

Measuring the Impact of Country-level Governance on Corporate Investment: A New Panel Data Evidence

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Abstract

Governance plays a key role in determining industrial investment. In addition, it has a dynamic impact on multiple business decisions. Given that, this study measures the role of country-level governance in protecting industrial investment. Using the 10-year (2007–2016) panel data from 12 Asian economies, we employ panel estimated generalized least square (EGLS), fully modified ordinary least square (FMOLS) and two-step system generalized method of moments (GMM) models to establish the relationship between defined variables. The empirical findings suggest that the countries with good governance situations subsequently enjoy a positive industrial investment. Following investors and property rights protection, a country with a good governance situation may have a voluminous industrial investment stemming from minimum default risk. The empirical findings of the current analysis highlight the significance of a good governance system in boosting industrial investment. A piece of important policy advice for corporate managers is to consider the governance condition while making an industrial investment. In addition, government officials should focus more on shaping better governance to ensure industrial growth. This study provides innovative insights into how country governance shapes corporate investment decisions specifically in Asian economies.

Keywords

Country-level governance, investment volume, Asian economies, macroeconomic factors

Introduction

This study unveils the impact of country-level governance (CLG hereafter) on corporate investment decisions. The poor country governance demonstrates the likelihood of high default risk, which eventually

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discourages the corporate firms to invest in acquiring the physical assets. It can also escalate both systematic and unsystematic risk, opportunity cost for new investment and information asymmetric issues by creating the high financial volatility and business uncertainty (Bernard et al., 2020). However, a country having low corruption rate, high political stability (PS), better law enforcement and proper accountability collectively known as good governance can trigger the new investment ventures due to probability of high future returns. Additionally, the corporate-level governance has a close link with CLG, which further determines the corporate investment volume (Al-Gamrh, et al., 2020; Suman & Singh, 2020). The exaggeration of better governance situation not only ensures overall economic prosperity through well management of economic activities but also provokes the favourable industrial environment. It attracts the entrepreneurs to make the investment, reduces the economic variability and escalates the production capacity, which ultimately enhances the living standard of a nation and demand for more industrial goods. This positive externality of governance results in more exploration of physical investment, initiated to meet the growing demand for industrial products (Du et al., 2018). Given to such advantages of better governance systems, the current analysis empirically assesses the effect of governance on corporate investment attitude.

Corporate firms make physical investment by acquiring three types of capital assets, including property, plant and equipment (PPE). Continuous investment in such types of assets is necessary in order to ensure business stability. Corporations make investments when demand for their products is growing, and expansion of production facilities meets investment criteria on a risk-adjusted basis. The favourable economic condition aptitudes the corporate investment volume due to the probability of high future return on investment projects (Farooq et al., 2021). In addition to this, proper accountability culture can reduce the undue influence of unfavourable factors on businesses and thus make the business growth-oriented. In line with these arguments, this study attempts to identify the significance of a country's governance condition in protecting the investment of corporate firms. To date, no direct study was found that mainly analysed such association between variables. Although some studies have attempted to explore the impact of macroeconomic condition, that is, financial development (Gupta & Mahakud, 2019), gross domestic product (GDP) growth rate (Farooq et al., 2021) and economic stability (Chen et al., 2019) on corporate investment attitude, literature is still scarce on this theme. This study adds a new concept by exploring the role of CLG in determining the corporate investment volume specifically in Asian economies where bad governance is a prevailing issue. It was evident from literature that CLG intensifies performance, innovation and cash management (Lee et al., 2020; Seifert & Gonenc, 2018). The findings of these studies argue to arrange more studies and to extend the analysis by evolving the corporate investment volume in relation with a country's governance.

In addition to economic progress, the better governance system has a promising role in establishing positive industrial growth. However, it is still uncommon in literature on how it determines industrial investment. By assuming the potential role of governance in industrial decisions, the increasing interest of this analysis falls into the possible derivation of corporate investment attitude due to a country's governance situation. Using a sample of non-financial sector firms from 12 Asian economies, we estimate the relationship between predicted variables by employing a number of econometric techniques, that is, panel estimated generalized least squares (EGLS), fully modified ordinary least squares (FMOLS) and system generalized method of moments (GMM) models. According to statistics, aggregate country governance index (CGI) positively relates with investment volume. Better governance condition can serve as stimulator for local business community as it prudently makes such arrangements that are necessary achieving business success. Furthermore, good governance promotes the favourable competitive environment in which no one can make the undue influence on each other and focus on their own business growth and quality enhancement. However, regulatory quality (RQ) demonstrates the negative impact on investment for lower-middle-income countries. The robustness was checked by

employing multiple econometric techniques and incorporating the different econometric problems, that is, heteroscedasticity, stationarity and endogeneity faced by panel data. Finally, analysis provides the novel evidence that governance can play a vital role in investment decision.

First, this study attempts to explore the three goals, that is, significance, contribution and implications. Concerning significance, this study accomplishes highlighting the role of CLG in determining the corporate investment volume. Second, in addition to firm-level determinants and other macroeconomic variables, it highlights the new insights regarding effectiveness of CLG and its explicit role in firm-level decision. Mostly, the previous studies focused on CLG and its dynamic impact on a variety of business decisions, but no study found which primarily focuses on CLG. This study brings forward the findings of previous studies to a new way of CLG and gives the clear path regarding corporate investment decision. Furthermore, the literature focuses on the relationship between CLG and other business decisions, that is, cash management, performance and innovation, but no study defines such relationship. Thus, the current study depicts the novel thoughts by tying a country's governance with investment decisions. Relating to implication, the empirical analysis provides clear implications to corporate managers, research individuals and even for country-level economic policy advisors. Corporate managers can module their investment strategies according to current country's governance situation and can reduce the beta of investment. Similarly, research scholars can use the current analysis to conduct further empirical studies and also to widen their governance concepts. Government economic advisors can stabilize the economic condition by focusing on exercising better governance. The poor governance situation not only obstructs economic growth but also destroys the local industrial development, which can create other economic complexities, that is, unemployment, high imports and capital flight.

