课程名称：财务专业英语

　　**Title:** Corporate Strategy, Internal Control and Investment Efficiency

Research Proposal

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**Abstract:**   
 What determines the corporate investment efficiency is a core issue of corporate investment research. However, prior finance literature ignores the corporate strategy’s heterogeneity. The relation between corporate strategy and corporate investment behavior has not been discussed yet. Different corporate strategies mean different corporate goals, profit models and organization structures. There are three corporate strategies from prior literature: Defenders, Prospectors and Analyzers—where the core dimension of this typology is the corporate update rate regarding its products and markets. Defenders maintain a narrow and stable product and market to compete on the basis of price, product quality and service quality, while prospectors continually seek new products and markets to be market leaders in their market. Analyzers have attributes of both defenders and prospectors. Based on the data of Chinese A-type share listed firms over the period 2012 to 2015, this article details the strategies of Chinese listed company with financial data according to strategy typology of management area, and investigates two aspects of content. First, we investigate the relation between corporate strategy and inefficient investment. Second, we investigate the moderating effect of internal control on above positive relation. First of all, our study shows that the company which has exhibits more like a prospector has more inefficient investment. Further, our study proves that this positive relation between corporate strategy and inefficient investment is reliant upon firm’s control environment. When the internal control is weaker, the positive relation between prospectors and inefficient investment is more significantly relative to defenders. Our study contributes to the related literature on the corporate strategy and investment efficiency, and it also has significant implications for decreasing inefficient investment in theory and policy.  
　　  
　　   
**Key words:** Corporate Strategy; Internal Control; Investment Efficiency

**1 Introduction**

1.1 Problem statement

What determines the investment efficiency of the enterprise has always been one of the core issues in the company's investment research. The existing literature on the influencing factors of investment efficiency is mainly based on the theory of principal-agent theory and information asymmetry theory, which explores the problem from the perspective of internal and external governance environment, internal control mechanism, information environment, the nature of ownerships and management characteristics, ignoring the influence of corporate strategic heterogeneity on investment efficiency and the moderating effect of internal control.

* 1. Statement of the research objectives

Different enterprise strategies mean different enterprise goals, profit modes and organization structures. According to the renewal rate of enterprise product and market, Miles et al. divided enterprise strategies into three types: defensive, offensive and analytical. Bentley et al. carried on the further consummation by using financial data to calculate three different type of strategies. Defense enterprises focused on fixed products and services market, by ensuring competitive price and quality of products and services to ensure their core competitive advantage, offensive enterprises are keen on developing new products and new markets, and strive to maintain the leading position in the industry, analytical enterprises lie between the two. The difference of the degree of information asymmetry and the degree of interest asymmetry between shareholders and management will affect the objective function (motivation) and decision space of management investment decision. Specifically, the degree of information asymmetry between shareholders and management is stronger in offensive enterprises than that of defensive enterprises, and the management objective function leads to more inefficient investment and greater decision-making space. Therefore, this paper argues that, compared with defensive corporate strategy, executives that lead aggressive enterprise strategy are more likely to invest inefficiently.

**2 Literature Review**  
2.1 The influencing factors of inefficient investment

The main reason for the inefficiency investment lies in the external financing constraints and the internal principal-agent relationship. Based on principal-agent theory, information asymmetry theory and financing constraint theory, domestic and foreign literatures have discussed the influencing factors of enterprise investment efficiency from different perspectives, including internal and external environment, managers and the nature of ownerships.

Literature on the internal and external environment of enterprises mainly discusses how to mitigate the conflict between shareholders and managers, reduce agency costs, and inhibit inefficient investment behavior of enterprises. From the perspective of enterprise external governance environment, Han Dongping et al. (2015) study the relationship of monetary policy, financing constraints and investment efficiency in Chinese private listed company. They find that under the condition of the loose monetary policy, the investment efficiency of the private enterprises with better external management ability will be lowered, and enterprises with better internal management ability tends to under-invest. Li Yanxi et al. (2015) study the relationship among the external governance environment, the ownerships and the investment efficiency of listed companies. They argue that reducing the degree of government intervention, improving the level of financial development and strengthening the construction of law are helpful to improve the investment efficiency of listed companies. Liu Eping and Guan Jingyi (2016) argue that commercial credit can not only restrain over-investment, but also alleviate under-investment, so it plays a two-way governance role in inefficient investment. Samet M, JarbouiA (2017) study the direct and indirect relationship between corporate social responsibility performance and investment efficiency. They find that corporate social responsibility indirectly improves the efficiency of investment through the process of helping enterprises solve agency problems and information asymmetry problems.

