SI</sub></i>			0.053 (1.382)
<i>MISSPI<sub>S0</sub></i>			0.052 (1.370)
<i>MISSPO<sub>SI</sub></i>			0.024 (0.922)
Observations	8,760	8,760	8,760
Adj. R-squared	0.057	0.056	0.066

## Panel C: Segment Reporting

	(1)	(2)
Dependent Variable →	$BHR_{i,t}$	$BHR_{i,t}$
Subsample Criteria	With Segments	Without Segments
$ESUR_{p,i,t}$	2.092* (2.163)	1.598*** (8.713)
$ESUR_{s,i,t}$	0.943 (0.689)	0.419* (2.021)
$MBE_{i,t}$	0.158** (2.937)	0.176*** (7.928)
$SIZE$	-0.022 (-1.231)	-0.012 (-0.909)
$BM$	-0.050 (-1.529)	-0.047** (-2.672)
$BETA$	0.149** (2.407)	-0.002 (-0.098)
<u>F-test</u>		
$ESUR_P = ESUR_S$	0.47	18.18***
Observations	506	8,252
Adjusted R-squared	0.237	0.133

Note: In this table we rule out alternative explanations. In Panel A we present persistence test, In column (1) we regress t+1 period earnings (profit after tax) as reported in standalone financial statements scaled by consolidated total assets on t period earnings (profit after tax) as reported in standalone financial statements. In Column (2) we regress t+1 period earnings (profit after tax) as reported in consolidated financial statements minus standalone financial statements scaled by consolidated total assets on t period earnings (profit after tax) as reported in consolidated financial statements minus standalone financial statements scaled by consolidated total assets. In Column (3) we regress t+1 period earnings (profit after tax) as reported in consolidated financial statements scaled by consolidated total assets on parent earnings (profit after tax) as reported in standalone statement scaled by consolidated total assets and subsidiary earnings (Consolidated minus standalone profit after tax) scaled by consolidated total assets. In column (4-6) we undertake similar analysis as column (1-3) but we test the persistence of cash flow from operations. We control for  $SIZE$  natural log of market value of equity;  $BM$  is book to market ratio and  $BETA$  is 3-year market beta. In Panel B, we present future return test,  $BHR_{t+1}$  one-year market-adjusted buy-hold returns for a firm  $i$  during year  $t+1$  regressed on all the variables mentioned in the contemporaneous returns test in Table 4 and 5. In Panel C, we partition the sample based on availability of segment level information. We estimate regressions using the Fama-MacBeth [1973] method, with the Newey-West [1987] correction for serial correlation. For a detailed variable description, refer to Appendix A2. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.



## **Online Appendix**

**Consolidated or Standalone earnings - What do investors react to?**

**Table OA1: Contemporaneous return test -Panel regression**

	(1)	(2)	(3)
Dependent Variables →	$BHR_{i,t}$	$BHR_{i,t}$	$BHR_{i,t}$
$ESUR_{C_{i,t}}$	1.253*** (10.889)		
$ESUR_{P_{i,t}}$		1.467*** (11.381)	1.538*** (11.759)
$ESUR_{S_{i,t}}$			0.588*** (3.168)
$MBE_{i,t}$	0.183*** (13.440)	0.198*** (15.419)	0.183*** (13.447)
$SIZE$	-0.001 (-0.340)	-0.001 (-0.385)	-0.001 (-0.408)
$BM$	-0.010*** (-5.797)	-0.010*** (-5.869)	-0.010*** (-5.849)
$BETA$	-0.024** (-2.553)	-0.024** (-2.547)	-0.024** (-2.528)
<b>F-statistic</b>			
$ESUR_p = ESUR_s$			20.86***
Observations	8,760	8,760	8,760
Adjusted R-squared	0.199	0.200	0.201
Year FE	YES	YES	YES
Industry FE	YES	YES	YES

