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A study of corporate misconduct: A study of M&A tendencies in China's A-share market

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1. Area of Research, Relevance, and Contribution

This chapter focuses on the main objective of this study, "whether firms are more inclined to initiate mergers and acquisitions (M&A) after engaging in misconduct in order to recoup the reputational damage caused by corporate misconduct". Firstly, the chapter will describe the background of the study: how modern firms suffer from misconduct and how M&A can enhance corporate reputation, in terms of past experiences and real-life cases. Secondly, the chapter will briefly explain the important concepts in the study, including the definitions of misconduct, corporate reputation and their causes. Finally, the chapter will present the theoretical and practical implications of the study. Summing up, this research project aims at studying i) the negative effects corporate misconducts may have on the firms' reputation, business and (market) value, ii) the various "*reputation repair*" strategies companies may take to recover damaged corporate reputation, and in particular iii) the effectiveness of the M&A approach to recover loss of value. Reputation is an extremely important "off-book" intangible asset that particularly matters for the various stakeholders of the firm (lenders, customers, suppliers, etc.). Chakravarthy et al. (2014) precise that "*reputation represents stakeholders' collective expectation about management's intent and ability to fulfill its commitments*". Misconducts form a large list of possible events (see below) that could *a priori* damage corporate reputation and value (Elsbach, 2003; Karpoff et al. 2008?).

Specifically, due to many undesirable factors within the modern company, misconducts of domestic and foreign listed companies have been frequent. In general, with the continuous advancement of information technology, misconducts of listed companies are nowadays disclosed in a timely and complete manner and rapidly disseminated through numerous formal or informal channels. When the stakeholders of an enterprise learn about a disclosed misconduct, their doubt about the enterprise's business intentions and its ability to fulfill commitments will increase and their expectations about the enterprise will decrease. Disclosure of corporate misconduct can cause serious damages to a firm's reputational capital (Murphy et al., 2009) and as a result some significant losses in the value of the company. At minimum, there are as many channels as the number of potential withdrawal of businesses, supports, and resources from stakeholders (customers, suppliers, investors, and creditors). All of them play a key role in the creation of corporate value (Elsbach, 2003; Karpoff et al. 2008).

At the company level, misconducts can concern various dimensions and in particular relate to the different corporate functions (finance/accounting, HR, marketing, productions, etc.). Companies' misconducts may relate to violation of laws and (economic or financial) regulations of the country in which the company is located, the industry to which the company is associated. Examples of types are financial fraudulent acts, product quality problems, patent breaches, environmental pollutions, etc. The number of such misconducts, that may be called corporate violations, is potentially considerable. In mainland China, in case of corporate violations, the CSRC and the SEHK can file a case against the company and publicly announce the violation penalty to the securities market in accordance with the relevant laws and regulations and the authorization of the State Council of China, especially for those companies who have been listed and thus, have generally-known social media to be disclosure their violations. Thus, corporate violations by listed companies are an important component of existing corporate misconducts that are disclosed and widely known to the public, and they represent the most typical and observable misconducts that cause damage to corporate reputation. In order to ensure that the corporate misconducts studied in this research are disclosed and widely received by corporate stakeholders, one will use the punished corporate violations of listed enterprises in China to represent corporate misconducts.

Following the disclosure of regulatory sanctions, such companies that have committed misconduct will not only passively suffer from the negative effects of reputational damage, but also proactively take various reputational repair measures to regain stakeholders' trust and thus safeguard the normal operation and future development of the firm. On the one hand, these reputation repair measures include targeted rectification of misconduct, such as rebuilding the organization's technology, manpower, and infrastructure, improving corporate governance (Chakravarthy et al., 2014), etc.; they also include other remedial measures that help to create a new corporate image and thus dilute the negative consequences of negative information, such as charitable giving and implementing other socially responsible behaviors (Koehn and Ueng, 2010), etc. However, for these measures, Shu and Wang (2018) argue that such reputation repair is path-dependent, i.e., previous negative events may have an "imprinting effect" on organizational behavior. If a company demonstrates good behavior that exceeds social expectations and norms, such as charitable giving, immediately after being penalized for a violation, stakeholders may experience cognitive dissonance and thus become skeptical. In the worst-case scenario, stakeholders may distrust the donor's true motives and interpret such good behavior as a sign of insincerity.

M&A is increasingly recognized as being a relevant option for firms to improve their reputation. Kim et al.? (2011) and Haleblian et al. (2017) argue that M&A can indirectly preserve corporate reputation by meeting the expectations of corporate stakeholders for corporate growth. In a real-life case within China, Red Yellow Blue Education also chose to initiate M&A to regain market trust and repair its reputation after corporate employee misconduct (child abuse incident) occurred and led to reputation damage through M&A announcement on social medias. Compared with socially responsible behaviors such as charitable donations for reputation repair, M&A requires disclosure of M&A transaction information in the form of interim announcements in accordance with the M&A and restructuring information disclosure rules issued by the China Securities Regulatory Commission, which can more quickly communicate with stakeholders; secondly, M&A is a long-term strategic investment activity focused on the company's business, and because of its relatively high cost, it can more strongly reflect the company's strength and effort to repair reputation?. Finally, M&A involves multiple stakeholders, and the M&A process is a channel for companies to actively and deeply communicate and establish substantive relationships with multiple stakeholders, which is conducive to expanding the scope of reputation repair.

