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Can media coverage restrain executive empire building and pursuit of a quiet life? Evidence from China

Zhaorui Guo^a, Kam C. Chan^{b,c,*}, Jun Huang^d

^a School of Finance and Business, Shanghai Normal University, Shanghai, China

^b School of Accounting, Zhongnan University of Economics and Law, Wuhan, China

^c Department of Finance, Gordon Ford College of Business, Western Kentucky University, Bowling Green, KY 42101, USA

^d Institute of Accountancy and Finance, Shanghai University of Finance and Economics, Shanghai, China

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ABSTRACT

Based on the unique institutional background of China's capital market, we study the effects of media coverage on executive empire building and pursuit of a quiet life among publicly listed firms over the period of 2007–2013. Our results suggest that media coverage and executive empire building and pursuit of a quiet life are positively correlated, particularly for state-owned enterprises (SOEs), which is in contrast to conclusions reached in previous studies. We contend that executive empire building and pursuit of a quiet life are not obvious governance violations in China and that the socially and politically desired governmental goals of job creation and labor harmony contribute to the positive correlation. The particularly strong findings among SOEs relative to non-SOEs corroborate our argument because SOEs typically pursue government-desired social goals. Our findings hold implications for improvement of the corporate governance environment in China and provide a useful perspective for the literature on media coverage.

1. Introduction

Agency theory suggests a divergence of interests between principals (shareholders) and agents (executives) in a firm (Jensen & Meckling, 1976). By seeking private benefits, executives may not act in the best interests of shareholders, which can lead to corporate governance issues. Many studies examine corporate board effectiveness and external monitoring mechanisms related to executive behavior. An emerging body of literature examines the role of media coverage as an alternate monitoring mechanism. The conceptual underpinning is that the media, as an external monitor, researches and disseminates information on the performance of a firm and its executives. Thus, media coverage acts as a firm monitor and reduces information asymmetry between outsiders and the firm. The threat of reputational capital loss and the peril of inviting legal and regulatory scrutiny encourages executives to act in the best interests of shareholders.

The evidence on the effectiveness of media coverage with regard to corporate governance is mixed, however. For instance, Dyck, Volchkova, and Zingales (2008) report that media coverage pressures Russian regulators to act on major corporate governance violations. In contrast, using changes in independent director appointments, Bednar (2012) shows that executives enact only symbolic changes to please the media, but their total compensation changes do not relate to media coverage. These studies focus on the impact of media coverage on blatant (visible) corporate governance issues, such as the appointment of independent directors and events leading to

* Corresponding author. School of Accounting, Zhongnan University of Economics and Law, Wuhan, China.

E-mail addresses: shufegzr@163.com (Z. Guo), johnny.chan@wku.edu (K.C. Chan), huangjun@mail.shufe.edu.cn (J. Huang).

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large shareholder losses.¹ Less visible issues, such as gradual empire building and pursuit of a quiet life by executives, receive less attention. It is unclear whether media coverage can restrain less obvious entrenchment by executives.

This paper examines the impact of media coverage on restraining executive empire building and pursuit of a quiet life among Chinese publicly listed firms over the period of 2007–2013. Different from the literature, in the Chinese context, empire building and pursuit of a quiet life may not be visible to media. Nonetheless, they destroy firm value. Shareholders suffer from such behavior (Chhaochharia, Kumar, & Niessen-Ruenzi, 2012). In addition, empire building and pursuit of a quiet life are difficult to detect. Hence, whether Chinese media coverage can perform similarly to that of the Western context is a research question.

China presents a useful laboratory for our study for two reasons. First, executive compensation in state-owned enterprises (SOEs) in China is highly regulated vis-à-vis non-SOEs.² In other words, executive monetary compensation in SOEs does not provide sufficient incentive to act in the best interests of shareholders. The regulated executive monetary compensation among SOEs naturally creates pressure to restrict the compensation of executives among non-SOEs. The generally low monetary compensation among Chinese executives motivates them to seek non-monetary substitutes for private benefits. Building a corporate empire and pursuing a quiet life in a firm becomes a natural way for Chinese executives to enrich themselves instead of maximizing shareholder value. Nonetheless, we expect that the motivation for executives to seek private benefits is stronger among SOEs than non-SOEs.