Note: In this Table, we repeat our analysis in Table 4 using Industry and year fixed effects. In column 1 we regress 12-month BHR ( $BHR_{i,t}$ ) on consolidated earning change over the previous year scaled by end of the year consolidated total assets ( $ESUR_{C_{i,t}}$ ). In column 2 we regress 12-month BHR on parent earning change over the previous year scaled by end of the year consolidated total assets ( $ESUR_{P_{i,t}}$ ). In column 3 we decompose earning change over the previous year (earnings surprise) into parent earning change ( $ESUR_{P_{i,t}}$ ) and subsidiary earnings change ( $ESUR_{S_{i,t}}$ ).  $MBE_{i,t}$  is indicator variable for meeting or beating prior year earnings at a consolidated level. We control for  $SIZE$  natural log of market value of equity;  $BM$  is book to market ratio and  $BETA$  is 3-year market beta. We test equality of coefficients using F-test. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.

**Table OA2: Contemporaneous return test – earnings estimates based on analyst forecasts**

Dependent Variables à	(1) $BHR_{i,t}$	(2) $BHR_{i,t}$	(3) $BHR_{i,t}$
$ESUR_{C_{i,t}}$	0.029** (2.174)		
$ESUR_{P_{i,t}}$		0.063** (2.555)	0.102*** (3.408)
$ESUR_{S_{i,t}}$			-0.029 (-1.180)
$MBE_{i,t}$	0.148*** (5.136)	0.138*** (4.712)	0.134*** (4.554)
$SIZE$	-0.038*** (-3.604)	-0.041*** (-3.880)	-0.043*** (-3.992)
$BM$	-0.135*** (-5.137)	-0.132*** (-5.017)	-0.133*** (-5.040)
$BETA$	-0.005 (-0.158)	-0.012 (-0.404)	-0.002 (-0.074)
<b>F-statistic</b>			
$ESUR_p = ESUR_s$			7.86***
Observations	930	921	909
Adjusted R-squared	0.154	0.160	0.164
Year FE	YES	YES	YES
Industry FE	YES	YES	YES

Note: In this table, we regress 12 months Buy Hold return on the earnings surprise which is calculated as difference between t year earnings (profit after tax) and consensus analyst estimates from I/B/E/S database.  $ESUR_{C_{i,t}}$  is EPS as reported in consolidated financial statements minus I/B/E/S estimate at consolidated level multiplied by outstanding shares and scaled by total consolidated assets.  $ESUR_{P_{i,t}}$  is EPS as reported in standalone financial statements minus I/B/E/S estimate at standalone level multiplied by outstanding shares and scaled by total consolidated assets.  $ESUR_{S_{i,t}}$  is difference between  $ESUR_{C_{i,t}}$  and  $ESUR_{P_{i,t}}$ . We control for  $SIZE$  natural log of market value of equity;  $BM$  is book to market ratio and  $BETA$  is 3-year market beta. We test equality of coefficients using F-test. We control for time dependence and cross-sectional dependence using year and Industry fixed effects. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.

**Table OA3: Contemporaneous return test based on market reaction around earnings announcement**

Dependent Variable →	(1) $CAR_{i,t}$	(2) $CAR_{i,t}$	(3) $CAR_{i,t}$
$ESUR\_EPS_{C_{i,t}}$	0.017** (2.309)		
$ESUR\_EPS_{P_{i,t}}$		0.036*** (4.023)	0.058*** (6.344)
$ESUR\_EPS_{S_{i,t}}$			0.022* (1.702)
$MBE_{i,t}$	0.021*** (18.722)	0.021*** (19.093)	0.020*** (17.936)
<b>F-Test</b> $ESUR\_EPS_{P_{i,t}} = ESUR\_EPS_{S_{i,t}}$			5.91**
Observations	14,205	14,210	14,168
Adjusted R-squared	0.034	0.034	0.039
Year FE	YES	YES	YES
Industry FE	YES	YES	YES