Based on the above background/premisse, this research will take the disclosed corporate violations of listed enterprises in mainland China as a proxy variable for corporate misconducts, and take the subsequent M&A activities initiated by enterprises as the research direction, focusing on the link between the initiation of M&A by enterprises and the reputational damage suffered by enterprises after the misconduct was generated and disclosed, and whether M&A by enterprises can effectively repair the reputational damage caused by corporate misconduct. More specifically, this research will focus on A-share listed companies in China, and retain disclosed misconducts identified as potentially having a reputational impact on a company

The key reason why corporate misconduct clearly punished publicly by regulators is taken as a proxy for corporate misconduct, while corporate breaches of social ethics, public expectation, or others that are not publicly punished by regulators are not, is that the definition of social ethics, ethics in practice, and others contains more subjective factors and lacks the practical, objective, and replicable methods needed in the study. On the other hand, this research argues/posits that reputation repair should involve at least three elements: first, a change in corporate reputation as a result of a negative event; second, proactive measures taken by the company to respond; and third, measures that are primarily targeted at stakeholders and that the company hopes to use to have a restorative effect on stakeholder relations and a positive impact on reputation. **More specifically, this paper will reflect the changes in the relationship between the firm and its stakeholders, represented by creditors, suppliers and customers, through three publicly disclosed and calculable financial data: cost of debt financing, business credit, and sales revenues, and expects to reflect the positive impact of a firm's reputation enhancement from the stakeholders' perspective in terms of the expected improvement in the relationship between the firm and its stakeholders after the implementation of a merger or acquisition.** However, it is often controversial to define whether a company has committed a violation of social ethics, ethical practices, or other violations that have not been sanctioned by regulatory agencies, and it is not possible to confirm whether such actions have actually harmed the expectations of direct stakeholders of the company. Therefore, for the sake of objective validity of the study, they are not considered in this paper.

In terms of the significance and practical contribution of this paper, on the one hand, most of the existing literature focuses on a series of negative effects of corporate misconduct resulting in reputation loss (Armoure et al., 2017; Graham et al., 2014), while there is relatively little research literature on how companies cope with reputation loss after a breach. Actually, there is a large body of research on the effects of corporate misconduct on corporate financial activities and on fundraising activities. However, the existing literature lacks sufficient attention to the subsequent adjustment of corporate investment activities. On the other hand, the small amount of literature examining the repair of reputational damage caused by corporate misconduct has mostly concluded that reputational damage in a crisis is difficult to avoid and that the key to coping is to reduce the extent to which misconduct evokes negative emotions among stakeholders and to reduce the likelihood of adverse behavior, thereby achieving the goal of repairing organizational reputation (Claeys et al., 2010; Dimo et al. 2007). This paper, however, focuses on M&A activities, which have received widespread attention in the capital market, and takes one of the core investment activities of enterprises, M&A activities, as the research object to explore the impact of corporate misconduct on M&A, which has certain theoretical value and practical significance.

In summary, compared to previous studies, the main innovations and contributions of this research can be summarized as follows:

(1) It focuses on the particular phenomenon that firms are more inclined to initiate mergers and acquisitions after being penalized for misconduct, and deepens the understanding of corporate behavior by exploring the real-life context, theoretical explanations, and mechanisms of action of this phenomenon and its impact on corporate performance. The existing literature, however, is less direct and systematic in its research on misbehavior and corporate investment in the face of penalties for violations, and ignores the proactive adjustment in investment by firms as decision executors in the face of reputational shocks. Therefore, this paper expands the analytical perspective of the previous theoretical literature.

(2) It adds new empirical evidence to the study of M&A motivation theory by examining the intrinsic motivations that make firms more inclined to implement M&A after misconduct is penalized by violations. While traditional studies of M&A motives have suggested motives such as the pursuit of synergies and managerial overconfidence from the perspective of firms and their executives, recent literature has increasingly focused on the impact of external environmental factors on corporate M&A. It is found that environmental factors such as financial crisis, M&A wave, national institutional environment, industry regulation, political promotion opportunities, and various selection activities can trigger adjustments in corporate M&A decisions. Based on the current situation of the capital market in China, this paper investigates M&A decisions in the context of firms' reputation losses due to misconduct, providing a new perspective to understand and assess the behavioral logic and decision-making mechanisms behind M&A from the perspective of reputation repair, expanding and extending the relevant literature.

(3) This research proposes a new perspective that, when firms face a reputation loss crisis caused by misconduct, they will use the method of adjusting their M&A behavior to cope and remedy, which enriches the research in the field of reputation repair. How firms repair reputations damaged by misconduct is an important unresolved issue in existing reputation research. The relevant literature suggests that firms respond positively by improving corporate governance, increasing charitable giving, voluntarily publishing social responsibility reports, and taking internal and external actions such as corporate name changes to mitigate negative reputational impacts resulting from misconduct. The study in this paper points out that initiating mergers and acquisitions is one of the important corporate reputation repair methods, which helps to regain the trust of key stakeholders in the capital

and product markets and attenuate the negative impact of reputation loss, enriching the related literature.

2. Research Question Being Addressed

This section will focus on the research hypotheses of this paper, the theoretical background and reality of the hypotheses, as well as the specific ways to confirm the hypotheses: including the measurement of the impact of the hypothesized existence, the subject of the measurement, and the reasons for the selection.

In this research, we focus on whether firms are more likely to initiate M&A activities for reputation repair purposes when they have been penalized for misconduct and have suffered reputational damage, and the effect of M&A initiated in this context on corporate reputation repair. Specifically, this paper examines the reactions of key stakeholders, including shareholders, creditors, suppliers, and customers with the cost of financing or cooperating from those stakeholders as proxies, who have a significant impact on corporate operations and development, and empirically examines the reactions of these key stakeholders to corporate sanctions for misconduct in order to verify the reputational damage caused by such violations. Finally, this research will examine the impact of M&A on corporate performance of these firms, and test the validity and effectiveness of M&A in improving the short-term performance of firms suffering from reputation loss due to misconduct from the perspective of results. The paper will also focus on whether horizontal M&As that occur in the same industry can produce better performance, i.e., better reputation repair, and whether there are differences in the propensity of different types of firms to repair reputation losses through M&As.

Therefore, this paper will present research questions from three perspectives which will be materialized separately by chapter:

(1) The relationship between penalties for misconduct and the propensity to merge

First, this paper focuses on whether investment decisions, one of the most important financial decisions of a firm, are affected after being subjected to regulatory penalties for corporate misconduct.

