Goodwill Supervision and Equity Investment Behaviors: Evidence from China

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Acknowledgments

Xingtong Fang acknowledges funding supported by the Chenguang Program of Shanghai Education Development Foundation and Shanghai Municipal Education Commission (22CGA76). Yun Xu acknowledges financial support from the Research Plan Project for Anhui Higher Education Institutions (Grant No. 2024AH052079), General Research Projects of Anhui University of Finance and Economics (Grant No. ACKYC23047). Jianfang Ye acknowledges financial support of the NSFC (NO.72342009, NO.72172085, NO.72325010)

Conflicts of Interest

To the best of our knowledge, the named authors have no conflict of interest, financial or otherwise.

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Abstract: This paper investigates the impact of stringent goodwill supervision on the equity investment behavior of listed companies. Using data from Chinese A-share listed firms between 2014 and 2020, we find that following goodwill-related regulatory, high-goodwill firms will increase investments in associates and joint ventures, particularly in competitive industries. Further analysis indicates that firms alter real investment behaviors rather than reallocation on financial statements. The goodwill-related regulatory policies significantly reduce new goodwill recognition, and goodwill impairment attracts significantly greater attention compared to impairments of equity-method investments. The enhanced scrutiny of goodwill impairments generated a spillover effect, leading firms to recognize more impairments for equity-method investments. This paper highlights the real effects of regulatory policies on corporate behaviors, reveal interdependencies across equity investments, and provide support for ongoing proposals to incorporate impairment testing into the equity method.

Keywords: Goodwill; Equity-Method Investments; Regulatory Enforcement; Impairment Recognition; Investment Behaviors

I. INTRODUCTION

With the growing scale of global mergers and acquisitions (M&As), goodwill has emerged as one of the most rapidly growing and highly debated assets on a firm's balance sheet. Goodwill in M&As reflects the expectation of the acquired party's future capacity to generate excess economic returns. However, it is essentially an unidentifiable intangible asset that lacks a reliable and objective valuation basis and cannot be independently monetized or traded in the market. Under the current accounting framework, the impairment testing of goodwill depends on the accurate prediction of future cash flows and the appropriate setting of key parameters, such as the discount rate. Consequently, the impairment process involves significant