Testing the role of the governance system in industrial investment supplements the robust evidence that any change in a country's governance situations has a pivotal role in industrial decisions. The current empirical analysis opens the new doors of research regarding the significance of governance situation in industrial investment decisions and urges to arrange more studies exploring the similar impact of a country's governance on other financial decisions. The research community and policy officials can get guidance from the underlying empirical analysis for making any future policy. Governance is a long-debated issue among nations and has a dynamic impact in boosting the economic prosperity of any country. However, its promising role in industrial decisions has not yet been well established in the literature. Thus, the current study can be marked as innovative as it explores the impact of better governance systems on industrial decisions. The current empirical analysis takes the six proxies of governance into consideration and checks their asymmetric impact on investment decisions. This study further provides the robustness to the empirical findings of existing literature.

The body of the article is organized as follows: the second section describes the findings of previous studies and develops the research hypothesis. The third section enriches the understanding of respective research methodology, the fourth section illustrates the statistical outcomes of data and the fifth section makes the discussion on main regression outcomes. In the sixth section, we conclude the whole discussion. The reference detail is given at the end of the article.

Literature Review

Existing literature mostly focused on corporate governance and their empirical outcomes in the form of better financial performance of a firm and transparency of other strategic decisions (Arora & Sharma, 2016). The existing literature further posed the techniques through which propensity of CLG can be

enhanced. The growing financial economics literature has apparently suggested that governance can enhance the outcomes on investment made by firms in different financial projects (Imran et al., 2020; Lei & Chen, 2019; Shahid & Abbas, 2019). But how CLG affects the investment decisions is still scratchable. Corporate managers intensify their investment attitude during a favourable economic condition (Farooq et al., 2021) that is interlinked with a country's governance (Mira & Hammadachi, 2017). Furthermore, good governance is an aggregate of certain factors, including PS, corruption control (CC) and government effectiveness (GE). The better performance on these factors substantially improves the performance of connected avenues, for example, financial development and infrastructure development that urge to promote the industrial sector specifically (Ahmed & Farooq, 2020).

The sustainability of the industrial sector is necessary as it vibrates the other economic sectors and provides the employment to the local population. Among the other macroeconomic factors, governance quality can hamper or magnify the industrial movement. In this regard, Jensen and Meckling (1976) induced the dynamic behaviour of governance among the firms and its relevant effect on corporate performance. They have documented the theory of a firm and proposed that weak enforceability can hurt the investor's sentiments. In addition to corporate governance, recent studies have defined the nexus between CLG and their relevant effect on number of corporate decisions. Sener and Selcuk (2020) have documented the governance effect on industrial diversification. They had documented the significant relationship between corporate governance and diversification but an insignificant effect of CLG. Seifert and Gonenc (2018) have suggested a decreasing trend between cash holding and governance quality. Governance quality allows the firms to hold less cash due to low business volatility. Corporate firms normally enhance their cash reserves when there exists the variability in corporate and country governance. Another study arranged by Pindado et al. (2015) has inspected the relevant positive effect of efficient governance of a country on corporate innovation activities. During better governance condition, firms actively indulge in innovation investment. The empirical findings of these studies transmit the research intentions towards exploration of proposed relationship between CLG and corporate investment.

Literature on Corporate Investment

The procurement of fixed assets alternatively known as capital investment is essential for survival and expansion of enterprises. Corporate firms, specifically manufacturing firms, actively indulge in capital investment to ensure the transparent and consistent business operations (Grazzi et al., 2016; Katti & Raithatha, 2020). However, there exist certain factors both at the firm level and at the macro level that influenced this decision. These factors are profitability, leverage and firm's size. In a macroeconomic context, GDP growth rate, inflation and financial development were the key factors that imperialized the investment decision (Farooq et al., 2021). The influential behaviour of these macroeconomic factors indicates that corporate investment may correlate with macroeconomic condition, that is, country's governance. Furthermore, Du et al. (2018) have reported that government integrity enacted the corporate investment decision significantly in China. Government's integrity condition somehow depicts the governance condition of that specific country. Hence, it can be concluded that governance condition can influence the corporate investment decision. Additionally, active investment decision stems from minimization of systematic and unsystematic risk, which is only achievable when there exists strict accountability, low strategic variability, high CC and inflexibility in law implication (Lee et al., 2020; Mathew et al., 2018).

