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STUDY OF EXCESSIVE INVESTMENTS: CONCEPTS AND MOTIVATIONS

Abstract. *Investments in the economy contribute to productivity growth; however, excessive zeal among investors can lead to overinvestment. This article explores the concept and causes of overinvestment. The motivation for overinvestment encompasses a combination of factors: the deviation of managers from owners' goals, information asymmetry, non-standardized corporate governance structures, as well as managerial characteristics and cognitive biases. Resolving these issues is crucial for mitigating the consequences of excessive investments and ensuring a more efficient allocation of resources within companies.*

Keywords: *excessive investments, motivation for excessive investments, corporate governance structure.*

INTRODUCTION

Investments in the economy promote productivity growth, but excessive enthusiasm of investors can lead to excessive investments. Investments become excessive when their large volumes are combined with declining returns. The enthusiasm of investors, which contributes to the excessive growth of investment, diminishes as their returns decline. The problem of excessive investments is crucial for China, where investments are a significant driver of economic growth. This article aims to investigate the reasons behind excessive investments, necessitating corrective actions in economic relationships.

ANALYSIS OF RECENT RESEARCH AND PUBLICATIONS

Numerous studies are currently being conducted to analyze the occurrence of excessive investments. Leading foreign and Chinese scholars have addressed theoretical aspects of excessive investments. Among them are Larry Lang, Robert Litzenberger, Li Lizhun, Ma Ciaomei, Gao Taoli, Li Feng, Sun Xiaolin, and others.

1. Concept of Excessive Investments

The definition of a firm's value is manifested in its ability to create economic benefits by utilizing production resources necessary for its operations, with the aim of increasing the firm's value.

Investment decisions of a company occupy a key position in financial decisions, indicating that the enhancement of the firm's value or its reinvestment is primarily achieved through the company's investment activities. With the development of the market economy, a firm's investments are subject to the dual impact of internal and external factors, and the investment efficiency of the firm is also influenced to varying degrees. In this context, several foreign scholars have conducted research on "optimal investments", leading to the identification of problems related to inefficient investments, excessive investments, and underinvestment.

Excessive investments originate from the "hypothesis of excessive investments" model proposed by Larry Lang and Robert Litzenberger, defined as companies that, due to the presence of a large amount of free cash flows, invest in investment opportunities with a net present value less than zero, reflected in companies with a Tobin's Q ratio of less than 1 (the ratio of the market value of the company to the replacement cost of the company's assets).

In recent years, based on the widespread occurrence of excessive investments in listed companies (open-type joint-stock companies whose shares are traded on the stock exchange), Chinese scholars have conducted corresponding research. They argue that companies, to enhance their competitiveness in the market, irrationally and sometimes blindly expand their business scale, investing in new projects that do not actually match the current situation of the company, even projects in areas unfamiliar to the company, resulting in excessive investments. Essentially, the conflict of interest between managers and shareholders, caused by the separation of ownership rights in modern corporate systems, leads managers to prioritize their personal gain and choose projects that maximize their own benefit, even if these projects have a negative net present value.

As a result, excessive investments are investment decisions that are not optimal in terms of value for the company, going beyond or deviating from its capabilities and growth opportunities, particularly projects with a negative net discounted income (NDI). This leads to inefficient capital allocation within the company. However, it is important to consider that when making investment decisions, a company may sacrifice short-term income by investing in projects with a negative NDI but capable of bringing long-term benefits to the company. In this case, it is not considered excessive investments.

2. Causes of Excessive Investments

2.1. Managerial Divergence from Owner Objectives

In the structure of the Chinese capital market, when making financial decisions, especially investment decisions, shareholders, managers, and creditors assess issues from the perspective of their own interests. Conflicts of interest between these parties are the root cause of inefficient investments in companies.

Firstly, there is a conflict between shareholders and management. The separation of ownership and control in modern corporate systems leads to a conflict of interest between shareholders and management. Shareholders tend to maximize shareholder profit and the firm's value, while the management, perhaps, is more concerned with their personal development or maximizing personal income. This creates an agency conflict between shareholders and management. As those directly responsible for the operational activities of the company, management is inclined to invest in projects that are beneficial for their own development, even if the net present value of the project is negative or contradicts the goals of maximizing the firm's value and shareholder profit. In such cases, management may use their informational advantage to provide shareholders with information supporting the decision in favor of a project that does not align with the goals of maximizing the firm's value, resulting in excessive investments in the company.

