Journal of Financial Economics 110 (2013) 1–17

Contents lists available at ScienceDirect

Journal of Financial Economics

journal homepage: www.elsevier.com/locate/jfec

The role of the media in corporate governance: Do the media influence managers' capital allocation decisions? ☆

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ARTICLE INFO

Article history:
Received 7 December 2012
Received in revised form
27 February 2013
Accepted 27 March 2013
Available online 6 June 2013

JEL classification:
G31
G32
G34

Keywords:
Media
Capital allocation
Acquisition
Corporate governance

ABSTRACT

Using 636 large acquisition attempts that are accompanied by a negative stock price reaction at their announcement ("value-reducing acquisition attempts") from 1990 to 2010, we find that, in deciding whether to abandon a value-reducing acquisition attempt, managers' sensitivity to the firm's stock price reaction at the announcement is influenced by the level and the tone of media attention to the proposed transaction. We interpret the results to imply that managers have reputational capital at risk in making corporate capital allocation decisions and that the level and tone of media attention heighten the impact of a value-reducing acquisition on the managers' reputational capital. To the extent that value-reducing acquisition attempts are more likely to be abandoned, the media can play a role in aligning managers' and shareholders' interests.

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1. Introduction

In an open capital market economy, guided by market signals, firms (and their managers) play an important role in the allocation of capital. Zingales (2000) proposes that the media can also play a role, perhaps positive, perhaps negative, in guiding firms (and their managers) in making capital allocation decisions. Dyck and Zingales (2002)develop this idea more fully. Given that the media collect, aggregate, disseminate, and amplify information, and to the extent that this information affects managers' reputations, they propose that managers are sensitive to the way in which the media report and comment upon their decisions. Managers may even be sensitive to whether the media reports on their decisions at all. After all, a bad decision that goes unnoticed may be no worse than a good decision that goes equally unnoticed.

In this study, we investigate whether, and to what extent, managers of publicly traded US corporations are sensitive to public news media in making one specific type of capital allocation decision. To wit: the decision of whether to complete or abandon a large proposed corporate acquisition that is accompanied by a negative stock market reaction at the announcement ("value-reducing acquisition attempt"). More specifically, we investigate whether the likelihood that a value-reducing acquisition attempt is abandoned is related to the level of media attention given to the attempt and to the tone of media coverage regarding the acquirer's attempt at the time of the acquisition announcement.

☆ We are indebted to an anonymous referee for his efforts to improve the paper. We are also grateful for constructive and helpful comments received from Mara Faccio, Gerard Hoberg, Byoung-Hyoun Hwang, E. Han Kim, Henri Servaes, Donald Teder, Hassan Tehranian, Wei Xu, Janet Yoakum, and seminar participants at the University of Texas at Dallas and the American Finance Association 2013 Annual Meetings.

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http://dx.doi.org/10.1016/j.jfineco.2013.06.003

Studies by Luo (2005), Chen, Harford, and Li (2007), Kau, Linck, and Rubin (2008), and Masulis, Wang, and Xie (2009) report that managers of acquiring firms appear to be influenced by their firms' stock price reactions at the announcement of proposed acquisitions—the more negative the stock price reaction, the greater the likelihood that a proposed transaction will be abandoned. One interpretation of this evidence is that managers "listen to the market" when deciding whether to abandon proposed acquisitions that investors perceive to be value reducing.

The unanswered question is: why do managers listen to the market? Or, more accurately, why do managers *sometimes* listen to the market? We propose that managers suffer a loss in both tangible capital (through their ownership of shares in their firms) and in human capital (through their loss in reputational capital as managers) when a value-reducing acquisition attempt is announced. We also propose that by abandoning the attempt the manager can expect to recover, at least in part, whatever tangible and reputational capital he may have lost at the initial announcement. Thus, the greater the loss in tangible and reputational capital that the manager incurs at the acquisition announcement, the greater the tangible and reputational capital that he expects to recoup at abandonment, and thereby, the more likely that he will be to abandon the proposed transaction.