Misconduct of listed companies may harm the rights and interests of stakeholders represented by investors and may pose a serious threat to both the existence and efficiency of capital markets (Amiram et al., 2018). Therefore, countries have public or non-public disclosure channels for corporate misconduct to alert corporate stakeholders of possible risks and losses. In China's financial and economic market, in response to corporate misconduct that violates the law, the Securities Regulatory Commission (SFC) and the stock exchange can investigate the company's case and publicly announce the violation penalty to the securities market based on relevant laws and regulations and the authorization of the State Council. Therefore, revealing violations can be one of the important punishments for corporate misconduct, which helps corporate stakeholders to identify risks and make appropriate decisions. Since the penalty decisions of the regulators are the result of repeated investigations and evidence, the public disclosure of information on penalties for violations is tantamount to sending a true and reliable signal to the capital market, and through this signal the market stakeholders will revise their views on the development prospects of companies that have committed such misconduct, which will inevitably have a certain negative impact on enterprises.

Second, this paper focuses on whether a firm's M&A decision, an effective measure to promote stakeholders' willingness to invest, is subsequently affected by regulatory penalties for misconduct when the investment decision is indeed negatively affected by the regulatory penalties the firm suffers as a result of the misconduct.

After a company is subject to regulatory penalties, it will not only passively suffer from various negative impacts, but also proactively take measures to respond and regain the trust of stakeholders in order to safeguard the normal operation and future development of the company. Such a response includes targeted corrective actions for misconduct, as well as adjustments in financial decisions, corporate culture and development strategies. In fact, how organizations respond to trust-breaking incidents has become a common concern in both academia and practice (Barnett and Pollock, 2012). From the existing literature, Autore et al. (2014), based on data from the U.S. capital market, find that reputational losses following disclosure of misconduct lead to a reduction in the ability of firms to raise funds, and investment activities as well as M&A activities are curtailed due to insufficient financial support. However, based on data from China's capital market, my preliminary investigation suggests that Chinese firms instead overinvest after being penalized, expecting to hedge and compensate for the negative impact of regulatory penalties and repair the damaged reputation in this way. Although these two types of literature do not directly examine the changes in M&A activities of firms after suffering reputational damage due to misconduct based on the

Chinese context, they do reflect the different thinking of scholars in the relevant fields regarding the "passive" and "active" responses of firms in the investment field. "passive" and "active" responses. Clearly, the changes in M&A activities of firms after misconduct is disclosed depend on the combined effect of two forces, reputation loss and reputation repair, and their final outcomes need to be further explored.

(2) The role of M&A in repairing the damaged reputation of a company after being punished for misconduct

When a firm's reputational assets are lost due to misconduct, steps can be taken to repair them, and such repair is stakeholder-driven. Although an organization's stakeholders are defined as all the various individuals and groups that influence or are influenced by the organization's actions, including consumers, employees, investors, communities, regulators, suppliers, government, and the media, among others (DiMaggio and Powell, 1983; Elsbach, 2003), in the case of a firm penalized for violations particular context, firms also become somewhat targeted in repairing their reputation, placing more emphasis on and responding to the demands of key stakeholder groups, or those with the most legitimacy, power, and urgency of claims (Mitchell et al., 1997). This research selects four key stakeholders: equity financiers, debt financiers, suppliers, and customers, and explores the reputational damage suffered by the firm with respect to these four stakeholders after a violation penalty and whether the firm's initiation of an M&A can achieve a reputation repair. These four stakeholders are chosen because, first, they are involved in the key financing and operational activities of corporate financial management, which are related to the availability of funds and product markets, and have an extremely important impact on the financial performance and cash flow of the firm; second, the sales revenue and contract costs of the firm are particularly sensitive to the misconduct of the violation because of its impact on customers, suppliers, and providers of funds (Karpoff et al., 2008). Compared to the community, employees, and government, these four types of stakeholders may incur their own economic losses due to the spillover effects of corporate violations and require companies to take measures to mitigate their relationships. Third, these four types of stakeholders have certain rights that can effectively influence the interaction between the company and other stakeholders and the dialogue among stakeholder groups (Pfarrer et al., 2010), e.g., withdrawal of funds by creditors can cause concerns among stakeholders such as investors and suppliers about the company's operating cash flow, which in turn affects the provision of resources by more stakeholders. Therefore, this chapter explores whether a firm initiating an M&A can improve its relationship with stakeholders and regain their support after the firm has been penalized for misconduct violations from four perspectives: equity financiers, debt financiers, suppliers, and customers, with the cost of financing or cooperating from those stakeholders as proxies of relationships' interest, which can also ensure a more significant, objective, and valid study.

(3) Corporate misconduct and M&A performance

This paper focuses on whether M&A implemented by firms after misconduct is disclosed can achieve good corporate performance, in order to verify the rationality and validity of the M&A initiation motives of firms to repair the reputational damage caused by misconduct. This is because, based on the fact that academics and practitioners tend to measure the effectiveness of M&A transactions by the level of corporate performance that can be quantified. In this paper, corporate performance will be used as a proxy variable for the effectiveness of M&A on corporate reputation repair as measured.

The question is not simply about the effect of M&A on firm performance or the effect of corporate misconduct on firm performance, but rather whether initiating M&A as a reputation repair motive is effective in enhancing firm performance in contexts where firms face reputational damage after being penalized for misconduct violations. From this perspective, a comparison among firms that generate misconduct may be a better fit for the research questions in this paper than a comparison among firms that implement M&A. Therefore, this paper will examine the effects of M&A behavior of offending firms from the perspective of firm performance, using all offending firms as the research target. If the implemented M&A fails to achieve good corporate performance, it means that not only is the motivation of the firm to initiate the M&A to repair the reputation affected by the misconduct not justified, but it may also lead to a waste of corporate resources and even social resources.

3. Literature Review

This section identifies and summarizes a relevant literature on corporate misconduct and corporate mergers and acquisitions, in order to clarify the research position and highlight innovative contributions. It first reviews research associated with the economic consequences of corporate misconduct suffering from non-compliance penalties, i.e. reputation loss and reputation repair in conjunction with the analysis of corporate reputation. Second, it discusses some research on M&A from the perspective of the M&A process, including the analysis of the motivation in the pre-M&A period, the process in the mid-M&A period, and the analysis of the performance in the post-M&A period.