Corporate firms cannot decide the capital investment intuitively. This decision is relatively backed with certain factors, including net present value (NPV) of investment, payback period and profitability index. The suitable fractional rate on these basic parameters encourages the firms to make investment (Gao et al., 2019). This decision is more relative in capital investment where enterprises are more curious about investment efficiency. However, an imperfect market can result in an unanticipated return and impede the corporate attitude to invest in long-term projects pronounced as capital investment (Calcagnini et al., 2019). Furthermore, bad governance augments the perceived default risk attached with capital investment. Managers have less information regarding the future outcomes, which perpetually leads to adverse selection for capital assets. Despite other factors, low governance eventually gears the market imperfection specifically in developing economies that have been already stuck in poor economic conditions (Castañer & Kavadis, 2013). Nevertheless, alienation of bad governance specifically at the country's level can stir the economic environment that propagates more long-term investment (Jin & Yu, 2018). Corporate investment volume is accustomed to governance sensitivity, which leads to success or failure of capital investment projects. Based upon these notions, it is more obvious to explore the relationship between governance and investment attitude in capital assets.

Literature on Country-level Governance

Exercising good governance can pave the path for economic development by fair allocation of resources. As specified by Kaufmann et al. (2010), the governance condition of a specific country can be assessed by six composite measures, including voice and accountability (VA), PS and absence of violation, GE, RQ, rule of law (RL) and CC. These indicators cover the broad spectrum of governance situation of a country. The study of Daniel et al. (2012) indicated the direct relationship between accountability culture and governance condition even at the firm's level. They suggested that an accountability culture made the corporate managers liable for their actions, which directly achieved the objective of good governance even at the level of the firm. Similarly, PS inferred the healthy governance situation as it built the confidence of stakeholders to make the long-term entrepreneurial plan based upon the current government economic policies (Jens, 2017). Corporations are often interested in making the long-term investment when a country has PS. GE encompasses the overall efficiency of a government in spending activities, responses towards political influence and credibility of economic policies (Kaufmann et al., 2010). The incredibility of a government's effectiveness urged the firms to involve in new ventures, that is, innovation projects (Guan & Yam, 2015).

As enhancing the discussion on a country's governance, RQ and RL enhanced the legislative confidence of firms, it also made the business environment more transparent and growth-oriented and promoted the freedom of expression. Corporate firms become indifferent to any legal discrimination and enhance their business operations without any fear of legal suppression (Saona & Martin, 2016). The control on corruption has significant representation in overall governance condition of a country. The low corruption index mitigates the business uncertainty and induces the corporate firms to indulge in investment projects (Pan & Tian, 2020). It further makes firms more likely to enhance the business volume, that is, trade credit activities (Ahmed & Farooq, 2020). The empirical findings of previous studies corroborate the significant impact of CLG on dynamic business activities and motivate to explore the possible impacts of governance on corporate investment volume.

Theoretical Background and Research Hypothesis

The hypothetical views about a country's governance and corporate investment volume were grounded on different governance theories. The 'invisible hands' theory proposed by Stiglitz (1989) claimed that an uncontrolled market could lead to distortion of fair market orientations and result in monopoly, inadequate resource distribution and low regional development. The federal government's 'invisible hand' may assist the industrial sector to manage their product demand, price control and uplifting the depressed sector by using the market intervention tools. However, this situation can only arise when good governance exists. Similarly, resource dependency theory of governance proposed by Pfeffer and Salancik (1978) somehow indicates the role of CLG in corporate investment attitudes. The notions of this theory can be expanded from corporate level to country representative, which plays a key role to ensure the availability of more country resources required to expand investment. They can develop the infrastructure, can relax the export restrictions and may allow firms to participate in international product representation contests. All these activities can eventually encourage the firms to invest more in their capital assets, that is, PPE. Transaction cost theory of governance states that strict VA can minimize the transaction cost of installation of new machinery (Williamson, 1979). Similarly, political theory of governance somehow represents the influence of PS on resource allocation for new investment projects (Peters, 2011). During high PS, corporate firms may indulge in new business ventures. The assumptions of governance theories and empirical findings of previous studies suggest the following relationship:

H1: There exists positive and significant relationship between a country's governance and corporate capital investment volume.

Research Methodology

Data Description and Sample Size

The analysis consists of 10 years (2007–2016) of panel data that comprises 6,654 firms belonging to the non-financial sector from 12 Asian economies. The main reason behind the selection of these countries is to develop a diverse sample for analysis. We applied the different data cleaning tools, that is, winsorize at 1% by both ends, and excluding the firms having missing information for 5 or more than 5 years that make the data more result oriented. The financial information of firm-specific variables was obtained from *Thomson Reuters Data Stream*, while the information on CLG was retrieved from *World Governance Index*¹ (WGI) of the World Bank. Similarly, data for other macroeconomic variables, that is, GDP growth rate, inflation rate (IFR) and financial sector developed, were collected from *World Development Indicators*² (WDI) sourced by the World Bank. Table A1 provides the brief description of number of selected companies and sample countries. The data availability statement lies as³

Variable Specification

In this study, corporate capital investment decision serves as a dependent variable and is measured with fraction of capital expenditure over total assets. This ratio depicts the percentage of funds invested by firms to purchase the PPE collectively known as capital assets. Corporate firms actively make long-term investment by acquiring the PPE because it is necessary to align with growth objectives. Enterprises

acquire the PPE to enhance their production capacity. Briefly, the acquisition of PPE is a physical investment in which funds are invested for more than 1 year. Thus, we have calculated this ratio by dividing the total assets on fixed assets (fixed assets/total assets) (Chen et al., 2017; Farooq et al., 2021). The explanatory variable is CLG condition that has six proxies, that is, VA, GE, PS and absence of violence, RQ, RL and control of corruption. The performance score on these indices ranges from -2.5 (bad governance) to 2.5 (good governance), while the aggregate index term as CGI enlists the average governance condition of a specific country. A country skewed towards a negative end can be termed as bad governance, while positive values may mark as good governance condition. These proxies have been used frequently in previous studies to assess governance (Lee et al., 2020; Seifert & Gonenc, 2018). In addition to these, profitability (EBIT/total assets), a firm's size (log to total assets) and leverage (total debt/total assets) were controlled at the firm's level, while GDP growth rate, IFR and financial sector development (FSD) were included as control variables at macro-level. GDP growth rate indicates the annual value addition in existing domestic products by all the production sources. Similarly, IFR depicts percentage change in consumer price index (CPI), which is change in prices of consumer goods.

