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Corporate ownership, corporate governance reform and timeliness of earnings: Malaysian evidence

Mable Lim *, Janice How, Peter Verhoeven

School of Economics and Finance, Queensland University of Technology, Queensland, Australia

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ABSTRACT

This paper provides the first evidence showing that ownership concentration and the identity of the largest shareholder matter to the timeliness of corporate earnings, measured by a stock price-based timeliness metric and the reporting lag. Using panel data of 1276 Malaysian firms from 1996 to 2009, we find a non-linear relationship between concentrated ownership, measured by the largest shareholding in a firm, and the reporting lag but not the timeliness of price discovery. Although firms with government as the largest shareholder and political connections have a significantly shorter reporting lag, only the former are timelier in price discovery. Firms with family and foreigners as the largest shareholder however are less timely in price discovery. While the reporting lag is shorter in the period after the integration of the Malaysian Code of Corporate Governance (MCCG) into Bursa listing rules, its impact on the timeliness of price discovery is mostly immaterial.

1. Introduction

Research on the timeliness of corporate earnings can be traced back to the 1968 seminal paper by Ball and Brown, where they describe accounting income numbers in terms of "relevance" and "timeliness". Timely disclosure of financial information can mitigate information asymmetry (Lang and Lundholm, 1999); prevent the opportunities for insider trading and misappropriation of corporate assets by managers (Leventis and Weetman, 2004); reduce the abuse by managers with privileged access to internal information (Scott, 1997); and lower the cost of capital (Euromoney Institutional Investor PLC, 2001). Timely disclosure can thus reduce the magnitude of periodic earnings surprises, which in turn, increases management credibility and reduces stock price volatility. It is therefore not surprising that regulatory agencies and listing authorities around the world,[1] including Malaysia, have established mandatory requirements regarding the timeliness of corporate disclosure of financial information.

In this study, we examine how corporate ownership relates to the timeliness of earnings. Timeliness is measured by both the reporting lag and the speed of price discovery; the latter is defined as the speed at which value-relevant information is

* Corresponding author.
E-mail address: s30.lim@qut.edu.au (M. Lim).

[1] For example, the European Commission recommends speedy dissemination of information to the market and prohibits private briefings and other forms of selective disclosure so that information can be made available to all investors at the same time. The US Securities Exchange Commission (SEC) enforces a tiered system to annual reporting where small firms (with market capitalization less than USD75 million) are required to lodge their annual reports within 90 days from the fiscal year-end, large firms (with market capitalization greater than USD700 million) within 60 days, and all other firms within 75 days. The reporting deadline is no later than 90 days from the end of the financial year for firms listed on the Toronto Stock Exchange. Timely disclosure also forms the basis of the Australian Stock Exchange, with a world-class technological platform (Company Announcement Platform, CAP) that enables listed companies to make simultaneous and rapid dissemination of disclosure. Even China has passed its first national Securities Law in 1998 to protect the interest of investors by requiring listed companies to disclose information that is likely to influence the stock price.

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reflected in the stock price (Beekes and Brown, 2006). Specifically, we ask how the timeliness of earnings is shaped by ownership concentration and the identity of the largest shareholder. We conduct our tests in Malaysia where highly concentrated ownership and control through pyramiding and crossholdings is ubiquitous – a salient feature of corporate ownership structure in most East Asian countries (Lim, 1981; Claessens et al., 2000; Faccio et al., 2001; Haniffa and Hudaib, 2006).

In Malaysia, publicly listed firms must make accurate, timely disclosure of material information to the investing public under the Companies Act (1965) and the guidelines issued by the Security Commission and Bursa Malaysia. The most significant change in the timeliness of corporate reporting was brought about by the implementation of the Malaysian Code of Corporate Governance (MCCG) in 2001, which became an integral part of the revamped listing requirements of Bursa in that year.[2] One of the objectives of MCCG is to identify the optimal framework for principles and best practices in corporate governance, including providing investors equal access to value relevant corporate information in a timely manner. The implementation and integration of MCCG into the Bursa listing requirements in 2001 provide a natural experiment to test whether the associated improvement in corporate financial disclosure affects the timeliness of earnings. As the implementation of MCCG is exogenous, our tests are not plagued by the perennial endogeneity problem in corporate governance studies. We also capitalize on the unique Malaysian institutional environment where the existence of political connections remains pronounced (Gomez and Jomo, 1999; Johnson and Mitton, 2003) by testing whether political connection matters to the timeliness of earnings.

