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The Risk of Corporate Debt Default and Local Chairman Appointment

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Abstract: Preventing and resolving debt default risks is of great significance to the sustainable development of enterprises. This paper selects non-financial A-share listed companies in China from 2007 to 2022 as the research object and empirically investigates the impact of local chairs on corporate debt default risks. The study finds that compared with companies without local chairs, companies with local chairs face lower debt default risks. From the perspective of identity research, this paper supplements and expands the relevant literature on identity economics and provides certain insights for the supervision of corporate debt defaults.

Keywords: local chair; debt default risk; hometown identity; identity

1. Introduction

Currently, the Chinese economy is transitioning from high-speed growth to high-quality development. Since the first substantive default of the "11 Chaori Bond" in 2014, the scale and amount of corporate debt defaults have continued to expand, with some enterprises falling into financial distress and unable to repay loans and interest on time. In 2022, a total of 302 bonds from 76 issuers defaulted in the Chinese bond market, with a default amount of up to RMB 56.332 billion. The non-performing loan ratio of Chinese commercial banks has also risen from 0.96% in 2013 to 1.71% in 2022, with the balance of non-performing loans reaching RMB 3.8 trillion. The issue of debt defaults is increasingly prominent in China's capital market, and effective measures are urgently needed to address it. Therefore, exploring the influencing factors of corporate debt default risk is of significant strategic importance for achieving the economic and social development goals outlined in the 20th National Congress of the Communist Party of China and is an indispensable part of promoting high-quality economic development.

Existing literature on debt default risk often starts from the macro external environment and the characteristics of the enterprises themselves. From the perspective of the external environment in which enterprises operate, their daily activities are inevitably influenced by the external macroeconomic environment. Luo Chaoyang and Li Xuesong (2020) found that cyclical fluctuations in the financial environment affect the risk level of corporate debt defaults. During periods of financial tightening, enterprises may face stricter credit conditions and higher financing costs, increasing their likelihood of defaulting. Besides the impact of financial cycles, policy changes are also important factors affecting corporate debt default risk. The introduction and adjustment of policies may alter the financing structure, costs, and availability for enterprises, thereby affecting their default risk. For example, the introduction of the "Shanghai-Shenzhen Stock Connect" trading mechanism has improved the governance standards of listed companies, providing them with broader access to capital markets and more diversified funding sources, significantly reducing the debt default risk faced by companies (Jia Xiuyan and Wu Junfeng, 2020). Relevant research has also found that under the regulatory framework of the "New Asset Management Regulations," the availability of short-term financing for enterprises with short-term loans for long-term investments decreases, increasing difficulties in managing the enterprise's capital chain and exacerbating the risk of corporate debt defaults (Yang Qing and Tian Ruyan, 2024). From the perspective of the characteristics of enterprises themselves, approximately 70% of debt default events originate from errors in internal management, with inappropriate strategic positioning (Wang Huacheng, 2019), improper asset allocation and governance structures (Deng Lu, 2020), scant social relationship networks (Xu Haoran and Jing Xin, 2016; Yildirim, 2019), radical investment and financing decisions (Meng Qingbin, 2019), and other factors all leading to an increase in corporate debt default risk. Conversely, the smaller the deviation of a company's strategic positioning from industry norms, the richer the social relationship network of its executives, the higher the quality of its financial information, and the more institutional and management shareholdings, the lower the probability of debt default.

Currently, in the field of corporate finance, many scholars have studied the economic impact of executives' personal characteristics on corporate governance based on the Upper Echelons Theory. Relevant literature has conducted extensive explorations from aspects such as executives' tenure (Lin Hongmei and Chen Xuanjuan, 2020), military experience (Fu Chao and Wang Wenjiao, 2021), professional backgrounds (Luo Rongxi and Chen Chao, 2019), and overseas backgrounds (Chen Huifa and Luo Sha, 2023). However, less attention has been paid to the important dimension of executives' hometown identity. For thousands of years, Confucian culture and its traditional values have occupied a central position in Chinese society, profoundly shaping people's deep affection for their hometown. In this cultural context, Chinese people generally exhibit a natural closeness and identification with their hometown (Kong Mingyu and Feng Yuan, 2012), and this sentiment has a significant impact on individual behavior. For example, with the intention of contributing more to their hometown, CEOs serving in their hometown will assume social responsibilities due to their hometown identity, reducing selfish behavior (Li Xiaorong and Wen Weirong, 2022), actively fulfilling civic tax obligations (Li Jiyuan, 2020), and promoting corporate innovation and active participation in environmental governance (Huang Zhen, 2022; Hu Jun, 2017). Additionally, some studies have suggested that a sense of belonging to one's hometown may drive executives to favor their hometown when making decisions, thereby harming creditors' interests and triggering agency conflicts. A strong hometown complex may prompt CEOs to prefer investing in their hometown, and such investments often have lower financial performance and operational efficiency compared to other non-emotionally driven investment projects (Cao Chunfang et al., 2018). Meanwhile, relevant research has also found that CEOs serving locally are more likely to choose local audit institutions, with the potential motivation being collusion to hide their embezzlement during their tenure (Rao Yulei et al., 2022).

