



Research Article

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Media negative coverage, punishment bulletins and market reaction: An empirical research on Chinese listed companies

Yuanyuan Ling and Qianhua Lei

School of Business Administration, South China University of Technology, Guangzhou, China

ABSTRACT

This paper studies the market reaction of the punishment bulletins and finds that the market reaction of the punishment bulletins is positive significantly. We also examine the impact of the media coverage on the market reaction of punishment bulletins and find that the more negative media coverage before punishment announcement of CSRC, the greater the positive market reaction of punishment bulletins.

Keywords: negative coverage; punishment bulletins; market reaction

INTRODUCTION

In recent years, China Securities Regulatory Commission (CSRC) enhance the requirements of information disclosure and reinforce the penalties for violations. Will the punishment bulletins influence the investors' behaviors? The first purpose of this paper is to explore the market reaction of punishment bulletins in China stock market. Recently scholars have proven the impact of the media in stock market, and medias have emerged as among some of the most powerful players in corporate governance[1].Media serves as an important information intermediary in the capital markets[2].

What is the impact of media negative coverage on market reaction to punishment bulletins of listed companies? This paper provides a beginning towards developing this understanding.

This paper is organized as follows. Section 2 is Theoretical analysis and Hypotheses development. Section 3 is sample selection and research design. Section4 is empirical analysis and section 5 is the conclusions.

EXPERIMENTAL SECTION

1. Theoretical analysis and Hypotheses development

Starting with Kryzanomski, scholars have researched the market reaction of suspended trading on the Canadian stock market; there is a negative abnormal return after the resumption of trading, consistent with Schlarbanm and Wu. Noura examined the market effect of firms stocks which violated the GAAP; the result is that the volatility of stock is positively correlated with the degree of violation. In china, the conclusions of market reaction of punishment bulletins are not consistent[3]. In China, the majority of investors are unable to distinguish the authenticity of news, show flock characteristics. Trading behaviours of noise traders are not based on the fundamentals. So once the announcement of punishment bulletins, affected by the investors' sentiment, the negative news lead stock prices fell. But after the end of news, the market will generate new demand, stock prices rebound. In addition, as the saying goes, there is no smoke without fire. Companies investigated have a great probability of being punished by CSRC. Then when the end of the investigation, the negative news has been reflected in the share price, the market has fully absorbed the information. Price will not fall. Based on the above analysis, we state this hypothesis as follows:

H1: *When listed firms are punished by the government agencies, the market reaction is positive.*

After Enron, the finance literature has recognized the important role of media in the stock market [1,2]. The media did perform "muckraking" roles in the American capital markets. By collecting, selecting, certifying and repackaging information, media dramatically reduce the cost of becoming informed; reduce the degree of information asymmetry among investors [4,5].

Merton emphasizes that Media coverage can cause the attention of potential investors, enhance stock liquidity, reduce the cost of capital and affect the market value of listed companies. Undeniably, some factors may cause media bias, but the role of media in the stock market was unanimously approved by foreign scholars. In China, researchers have begun to investigate the role of media in Chinese capital market. Sheng and Li (2010) empirically test the corporate governance role of media in China. Their evidence shows that the basic mechanism is the involvement of administrative organizations, which is motivated by the media exposure of governance violations. Cu and Li (2012) argue that the Chinese media fulfills an active "watchdog" role in monitoring corporate governance violation and protecting minority shareholders.

Exposure of infringements, companies face enormous public pressure. The public opinion pressure created by this news has an impact of forcing them to take efforts to make changes in order to conform to social expectations, establish a good image and regain social acceptance. When media expose the bad news of companies ahead of CSRC, investor obtain the information, prices fell rapidly. With the increasing the negative coverage of companies, intense reaction of market, the pressure of correction increase, When negative news gradually fade away, investors return to rational, announcement of punishment bulletins is a good news for them at that time. We propose the following hypothesis:

H2: *More media negative coverage before announcement of punishment bulletins will lead to larger positive market reaction of punishment bulletins.*

2. Sample Selection and Research Design

2.1 Sample Selection

We obtain the illegal firms from the GILDATE, which excludes the events samples happening at same year and same month, to avoid affecting the market reaction. After deleting missing samples, we obtain 656 event samples; all variables (excluding dummy variables) are winsorized at 1% and 99%, following Jiang et al..

We use market adjustment method to calculate CAR. If the punishment day is the trading day, so the punishment day is the event day; if the punishment day is the holiday or suspension day, so the next trading day of punishment day is the event date. The paper considers the event day as the T0, the centre day, and selects symmetrical event window, such as 3, 5, 7, 11, 21. For example, 3 days period event window is [T0-1, T0+1].

2.2. Regression model

We test the hypotheses using the following multivariate regression:

$$CAR[-t, t] = \beta_0 + \beta_1 * Media + \beta_2 * Asset + \beta_3 * Debt + \beta_4 * Risk + \beta_5 * ROA + \beta_6 * Growth + \beta_7 * State + \beta_8 * Reformyear + Industry + \varepsilon \quad (1)$$

Where CAR [-t, t] is the cumulative abnormal returns in window [-t, t]; media is the number of negative articles covered by media before punishment bulletins. Some basic characteristics of the company will affect stock returns [6], So this paper control for these basic features in the regression equation, such as asset, debt, risk, ROA, growth, state, reformyear (most of Chinese listed firms begin their share segregation reform in 2006, so we use a dummy variable to indicate the impact of share segregation reform) and industry. Table 1 is the variables definition.

