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Does monitoring by the media improve the performance of government banks?

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ABSTRACT

By examining cross-country data for the period from 2000 to 2010, this study investigates whether monitoring by the media affects the performance of government-owned banks (GOBs). The results indicate that GOBs under strong monitoring do not underperform privately owned banks (POBs), whereas those under weak monitoring do underperform POBs. Further, we find that the strength of the media's monitoring has an important effect on corruption behavior and banks' performance. This result provides an important policy implication that the government should minimize its ownership, and therefore its influence, in the media sector if it intends to improve the performance of its GOBs.

1. Introduction

The media, a private and competitive entity, is important to the system of checks and balances in a modern democracy (Djankov et al., 2003). A free press is a powerful medium for controlling political corruption (Brunetti and Weder, 2003). When government ownership of the media or the media's concentration is low, the media plays an effective role in monitoring bank corruption (Houston et al., 2011). However, no cross-country or direct empirical evidence has verified whether or how the media's monitoring affects corruption in the lending practices of government-owned banks (GOBs). Therefore, the current study aims to address this research gap.

Government-owned banks, which are controlled by the government to some extent, are susceptible to the political considerations of government officials. The literature on GOBs has concluded that political considerations influence their lending decisions, such as interest rates and total loan amounts (Sapienza, 2004; Dinç, 2005). Political concerns also adversely affect the operation of these banks, thereby resulting in their lower profitability and loan quality (Iannotta et al., 2007; Shen and Lin, 2012). In general, GOBs significantly underperform privately owned banks (POBs) because of political concerns unless these banks are in less corrupt countries (Boehmer et al., 2005; Shen and Lin, 2012; Shen et al., 2014).

In this study, we investigate whether the monitoring by the media reduces the corruption in the lending of GOBs. First, the corruption in GOBs might occur because of political interference (Khwaja and Mian, 2005; Claessens et al., 2008). Further, the media searches for scandals in the government sector to draw a greater audience and to increase viewer or listener ratings (Besley and Prat, 2006). Given that GOBs are part of the government sector, the corruption in the lending of these banks is akin to a scandal for an administration that could receive considerable attention from the media[1]. Thus, we conjecture that the media's monitoring could

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[1] The media periodically reports the corruption behavior of government banks. For instance, on August 14, 2003, the Korea Herald, one of South Korea's largest newspapers, reported a scandal involving Kwon Roh-kap and the Hyundai Group.

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mitigate the corruption in the lending of GOBs and could therefore motivate them to improve their performance. We test the above conjecture by following Djankov et al. (2003) who consider that the government's ownership of media determines the level of monitoring. We define strong (weak) monitoring as the level in countries whose governments have low (high) media ownership.

The literature has identified the negative correlation between the government's ownership of media and the media's monitoring. Houston et al. (2011) give a survey that uses a questionnaire provided by the World Business Environment Survey (WBES) to 5000 firms across 59 countries. The authors determine that both the government's ownership of media and the media's concentration weaken the link between private monitoring and the corruption in the lending of banks. However, in contrast, we use real and quantified accounting variables instead of a survey to examine how the media's monitoring could affect the corruption behavior of GOBs.

We use a sample of 258 GOBs and 2327 POBs in 64 countries from 2000 to 2010. We find that GOBs on average have a significantly low return on assets (ROA), return on equity (ROE), and net interest income to total assets (NIM) during the sample period. Hence, GOBs tend to underperform POBs. Further, the GOBs in countries with strong monitoring perform as well as POBs. This evidence confirms the concept that the media's monitoring might alleviate the corruption in the lending of GOBs. In contrast, we determine that GOBs in countries with weak monitoring underperform POBs in terms of ROA, ROE, and NIM. Without strong monitoring, GOBs poorly allocate their financial resources and thus exhibit poor operating performance. This finding is consistent with the political view that the government's ownership of banks yields distorting effects on the allocation of financial resources (Sapienza, 2004; Dinç, 2005; Iannotta et al., 2007, 2013; Micco et al., 2007; Shen and Lin, 2012; Disli et al., 2013; Shen et al., 2014; Nys et al., 2015).