3.1. Research related to corporate misconduct and reputation loss

In the long-term, widely disclosed misconduct will create a crisis for the firm and give people reason to think badly about the organization (Coombs, 2007), and there is general agreement in the literature that misconduct that violates the law can cause serious reputational damage to the firm. Karpoff and Lott (1993) state that reputational damage can be thought of as the change in the value of the firm at the time of the first disclosure of the breach minus the legal penalty for the breach. For the offending firm, only a small portion of the loss is explained by court enforcement and criminal fines, and the reputational cost of the firm's violation is substantial, accounting for the vast majority of the cost paid by the firm upon disclosure of the violation. a more accurate measure of reputational loss is provided in a further study by Karpoff et al. (2008), which argues that the reputational loss caused by misconduct can be estimated as the expected loss in the present value of future cash flows due to lower sales, higher contracts, and financing costs. On average, if a company increases its market value by one dollar by misleading the market, when its misconduct is disclosed, the company loses, first, that increased dollar and, in addition, it loses an additional $3. 08. The $3.08 is: $0.36 in expected legal penalties and $2.71 in reputational damage. Overall, the reputational loss is more than 7.5 times the sum of all penalties imposed through the legal and regulatory systems. Also, Murphy et al. (2009) argue that the reputation-related market losses that occur around accounting scandals are due to increased uncertainty and lowered expectations among stakeholders about the firm's intentions and ability to fulfill its commitments.

Moreover, because disclosures of corporate misconduct occur after the fact, this means that the positive information previously provided by the company to the outside world may be untrue and a denial of the company's historical information. And because information about corporate misconduct punished by regulators is mostly announced in various media nationwide, information is disseminated quickly and widely, so the damage to corporate reputation from this type of corporate misconduct is more rapid and dramatic than the damage caused by other types of misconduct. The destruction of corporate reputational capital has a variety of possible consequences that affect the relationship with stakeholders. Liebman and

Milhaupt (2008) argue that the reputational penalties arising from violations affect the present value of the firm by increasing future costs or reducing future revenue to affect the present value of the firm, as counterparties change the conditions under which they will do business with the firm, not only raising the firm's operating costs, but also potentially harming its growth. Thus, from all perspectives, changes in reputational assets affect the way stakeholders interact with the organization (Coombs, 2007).

3.2. Research related to reputation repair in mergers and acquisitions dimension

A part of the literature examines the proactive repair of a firm's reputation after misconduct is disclosed from the perspective of the interaction between the firm and its stakeholders. Organizational misconduct puts stakeholders at risk and stakeholders may withdraw their support and resources, thus hindering the organization's chances of survival and success (Elsbach, 2003; Gillespie et al., 2014), which urgently requires organizations to take steps to repair their reputation, reduce negative impacts and prevent negative behavioral intentions, and regain stakeholder trust. Karpoff (2012) argues that how firms repair damaged reputations is one of the important unresolved issues in existing reputation research.

Focusing on the relationship between reputation and corporate mergers and acquisitions, reputation is widely recognized as an important (off-book) intangible asset for firms to improve their performance, maintain a competitive advantage and enhance the value of the firm (Amit and Schoemaker, 1993). A good reputation is beneficial for firms to attract external financing and has a driving effect on corporate investment (Chalençon et al., 2017). Chalençon et al. (2017) also find that reputation is a key factor influencing M&A value creation and that acquirer reputation has a positive effect on M&A transactions regardless of whether the target is domestically or overseas. On the flip side, negative reputation negatively affects corporate M&A and other investments. Autore et al. (2014) found that violations can damage a company's reputation and increase information asymmetry between stakeholders and management, which leads to difficulties in obtaining external financing for the offending company, and therefore the company may not be able to finance all profitable investments, and subsequently overall corporate investment will decline, and M&A investment will also decline. Overall, the disclosure of non-compliance leads to a reduction in the size of both financing and investment.

Another dimension of the relationship between reputation and M&A is that M&A can also have an impact on corporate reputation, and Muehlfeld et al. (2007) focus on the fact that the discontinuation of an M&A transaction can be detrimental to the reputation of the principal merging firm. They find that the successful completion of an M&A transaction is related to the firm's reputation, resources (direct and opportunity costs) and learning. It is in the interest of the principal merging firm to complete the deal after the public announcement of the M&A, while the aborted M&A has a negative effect on its reputation and implies that it is using resources inappropriately. studies by Kim et al. (2011) and Haleblian et al. (2017) both state that because of the important role of M&A in promoting firm growth and improving firm value and quality, undertaking more M&A may be associated with meeting the high expectations of investors and other stakeholders.

3.3. Research related to corporate mergers and acquisitions

Since the 19th century, companies in various industries and fields have accelerated their expansion by means of M&As, setting off five large-scale waves of M&As, and scholars at home and abroad have conducted a lot of theoretical and experimental research on the topic of corporate M&As. M&A is a dynamic and complex game and decision-making process that can be divided into three stages: pre-M&A (motivation analysis), M&A (deal execution) and post-M&A (economic consequences). It is worth discussing these stages shortly.

(a) Pre-M&A - Motivation for M&A

Corporate M&A decisions remain a complex and mysterious "black box" and have attracted a large number of scholars to explore the motivations for M&A. The pursuit of synergies is the most common and accepted motivation for firms to engage in M&A. Prior to M&A, firms have difficulty in meeting the potential requirements for economies of scale, including horizontal economies of scale (economies of scale that reduce costs), vertical economies of scale (economies of scale that reduce transaction costs), and other economies of scale (economies of scale in management functions). Shleifer and Vishny (2003), based on the history of M&A activities of US firms, first explicitly suggest that the main motivation for M&A is related to the market value of the acquirer's stock. The stock market if the value of the acquirer, the target, and the post-integration. Savor and Lu (2009) also find that the market overvalues the acquirer more than the target, that the likelihood of a firm becoming an acquirer increases significantly when the stock price is overvalued, and that these acquirers with overvalued stock prices are more likely to take stock payments in M&A transactions.