FSD is an average performance score of financial institutions and financial markets on depth, access and efficiency. A country having an aggregate score of 0.60 or greater can be categorized as financially developed, otherwise underdeveloped or developing. The study of Farooq et al. (2021) intensified the concepts of these factors as significant determinants of corporate capital investment. Table 1 summarizes the brief description, role and relevant measurement of these variables.

Table 1. Description of Variables.

Sr no.	Variable	Role	Measurement	References
1	Corporate investment	DV	Investment in fixed assets	Ciżkowicz and Rzońca (2012), Chen et al. (2019), Farooq et al. (2021)
2	Country-level governance	IV	WGI index	Seifert and Gonenc (2018), Lee et al. (2020)
3	Profitability	CV	EBIT/total assets	Vo (2019), Bernard et al. (2020)
4	Firm's size	CV	Log of total sales	Vo (2019), Bernard et al. (2020)
5	Leverage	CV	Total debt/total assets	Vo (2019), Bernard et al. (2020)
6	GDP growth rate	CV	Annual growth rate of GDP	Fu and Liu (2015), Vo (2019)
7	Financial development	CV	Aggregate performance on depth, access and efficiency	Fu and Liu (2015), Vo (2019)
8	Inflation rate	CV	Change in consumer price index (CPI)	Fu and Liu (2015), Vo (2019)

Source: Authors' own calculation.

Description: This table shows the description of variables and their relevant measurements extracted from previous studies conducted on the same theme.

Abbreviations: DV = dependent variable, IV = independent variable and CV = control variable.

Model Specification

The proposed model for this study can be expressed in the following econometric equation:

$$Y_{ijt} = \alpha_i + \beta_1 X_{jt} + \beta_2 CV_{jt} + \beta_3 FCV_{ijt} + \varepsilon_{ijt} \quad (1)$$

where Y_{ijt} is a latent variable that represents the dependent variable, and X_{jt} is a vector for explanatory variables indicating the country j and time t . Similarly, α is a constant and indicates the slope of regression line, β is a coefficient vector and exemplifies the degree of change due to change in other variables and ε_{it} is an error term. Note that CV is the abbreviation for country level and FCV is an acronym for firm-specific control variables.

$$\begin{aligned} INV_{ijt} = & \beta_o + \alpha_1 CGI_{jt} + \sum_{k=1}^6 \alpha_k CGI_{kjt} + \beta_1 ROA_{ijt} + \beta_2 FS_{ijt} + \beta_3 LVG_{ijt} + \gamma_1 GDP_{jt} \\ & + \gamma_2 FSD_{jt} + \gamma_3 IFR_{jt} + \varepsilon_{ijt} \end{aligned} \quad (2)$$

However, CGI is a function of

$$CGI_{ijt} = f(VA, PS, GE, RQ, RL, CC)$$

Equation 2 explains the comprehensive regression modulation among the variables. In this equation, INV reflects the investment and CGI is the aggregate governance index. As likely, VA, PS, GE, RQ, RL and CC are acronyms of voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and corruption control relatively. Other abbreviations are as follows: ROA is for profitability, FS for firm size, LVG for leverage, GDP for gross domestic product growth and IFR for inflation rate. All these proxies demonstrate the proposed econometric model for analysis.

Methodological Discussion

To estimate the regression, we originate the analysis from ordinary least square (OLS) with cross-section fixed-effects method, which can also be pronounced as panel fixed-effects model. The results obtained from Hausmann test specifies that fixed-effects model is more appropriate as compared to random effects. However, as the analysis carries the range of macroeconomic variables, there exists an explicit probability for the problem of stationarity and endogeneity as well. To synchronize whether data are stationary or not, unit root test was applied, and results of augmented Dicky–Fuller (ADF) test suggest that data are not stationary at level. This problem was resolved by taking lag difference of variables, which converts the data into stationary at level 1 as presented in Table 2. Next, to identify the possible presence of endogeneity, Wald test was applied, and statistics of this model was shown in Table 3. The statistical outcomes of this model predict that probability values of constants C are equal to 0, which accepts the alternate hypothesis articulated as *explanatory variables are correlated with error term*. In this situation, implication of the GMM model is voidable as it has capacity to resolve the problem of endogeneity. GMM model was first discovered by Griliches and Hausman (1986) to pursue the possible problem of endogeneity in both panel and longitudinal data. Furthermore, we have also employed panel EGLS due to the problem of heteroscedasticity (as shown in Table 3) and FMOLS test due to stationarity problem of the main variables of study (as shown in Table 2).

Table 2. Unit Root Testing.

