



Anti-corruption campaigns and corporate information release in China[☆]

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ABSTRACT

Chinese anti-corruption campaigns executed by CCDI (Central Commission for Discipline Inspection) put politicians under high scrutiny. We employ CCDI's inspections as the event and use counterfactual analysis to show that corporations in inspected provinces significantly suppress negative information release evidenced by stock prices following Chen et al. (2001). The variation of political maneuvers to suppress negative information release is consistent with local politician's influences and incentives in affiliated firms, e.g., SOEs or politically connected non-SOEs. SOEs continue to suppress negative information release while non-SOEs experience mean-reversion after inspections. Good governance and auditor's quality partially mitigate manager's incentives to suppress bad news.

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1. Introduction

Corruption has become an endemic problem for most countries with weak legal systems (World Bank, 2015). Corruption not only impedes long-run economic development or growth¹ (Krueger, 1974; Shleifer and Vishny, 1993; Rose-Ackerman, 1999; Mauro, 1995) but also causes social problems (Manion, 2004). Governments around the world are taking measures to curb corruption especially corruption related to government officials and bureaucrats. China, the largest emerging economy, faces rampant corruption due to the lack of institutions such as an autonomous legal system, independent news media or legal political opposition, as the one-party political system and the centrally planned economy render bureaucrats with great monopolistic powers.² China's corruption problem is evidenced by its low score of only 40 out of 100 in 2016 Corruption Perception Index reported by Transparency International. A study by Hu and Guo (2001) estimate that 4 to 8% of GNP in China is depleted by corruption.

CCDI (Central Commission for Discipline Inspection) emerges as the leading executive agency on discipline affairs of CPC (Chinese Party of Communist) to fight corruption. The anti-corruption campaigns in China that started in 2013 by CCDI are becoming

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¹ Controversially, anti-corruption campaigns may deter "efficient corruption" that otherwise would allow firms to get things done in an economy plagued by bureaucratic holdups (Bardhan, 1997).

² Ades and Di Tella (1999) show that monopolistic powers of bureaucrats increase the probability of corruption.

increasingly critical to restoring trust and legitimacy of the government which would otherwise be in jeopardy due to common perceptions of corruption within ruling authorities. To enforce the anti-corruption initiatives of the “Eight-point Policy” announced by Chinese central government in 2012, the secretary of CCDI Qishan Wang started to dispatch central inspection teams to various provinces in China from 2013. Since then, CCDI regularly dispatches central inspection teams to government entities or agencies to spot corruption and scrutinize politicians. The anti-corruption inspections dictated and executed by CCDI are the most important political events that aim to spot corruption and collect information of disciplining violation nationwide.

In this paper, we study the proposition that politicians and their affiliated corporations (located in politician's provinces) will suppress negative information during the anti-corruption campaigns by CCDI. For local bureaucrats under the intense scrutiny during the period of CCDI's inspections, any negative news or information may provide clues to central inspection teams about local government's wrongdoings or corruption evidence. Local politicians under CCDI's inspections will use their political influences and powers to manage potential damage, e.g., political maneuvers of suppressing negative news³ suggested by Peltzman (1976) and Watts and Zimmerman (1986). We hypothesize that firms with strong local political affiliation will show a more pronounced pattern of suppressing negative information release, e.g., SOEs or companies with strong political connections. We also hypothesize that higher quality of corporate governance and auditors will mitigate distortion of stock prices due to political events such as anti-corruption campaigns. Empirically we focus on the information content of stock prices related to the negative news release and empirically following the method proposed by Chen et al. (2001) to extract market information content from share prices.

Piotroski et al. (2015) study corporate information release corresponding to political events in China. They focus on meetings of National Congress and provincial-level promotion as the context and find that corporations linked with politicians involved in the two political developments will temporarily restrict the release of negative information. Different from their setting, we choose the anti-corruption campaigns carried out by CCDI as the political event. The event associated with CCDI's inspections is significantly distinct from the political event studied by Piotroski et al. (2015). Political promotion events studied by Piotroski et al. (2015) are endogenous to local corporations and their causality relation is not fully addressed. In contrast, CCDI's inspection events are relatively exogenous to local corporations. Further, sequential rounds of these inspections allow us to carry out counterfactual analysis to draw causal inference on local information released by corporations.

CCDI kicked off the first round of inspections in May 2013 and since then continued many rounds of inspections by dispatching inspection teams to various provinces. The anti-corruption campaigns of CCDI have surprised the media and press regarding its duration and severity by targeting all levels of corrupt officials described as “fliers or tigers.” Central inspection teams are under the direct leadership of Qishan Wang, and their mandate focuses on uncovering wrongdoings, including abuses of power for personal interests, bribery and inappropriate work styles characterized by bureaucracy, hedonism, and extravagance. Between 2013 and 2014, CCDI completed four rounds of inspections, covering all provinces in China. CCDI formally releases the news of targets and date that CCDI's inspection teams will visit on its website, followed by the CCDI deployment meeting and formal visits to targeted provinces. The detailed information of the CCDI's inspections is reported in Appendix A.

Government and party officials exert significant influence on corporations in China (Cao et al., 2016; Piotroski et al., 2015). Local politicians face significant scrutiny when a province is stationed by CCDI's central inspection teams. They will try to manage any potential downside risk related to negative news since adverse news will incur substantial cost for their careers. Li and Zhou (2005) report that negative economic news such as slow GDP growth will lower the promotion probability for governors. To cope with CCDI's inspection, politicians under scrutiny during CCDI's inspections may attempt to influence local corporations by suppressing bad news or negative information from poor performance. Chen et al. (2001)'s approach to extract market information content of stock prices offers an ideal method to gauge negative information released by corporations. Piotroski and Roulstone (2004) and Piotroski et al. (2015) use the method to study corporation information release in US and China, respectively. It has been recognized by the literature that a firm's information environment (disclosure policy, analyst following) or institutional environment (property rights protection, quality of government, political) can influence the relative importance of firm-specific as opposed to market-wide factors (Chan and Hameed, 2006; Jin and Myers, 2006; Morck et al., 2000). CCDI's inspections will place local politicians into heavy scrutiny, which results in abnormal economic/political environment and significantly affects bureaucratic and corporate behaviors.

Since CCDI's every round of inspections covers a few provinces in the sequence determined by CCDI's headquarter. It makes local corporations hard to possess private information about future inspections, the provinces without contemporaneous inspections become an ideal counterfactual group. This approach enables us to draw a causality inference of the anti-corruption campaigns on corporate information release. Further, we control possible endogeneity regarding which province will be inspected first by comparing different round of inspections and with a propensity score matching of firms from uninspected provinces. To avoid any confounding impact from the corporate news that bias information content of stock prices, we exclude corporations that have confounding events in our event window due to the earnings announcement, acquisitions, or unrelated ones.⁴

We find corporations in provinces subject to the inspections by central inspection teams from CCDI experience a significantly lower level of negative news compared to the corporations from uninspected provinces at the same event window. After the event window of CCDI's inspections, the treatment firms, especially non-SOE firms significantly increase the release of negative

³ One caveat is that we do not intend to examine the overall news in the economy or corporations.

⁴ Griffin et al. (2016) show that over 100 top executives of listed firms mostly SOEs in China are investigated from 2012 to 2015 due to the anti-corruption campaigns. However, any corrupt investigations of executives during CCDI's inspections will work against our findings. Therefore, we do not explicitly consider these corruption cases of corporate executives.

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