(b) Mid-term M&A - Transaction execution

Boone and Mulherin (2007) provide a detailed breakdown of the intermediate M&A process, which consists of two periods: the private M&A period and the public M&A period. Muehlfeld et al. (2007) argue that the intermediate stage of M&A is complex and uncertain, but is often overlooked by scholars. Muehlfeld et al. In this stage, the parties negotiate a number of elements of the M&A transaction, including the choice of payment method and the determination of the M&A ratio. Myers and Majluf (1984) argue that in an information-asymmetric environment, investors will perceive different payment methods as different expressions of information, and if the executives of the main merging firm decide to maximize shareholders' interests, they will not be able to make a decision.

King et al. (2004) also find that managers of merging firms tend to use cash for acquisitions when they believe that the firm's stock price is undervalued, while they are more likely to use stock for acquisitions when they believe that the firm's stock price is overvalued, are more likely to use stock for acquisitions, suggesting that the market should view stock-financed transactions as a signal that the acquirer is overvalued. Di Giuli (2013) argues that in a merger, the acquirer is able to dominate the payment method decision and they will take advantage of the stock premium and choose stock as the payment method. In this process, the managers of the target firm also overestimate the synergies due to their belief in the quality of the merger, considering the long-term value of the shares of the merged entity. When the merging firm faces a better investment opportunity it may use stock as a payment method more often in M&A transactions.

From the perspective of M&A ratios, Chalençon et al. (2014) suggest that the percentage of the acquisition target's equity capital determines the acquirer's degree of power and commitment. Muehlfeld et al. (2007) argue that in M&A, the percentage of the acquisition proposed by the principal merging firm provides information on whether the deal is one in which it pursues strategic objectives or financial benefits. If the principal-merging firm seeks a high percentage ownership deal, it implies that the M&A is of greater strategic importance and therefore requires a higher level of management as decision maker. Thus, strategic transactions associated with high percentage M&A may be pursued with greater intensity, thereby increasing their chances of completion.

(c) Late stage of M&A - Corporate M&A performance

Research on M&A performance can be broadly divided into two categories: market performance and accounting performance. Most studies on market performance use the event study approach. The event study approach is based on the efficient market hypothesis and uses company stock price data to calculate Cumulative Abnormal Returns (CAR) or Buy and Hold Abnormal Returns (BHAR) at the time of M&A announcement to determine the impact of M&A transactions on firm value. One of the first to use the event study method was Fama (1969), who demonstrated the short-term wealth effect of M&A on shareholders by comparing the change in company stock prices during the pre- and post-merger window. Although the literature on M&A performance generally agrees that the target firm can achieve better performance, there is no consistent conclusion on whether the principal merging firm can profit from the M&A activity. Schwert (1996) studied 1814 M&A events between 1975 and 1991 and found that, on average, shareholders of the target firm were able to earn a 35% excess cumulative return during the event window. From the perspective of the principal merging firm, some scholars argue that the performance of the principal merging firm is negative after the M&A. For example, Agrawal and Jaffe (2001) find that the shareholders of the acquiring firm lose 10% of their wealth five years after the completion of the M&A. While another part of scholars get the opposite conclusion, for example, Jensen and Ruback (1983) argue that the excess cumulative return of bidding firms in a successful tender offer is a positive 4%.

Muehlfeld et al. (2007) suggest that the M&A activities The possible motives can be broadly classified into two categories: economic reasons and management preferences, which theoretically have different effects on post-merger performance. Among them, economic reasons are mainly efficiency-based (i.e., M&A may lead to reallocation of corporate assets and efficiency gains) and market power-based (M&A may eliminate competition, gain pricing advantages or other forms of market power). Management preferences, on the other hand, include management arrogance and management self-interest. In both types of winters, M&A based on economic reasons perform better, while deals driven by management preferences on average show poorer performance.

4. Analytical Framework

This section focuses on the research methodology of this paper: theoretical qualitative analysis and empirical quantitative research study, as well as the main theories and models that will be adopted under the specific research methodology. It is worth mentioning that empirical quantitative research is the main way to verify the

research hypotheses in this paper, while theoretical analyses are mainly used to identify the research problems and give practical recommendations.

This research will use an empirical study to examine the impact of misconduct on M&A and its economic consequences, and the empirical analysis will be carried out in three steps. First, a sample of Chinese listed companies will be used to empirically test the relationship between corporate misconduct penalties and corporate propensity to initiate M&A, and analyze the changes in corporate propensity to initiate M&A, the frequency of M&A, and the size of M&A after being penalized for misconduct. One will also test the hypothesis that firms will initiate M&A activities for reputation repair motives when they have been penalized for misconduct and have suffered reputational damage.

Second, this research will examine the effect of firms' reputation repaire for implementing M&A from the perspective of stakeholders through focusing on the change of financing or cooperating cost with main stakehoders before and after the M&A. One will empirically examine the responses of these key stakeholders to information about corporate violations and penalties to verify the reputational damage caused by corporate misconduct by focusing on key stakeholders who have a significant impact on corporate operations and development, including shareholders, creditors, suppliers, and customers. The study will focus on whether the implementation of M&A by the offending firm can have a positive impact on the relationship between the firm and key stakeholders to verify whether M&A behavior can produce certain reputational repair effects through two different channels: capital market and product market. **For example, for the bond stakeholders, the lower cost of financing is a concrete expression of the higher degree of trust in the creditor's reputation of the enterprise; and for the business activities of stakeholders, the scale of co-operation, such as sales and purchases, is a concrete expression of the higher degree of trust in the creditor's reputation of the enterprise by the suppliers and customers. In conclusion, the improvement and growth of the enterprise's financial performance can not be separated from the promotion of external stakeholders; and one of the most important reasons for external stakeholders to co-operate with the enterprise to promote the development of the enterprise is the trust in the enterprise's reputation. Therefore, in this paper, the growth of some of the financial data of the enterprise as a symbol of "positive effects" on the reputation.** Further, the study focuses on whether M&A by the offending firm can have a positive impact on the firm's relationship with its key stakeholders to verify whether M&A can have a reputational repair effect through two different channels: the capital market and the product market.