Variables	At Level		At First Difference	
	Statistic	Prob.**	Statistic	Prob.**
Investment	11,954.500	0.000		
Governance	7,676.680	0.6355	21,331.700	0.000
Voice and accountability	4,887.400	1.000	25,794.400	0.000
Political stability	18,232.500	0.000		
Governance effectiveness	7,709.850	1.000	22,897.700	0.000
Regulatory quality	5,543.640	1.000	21,259.400	0.000
Rule of law	10,420.500	0.000		
Corruption control	9,622.320	0.998	18,186.200	0.000
Profitability	17,566.660	0.000		
Firm size	14,004.600	0.000		
Leverage	12,029.900	0.000		
GDP growth rate	32,352.900	0.000		
Inflation rate	17,107.300	0.000		
Financial sector development	4,924.940	1.000	42,341.000	0.000

Source: The authors.

Note: **Probabilities for Fisher tests are computed using an asymptotic chi-square distribution. All other tests assume asymptotic normality.

Description: This table reports the statistical outcomes of ADF test.

Table 3. Heteroscedasticity and Endogeneity Diagnostic Tests.

Panel Cross-section Heteroscedasticity LR Test			
Method	Value	d.f.	Prob.
Likelihood ratio	31,330.690	5,021	0.000***
LR test summary			
Restricted Log L	16,022.390	46,290	
Unrestricted Log L	31,687.740	46,290	
WALD Test for Endogeneity			
Test Summary	Value	d.f.	Prob.
t-statistics	5.130	40,092	0.000***
f-statistics	26.318	(140,092)	0.000***
Chi-square	26.318	1	0.000***

Source: Authors' own calculation.

Note: *** Significant at 1%.

Description: We test the data stationarity by applying the unit root test and endogeneity through Wald test.

Statistical Analysis

Descriptive Statistics

Table 4 illustrates the descriptive statistics of variables of study in the form of mean, range, standard deviation, skewness and kurtosis. Investment (INV) has a mean value of 0.381, which suggests the capital investment percentage as compared to total assets. Corporate firms invest about 38.1% in procurement of fixed assets. CGI has a positive mean value of 0.341. This value indicates the overall governance condition, which is quite better as it is nearer to the positive end. Other governance proxies, that is, VA, GE, RQ, RL and CC have positive mean values of 0.002, 0.011, 0.013, 0.009 and 0.017, relatively, while PS has a negative mean value of -0.001 . The performance score on these indices depicts that most of the governance parameters lie somehow in good condition irrespective of PS, which is not in a good position. The mean value of ROA is 0.057, which specifies that the earning capacity of firms is 5.7% by utilizing their assets. The firm's size has a mean value of 2.421, which implies that the size of firms and leverage percentage is 0.282 or 28.2% conceptualizing the loan acquiring percentage to finance the assets. Macroeconomic variables, that is, GDP, IFR and FSD have mean values of 4.204, 3.241 and 0.654, relatively. These values reflect the average trend of variables in numerical form. Next, range values show the total span from positive to negative end, that is, maximum to minimum, and standard deviation represents the average degree of dispersion from mean values. The skewness and kurtosis portray the data pattern.

Table 4. Overall Descriptive Statistics.

	Mean	Range	Std. Deviation	Skewness	Kurtosis
INV	0.381	0.356	0.182	0.072	2.530
CGI	0.345	2.791	0.790	0.110	1.354
VA	0.002	0.591	0.050	-2.555	25.680
PS	-0.001	0.922	0.112	-0.151	4.421
GE	0.011	0.625	0.108	0.827	3.962
RQ	0.013	0.483	0.077	0.444	4.263
RL	0.009	0.390	0.072	0.531	3.303
CC	0.017	0.621	0.080	-0.608	3.717
ROA	0.057	1.788	0.080	-0.876	3.621
FS	2.421	5.664	0.076	0.362	3.380
LVG	0.282	0.989	0.172	0.519	2.791
GDP	4.204	19.942	0.038	-0.098	3.063
IFR	3.241	21.638	0.034	1.022	3.663
FSD	0.654	0.692	0.018	-0.355	1.756

Source: The authors.

Abbreviation: INV = capital investment, CGI = country governance index, VA = voice and accountability, PS = political stability, GE = government effectiveness, RQ = regulatory quality, RL = rule of law, CC = corruption control, ROA = profitability, FS = firm size, LVG = leverage, GDP = growth rate, IFR = inflation rate and FSD = financial sector development.

Table 5. Country-wise Mean Values.

	INV	CGI	VA	PS	CC	RQ	RL	GE
China	0.374	-0.523	-1.654	-0.534	0.171	-0.231	-0.436	-0.447
Japan	0.348	1.273	1.027	0.973	1.514	1.150	1.392	1.581
Malaysia	0.383	0.318	-0.440	0.118	0.153	0.580	0.468	1.032
Pakistan	0.530	-1.087	-0.804	-2.491	-0.948	-0.630	-0.839	-0.723
Philippine	0.389	-0.402	0.010	-1.337	-0.599	-0.098	-0.458	0.067
Singapore	0.345	1.527	-0.153	1.280	2.145	1.964	1.698	2.235
South Korea	0.379	0.769	0.691	0.311	0.513	0.962	0.995	1.140
Thailand	0.437	-0.305	-0.606	-1.180	-0.378	0.215	0.151	0.274
Turkey	0.393	-0.121	-0.214	-1.160	0.013	0.324	0.018	0.292
U.A.E.	0.449	-0.338	-1.814	-0.427	-0.014	0.077	0.130	0.016
India	0.416	-0.264	0.437	-1.163	-0.428	-0.383	-0.020	-0.026
Indonesia	0.414	-0.382	0.053	-0.714	-0.617	-0.274	-0.538	-0.202

Source: Authors' own calculation.

Note: This table reflects the average trend of variables for a specific country.