Table-1: Variables Definition

Dependent variables	
CAR[-1,1]	cumulative abnormal returns in Window [-1,1]
CAR[-2,2]	cumulative abnormal returns in Window [-2,2]
CAR[-3,3]	cumulative abnormal returns in Window [-3,3]
CAR[-5,5]	cumulative abnormal returns in Window [-5,5]
CAR[-10,10]	cumulative abnormal returns in Window [-10,10]
Independent variable	
Media	number of negative articles before punished
Control variables	
Asset	log of total assets in the year before firm is punished
Debt	asset-liability ratio in the year before firm is punished
Risk	standard deviation in the daily return of year before firm is punished
ROA	ROA in the year before firm is punished
Growth	sales growth in the year before punished
State	If firm is state-owned, this variable equals to 1; otherwise, 0
Reformyear	If event year is before 2007, this variable equals to 1; otherwise, 0
Industry	Industry dummy variable

3. Empirical Analysis

3.1 Descriptive Statistics

Table 2 reports the descriptive statistics. The mean of CAR is 0.3052, which means that the market reaction of punishment bulletins is positive in Chinese stock market. In order to improve corporate governance or to improve value, companies need to make rectifications after being punished, which is a good news for the investors. The minimum of CAR [-1,1] is -0.2050, and the maximum is 15.3931, suggesting that different companies have quite different market reaction after being punished.

Table 2: Descriptive Statistical

Variable	Obs	Mean	Median	Std. Dev.	Min	Max
CAR[-1,1]	656	0.3052	-0.0132	1.9776	-0.2050	15.3931
CAR[-2,2]	656	0.3069	-0.0118	1.9734	-0.2772	15.3658
CAR[-3,3]	656	0.3093	-0.0108	1.9718	-0.3097	15.3447
CAR[-5,5]	656	0.3124	-0.0091	1.9578	-0.4111	15.1877
CAR[-10,10]	656	0.3094	-0.0117	1.9212	-0.5661	14.7508
Media	656	7.3720	0.0000	16.4301	0.0000	97.0000
Asset	656	20.9808	20.8697	1.0761	18.7601	24.1126
Debt	656	0.8084	0.6286	0.7636	0.0827	5.2227
Risk	656	-3.6717	-3.6630	0.2750	-4.2679	-2.9335
ROA	656	-0.1499	0.0046	0.5103	-3.2057	0.2118
Growth	656	0.0403	0.0399	0.5477	-1.0000	3.1839
State	656	0.4573	0.0000	0.4986	0.0000	1.0000
Reformyear	656	0.7881	1.0000	0.4090	0.0000	1.0000

Table 3: Multiple Regression Analysis of Relationship between Media Negative Coverage and Market Reaction of Punishment Bulletins

VARIABLES	CAR[-1,1]	CAR[-2,2]	CAR[-3,3]	CAR[-5,5]	CAR[-10,10]
Media	0.01717*** (3.91)	0.01731*** (3.95)	0.01753*** (4.00)	0.01750*** (4.03)	0.01734*** (4.07)
Asset	-0.1471* (-1.86)	-0.1469* (-1.86)	-0.1480* (-1.87)	-0.1532* (-1.96)	-0.1579** (-2.06)
Debt	1.1762*** (8.95)	1.1741*** (8.96)	1.1719*** (8.95)	1.1668*** (8.99)	1.1442*** (9.00)
Risk	0.04633 (0.16)	0.03456 (0.12)	0.03225 (0.11)	0.02354 (0.08)	0.05011 (0.17)
ROA	1.1330*** (5.86)	1.1260*** (5.84)	1.1226*** (5.83)	1.1306*** (5.92)	1.1138*** (5.95)
Growth	0.4210*** (3.06)	0.4163*** (3.04)	0.4133*** (3.02)	0.4069*** (3.00)	0.4026*** (3.03)
State	0.02434 (0.16)	0.02613 (0.17)	0.02736 (0.18)	0.03921 (0.26)	0.02874 (0.20)
Reformyear	0.1871 (0.99)	0.204 (1.08)	0.2079 (1.10)	0.218 (1.16)	0.2381 (1.30)
Industry	control	control	control	control	control
Constant	2.5137 (1.39)	2.4467 (1.35)	2.4526 (1.36)	2.4996 (1.40)	2.7061 (1.54)
N	656	656	656	656	656
Adj R2	0.181	0.182	0.183	0.184	0.188
F	8.6221	8.6658	8.7032	8.7952	8.9636

Notes: The symbols ***, **, and * denote significance at the 1%, 5% and 10% levels, respectively.

3.2 Multiple Regression Analysis

As shown in Table 3, controlling the influence of other factors, coefficients of Media variable is positive, which are significant at the 1% level. Namely the more negative coverage of media before punishment bulletins, the more positive market reaction after punishment bulletins.

Based on different characteristics of the financial industry, the paper also removes the samples of financial industry. The conclusions are also not change. Finally, we select different event window, such as CAR[-4,4], CAR[-6,6], CAR[-7,7], CAR[-8,8] and CAR[-9,9], the findings are the same too. Conclusions in our paper are robust.

RESULTS

This study systematically explores the market reaction of punishment bulletins and the impact of media on the market reaction of punishment bulletins. This paper finds that market reaction of punishment bulletins is significantly positive and the market reaction of punishment bulletins by different regularly bodies is different. Moreover, this paper finds that more negative media coverage before announcement of punishment bulletins leads to more positive market reaction after punishment bulletins. Last, we also find that the media is more important in firms with serious Type II agency cost.

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