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Does media governance restrict corporate overinvestment behavior? Evidence from Chinese listed firms

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ABSTRACT

Using China's A-share listed firms from 2007 to 2011, this paper empirically tests how media governance affects firms' levels of overinvestment and whether external supervision and informal institutional mechanisms reduce these levels. We find that media governance and overinvestment are significantly negatively related. When firms are located in a district with a stronger media governance environment their levels of overinvestment are lower, indicating that media governance significantly restricts overinvestment behavior. When internal corporate governance efficiency is low, the negative relationship between the media environment and overinvestment behavior is significantly enhanced, indicating that when internal governance or formal systems have reduced efficacy, an important complementary role is played by external supervision and the informal institutional environment. After considering endogeneity and different measures of overinvestment and other related variables, the conclusions remain unchanged.

1. Introduction

In the recent years, overinvestment has become an important problem in China's macro- and micro-economic development. For example, a report released by Li, China's chief representative to the International Monetary Fund (IMF), on April 15, 2013 stated that the level of overinvestment in China was 12–20% above

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the equilibrium level as a share of GDP.[1] Academic research shows that serious problems are caused by inefficient investment by Chinese corporations (Tang et al., 2007) and that overinvestment by listed Chinese companies is relatively common (e.g., Li and Jiang, 2007; Wei and Liu, 2007; Jiang et al., 2009; Luo et al., 2012). Scholars have recently explored methods for managing overinvestment, mostly by focusing on the level of overinvestment by corporate or direct stakeholders. That is, recent studies on the governance of overinvestment have mostly been conducted from the internal corporate perspective and less attention has been paid to the role of informal institutional mechanisms, such as the external environment or external supervision. In China, a typical emerging market economy in transition, the formalization and implementation of the legal system is not perfect and certain informal institutions have an important role in managing firms' behavior (Allen et al., 2005; Chen et al., 2013).

Many recent studies have shown that the effects of media supervision on public opinion may effectively supplement internal corporate governance. In particular, given the high degree of information asymmetry in the capital market, the media acts as an information intermediary (Zavyalova et al., 2012). By collecting and disseminating information, the media develops an effective information environment and helps to reduce asymmetry between corporations and external investors. As a typical emerging market economy, China exhibits a wide disparity in the levels of media development in different areas (Yu, 2012), providing a useful setting for examining the supervisory function of the media governance environment on corporate behavior.

Based on China's A-share listed firms from 2007 to 2011, this paper empirically tests how media governance affects the level of overinvestment and whether external supervision and informal institutions can reduce overinvestment. We find that media governance and overinvestment are significantly negatively related. That is, if a district has a stronger media governance environment, corporations' levels of overinvestment are lower, suggesting that media governance significantly restricts overinvestment behavior. In addition, when corporate governance efficiency is low, the negative relationship between the media environment and overinvestment behavior is significantly enhanced, indicating that external supervision and the informal institutional environment play an important complementary role when internal governance or formal systems have reduced efficacy. After considering endogeneity and different measures of overinvestment and other related variables, the conclusions remain unchanged.

Our study makes three main contributions to the literature. First, it shows that the media governance environment can help to efficiently reduce the overinvestment levels of corporations, which enriches and expands the literature on the governance function of media supervision. Second, it explores how overinvestment behavior by corporations may be inhibited. Because previous studies on overinvestment governance have mostly focused on the design or restriction of overinvestment within corporations or by their direct stakeholders, little attention has been paid to supervisory roles outside the firm and to informal institutional mechanisms. Therefore, this paper further extends the literature in this field. Third, our study shows that when internal corporate governance fails, restrictions on overinvestment that are based on external supervision are significantly enhanced. In other words, when a formal system of internal governance fails, external oversight or informal institutional arrangements can have a significant supplementary role. This paper thus complements the literature that explores the corporate governance effects of informal institutions.

The remainder of the study is structured as follows. Section 2 provides a literature review and introduces the research hypotheses. Section 3 describes the sample and our research design. Section 4 presents and analyzes the empirical results. Section 5 provides some conclusions.

2. Literature review and research hypotheses

2.1. Literature review

2.1.1. Corporate overinvestment behavior

The previous academic literature mainly discusses the reasons for overinvestment from the principal-agent and asymmetric information perspectives. In terms of the principal-agent view, Jensen (1986) argues that the

[1] *Source:* http://finance.ifeng.com/news/macro/20130416/7909163.shtml.