Abbreviation: INV = capital investment, CGI = country governance index, VA = voice and accountability, PS = political stability, GE = government effectiveness, RQ = regulatory quality, RL = rule of law, CC = corruption control, ROA = profitability, FS = firm size, LVG = leverage, GDP = growth rate, IFR = inflation rate and FSD = financial sector development.

Table 5 revised the overall descriptive statistics to country wise and reflects the average responses of variables in different countries. If we focus on the main variables of interest, that is, aggregate governance and investments as shown in columns 2 and 3, it is clear from the table that Pakistan has the worst governance condition (-1.087), while it has the highest fixed assets investment rate (0.530). On the other hand, Singapore has a good governance index (1.527) as compared to other countries, but it has the lowest capital investment percentage of 0.345. These statistics depict that corporate firms enhance their capital reserve during high worst governance conditions. The statistical values of other proxies of governance present a mixed relationship with corporate investment volume.

Correlation Metrics

Table 6 presents the correlation statistics and multicollinearity diagnostic. As shown in column 2, CGI has a positive correlation value of 0.623. This value indicates a positive correlation behaviour of governance with investment. It further supported the hypothesis, that is, high correlation between governance and investment volume which was later supported in regression tables. With regard to control variables, outcomes of correlation analysis depict that ROA and FS have negative correlation, while LVG has positive correlation statistics. Similarly, macroeconomics, that is, GDP (0.063) and IFR (0.122), exhibit positive correlation, while FSD (-0.134) demonstrates a negative correlation value. All these values enhance the understanding of the proposed relationship between independent and dependent

Table 6. Correlation Analysis.

	INV	CGI	ROA	FS	LVG	GDP	IFR	FSD
INV	1.000							
CGI	0.623	1.00						
ROA	−0.059	−0.145	1.000					
FS	−0.062	0.194	0.088	1.000				
LVG	0.325	−0.204	−0.228	0.014	1.000			
GDP	0.063	−0.744	0.105	−0.137	0.142	1.000		
IFR	0.122	−0.594	0.188	−0.288	0.185	0.455	1.000	
FSD	−0.134	0.869	−0.192	0.257	−0.199	−0.642	−0.753	1.000
Panel B: Multicollinearity diagnostic test								
VIF	6.231	4.653	6.982	3.666	4.999	6.932	7.231	5.854

Source: Authors' own calculation.

Abbreviation: INV = capital investment, CGI = country governance index, ROA = profitability, FS = firm size, LVG = leverage, GDP = growth rate, IFR = inflation rate and FSD = financial sector development.

variables. As presented in Table 6, most of the correlation values do not exceed 0.70, indicating the no multicollinearity problem. Furthermore, outcomes of variance inflation factor (VIF) signify no multicollinearity among variables as all the values fall below 10, which is acceptable for no multicollinearity. It was the brief presentation of variables regarding descriptive statistics and correlation. The next section carries the discussion on regression analysis.

Regression Analysis

Table 6 exemplifies the regression statistics on how a country's governance affects the investment decisions of the industrial sector. As the statistics show, all the proxies of governance (VA, PS, GE, RQ, RL and CC), including CGI, have a significant and positive association with investment decisions. All proxies are significant at the 1% level. Similarly, ROA has a significant and negative effect, but it converts to a positive relationship after controlling the endogeneity issue. Other control variables, that is, FS and LVG, carry the positive and significant relationship with investment decisions. At the country level, GDP and FSD show a positive influence for models (2) and (3), while they show a negative relationship with regard to model (1). Conversely, the statistical outcomes of all three models indicate that IFR has a significant but inverse relationship with investment decisions.

Table 7 shows robustness analysis when the sample was segregated into two main categories, that is, lower-middle, and upper-middle-income countries. Focusing on coefficient values, mostly, variables carry similar relationship as shown in Table 6 (instead of RQ, which has a negative influence on lower-middle-income countries).

Table 7. Country Governance and Corporate Investment.

	Panel EGLS (1)	FMOLS (2)	2-step System GMM (3)
C (constant)	0.397*** (0.000)	0.253*** (0.000)	0.151*** (0.000)
CGI (governance)	0.366** (0.001)	0.855*** (0.008)	0.454*** (0.000)
VA (voice and account)	0.065** (0.000)	0.111*** (0.010)	0.236*** (0.000)
PS (political stability)	0.095** (0.000)	0.145*** (0.000)	0.270*** (0.000)
GE (govern. effectiveness)	0.072** (0.000)	-0.162*** (0.000)	0.182*** (0.000)
RQ (reg. quality)	-0.021** (0.244)	0.144*** (0.001)	0.808*** (0.000)
RL (rule of law)	0.050** (0.008)	-0.193*** (0.000)	0.185*** (0.000)
CC (corruption control)	0.067** (0.000)	0.128*** (0.004)	0.868*** (0.000)
ROA (profitability)	-0.065** (0.000)	-0.112*** (0.000)	0.053*** (0.000)
FS (firm size)	0.015** (0.000)	0.126*** (0.000)	0.035*** (0.000)
LVG (leverage)	0.207** (0.000)	0.020*** (0.000)	0.073*** (0.000)
GDP (GDP growth rate)	-0.006** (0.000)	0.007*** (0.000)	0.032*** (0.000)
IFR (inflation rate)	-0.006** (0.004)	-0.014*** (0.000)	-0.070*** (0.000)
FSD (fin. sect. development)	-0.055** (0.000)	0.069*** (0.000)	0.113*** (0.000)
Adjusted R-square	0.066	0.855	0.708
S.E. of regression	0.086	0.068	0.056
Prob. (J-statistic)	-	-	0.185
Prob. (f-statistics)	0.000	-	-

Source: The authors.