Using fixed-effects panel regressions for a sample of 599 firms listed on Bursa Malaysia from 1996 to 2009, we find evidence of a non-linear relationship between concentrated ownership, measured by the largest shareholding in a firm, and the reporting lag but not the timeliness of price discovery. We further examine whether these relationships are driven by the identity of the largest shareholder. Our data source permits the following five groups of largest shareholders to be identified: individuals/families; foreigners; financial institutions; state/government; and others, consisting of mutual funds/nominees/trusts/trustees, industrial companies, and foundations. Results show firms with government as the largest shareholder have a substantially shorter reporting lag and timelier price discovery, contrary to the commonly held view that government-owned firms adopt a more opaque information environment in order to cover up their inefficiency (Shleifer and Vishny, 1997) and perverse actions of favoring certain parties and expropriating rents from minority shareholders (Johnson and Mitton, 2003). Cheng and Courtenay (2006) also find government-owned firms in Singapore are associated with greater transparency, in line with the government's support for better disclosure policies.

Although the identity of other largest shareholder groups does not seem to matter to the reporting lag, we find they are significant in explaining the timeliness of price discovery. As expected, family firms are significantly less timely in price discovery, consistent with these firms preferring a more opaque environment possibly to conceal their ill-gained benefits. So are foreign-owned firms, although this result is contrary to our expectation. We also find the presence of other substantial shareholders in the firm exacerbates the adverse effect on corporate transparency by the largest shareholder. Therefore, the presence of other substantial shareholders does not alleviate agency problems within the firm.

As expected, the reporting lag is shorter in the post-MCCG period, suggesting an improvement in corporate financial disclosure and reporting. However the impact of the implementation of MCCG on the timeliness of price discovery is mostly immaterial. Partitioning our sample into the pre- and post-MCCG periods, we report much stronger results in the pre-MCCG period due primarily to the greater variation in financial reporting during this relatively less regulated regime. Finally, we find firms with political connection take a significantly shorter time (about 5 days shorter) to release their financial reports but have a less timely price discovery than non-connected firms.

Price discovery is the dynamic process by which new information is incorporated into market prices. Consequently, knowledge about the price discovery process and the speed at which this process occurs are relevant to market design, the nature of information channels/flow, and informed trading. Our study furthers our understanding of the price discovery process and contributes to the literature[3] by providing the first evidence that corporate ownership and identity of the largest shareholder are important determinants of the timeliness of price discovery. Our finding that the identity of the largest owners matters more to the timeliness of earnings than their fractional shareholding has important implications for many countries in the neighboring region where concentrated ownership and strong government intervention are salient features of the capital markets.

The remainder of our paper is organized as follows. Section 2 discusses our predictions, followed by data and research method in Section 3. Section 4 presents the empirical results, and Section 5 summarizes and concludes.

[2] Bursa Malaysia notes that "Timely disclosure of material information is critical for building and maintaining corporate credibility and investor confidence" (http://www.bursamalaysia.com/misc/system/assets/2349/rules_lr_guides_CDBP-final2012.pdf). Paragraph 9.22 of the revamped listing rules mandates all listed firms to submit their interim quarterly reports to Bursa no later than two months after the end of each quarter of the financial year, and paragraph 9.23 requires all listed firms to announce to Bursa its annual audited financial statement together with the auditors' and directors' reports within four months after the fiscal year end, followed by the submission of its annual audited financial statement together with the auditors' and directors' reports to Bursa and shareholders no later than six months after the fiscal year end (Bursa Malaysia Securities Berhad, 2013).

[3] Refer to Brown et al. (2011) for a review of past studies on the timeliness of price discovery of corporate earnings.