2. Theoretical Analysis and Research Hypotheses

In China, the term "hometown" often carries a special sentiment, reflecting people's identity with their hometowns. Hometown identity refers to the tendency of individuals, driven by emotional ties to their hometown, to make decisions that benefit it (Hogg, 1995). This identity is particularly evident in China, as evidenced by ancient poems such as "Alone in a foreign land, I am twice homesick on a holiday" and "Looking up, I gaze at the bright moon; looking down, I think of my old home," which embody hometown identity and have been integrated into traditional Chinese culture, exerting a profound influence on individuals' values. This paper argues that local chairmen, influenced by hometown identity and social opinion, will constrain and regulate corporate default behavior, strengthen control over corporate financial conditions, and reduce the risk of debt default.

From the perspective of hometown identity, first, identity theory suggests that individuals' emotional preferences for their hometown subtly influence their cognition and behavior. Therefore, in the decision-making process, individuals may prioritize economic factors and interests related to their hometown group, giving more attention and resources to the hometown, thereby promoting its economic and social development (Xu Lan, 2020). Under this psychological effect, local chairmen focus more on legitimate and compliant business operations rather than maximizing economic benefits. Second, hometown identity enhances the moral self-awareness of local chairmen, making them prioritize group interests over personal desires when making decisions. Li Jiyuan (2020) found that attachment to one's hometown motivates local CEOs to actively take on social responsibilities, regulate corporate behavior, and fulfill civic duties. Finally, as a special psychological tendency, hometown identity is driven by individuals' deep affection and identity with their birthplace or place of growth. This identity profoundly influences their behavioral choices in strategic planning and decision-making processes (Ren, 2021). People highly identify with their hometown's culture and geographical environment, take on social responsibilities, and make corresponding changes to corporate business strategies.

From the perspective of social opinion, compared to non-local chairmen, local chairmen's past life, work, and education experiences help them build their social networks, which facilitate the formation of informal oversight and restraint mechanisms. Personal reputations and information spread rapidly within social networks, but individuals with a bad reputation for defaulting may lose their entire network (Pan Yue et al., 2009). For most people, the hometown is a sacred place, and they prefer to establish a positive image there. Therefore, local chairmen have an incentive to conscientiously abide by local rules and institutional requirements, actively take on social responsibilities, and minimize debt defaults by their companies. Based on this, this paper proposes a hypothesis:

Hypothesis: Compared to other companies, companies with local chairmen will positively inhibit corporate debt default risk.

3. Research Design

3.1 Model Construction and Variable Definitions

Drawing on the research of Li Jiyuan (2020), Xie Deren (2022), and Liu (2023), this paper constructs Equation (1) to test Hypothesis 1:

EDR=β0+β1*Nach+β2Size+β3Growth+β4TobinQ+β5Board+β6Dual+β7Top1+β8Indep+β9Liquid+β10Cashflow+β11Fixed+β12Return+β13Insa+β14Cshare+Year+Industry+ε （1）

In Equation (1), the dependent variable is EDR (Enterprise Default Risk). Firstly, this paper adopts the Naive model proposed by Bharath and Shumway (2008) to estimate the default probability (EDF) as a proxy for default risk. We calculate the default risk through the following steps:

$$DD_{it} = \frac{\log\left(\frac{Equity_{it} + Debt_{it}}{Debt_{it}}\right) + \left(r_{it-1} - \frac{\sigma_{Vit}^2}{2}\right) \times T_{it}}{\sigma_{Vit} \times \sqrt{T_{it}}} \#(1.1)$$

Where is the distance to default; is the total market value of the company; is the book value of the company's debt; is the expected return on assets, which is set to 1 year in the formula; is an estimate of the volatility of the company's assets, calculated as follows. is the volatility of stock returns, and the calculation of is as follows:

$$\sigma_{it} = \frac{Equity_{it}}{Equity_{it} + Debt_{it}} \times \sigma_{Eit} + \frac{Debt_{it}}{Equity_{it} + Debt_{it}} \times (0.05 + 0.25 \times \sigma_{Eit}) \#(1.2)$$

Based on Equations (1.1) and (1.2), we can calculate the distance to default risk. Then, using the standard cumulative normal distribution function Normal(.), we can obtain the corporate debt default probability, as shown in Equation (1.3):

$$EDF_{it} = Normal(-DD_{it}) \#(1.3)$$

Secondly, drawing on the approach of Sun Zheng (2006), this paper also uses whether a company has defaulted on its debts (Violate) as another proxy for default risk. When the sum of a company's short-term borrowings and non-current liabilities due within one year at the end of the previous year is greater than the cash paid for repaying debts in the current year, the dummy variable Violate is set to 1, indicating that the company has defaulted; otherwise, it is set to 0, indicating that the company has not defaulted.