Second, in contrast to blatant corporate governance violations, such as those reported by Dyck et al. (2008) and Atul, Misra, and Shi (2017), empire building and the pursuit of a quiet life may actually be welcomed in an emerging market such as China. The Chinese government promotes socially and politically desirable goals of job creation and economic growth. Empire building means growth in firm scale and scope, which is apparently consistent with governmental goals. Similarly, it is always desirable and politically advantageous to preserve labor harmony in terms of better employment terms and fringe benefits. Labor harmony can serve as an excuse for executives' pursuit of a quiet life. Thus, all things considered, the media may not be able to recognize the adverse impact of executive empire building and the pursuit of a quiet life on firm value; rather, they may interpret firm growth and labor harmony as good executive performance. Given that SOEs are under the control of the state, we contend that socially desirable goals and labor harmony motivations are much stronger among SOEs than non-SOEs. Thus, the monitoring function of media coverage is questionable in these less obvious corporate governance violations, particularly among SOEs. The coexistence of SOEs and non-SOEs in China offers a unique opportunity to examine our research question, as we can compare and contrast our findings among subsamples of SOEs and non-SOEs. A much stronger result among SOEs relative to non-SOEs would corroborate the arguments that media is ineffective in China to restrain empire building and quiet life pursuit.

We offer three findings. First, we study the relation between media coverage and earnings management in China and report that media coverage curtails earnings management in the full sample and among non-SOEs only. Hence, we show that our media coverage measurement is consistent with the literature (e.g., Qi et al., 2014); that is, media coverage can curtail earnings management when we do not distinguish SOEs from non-SOEs. For SOEs, we do not find a significant relation between media coverage and earnings management. We show that the media in China are generally ineffective in monitoring SOEs, and we offer preliminary evidence to suggest that the behavior of SOEs in empire building and quiet life pursuit may be different from that of non-SOEs. Second, for SOEs, we document that media coverage is positively correlated with executive empire building and pursuit of a quiet life. These positive correlations are robust to a battery of alternative analyses and endogeneity correction. We observe that media coverage in China does not restrain executive empire building or pursuit of a quiet life for SOEs. In contrast, media coverage helps executives build their empires and provides the quiet life for them. Thus, media do not serve a monitoring role in the context of executive empire building and pursuit of a quiet life in China. For non-SOEs, the results share some similarity with those of SOEs, but they are much weaker. Hence, the overall findings corroborate our argument that less obvious corporate violations are difficult to monitor by media coverage, particularly for SOEs when the Chinese government presumably promotes job creation, economic growth and labor harmony. Our findings suggest that Chinese media are indeed unable to perform as well as Western media. In other words, the monitoring function of media coverage differs in a Western context vis-à-vis Chinese context. Third, we report that firms (both SOEs and non-SOEs) with weak internal corporate governance exhibit stronger positive relations between media coverage and empire building and between media coverage and pursuit of a quiet life. These findings suggest that media coverage acts as a substitute for internal corporate governance. When a firm has strong corporate governance, the influence of media coverage is less. Thus, the mechanism underlying the effects of media coverage on empire building and the pursuit of a quiet life is the corporate governance channel. Overall, our findings have implications for improvement of the corporate governance environment in China and other emerging markets, and they provide a useful perspective for the literature on media coverage.

2. Literature review and research questions

2.1. Empire building and pursuit of a quiet life

Jensen and Meckling (1976) describe conflicts between executives and shareholders as a principal–agent problem. Jensen (1986,

¹ Dyck et al. (2008, p. 1095) present the case in which Tomskenft, a Russian firm, approved a plan to dilute its equity only after relocating its shareholder meeting to a distant location on short notice so that the majority of shareholders could not attend the meeting in the new location. The approved plan was unfavorable to the majority of the shareholders.

² Xu, Li, Yuan, and Chan (2014) discuss regulated executive compensation in China. The authors report that a Chinese SOE executive: (1) cannot receive a base salary of more than five times the average salary of a typical employee of the firm, (2) cannot garner a performance-based bonus more than three times the executive's base salary, and (3) cannot collect long-term incentive pay greater than 40% of the executive's total compensation in (1) and (2).

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