Secondly, there is a conflict between shareholders and creditors. Many experts and researchers have studied the impact of debt financing on investment behavior, but no unanimous conclusion has been reached. Usually, in the case of a high level of corporate indebtedness, shareholders and management align against creditors, and shareholders have strong incentives to direct the company's assets into high-risk, high-reward projects. In case of success, they receive the majority of the investment's profits, but in case of failure, most of the losses are borne by the creditors. Overinvestment by a company often involves the choice of high-risk, high-reward projects, which is detrimental to the interests of creditors. However, when the net present value of a project is insufficient to repay the company's debts, shareholders cannot share the profits from investments. Even if the net present value of the project is positive and the probability of success is high, shareholders may refrain from investing, which is also a manifestation of underinvestment. Creditors play a positive role in managing the company by making timely debt payments, and their control can prevent the risk of transferring management power and to some extent, suppress undesirable investment behavior of the management. Short-term debt can also reduce agency costs. Various factors, such as the company's level of indebtedness and investment returns, can lead to inefficient investments by the company, causing conflicts of interest between shareholders and creditors and possibly resulting in excessive or inadequate investments by the company. However, due to the positive role of creditors in corporate governance, undesirable investment behavior of the company can be reduced.

Thirdly, there is a conflict between controlling shareholders and small to medium-sized shareholders. Based on principal-agent theory, the problem of agency is mainly related to the conflict of interest between shareholders and management. However, when the concentration of corporate capital reaches a certain level, the agency problem will be shifted into a conflict of interest between controlling shareholders and minority shareholders. The main shareholder often sacrifices the interests of minority shareholders to gain the benefits of private control, and the controlling shareholder may seek advantages through inefficient investments and excessive diversification. Relevant expert research shows that given the current state of the capital market, it is difficult for companies to protect the rights and interests of small to medium-sized shareholders, and they are often controlled by major shareholders, leading to conflicts among shareholders. Large shareholders often choose corporate decisions that are favorable to them.

2.2. Information Asymmetry

The theory of information asymmetry was proposed by American economists such as George Akerlof, Michael Spence and Joseph E. Stiglitz. They were awarded the Nobel Prize in 2001 for their "analysis of markets with asymmetric information", which, along with the earlier work of James A. Mirrlees and William Vickrey in 1996, underscored the significance of informational issues in economics.

According to the theory they put forth, due to differences in the amount of information available to all parties participating in a market economy, stemming from objective factors such as delayed information transmission, information losses caused by intentional withholding of information during its transmission, and variations in the degree of information possession among different economic agents or stakeholders, the party possessing a greater amount of information will gain a competitive advantage.

Information Asymmetry Information asymmetry is a critical factor contributing to excessive investments. In the Chinese corporate landscape, information is not always equally accessible to all stakeholders, leading to discrepancies in their understanding of a company's prospects and investment opportunities.

This imbalance in information availability can result in several scenarios:

- **Managerial Opportunism:** Managers may take advantage of their superior access to company information, making investment decisions that primarily benefit their personal interests. In such cases, they might opt for projects that enhance their status or income, even if those projects are not aligned with the company's overall strategic goals or do not offer positive net present value. The owner rarely directly participates in the business activities of the enterprise, and the likelihood of obtaining any effective information is not strong. In cases of not knowing the facts, the owner receives informational feedback from the manager, and this information is mostly more "favorable" information for the project that the management expects to invest in, such as economic potential, existing ample room for development, etc.
- **Misleading Shareholders:** Management, armed with privileged information, can manipulate or selectively disclose data to shareholders to persuade them to approve investments that may not be in the best interest of the company. This manipulation can result in excessive investments driven by shareholder approval based on incomplete or biased information.
- **Herding Behavior:** In situations where information is scarce, or there is a lack of transparency in the investment process, investors may follow the crowd and make investment decisions based on the actions of others. This herd mentality can lead to overinvestment as multiple parties simultaneously invest in projects, causing resources to be inefficiently allocated.

Information asymmetry exacerbates the agency problems between various stakeholders, leading to suboptimal investment decisions and potentially resulting in excessive investments. The scenarios mentioned indicate that the current development of China's capital market is inadequately justified, and the corresponding mechanisms require further refinement.

2.3. Non-Standardized Corporate Governance Structure

Another significant driver of excessive investments is the lack of standardized corporate governance structures. Corporate governance practices vary widely among companies, and this lack of uniformity can contribute to poor decision-making in terms of investments.