Finally, one will examine the impact of M&A implementation by violating firms on firm performance in the particular context of firms being penalized for misconduct violations. Expanding from revealing phenomena, theoretical analysis, and mechanism testing for firm The performance test will examine that firstly, more severe violation of the firms occure, the greater the marginal probability to undertake a M&A for firms because of the need for reputation repair; secondly, the implementation of M&A by the violating firm is beneficial in improving the relationship and expectation of stakeholders of the firms; and thirdly, also improving the firm's short-term performance which verifies the effectiveness of M&A initiated by the violating firm in repairing its reputation from an outcome perspective.

5. Proposed Research Methodology or Methodologies

This research uses a combination of theoretical analysis and empirical research to examine the relationship between penalties for misconduct and M&A behavior. In terms of theoretical analysis, this research will use qualitative analysis to analyze the theory on which this research is based, and review and summarize the literature on corporate misconduct, reputational assets, and M&A behavior, and use inductive and deductive methods to analyze the key research questions and propose reasonable research hypotheses. In terms of empirical research, this research uses quantitative analysis methods and statistical software to analyze data from multiple perspectives, such as descriptive statistical analysis, correlation analysis, univariate comparative analysis, and multiple regression analysis. In the multiple regression analysis, this research mainly uses OLS model and Logit model to test and propensity score matching method (PSM) and double difference method (DID) to deal with the endogeneity problem of the model to ensure the robustness of the research findings. Finally, this research aims at providing some managerial and, where relevant, policy recommendations.

It is worth mentioning that this paper does not adopt the research method of contacting enterprises and their key stakeholders and analyzing the samples through interviews or questionnaires. This is because, on the one hand, for different enterprises and key stakeholders, there is subjectivity in the measurement of corporate reputation, so the direct contact interview is less objective for this study; on the other hand, the

sample of enterprises obtained by direct contact is very limited, so this paper chooses to adopt the unified quantitative analysis of public platform data in order to ensure that the results of the study are universal.

6. Data Analysis Plan

This chapter will focus on the basic information about the research sample, its size, how and why it was selected, and the specific model used to corroborate the research hypotheses.

This research will select an initial sample of Chinese A-share listed companies from 2008 to 2022 for empirical analysis, and select variables and construct models at three levels: the relationship between corporate penalties for misconduct and corporate M&A propensity, the role of corporate M&A in repairing damaged reputation after corporate penalties for misconduct, and corporate misconduct and M&A performance. The final sample involves observations of listed companies over a 14-year period. **In other words, the original sample size of Chinese A-share listed companies used for analysis in this paper is expected to be over 4,000, with a time span of 14 years.**

Moreover, in this study, the sample variables are selected from three major Chinese stock information databases, CSMAR, WIND, and IFIND, which include all the disclosed financial and operational data, stock market information, and some misconduct information of Chinese A-share listed firms. This paper selects these three databases because they are the most commonly used information collection databases by Chinese financial institutions and investors. Therefore, this paper argues that the sample information from these three databases is not only comprehensive and reliable, but also can better represent the information perspectives of parties related to corporate reputation.

At this stage, the specific model and variable selection for this study is expected to be as follows:

(1) The relationship between penalties for misconduct and the propensity to merge

In order to test the effect of violation penalties on corporate M&A, this research chooses whether firms initiate M&A, the frequency of corporate M&A and the size of corporate M&A as the variables to explain.

Among them, considering the variable to explain whether the firm initiates M&A as a dummy variable, the Logit model will be used to construct the parameter estimation in this research.The equation of the Logit model is:

$$P(i) = 1/[1 + \exp(-\beta X(i))]$$

The left side of the above equation $P(i)$ denotes the probability that firm *i* initiates an M&A. On the left-hand side, β is the vector of coefficients that weight the supposedly explanatory variables X, with X(i) the vector of values associated with firm *i*, including explanatory variables (misconducts, fines, etc.) and all control variables, which are traditional variables retained in the M&A literature, and some variables able to capture a year effect and a industry effect.

Because the M&A frequency and M&A size, are continuous variables, one will use regression models. To avoid the effect of endogeneity, all control variables are treated with a one-period lag. Also, to mitigate the serial correlation problem at the firm level, the standard errors of all regression coefficients are clustered robustly at the firm level in this chapter. A typical regression model is formulated as

$$\begin{aligned} MA_{i,t} = {} & \beta_0 + \beta_1 \text{ Fraud }_{i,t-1} + \beta_2 \text{ Size }_{i,t-1} + \beta_3 \text{ ROA }_{i,t-1} + \beta_4 L_{EV} V_{i,t-1} + \beta_5 \text{ Zscore }_{i,t-1} \\ & + \beta_6 \text{ OCF }_{i,t-1} + \beta_7 \text{ Growth }_{i,t-1} + \beta_8 \text{ Board }_{i,t-1} + \beta_9 \text{ Independ }_{i,t-1} \\ & + \beta_{10} \text{ Analyst }_{i-1} + \beta_{11} \text{ Dual }_{i,t-1} + \beta_{12} \text{ SOE }_{i,t-1} + \text{ Yeardummy} \\ & + \text{ Industrydummy} + \varepsilon_i \end{aligned}$$

Where ε_i stands for the error of the model. Meanwhile, in order to test the moderating effect of property rights nature on corporate misbehavior and M&A initiation, this research will group regressions of both the above logit model and OLS model according to the nature of corporate property rights.

Specifically, our goal is to assess the firm's propensity to merge (MA) and one will split this into three measures, namely whether or not to merge (MAyes), the frequency of mergers and acquisitions (MAcount), and the size of mergers and acquisitions (MAamount). MAyes is a dummy variable signaling whether a firm initiated an M&A in the year, of course it takes the value of 1 if the firm initiated an M&A in the year, and 0 otherwise. MAcount is the number of times a firm initiated an M&A in the year (it is therefore a discrete variable). M&Aamount is the logarithm of the total transaction consideration of the firm's M&A in the year, after adding 1 (it is therefore a continuous variable). These three variables describes the propensity of firms to initiate M&A from different perspectives. Since the propensity to initiate M&A is examined, the year in which the M&A is initiated is defined according to the date of the first announcement of the M&A.