Note: *** Significant at 1%, ** significant at.

Table 8. Robustness Analysis Across Lower-Middle and Upper-Middle-Income Countries.

	Lower-Middle-Income Countries		Upper-Middle and High-income Countries	
	(1)	(3)	(1)	(3)
C (constant)	0.365*** (0.000)	1.488*** (0.020)	0.442*** (0.000)	1.033*** (0.000)
CGI (governance)	0.409*** (0.000)	3.475*** (0.039)	0.280*** (0.022)	2.434*** (0.000)
VA (voice and account)	-0.221*** (0.000)	7.261*** (0.033)	0.044*** (0.032)	1.657*** (0.000)
PS (political stability)	0.074*** (0.000)	6.598*** (0.038)	0.076*** (0.000)	1.755*** (0.000)
GE (govern. effectiveness)	0.091*** (0.000)	8.155*** (0.043)	0.046*** (0.026)	1.899*** (0.000)
RQ (reg. quality)		-7.769*** (0.042)	0.020*** (0.000)	1.937*** (0.000)
RL (rule of law)		6.952*** (0.034)	0.046*** (0.028)	1.695*** (0.000)
CC (corruption control)	0.135*** (0.000)	7.140*** (0.040)	0.044*** (0.047)	0.686*** (0.000)
ROA (profitability)	-0.074*** (0.000)	0.083*** (0.060)	0.065*** (0.000)	-1.497*** (0.000)
FS (firm size)	0.022*** (0.000)	0.011*** (0.000)	0.013*** (0.000)	0.039*** (0.000)
LVG (leverage)	0.198*** (0.000)	0.305*** (0.000)	0.212*** (0.000)	

(Table 8 continued)

(Table 8 continued)

	Lower-Middle-Income Countries		Upper-Middle and High-income Countries	
	(1)	(3)	(1)	(3)
GDP (GDP growth rate)	0.003*** (0.000)	0.093*** (0.094)	0.129*** (0.000)	0.010*** (0.004)
IFR (inflation rate)	0.007*** (0.000)	−0.010*** (0.086)	−0.001*** (0.000)	−0.009*** (0.000)
FSD (fin. sect. development)	0.179*** (0.000)	0.460*** (0.103)	0.113*** (0.000)	−1.143*** (0.002)
Adjusted R-square	0.079	0.249	0.062	0.505
S.E. of regression	0.078	0.120	0.086	0.125
Prob. (J-statistic)		0.612		0.249
Prob. (F-statistic)	0.000		0.000	

Source: The authors.

Note: *** Significant at 1%, ** significant at 5% and *significant at 10%.

Discussion

The objective of the current analysis is to explore the empirical relationship between CLG and industrial sector investment decisions. Owing to regression analysis, we employ a set of econometric techniques, including panel EGLS, FMOLS and two-step system GMM models for regression estimation among the variables and to address the multiple econometric problems, that is, heteroscedasticity, stationarity and endogeneity. Table 6 presents the main regression results. Following the statistical outputs of the GMM model, CGI has a positive and coefficient value suggesting that favourable governance condition can enhance the capital investment volume. Corporate firms confidently make new investments into long-term projects when a country presents a better governance situation as it enhances the return on investment and alienates the default risk on investment. The significant and positive relationship is in line with the main alternate hypothesis (H_1). This relationship is somehow in accordance with Jin and Yu (2018) in which they have developed a channel for possible effects of government governance on investment efficiency through executives' network. The empirical findings of their study indicated that an institutional protection by a federal government can enhance the managerial confidence to invest in long-term projects in China. In addition to p -value, the coefficient value is 0.454, which suggests that 1% change in governance index would cause a 0.454% change in investment level.

Similarly, the coefficient values of other proxies of governance, including VA, PS, GE, RQ, RL and CC, depict a similar trend as CGI exemplifies. According to statistics, VA and PS have a positive and significant impact on investment and hold the coefficient values of 0.236 and 0.270, relatively. A country that follows a strict policy of accountability and does not allow unfavourable factors to penetrate into industrial decisions may enjoy high industrial growth (Calcagnini et al., 2019). Similarly, political stability provokes the uninterrupted functioning of industrial activities that have positive spillover impact on industrial investment (Jens, 2017). Moreover, the high-performance scores on these two indicators of governance, subject to an overall assurance for institutional protection, eventually lead to stimulate capital investment. Similarly, positive association of GE with investment decisions demonstrates the

overall government efficiency that boosts the industrial confidence to widen their business set-ups (Du et al., 2018). As expected, RQ, RL and CC carry positive and significant coefficient values of 0.185, 0.868 and 0.053, respectively. The strict legislative environment can widen the investment due to legalization and indication of protection of property rights, which encourage the installation of new projects (Jin & Yu, 2018). Similarly, control of corruption can improve and maximize the wealth of enterprises. The high corruption payments serve as indirect taxes paid to government officials through unfavourable means and hinder the industrial activities. However, cutting of such payments induces positive growth in investment activities (Okafor et al., 2021; Paunov, 2016).

