

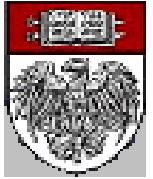
# **The Missing Role of Media in Corporate Governance**

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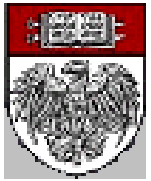
Booth School of Business

# The Importance of News

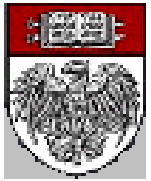


- Information plays a crucial role in our modern capitalist system
  - Production decisions
  - Investment decisions
  - Hiring decisions
- Depending on its effects on the receivers we can classify news as
  - Good
  - Bad
- “Journalism is to print what someone else does not want printed: everything else is advertising”

# Example

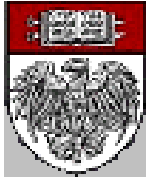


# The Laocoön Syndrome





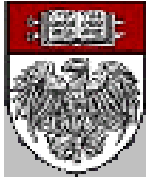
# Why Difficult to Bear Bad News?



## I. Economic reasons:

- 1) Negative updating about quality
  - CEO is afraid to share bad info with the Board.
- 2) Negative updating about value system
  - Loyalty vs. honesty
- 3) Concentrated costs diffuse benefits
  - Speaking against an internal appointment of a mediocre candidate
- 4) Fear of retaliation from the powerful
  - emperor has not cloth

# Why Difficult -2



## II. Psychological reasons:

### 1) Denial

- Trojans

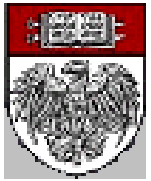
### 2) Mix the message with the messenger

- Doctor with disease

### 3) Implicit negative judgment

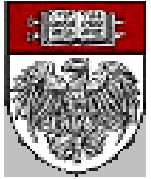
- Colleagues of whistleblower feels treated like crooks

# Why is at the core of corporate governance?



- 1) Effectiveness of boards
  - Boards are sold PRs
- 2) Incentives of boards
  - how do we build directors' reputation?
- 3) Cost of overvalued equity
- 4) Corporate fraud
  - Employees do not have an incentive to talk
- 5) Corporate malfeasance

# How to solve it?



## 1. Shielding Laocoön

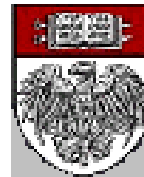
- tenure system
- independent appointment
- corporate culture

## 2. Pre-assigning the Laocoön's role

- Devil's advocate
- Attorney's general
- Auditors



# Mechanisms to solve this problem:



## 3) Rewarding Laocoön

### i. Competition

- Electoral campaign
- Adversarial system in courts

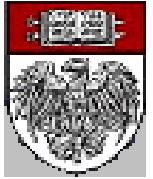
### ii. Monetary reward

- Short seller
- Qui tam statute
- Scoop sales

### iii. Fame

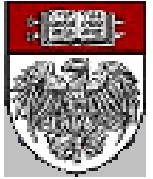
- Pulitzer prize

# Historically Media Played a Role



- Media had a double incentive to dig out news :
    1. Owners had an incentive to sell more copies
    2. Journalists had an incentive to become more famous (and get better jobs):
- > combination ensured a certain degree of accountability

# What made that possible?

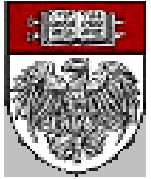


- Economics of newspapers and TVs:
  - Very high fixed costs and low marginal cost
  - Segmented by geographical areas
  - Network externality present in classified ads.

=> Oligopoly

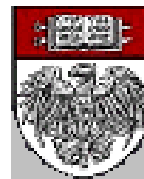
=> Highly profitable

# Haute Couture Model



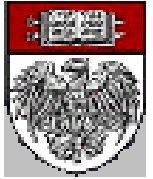
- In fashion haute couture loses money, it is done because
  - it helps create brand awareness (barrier to entry)
  - it excites the most talented designers
    - on the job consumption
- The more profitable the fashion industry is, the more extravagant the fashion shows are.
- During industry downturns, haute couture is the first to be cut.