However, this negative correlation between the media ownership and GOBs' performance cannot be used to infer any causal relationship between these two sets of variables. One possible channel is the role of corruption behavior in GOBs. We further examine whether the strength of the monitoring has an important effect on the corruption in lending and the banks' performance. Given that the corruption in the lending of GOBs is unobservable, an indirect test is to examine whether the influence of monitoring on bank performance varies with the corruption level of a country. If the corruption behavior has a role, then the influence of the media's monitoring on performance should appear in countries with high corruption levels but not in those with low corruption levels. Our results support this conjecture. When the corruption behavior is lower, the influence of the media's monitoring on the banks' performance disappears.

This study contributes to the literature in three ways. First, we relate the effect of the media's monitoring to the banking literature. Only one study has examined the effects of government-owned media on the corruption in bank lending (Houston et al., 2011). That study uses WBES survey data to test whether the type of ownership of media mitigates the corruption behavior of bank officers. In contrast, this study focuses on GOBs that suffer more from the corruption in lending (Khwaja and Mian, 2005; Claessens et al., 2008) and applies real and quantified accounting variables to examine how the media's monitoring could affect this corruption.

Second, this study connects the strand of literature on GOBs from the political perspective[2]. Prior studies indicate that GOBs significantly underperform POBs during election periods (Sapienza, 2004; Dinç, 2005; Iannotta et al., 2007, 2013; Micco et al., 2007). For example, Sapienza (2004) demonstrates that GOBs charge lower interest rates to firms affiliated with the ruling party than to firms without such an affiliation. Dinç (2005) suggests that GOBs increase their lending during election periods more than POBs do. Micco et al. (2007) identify that GOBs have worse performance than POBs in developing countries, especially during election years. In the current study, we determine that GOBs with weak monitoring underperform POBs. This result supports that the political intervention of bureaucrats leads to inefficient lending in GOBs. Moreover, we observe that GOBs with strong monitoring perform as well as POBs. Thus, our results also complement the findings of Boehmer et al. (2005) and Shen and Lin (2012) who identify that good country governance positively affects the banks' performance.

Third, our results present strong policy implications. Weak monitoring by the media is associated with poor performance, but strong monitoring can improve the operational efficiency of GOBs. These observations verify the importance of the media to governments. Accordingly, governments should minimize their influence on the media if they aim to improve the performance of their GOBs.

The remainder of this paper is organized into four sections. Following the introduction, Section 2 introduces the hypotheses. We describe our data and present the basic statistics in Section 3. Section 4 presents the empirical results, and Section 5 concludes the study.

2. Hypothesis development

In general, GOBs significantly fall behind POBs in terms of their performance because of political considerations. For example, Shen and Lin (2012) use the changes in banks' CEOs within 12 months of presidential or parliamentary elections as a proxy for political interference to discuss its negative influence. By adopting a sample of European banks, Iannotta et al. (2013) find that the operating risk and governmental protection of GOBs tend to increase during election years. Based on these findings, we posit that political interference could destroy the GOBs' primary function of efficiently allocating scarce capital (Beck et al., 2006; Barth et al., 2009). Political considerations might also encourage GOBs to implement more corrupt lending practices (Khwaja and Mian, 2005; Claessens et al., 2008).

Corrupt lending practices might be alleviated through monitoring from a private and competitive media entity. For example, Brunetti and Weder (2003) confirm that the free press is a powerful control on corruption for a large cross-section of countries. Besley and Prat (2006) demonstrate that media plays an essential role in government accountability by developing a model of democratic politics in which media capture is endogenous. Such a model proves that the features of media can determine the ability of the government to exercise such capture and therefore influence political outcomes. Houston et al. (2011) also argue that the media's monitoring increases the probability of being detected and punished and thus consequently deters potential corrupt activities in bank loans. When the level of monitoring is well-established, it reduces the corruption in bank loans, which in turn can improve

Kwon, a close assistant to former President Kim Dae-jung, was charged with taking more than US$17 million from Hyundai in 2000. Meanwhile the state-run banks and corporations poured a total of 33 trillion won into Hyundai to salvage it. On November 25, 2003, the Asia Times reported that Bank Negara Indonesia was involved in a fraud that consisted of huge losses in connection with the alleged issuance of fictitious letters of credit worth US$200 million between December 2002 and July 2003. The Asia Times quoted information from local newspapers and indicated that three of the Golkar party's seven presidential candidates allegedly received campaign funds from the suspect. More recently, the Financial Times of India also reported a bribery case regarding the head of the state-owned bank, the Syndicate Bank, on August 3, 2014.

[2] The influences of political factors on commercial banks are also discussed in the studies of Brei and Schclarek (2013) and Jackowicz et al. (2013).