We further propose that it is through managers' reputational capital that the media play a role in guiding managers' decisions to abandon proposed acquisitions. By reputational capital we have in mind the value to the manager of his future employment opportunities in the managerial labor market.

In the spirit of Dyck, and Zingales (2002), we propose that managers' reputational capital is affected by the media in two ways. First, the media disseminate news of managers' actions and thereby, increase the fraction of participants in the managerial labor market who learn of them. Second, the media characterize managers' actions and thereby, help to shape perceptions of those actions. If so, for a given decline in stock price at acquisition announcement, the manager of the acquiring firm incurs a greater loss in reputational capital when the proposed transaction is widely covered by the media, especially when the announcement is greeted by a more negative tone in the media coverage. Thus, our framework predicts that, in deciding whether to abandon a value-reducing acquisition attempt, a manager is more sensitive to the stock market reaction the higher the level of media attention given to the proposed acquisition. Our analysis further predicts that the manager is even more sensitive to the stock market reaction when the proposed acquisition receives wider media coverage in combination with a more negative tone of the coverage.

We conduct the study using 636 proposed mergers and acquisitions, each with a transaction value of at least $100 million and each of which was accompanied by a negative stock market reaction at its announcement, that were announced during January 1, 1990 through December 31, 2010. The dependent variable in our analysis is whether the proposed acquisition is abandoned (or not). The key independent variables are the acquirer's stock price reaction at the announcement, the value of the Chief Executive Officer (CEO)'s share ownership, the level of media attention given to the proposed acquisition, and the tone of media coverage about the proposed acquisition.

The results of this analysis are consistent with the proposition that the level of media attention and the tone of media coverage play an important role in managers' decisions to abandon value-reducing acquisition attempts. To begin, as do others, we find that in a probit analysis, proposed value-reducing acquisitions are more likely to be abandoned the more negative is the stock price reaction at the announcement of the proposed transaction. We further find that when we include the CEO's change in tangible capital, both the stock price reaction and the CEO's change in tangible capital are significantly negatively correlated with the likelihood of acquisition abandonment. The latter result is consistent with the proposition that CEOs are sensitive to the effect of the abandonment decision on their tangible wealth. The continued significance of the stock price reaction alone indicates that the CEO is not only sensitive to the effect on his tangible wealth.

When we include the level of media attention interacted with the announcement-period stock price reaction as our proxy for the effect of the transaction on the CEO's reputational capital, this term enters with a negative and statistically significant coefficient as does the change in the CEO's tangible capital. However, the stock price reaction alone loses its statistical significance. The loss of significance of the stock price reaction alone in combination with the significance of the interaction term is consistent with the notion that it is the CEO's concern with the effect of the abandonment decision on his tangible and reputational capital that induces him to listen to the market.

When we include the three-way interaction of the level of media attention, the negative tone of the media coverage, and the stock price reaction, the coefficient of this variable is negative and significant as is the coefficient of the change in the CEO's tangible capital. However, neither the two-way interaction of the level of media attention and stock price reaction nor the two-way interaction of the tone of media coverage and the stock price reaction is statistically significant. The lack of statistical significance of the two-way interaction terms in combination with the negative significance of the three-way interaction term implies that it is not the level of media attention nor the tone of the media coverage, per se, that are important, but rather whether the negative tone of the coverage is widely disseminated.

In sum, the results of our tests are consistent with the hypothesis that managers "listen to the market" when it is in their best interests to do so, and it is in their best interests to do so when they have more capital, both tangible and reputational, at risk.

Narrowly interpreted, the results of our study indicate that corporate managers are sensitive to the media when considering whether to abandon large acquisition attempts to which the stock market reacts unfavorably. In particular, the greater the media attention given to the potential acquirer and the more negative the tone of media coverage about the proposed acquisition, the greater the

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