The dependent variable EDR is measured by both EDF and Violate. When the default probability (EDF) is used as the dependent variable, an OLS regression is performed; when whether a default has occurred (Violate) is used as the dependent variable, a Logit regression is performed.

The explanatory variable in this paper is Nach. Drawing on the approach of Hu Jun (2017), this paper determines whether the chairman's hometown is the same as the company's registration place. If they are the same, the value is set to 1, indicating that the chairman is serving locally; otherwise, it is set to 0, indicating that the chairman is serving in a different location.

In addition, drawing on the approaches of Wang Huacheng and Liu Huan (2019), Zhai Shuping and Han Xian (2022), He (2023), and others, the selection and calculation methods of the control variables in this paper are shown in Table1. This paper also controls for annual (Year) and industry fixed effects. Meanwhile, the regression results have been adjusted for robust standard errors to account for heteroscedasticity.

Table1 Variable Definitions Table

Variable Types	Variable Names	Variable Symbols	Variable Definitions
Dependent Variable	Whether Defaulted	Violate	If the enterprise violates regulations, the value is 1; otherwise, it is 0
	Enterprise Default Probability	EDF	Refer to the enterprise default probability calculated above
Independent Variable	Local Chairman Appointment	Nach	If the chairman's hometown is the same as the enterprise's registration place, the value is 1; otherwise, it is 0

Mechanism Variable	Financing Constraints	SA	(Total Capital - Cash Flow) / Cash Flow
	Management Expense Ratio	Agency1	Management Expenses / Operating Revenue
	Management Expense Ratio	Agency2	Operating Revenue / Average Total Assets
Control Variable	Company Size	Size	Natural logarithm of total assets
	Growth Potential	Growth	(Operating Revenue of the Current Year - Operating Revenue of the Previous Year) / Operating Revenue of the Previous Year
	Tobin's Q Ratio	TobinQ	(Market Value of Tradable Shares + Number of Non-tradable Shares × Net Asset Value per Share + Book Value of Liabilities) / Total Assets
	Board Size	Board	Natural logarithm of the number of board members
	Duality (CEO and Chairman Roles Combined)	Dual	If the chairman and CEO are the same person, the value is 1; otherwise, it is 0
	Largest Shareholder Ownership Percentage	Top1	Shareholding percentage of the largest shareholder in the enterprise
	Independent Director Ratio	Indep	Number of independent directors divided by the total number of directors
	Current Ratio	Liquid	Current Assets / Current Liabilities
	Cash Flow Ratio	Cashflow	Net Cash Flow from Operating Activities / Total Assets
	Fixed Asset Ratio	Fixed	Net Fixed Assets / Total Assets
	Annual Individual Stock Return Rate	Return	Annual individual stock return rate considering cash dividend reinvestment
	Compensation of Top Three Executives	Insa	Natural logarithm of the total compensation of the top three executives
	Chairman Ownership Percentage	Cshare	Proportion of the chairman's shareholding in the total number of shares of the enterprise

3.2 Sample Selection and Descriptive Statistics

This paper takes non-financial A-share listed companies from 2007 to 2022 as samples. The data on chairmen's hometowns are mainly sourced from: (1) the CNRDS Chairman and CEO Research Database; (2) this paper also comprehensively utilizes listed company announcements (annual reports, prospectuses), media reports, publicly available legal documents, and web search engines to supplement and improve the database information. Corporate debt default data and financial data are sourced from the Guotai'an Database. Furthermore, based on research conventions, the following treatments were applied to the raw data: (1) excluding companies that have been delisted, suspended, or placed under temporary suspension of trading; (2) excluding listed companies in the financial industry; (3) excluding observation samples with missing variables; (4) excluding insolvent samples; (5) to avoid the influence of outliers, following the practices in existing literature, all continuous variables were trimmed at the 1% and 99% percentiles.