From the perspective of internal governance environment of the enterprise, Hou Qiaoming et al. (2017) study the dynamic effects of managerial agency behavior and managerial overconfidence on the corporate inefficienct investment from the perspective of corporate life cycle. They find that with the development of corporate life cycle stage, managerial agency behavior is gradually strengthed, and managerial overconfidence level is gradually weakened. Jin Qinglu et al. (2012) examine how monetary policy influences the financing constraints and investment efficiency. The study finds that the loose monetary policy reduces the financing constraints of private enterprises. When private enterprises face good investment opportunities, loose monetary policy will improve the investment efficiency of private enterprises. In addition, this paper finds that the impact of monetary policy on investment efficiency is non-linear. When the private enterprises face the poor investment opportunities, loose monetary policy will reduce the efficiency of investment private enterprises. Xiao (2013) classifies the over-investment samples and the under investment samples. If the growth opportunities of the company in the previous year are poor, they will have excessive sufficient funds, i.e. the company is inclined to over invest. On the contrary, if the growth opportunities of the company in the previous year is good, it is difficult to obtain sufficient funds for investment,i.e. the company tend to under-investment at that year. Assaf Eisdorfer et al. (2013) examines how the similarity between the executive compensation leverage ratio and the firm leverage ratio affects the quality of the firm’s investment decisions. They find larger leverage gap (i.e., a bigger difference between these two ratios) leads to more investment distortions. Managers with more debt-like compensation components tend to under-invest, whereas managers with larger equity-based compensation engage more in over-investment. Wang Huacheng, Zhang Xiuping, Gao Hao (2016) tested the impact of corporate strategy on over investment. The reasearch finds that corporate strategy has a significant impact on over investment. Compared to defensive enterprise strategy, the positive correlation between offensive business strategy and over investment is more significant.

On the other hand, some literature have discussed the influencing factors of inefficient investment based on managers' perspective. As the decision-maker of enterprise, the investment behavior of the enterprise is directly affected by enterprise managers. The characteristics of enterprise managers are different, and the efficiency of enterprise investment will be different. Bradrania R, Westerholm P J, Yeoh J (2016) find that individuals who allocate a higher proportion of their wealth to equities will be less risk averse. Corporations with trader CEOs have higher capital expenditures and make more acquisitions. CEOs with higher portfolio turnover engage in riskier forms of corporate investment.

In addition, in view of China's special institutional background, domestic scholars have proved that the nature of ownerships is one of the factors affecting excessive investment in enterprises. Yu Kun et al. (2014) find a puzzle that the investment efficiency of non-SOEs is significantly lower than SOEs in recent years. The gap between investment efficiency of non-SOEs and SOEs becomes larger when the monetary policy becomes tight. Chen R, Ghoul S E, Guedhami O, et al. (2014) find government and foreign institutional owners are associated with different levels of information asymmetry and agency problems. Government (foreign) ownership weakens (strengthens) the sensitivity of investment, thereby increasing investment inefficiency (efficiency).

2.2 The summarize of the literature

The literatures on the influence factors of over-investment are mainly based on principal-agent theory and asymmetric information theory. From the perspective of internal and external environment, managers and ownerships, the paper probes into the factors influencing the financial decision-making behavior of enterprises over investment. The relevant research results are very rich. However, this kind of literature emphasizes the influence of internal and external governance environment, internal control mechanism, information environment, ownerships and managers’ characteristics, ignoring the influence of corporate strategic heterogeneity on the investment efficiency and the moderating effect of internal controls. Enterprise strategies determine the overall development direction of the enterprise in the future. The implementation of the enterprise strategy directly affects the functions and decisions of the enterprise. Therefore, the discussion of the relationship between enterprise strategy and investment efficiency will help to understand the mechanism and the conditions of the influence of the enterprise strategy on the inefficient investment, which enriches the relevant literatures on the factors influencing the investment efficiency.

**3 Hypothesis**

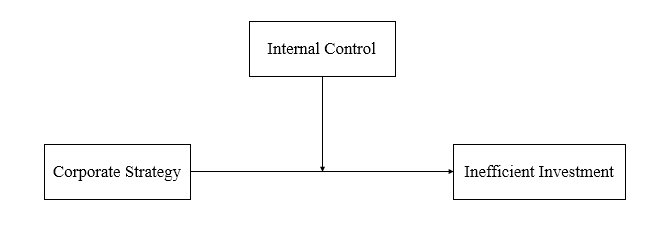
Due to the existence of the principal-agent problem, shareholders and management interests are usually inconsistent. For example, shareholders want to maximize profits, while management performance is usually linked to the size of the company. So management has the motivation to pursue their own interests by investing in projects with negative NPV, resulting in inefficient investment. The internal control mechanism of attacking enterprises is more dispersed and the shareholder's supervision cost is larger, while the defensive enterprises are more concentrated and stable in order to ensure the production efficiency of enterprises. A better and more stable internal control mechanism helps curb inefficient investment. When the enterprise strategy is not the same, the information environment is not the same. Attacking companies tend to lack detailed planning when screening new investment opportunities. Compared with defensive ones, defensive firms are always committed to ensuring certainty of future returns. Detailed plans are made before investing in new projects and entering new areas of investment. Detailed plans will help defensive enterprises to obtain more high-quality information about investment projects, and the likelihood of over-investment is less. While the attacking enterprises lack of detailed planning, management of freedom to play a greater space, motivated for their own profit to invest in damage to the enterprise value of the project.