Note: In this table we present the results for the contemporaneous returns test; In column 1 we regress 3-day Cumulative abnormal return adjusted to Fama- French risk factors ( $CAR_{i,t}$ ) on consolidated earning per share change over the previous year scaled by beginning of the year share price ( $ESUR\_EPS_{C_{i,t}}$ ). In column 2 we regress 3-day Cumulative abnormal return adjusted to Fama- French risk factors ( $CAR_{i,t}$ ) on parent earnings per share change over the previous year scaled by beginning of the year share price ( $ESUR\_EPS_{P_{i,t}}$ ). In column 3 we decompose earnings per share change over the previous year into parent earning change ( $ESUR\_EPS_{P_{i,t}}$ ) and subsidiary earnings change ( $ESUR\_EPS_{S_{i,t}}$ ).  $MBE_{i,t}$  is indicator variable for meeting or beating prior year earnings at a consolidated level. We test equality of coefficients using F-test. We control for Industry and Year fixed effects. For a detailed variable description, refer to Appendix A2. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.

**Table OA4: Ruling out alternate explanation - Ind AS implementation**

	(1)	(2)
Dependent Variables →	$BHR_{i,t}$	$BHR_{i,t}$
Subsample Criteria	Pre-2016	Post-2016
$ESUR_{P_{i,t}}$	1.608*** (9.245)	1.342*** (7.161)
$ESUR_{S_{i,t}}$	0.600** (2.451)	0.554** (2.057)
$MBE_{i,t}$	0.186*** (10.231)	0.179*** (9.297)
$SIZE$	-0.012*** (-3.352)	0.016*** (4.313)
$BM$	-0.016*** (-5.884)	-0.005** (-2.188)
$BETA$	-0.022 (-1.632)	-0.020 (-1.609)
<b>F-Test</b>		
$ESUR_p = ESUR_s$	12.92***	7.42***
Observations	5,757	3,003
Adjusted R-squared	0.203	0.167
Year FE	YES	YES
Industry FE	YES	YES

Note: We repeat our analysis in Table 4 column (4), we divide sub-sample on the basis of pre and post Ind AS implementation. In column 1-2 we decompose earning change over the previous year (earnings surprise) into parent earning change ( $ESUR_{P_{i,t}}$ ) and subsidiary earnings change ( $ESUR_{S_{i,t}}$ ).  $MBE_{i,t}$  is indicator variable for meeting or beating prior year earnings at a consolidated level. We control for  $SIZE$  natural log of market value of equity;  $BM$  is book to market ratio and  $BETA$  is 3-year market beta. We test equality of coefficients using F-test. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.

**Table OA5: Cross sectional variation based – Wholly owned Vs Partially owned subsidiary**

	(1)	(2)
Dependent Variables →	$BHR_{i,t}$	$BHR_{i,t}$
Subsample Criteria	Wholly Owned	Partially Owned
$ESUR_{P_{i,t}}$	1.267*** (5.786)	2.021*** (3.399)
$ESUR_{S_{i,t}}$	0.177 (0.331)	0.619 (1.770)
$MBE_{i,t}$	0.204*** (5.847)	0.151*** (5.909)
$SIZE$	-0.007 (-0.522)	-0.022 (-1.533)
$BM$	-0.037** (-2.798)	-0.069** (-2.614)
$BETA$	-0.034* (-2.116)	0.072 (1.127)
<b>F-Test</b>		
$ESUR_p = ESUR_s$	3.55*	4.13*
Observations	4,064	4,673
Adjusted R-squared	0.132	0.145

Note: In Table OA5 , we repeat the analysis in Table 4 and we divide the sample on the basis of wholly owned or partially owned subsidiaries. In column 1-2 we decompose earning change over the previous year (earnings surprise) into parent earning change ( $ESUR_{P_{i,t}}$ ) and subsidiary earnings change ( $ESUR_{S_{i,t}}$ ).  $MBE_{i,t}$  is indicator variable for meeting or beating prior year earnings at a consolidated level. We control for  $SIZE$  natural log of market value of equity;  $BM$  is book to market ratio and  $BETA$  is 3-year market beta. We test equality of coefficients using F-test. The t-statistics is reported in parentheses. \*\*\*, \*\*, and \*, correspond to  $p < 0.01$ ,  $p < 0.05$ ,  $p < 0.1$ , respectively.