At the core of corporate governance is the establishment of an effective management mechanism, allowing adaptation to the dynamic environment in which the enterprise operates, conducting scientific and efficient management of the enterprise, facilitating the pursuit of the goal of maximizing the enterprise's value, and safeguarding the legal rights and interests of stakeholders. Corporate governance permeates all business activities of enterprises, and investment decisions occupy a central place in corporate financial decisions. Corporate governance plays an extremely important role in the investment decision-making process, as reflected in the oversight of corporate investment behavior. Therefore, the non-standardized structure of corporate governance is one of the significant reasons for excessive investments.

Corporate governance is divided into external governance and internal governance. Given the unique characteristics of the equity structure of Chinese listed companies, characterized by a high degree of capital concentration, the primary purpose of corporate governance is to address the interests of shareholders and management. External governance primarily involves the implementation of corporate governance through market mechanisms, external competitive market systems, legal mechanisms, and the protection of the legal rights and interests of stakeholders. Internal governance pertains to the establishment of control mechanisms, checks and balances between owners (mainly shareholders) and management through institutional mechanisms, the reasonable distribution of rights and responsibilities between owners and management, a mutual system of checks and balances between shareholders, creditors, and managers, as well as the prevention and limitation of excessive investments by companies.

When a company is controlled by a major shareholder, it often prefers to make decisions that benefit itself, disregarding the interests of all shareholders. In such cases, the efficiency of the corporate governance mechanism within the company is also significantly compromised.

In companies with weak corporate governance structures or non-standardized practices, there may be a lack of checks and balances to oversee managerial actions. Without appropriate mechanisms to monitor and control management, the decision-making process can be skewed towards managerial interests, leading to investments that favor personal gain or career advancement rather than long-term value creation.

Furthermore, companies without clear governance guidelines may struggle to establish effective control over investment decisions. This can lead to excessive investments, especially if management is not held accountable for their investment choices or if there is no transparent system in place to evaluate the performance of investment projects.

2.4. Managerial Characteristics and Cognitive Biases

Personal characteristics and cognitive biases of managers also play a role in stimulating excessive investments. Theories such as principal-agent relationships and information asymmetry imply the presence of a prerequisite, assuming that enterprise management is a rational economic agent, and that management exercises its right to make appropriate decisions. However, in practice, managers are often not entirely rational individuals and are influenced by their subjective psychological factors, primarily manifested in the overconfidence of managers, herd mentality, and so on.

Managers may exhibit excessive confidence in their abilities, believing they have a higher chance of success, while ignoring psychological bias stemming from previous failures. This leads to the adoption of optimistic but unfounded investment decisions. This excessive managerial self-assuredness can lead to a propensity for risk, an overestimation of project benefits, and a readiness to pursue projects that offer uncertain and high rewards. Under such an approach, it is challenging to assess the true benefits of a project, and the choice becomes unscientific and irrational.

Additionally, managers may succumb to behavioral biases, such as the "sunk cost fallacy", where they continue to invest in unsuccessful projects simply because they have already allocated resources to them. This can perpetuate investments that no longer make financial sense.

Thus, enterprise management does not effectively align with the actual business situation and the competitive strength of the enterprise itself. It does not consider whether the investment project aligns with market analysis and reasonable planning but blindly follows and imitates, leading to irrational behavior and excessive investments by enterprises.

CONCLUSIONS

The driving forces of excessive investment comprise the following four factors: the deviation of managers from owners' goals, information asymmetry, non-standardized corporate governance structure, managerial characteristics, and cognitive biases. By studying the factors of excessive investments, we further deepen our understanding of excessive investments, which, in turn, necessitates the development and implementation of measures in economic and financial relationships.

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ДОСЛІДЖЕННЯ НАДМІРНИХ ІНВЕСТИЦІЙ: КОНЦЕПЦІЇ ТА МОТИВИ

Резюме. *Інвестиції в економіку сприяють зростанню продуктивності. Однак надмірне завзяття серед інвесторів може призвести до надмірних інвестицій. У статті розглянуто концепції та причини надмірних* *інвестицій. Мотивація надмірного інвестування охоплює комплекс чинників: відхилення менеджерів від цілей власників, інформаційна асиметрія, нестандартизовані структури корпоративного управління, а також управлінські характеристики та когнітивні упередження. Розв'язання цих проблем має вирішальне значення для пом'якшення наслідків надмірних інвестицій і забезпечення більш ефективного розподілу ресурсів у компаніях.*

Ключові слова: *надмірні інвестиції, мотивація до надмірних інвестицій, структура корпоративного управління.*

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