In terms of corporate-specific control variables, profitability (ROA) has positive and significant relationship with investment, and its coefficient value is 0.053. More profitable firms have high cash reserves and are confident about their venture investment. The coefficient values of FS and LVG are 0.035 and 0.073, relatively, indicating a positive and significant regression with investment. The larger firms invest more in acquiring the PPE collectively known as capital investment to meet its growing demand in sales. Similarly, the availability of more bank loans enhances the financial pace for new investment (Farooq et al., 2021; Mondosha & Majoni, 2018).

By extending the discussion on macroeconomic variables and their possible effects on investment volume, it can be observed that GDP growth rate and FSD have a positive and significant relationship, while IFR has a negative and significant regression with investment volume. The positive relationship of GDP growth rate numerates the overall prosperous economic situation, which leads to accelerate the industrial activities and thus more physical investment (Tokuoka, 2013). However, IFR hampers the enterprises' investment attitude as it decreases the NPV of investment and thus discourages the firms to invest in fixed assets (Cizkiewicz & Rzońca, 2012). Similarly, a positive influence of FSD indicates financial sector's role in facilitating the industrial activities. A developed financial sector may offer more funds to the industrial sector at relatively cheap rates (Farooq et al., 2021). In conclusion, overall regression results of variables stratify the empirical findings of previous studies.

In addition to panel analysis, Table 7 segregates the discussion of country governance into lower-middle and upper-middle-income countries and presents relevant regression results. It enhances the empirical understandings on governance effect more comprehensively. Some proxies of CGI have a similar impact (VA, PS, GE, RL, CC) as shown in Table 6, while others carry the inverse relationship (RQ has a negative coefficient value for lower-middle-income countries) with investment decisions. These values prescribe a specific relationship in both panels.

Conclusion and Policy Suggestions

The main objective of the current study is to explore the possible adherence of corporate capital investment volume with CLG situation. The study analysed the governance condition of 12 selected Asian economies and investigated the change in investment by changing in governance conditions across the countries. The statistical outcomes of multiple econometric models confirm the positive and significant impact of good governance on investment. Better governance situation in a country turns the managerial attitude to widen their production activities by making continuous investments in fixed assets. Furthermore, it ensures the return on capital investment, alienates the problem of information asymmetry and alleviates the possible default risk caused by uncertain economic condition and poor

governance situation. In addition to governance, this study introduces the dynamic impacts of other firm-specific variables, that is, profitability, leverage and firm's size on investment attitude. The current analysis also considers some macroeconomic factors, including GDP growth rate, IFR and FSD to assess the impact of economic variability on industrial investment. The empirical findings were found robust even while distributing the sample across lower-middle and upper-middle-income countries.

The empirical findings are in line with the alternate hypothesis (H1) and specify the novel insights on how governance situation can determine investment volume. It transfers the traditional arrangements of research on corporate investment to a new path by adding the governance implications for the industrial sector. Globally, the current analysis provides important policy implications for multiple countries of the world regarding the significance of governance even in industrial decisions. The policy officials from the emerging worlds should focus more on exercising governance by controlling corruption, protecting property rights and ensuring RL. Such governance practices can substantially improve the growth of the domestic industrial sector. However, the current analysis is limited to not suggesting the possible treatments for adverse-effect RQ for lower-middle-income countries. Future studies can introduce the interaction effect of some firm-specific variables with this proxy, which can turn this negative impact into a positive impact.

Moreover, the analysis period was limited to the year 2016 due to the non-availability of recent data, which is another limitation of the study that can be incorporated in future studies. In addition, the recent years cannot be considered due to the potential effect of COVID-19 in the year 2020. Responding to the COVID-19 policies, the corporate managers can dynamically formulate the investment policies. Moreover, the governance regimes might also change during the COVID spread as the government has relaxed many norms in favour of enterprises during this specific era. Thus, the analysis cannot be extended to the recent years specifically within the current objective of the study. Thus, future analysis can be arranged by evolving the COVID-19 effect on the relationship between governance and investment.

Implications and Policy Recommendations

This study has the following policy implications:

- This study introduces the importance of good governance in the expansion of industries, which can exogenously impact upon other factors, that is, employment generation, export increment and overall economic prosperity.
- Corporate managers should consider the governance sensitivity while deciding about investment as governance has a significant impact on investment.
- National policymakers are recommended to focus on exercising better governance and should consider it as an important economic tool to manage the economic health of country.
- As the findings reveal, a proxy of governance, that is, RQ, has a negative impact on corporate investment. This negative impact provides policy guidance to policy officials of lower-middle-income countries. They should not apply such sanctions that hinder the investment level of the industrial sector.

Appendix

Table A1. List of Selected Countries and their Firms.

Sr. No.	Country Name	No. of Firms	Sr. No.	Country Name	No. of Firms
1	China	1,503	7	South Korea	821
2	Japan	1,961	8	Thailand	256
3	Malaysia	366	9	Turkey	110
4	Pakistan	112	10	United Arab Emirates	7
5	Philpine	55	11	India	1,154
6	Singapore	171	12	Indonesia	138
Total					6,654

Source: Thomson Reuters data stream.

Note: Table 1 enlists the strength of companies from 12 Asian economies. These are the non-financial publicly listed firms and firms from the financial sector were excluded because the objective was to find the impact on capital investment, which is not common in firms related to the financial sector.

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1. <http://info.worldbank.org/governance/wgi/>
2. <https://data.worldbank.org/indicator>
3. The numerical data used to make the regression analysis are available at ‘Thomson Reuters DataStream’ and ‘The World Bank Data Source’. These data sites are accessible by monetary subscription and freely.

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