Discussion on "Corporate Reputation in Debt Market: Evidence from Lawsuits" by Matthew Yiu

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Summary

An interesting research that connects corporates' litigation history and their bond prices/yields.

- Using lawsuit, which presumably shocks corporate's reputation, the authors conducts two sets of analyses: an event study and an impact analysis
- In the event study, the authors find that bond price responds to lawsuit announcements
- In the impact analysis, the authors find a litigated company issues bonds with higher yield, shorter maturity, and less proceeds compared to non-litigated companies
- The reputation penalty varies across company types, legal environments and social capital conditions
- According to the authors, it is the first such research on China's public bond market, and it verifies that reputation damage matters in the Chinese market as in the US market.

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General Comments

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- Credit quality of the issuer/security:
  - the rating for corporate bonds in China is mostly done by China domestic credit rating agencies or joint venture agencies
  - the ratings have been criticized for generally inflated and insufficiently differentiated rating across good and bad credits
  - this undermine the information content that the bond rating variable is meant to carry
  - the differentiation of reputation damage from solvency risk by “cash flow over litigation stake” variable is not sufficient, as solvency risk relies on much more information, e.g. market valuation of the asset/liability
  - one solution: probability of default (Credit Research Initiative of NUS)

General Comments (continued)

The study, perhaps not surprisingly, is subject to the usual comments on event studies and impact analyses, i.e. confounding factors are not well measured and controlled for: among them, credit quality and market liquidity are the two important factors determining bond price/yield, in addition to endogeneity

- The liquidity of the bond market can also affect the bond price/yield profoundly. Using ask-bid spread may potentially mitigate this concern.
- On endogeneity issue is important for this study: the choice of the instrumental variable for social capital in China is questionable:
  - the China General Social Survey is extremely outdated
  - the score of the environmental suitability for growing a particular kind of crop, a cultural variable, to proxy the likelihood for litigation is doubtful
- Any empirical studies on China subject to structural development and policy changes, not sure this study is free from this issue given the sample period.

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Some comments on the technical side

- The width of the window in the event study:
  - the litigation process may be quite long, somewhat difficult to believe that the lawsuit result is only known to the market within that narrow window
  - perhaps more important, there could be other things going on within that window, e.g. market sell-off globally or domestically policy change/intervention
  - the lawsuit variable might just capture something else happening concurrently

- Unclear what the variable for "home province of the bond issuer" can actually capture:
  - the bonds studied in this paper are exchange-listed, and their investors are likely to be from all over the country and overseas
  - investors' perception of the corporate reputation is not likely to be much affected by the legal environment of the home region only

Minor comments on the technical side

- No differentiation for the time length between the litigation and the bond issuance:
  - the longer the length after the litigation, expect the less impact on the bond yield (short-term memory of the market)
- No differentiation between complete litigation and ongoing litigation
- Would like to understanding the extremely high R-sq in Table 6:
  - because of SOEs?
- No information on how the authors deal with the changes of the companies' characteristics , e.g. governance and ownership.

Thank You

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