The explanatory variable one wants to tests is “Fraud”, the violation penalty variable that signals whether the firm was subject to violation penalty in the previous year. This variable therefore takes the value of 1 if the firm was disclosed to have violation penalty in the previous year, otherwise it is defined as 0. At this stage, one does not consider to investigate the occurrence of multiple violation penalties in a year. The reason is that some listed companies need a period of time to adjust their M&A strategies, as well as to find M&A targets, conduct due diligence and sign preliminary M&A agreements after receiving violation penalties. Hence, one may also lag the violation penalty variable by one period to provide a more adequate time guarantee for the impact of corporate M&A.

The control variables are standard in the existing literature on M&A. They include firm size (Size), profitability (ROA), gearing (LEV), Z-score, operating cash flow (OCF), growth (Growth), board size (Board), percentage of independent directors (Independ), analyst attention (Analyst), Dual (Dual) and nature of equity (SOE). In addition, one also controls for both Year and Industry effects.

(2) The role of M&A in repairing the damaged reputation of a company after being punished for misconduct

The explanatory variables in this study include shareholder relationship, creditor relationship, supplier relationship, and relationship with customers.

The shareholder relationship will be measured by the cost of equity financing, and the PEG model proposed by Easton (2004) will be used as a metric. The model is as follows:

$$\text{Equitycost}_0 = \sqrt{(EPS_2 - EPS_1)/P_0}$$

In the above model, EPS_2 represents the projected EPS of the listed company in the second period, EPS_1 represents the projected EPS of the listed company in the first period, and P_0 represents the stock price in the zero period. The projected EPS for each period is taken as the average value. Since the cost of equity capital calculation model requires $EPS_2 - EPS_1 > 0$, one will exclude companies with $EPS_2 - EPS_1 < 0$ and missing data to obtain the company's cost of equity financing, which corresponds to the cost of debt financing, and this chapter will multiply the cost of equity financing by 100 for testing. Also because of the design of PEG model, there are more missing values of equity financing cost.

The shareholder relationship will be measured by the cost of debt financing, which is measured using the sum of interest expense plus fees and other finance charges as the total debt financing cost of the firm, divided by total liabilities multiplied by 100. In the robustness test, this research will also try to use interest expense as a percentage of interest-bearing liabilities to measure the cost of debt financing of the firm, and the interest expense, fees, and other financial expenses used in the constructed variables will use the breakdown of financial expenses in the notes to the financial statements.

The regression models will be as follows:

$$\begin{aligned} \text{Equitycost}_{i,t} = {} & \beta_0 + \beta_1 \text{ Fraud}_{i,t-1} + \beta_2 \text{ Size}_{i,t-1} + \beta_3 \text{ ROA}_{i,t-1} + \beta_4 \text{ LEV}_{i,t-1} \\ & + \beta_5 \text{ Zscore}_{i,t-1} + \beta_6 \text{ TobinQ}_{i,t-1} + \beta_7 \text{ Insthold}_{i,t-1} \\ & + \beta_8 \text{ Board}_{i,t-1} + \beta_9 \text{ Independ}_{i,t-1} + \beta_{10} \text{ Dual}_{i,t-1} + \beta_{11} \text{ SOE}_{i} \\ & + \text{Yeardummies} + \text{Industrydummies} + \varepsilon_i \end{aligned}$$

$$\begin{aligned} \text{Debtcost}_{i,t} = {} & \beta_0 + \beta_1 \text{ Fraud}_{i,t-1} + \beta_2 \text{ Size}_{i,t-1} + \beta_3 \text{ ROA}_{i,t-1} + \beta_4 \text{ LEV}_{i,t-1} \\ & + \beta_5 \text{ Zscore}_{i,t-1} + \beta_6 \text{ TobinQ}_{i,t-1} + \beta_7 \text{ Insthold}_{i,t-1} \\ & + \beta_8 \text{ Board}_{i,t-1} + \beta_9 \text{ Independ}_{i,t-1} + \beta_{10} \text{ Dual}_{i,t-1} + \beta_{11} \text{ SOE}_{i} \\ & + \text{Yeardummies} + \text{Industrydummies} + \varepsilon_i \end{aligned}$$

Similarly to the first investigation, all control variables are lagged by one period. And this research will be robust to the standard errors of all regression coefficients at the firm level. The explanatory variable “Fraud” is consistent with/similar to? the explanatory variable in the previous study on the relationship between corporate penalties for misconduct and corporate propensity to merge. The penalty variable “Fraud” is whether the firm has a record of penalties for violations in the previous year, and takes the value of 1 if the firm was disclosed to have penalties for violations in the previous year, otherwise it is defined as 0. Multiple occurrences of penalties for violations in a year are not calculated cumulatively.

The control variables are based on existing literature and are consistent with the previous study model on the relationship between corporate penalties for misconduct and corporate propensity to merge. In addition, the year and industry variables are also controlled for in the model.

What about suppliers and costumers?

(3) Corporate misconduct and M&A performance

The model constructed in this question aims to test the effect of M&A “behavior” on firm performance. The ereturn on total assets and return on net assets, are continuous variables to investigate with standard regressions models. To avoid the effect of endogeneity, all control variables are treated with a one-period lag. The regression models are:

$$
\begin{gathered}
\text{Performance }_{i,t} = \beta_0 + \beta_1 \text{ Fraud\_MA }_{i,t} \\
+\beta_2 \text{ Size }_{i,t-1} + \beta_3 \text{ LEV }_{i,t-1} + \beta_4 \text{ OCF }_{i,t-1} \\
+\beta_5 \text{ First }_{i,t-1} + \beta_6 \text{ Second }_{i,t-1} + \beta_7 \text{ Insthold }_{i,t-1} + \beta_8 \text{ Board }_{i,t-1} \\
+\beta_9 \text{ Independ }_{i,t-1} + \beta_{10} \text{ Dual }_{i,t-1} + \beta_{11} \text{ SOE }_{i} + \beta_{11} \text{ Age }_{i} \\
+\text{Yeardummies} + \text{ Industrydummies } + \varepsilon_i
\end{gathered}
$$