To sum up, compared with the defensive enterprises, the attacking enterprises have higher risk level, poor organization and profit stability, higher information asymmetry, which aggravates the principal-agent problem, and leads to inefficient investment. The following is a hypothesis:

**H1:** the relationship between offensive and non-efficient investment is more significant than defensive enterprise.

Good and strict internal control can improve the quality of enterprise information, reduce the degree of asymmetric information, so as to reduce agency costs and facilitate outside investors to make reasonable investment decisions. However, the principal-agent problem of the large information asymmetry of the attacking enterprises causes the inefficient investment, and the good internal control can effectively reduce the agency problem and restrain the inefficient investment.:

**H2:** internal control can adjust the relationship between enterprise strategy and non-efficiency investment.



**Picture 1 Conceptual Model**

**4 Methods**  
4.1 Sample selection and data source

This paper chooses the data of 2012-2016 A-share listed company as the research object. And deals with it according to the following steps: First,exclude the sample of the listed companies in the financial industry. Then, eliminate the company with St history. In the end to reduce the impact of the extremum on the regression results of the model, all the continuous variables are winsorized at the level of 1 % . All data selected in this paper are from the CSMAR database.

4.2 Model construction

4.3 Variable definition

4.3.1 explained variable

INV for investment efficiency, drawing on the model of Richardson (2006), using the data of sample company 2012-2016 to return the model 1. The residuals in the model are inefficient investment, greater than zero samples for excessive investment, less than zero for lack of investment.

4.3.2 explanatory variables

Strategy is enterprise strategy, this paper constructs a discrete variable to measure the company strategy, referring to the research of Bentley ET (2013). This variable focuses on the following 6 features of the company.

• Research and development spending as a proportion of sales revenue: Since aggressive companies often have more innovative behavior, they will have more research and development spending (hambrick,1983).

• Ratio of headcount to sales revenue: This metric measures the ability of companies to produce and deliver products and services. Aggressive companies have less efficiency requirements than defensive companies, so more people are required to sell revenue per unit (Thomas et al.,1991).

• The historical growth rate of sales revenue: Attacking companies usually have a stronger ability to grow, this article refers to Bentley, etc. (2013).The use of sales revenue historical growth rate is to measure the growth of the company.

• Sales and management costs account for sales revenue: Aggressive companies usually have higher sales and management costs to expand the product market (hambrick,1983).

• Number of employees volatility: Aggressive companies tend to have weak organizational stability and shorter staff tenure (Miles and snow,1978,2003). Staff volatility is a measure of organizational stability.

• Fixed asset growth as a proportion of total assets: Aggressive companies tend to have higher human resource densities, while defensive firms usually have higher capital densities (hambrick,1983).

Referring to the study of Bentley ET (2013), the above 6 variables are averaged over the past 5 years. For the first 5 variables, each year-industry sample is divided into 5 groups from small to large, the smallest group assignment is 1 points, the second small group assignment is 2, and so on, the largest group assignment is 5; for the 6th variable grouping method is opposite, that is, the smallest group assignment is 5, and the largest group assignment is 1. For each "company-year" sample, the grouping score of 6 variables is added, and the measure variable of $number is Üstra. A higher strategy value means a more aggressive corporate strategy, while a lower strategy value means that the company's strategy is more conservative.

(3) Moderating variable

IC for internal control, the use of Dibo internal control index to measure the internal control.

4.3.4 control variables

**Table 1 Definition of control variables**

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| --- | --- |
| Name | Measurement |
| Size | The size of company=LnAsset |
| Leverage | Asset-liability ratio =Total liability/Total asset |
| CFO | Cash flow=Net operating cash flow/Total asset |
| Growth | The growth of company=The increase rate of revenue |
| Pattern | Nature of ownership，if the company is state-owned-enterprise, Pattern=1, else Pattern =0 |
| Exstock | Managerial ownership=the stock that the management holding／Total stock |
| Instock | Institutional investors ownership=the stock that the institutional investors holding／total stock |
| Expay | Executive pay=the top 3 executive pay of the management/Total pay of the management |
| Outdirector | Proportion of independent directors=the number of independent directors／the total number of directors |

**5 Possible results**

1.As is discussed in the above hyphothesis, inefficienct investment level of prospective enterprises is higher than that of defensive enterprises. Internal control can moderate the relationship between corporate strategy and inefficient investment.

2. If inefficienct investment level of defensive enterprises is higher than that of prospective enterprises, this may be because under-investment in China is more common, offensive strategy has driven investment, reducing the under-investment level.

**6 Discussion**

The proposed approach has many drawbacks as a methodology for strategy assessment, I look forward to seeing future refining of this .

I do not divide the inefficient investment into over investment and underinvestment to study respectively, the two aspects should be explored in near future.

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