# Same for Investigative Journalism



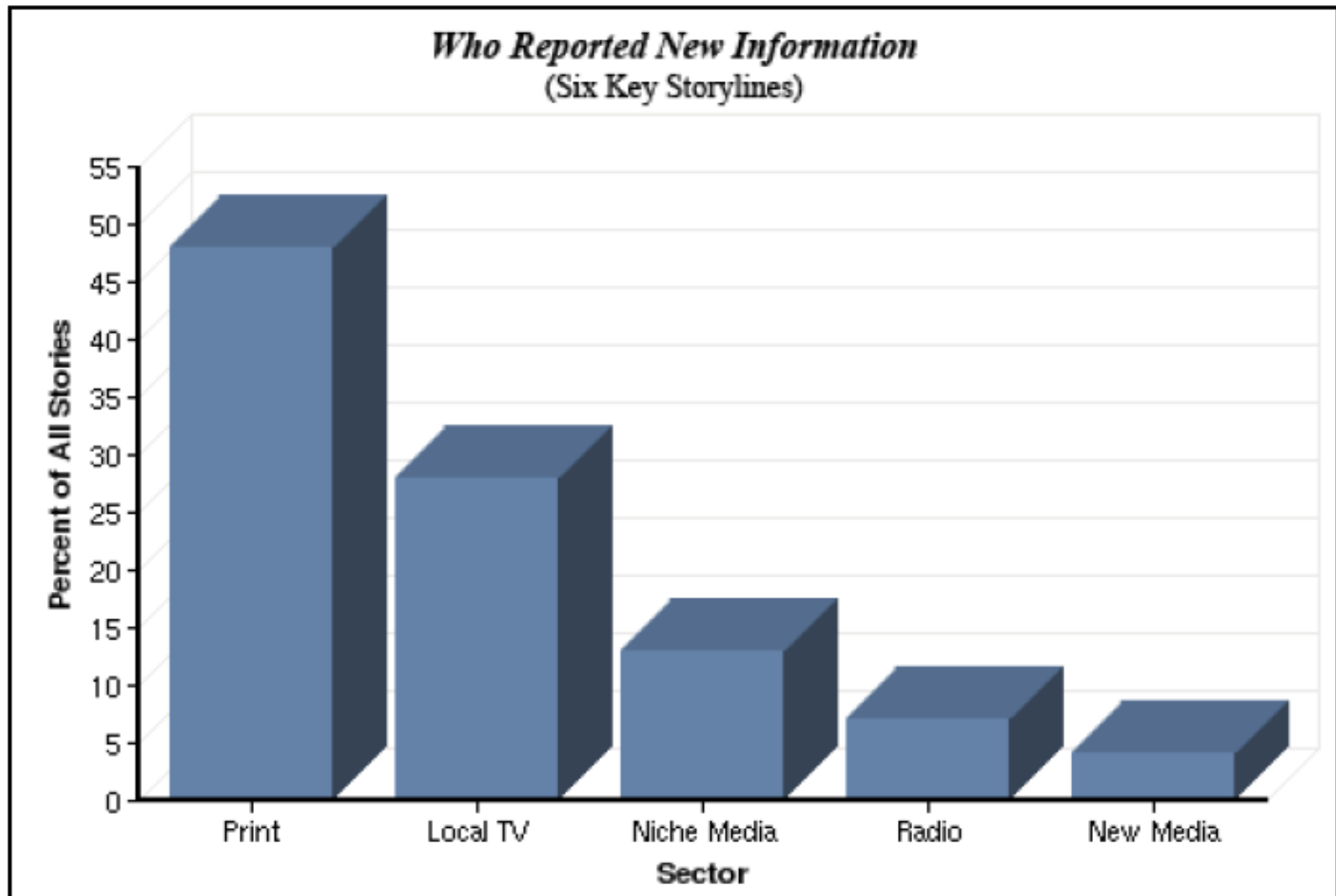
- Done to
  - prevent entry
  - attract the most talented individuals
  - share rents with workers
- Internet had devastating effects on the profitability of newspapers.
  - Classified ads moved to Craigslist
  - Internet expanded supply
  - More efficient ads
  - Crazy price war

# Two paradoxes of the information age



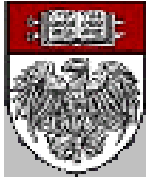
- 1) As information becomes more easily available, it becomes less easily excludable, and thus the quality of information in the system deteriorates.
- 2) Increased competition in the media world brought by the digital media led to
  - a greater diffusion of news, but to
  - a deterioration in the quality of news published.





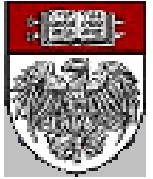
...is shrinking markedly. What, if anything, is taking up that

# The Fang Trust



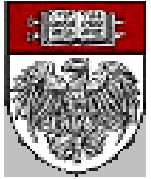
- Among Facebook, Google, and Amazon they control most of the media diffusion process
- When Kantor and Streitfeld wrote against Amazon in the NYT, the public editor intervened in Amazon defense.
- Where is she going to work now?
- At the Washington Post, owned by ... Jeff Bezos, CEO of Amazon

# Consequences -1



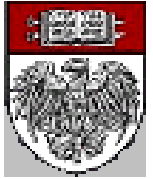
- Shiller (2000) points out that financial bubbles were born at the same time as the media.
- What Shiller does not say is that the media is the primary enabler (if not the cause) of bubbles.
- In 10 years two bubbles in the United States
- Is this just a coincidence?

# Consequences -2



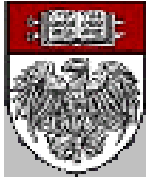
- The primary cause of the 2008 financial crisis was fraud
  - Fraudulent mortgages
  - Sold fraudulently to investors
- Why this was never brought to the attention of the public at large before the crisis?

# Consequences -3



- Bad corporate governance
  - Who points out when CEOs do something wrong?

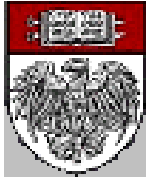
# The Role of Academia



- Academia today looks much like the newspaper trade of 30 years ago:
  - lots of rents
  - people consume those rents in research.
- Some of this research is irrelevant, some will be relevant 200 years from now.
- Academics don't need to spend time doing investigative journalism, but they should be using big data to expose what doesn't work in the capitalist system.

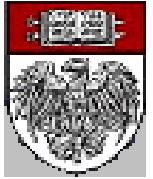


# The Role of Academia -2



- The big advantage academia is a separation between fundraising and research.
- It used to be there in newspapers
- Less so now
- It's time for academia to use that separation to its advantage—and the advantage of the public at large—by picking up some of the slack left by the falling fortunes of many newspapers.

# Infomercial



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