The corporate performance in the above equation will be explored using accounting performance indicators. On the one hand, although the market response is based on stock prices, the stock price performance of the capital market may have certain shortcomings in distinguishing between real economic gains and capital market inefficiencies. As a result, the examination of firm performance after initiating M&A from accounting performance indicators facilitates the return to the basic qualities of accounting and the analysis of whether the initiation of M&A by firms can bring real economic gains. On the other hand, for the purpose of this research, the differences in corporate performance between the two types of samples of firms that initiate M&A and those that do not are examined, since market performance cannot be calculated if the firm does not initiate M&A, and can only be compared by means of financial performance. This chapter uses return on total assets (ROA) and return on net assets (ROE) to measure firm performance. From a measurement perspective, return on total assets (ROA) is measured using net income divided by average total assets multiplied by 100, and return on net assets (ROE) is measured using net income divided by average net assets multiplied by 100. In the robustness tests, this chapter also uses industry-year-adjusted ROA and ROE for validation. Fraud_MA has been already discussed, and control variables consistent with previous ones include firm size (Size), gearing ratio (LEV), operating cash flow (OCF), shareholding of the first largest shareholder (First), shareholding of the second to tenth largest shareholders (Second), shareholding of institutional investors (Insthold), board size (Board), independent director (Independ), and two-employee shareholding. Independence, Dual, SOE, and Age. In addition, this chapter also controls for both Year and Industry.

7. Expected Results

The results expected to be obtained from this study are: firms can suffer reputational damage as a result of misconduct; and for the purpose of reputational repair, firms will initiate mergers and acquisitions (M&A) activities; and, implemented

M&A activities will be instrumental in contributing to the improvement of firm performance.

Combining the three main research questions described above: the relationship between corporate penalties for misconduct violations and the propensity for corporate M&A, the role of corporate M&A in repairing a firm's damaged reputation after being penalized for misconduct, and corporate misconduct and M&A performance, the main expected findings of this research can be summarized as follows:

(1) The relationship between penalties for misconduct and the propensity to merge

Since this research suggests that firms motivated to initiate M&A activities for reputation repair in the context of reputation loss due to misconduct, this research expects to find that within China, firms that have been penalized for misconduct violations are more likely to initiate M&A, and their M&A frequency is higher and their M&A size is larger.

(2) The role of M&A in repairing the damaged reputation of a company after being punished for misconduct

This research expects to find that in Chinese domestic capital markets, corporate M&A behavior moderates firms' relationships with key capital providers. This is reflected in lower equity financing costs for firms that perform M&As relative to firms that are penalized for misconduct and do not perform M&As after the penalties are disclosed. In product markets, M&A can facilitate relationships with suppliers upstream and downstream in the supply chain after misconduct is sanctioned and disclosed. This is reflected in the higher amount of commercial credit from suppliers and higher sales revenue to customers for firms that implement M&A relative to firms that do not M&A after misconduct is penalized and disclosed. Therefore, this research is expected to conclude that M&A activity by firms can have a reputational repair effect by easing relationships with key stakeholders.

(3) Corporate misconduct and M&A performance

The study expects to show that M&A activities performed by firms that have been penalized by regulators for misconduct can have some positive impact on the improvement of corporate performance.

Specifically, firms that implement M&As should have higher return on total assets and return on net assets for the year relative to firms that do not acquire after suffering regulatory penalties for misconduct. Reputation-based M&A by non-compliant firms can have the effect of improving short-term corporate performance by helping firms improve access to resources and maintain and redeem stakeholder relationships.

In summary, this research analyzes the impact of misconduct on corporate M&A behavior. It also expects that the intrinsic drive to repair reputation will motivate firms whose misconduct is disclosed to actively initiate M&A, and that M&A behavior can help firms repair reputation damage and improve corporate performance in the short run.

8. Temptative managerial and policy recommendations

In this section, the recommendations and guidelines expected to be given in this study will be elaborated from three perspectives: from the regulator, from the firms themselves, and from the firms' stakeholders.

For the managerial recommendations, one may consider the firm managers' or stakeholders' (among which shareholders) perspectives. From a corporate managers' perspective, when a company faces reputational damage caused by misconduct, the focus of reputation repair measures should be to coordinate actions in two different directions, internal rectification and external image building, so as to improve what? Reputation? and address the problems and deficiencies of the company in a targeted manner, and to prevent the recurrence of violations at the root. **In depth, on the one hand, this study can help firms understand the extent to which their reputation suffers after misconduct has occurred, and the extent to which misconduct is minded from different stakeholder perspectives, thus helping firms to target the repair of specific stakeholder relationships. On the other hand, this paper also suggests an important way for firms to repair their reputation from the external level: mergers and acquisitions. Firms can not only use the usual means to restore relationships and images in the eyes of stakeholders after a misbehavior, but also initiate M&As to stimulate stakeholder expectations of the firm's future and value.**

From the corporate stakeholders' perspective, one expects the findings of this research to remind to capital market investors and other stakeholders to be cautious in their understanding of corporate response strategies after misconduct is disclosed. All of them should pay more attention to screening the true value of corporate corrective actions. Specifically, investors should pay attention to the substantive M&A motives of listed companies. Therefore, this research suggests investors to evaluate the M&A projects of listed companies from the perspective of long-term development strategies and pay attention to the screening of the real intention and intrinsic value of corporate M&A actions.

From the regulation perspective, regulators need to reasonably anticipate and provide targeted guidance and oversight on the responses of enterprises that have engaged in misconduct. As the number of cases of corporate misconduct penalties has continued to increase since the 21st century, the economic consequences of misconduct penalties have become more serious, and companies that suffer reputational damage due to misconduct have increasingly become a special and large group type. Therefore, in addition to reducing the probability of corporate misconduct by increasing the cost of corporate misconduct, regulators should also guide and supervise the behavioral decisions of companies after being penalized to avoid weakening or distorting the governance role of regulatory penalties. **In other words, disclosure, warnings or substantial penalties for non-compliant enterprises are not the end of the road for regulators to regulate corporate misconduct. Regulators also need to provide guidance on how companies should comply with the law on a daily basis: for example, by organizing activities or seminars on business-related laws and regulations, setting up a platform for sharing business data and information, and providing substantive support to exemplary companies.**

Of course, all this discussion will need to be updated, refined and probably amended after the empirical investigation and based on its results.

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