Table2 reports the descriptive statistics of the variables. Among them, the mean of Violate is 0.087, indicating that about 8.7% of the companies have defaulted on their debts; the maximum value of EDF is 0.996, the minimum value is 0, and the standard deviation is 0.059, indicating significant differences in debt default probabilities among different companies; the mean of Nach is 0.666, indicating that about 66.6% of the companies have local chairmen. The descriptive statistics of the remaining variables are within a reasonable range.

Table2 Descriptive Statistics Results

Variable	N	Min	Max	Mean	SD	p25	p50	p75
Violate	13625	0.000	1.000	0.087	0.282	0.000	0.000	0.000
EDF	15332	0.000	0.996	0.006	0.059	0.000	0.000	0.000
Nach	15332	0.000	1.000	0.666	0.472	0.000	1.000	1.000
Size	15332	19.800	26.450	22.200	1.255	21.310	21.990	22.860
Growth	15332	-0.631	2.609	0.183	0.332	0.005	0.132	0.290
TobinQ	15332	0.812	9.833	2.088	1.239	1.288	1.699	2.429

Board	15332	1.609	2.708	2.128	0.197	1.946	2.197	2.197
Dual	15332	0.000	1.000	0.294	0.455	0.000	0.000	1.000
Top1	15332	8.087	75.840	33.680	14.540	22.340	31.500	43.160
Indep	15332	25.000	60.000	37.530	5.347	33.330	33.330	42.860
Liquid	15332	0.236	21.340	2.407	2.284	1.192	1.683	2.675
Cashflow	15332	-0.220	0.283	0.055	0.066	0.014	0.052	0.094
Fixed	15332	0.003	0.769	0.215	0.151	0.099	0.186	0.299
Return	15332	-0.829	6.353	0.218	0.675	-0.209	0.050	0.444
Insa	15332	12.280	16.880	14.500	0.707	14.040	14.470	14.940
Cshare	15332	0.000	57.280	10.750	14.600	0.000	1.250	19.870

4. Empirical Results

Hypothesis 1 employs a step-by-step regression approach, and Table3 reports the regression results for Hypothesis 1. The dependent variable is measured by both the enterprise default probability (EDF) and whether a default has occurred (Violate). Columns (1) and (3) report the regression results without including control variables; columns (2) and (4) report the regression results after including control variables. The results show that the coefficients of the explanatory variable Nach are significantly negative at the 1% level in both cases. This indicates that when a company has a local chairman, it is more likely to reduce debt default behaviors and decrease the default probability. The above results verify Hypothesis 1 from two dimensions: the enterprise default probability and whether a default has occurred.

Table3 Hypothesis 1 - Local Chairman Appointment and Corporate Debt Default Risk

Variable	EDF		Violate	
	（1）	（2）	（3）	（4）
Nach	-0.013***	-0.011***	-0.217***	-0.328***
	(-12.98)	(-11.16)	(-3.23)	(-4.75)
Size		0.010***		-0.085**
		(18.52)		(-2.13)
Growth		-0.001		-0.558***
		(-0.62)		(-4.81)
TobinQ		0.001***		-0.012
		(2.68)		(-0.36)
Board		0.003		-0.028
		(0.85)		(-0.13)
Dual		-0.002*		-0.205***
		(-1.87)		(-2.74)
Top1		-0.000*		-0.007***
		(-1.76)		(-2.74)
Indep		0.001***		-0.006
		(2.88)		(-0.83)
Liquid		0.000		-0.026
		(0.69)		(-1.30)
Cashflow		-0.023***		1.630***
		(-2.92)		(2.92)
Fixed		0.001		-0.408
		(0.20)		(-1.43)
Return		-0.002*		-0.086
		(-1.66)		(-1.13)
Insa		-0.007***		-0.303***
		(-8.22)		(-5.03)
Cshare		0.000		-0.003
		(0.69)		(-1.23)
Constant	-0.003	-0.139***	-3.035***	3.767***
	(-0.35)	(-8.64)	(-4.07)	(2.97)
Year/Industry	YES	YES	YES	YES
Pseudo R2/ Adjusted R2	0.069	0.096	0.058	0.071
Observations	15332	15332	13625	13625

Note: *, **, and *** indicate significance at the 10%, 5%, and 1% levels, respectively.

5. Research Conclusions

Using data from non-financial A-share listed companies in China from 2007 to 2022, this paper finds that compared to companies with out-of-town chairmen, companies with local chairmen exhibit fewer debt default behaviors and have a lower probability of debt default. This paper investigates corporate debt default behavior from the perspective of identity as an informal institution, thereby expanding the literature on identity economics theory and the factors influencing corporate debt default. It complements research on the influence mechanism and economic effects of chairman selection in listed companies, providing policy reference value for current private enterprise reform practices and possessing certain practical significance.

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