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Types of Institutional Investors and Financial Reporting Timeliness: Empirical Study in Malaysia

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Abstract

This study investigates the association between types of institutional investors and audit report lag in Malaysian public listed firms. Our sample consists of 434 companies for the financial year 2009. We find a negative relationship between the long-term institutional investors and audit delay. However, we do not find any significant association between the short-term institutional investors and audit delay. Our study reiterates prior findings that long-term dedicated institutions are more involved in corporate governance and shareholder activism and serve a better monitoring and disciplining role than their counterparts, the transient institutions.

Keywords: Audit lag; Institutional ownership; Dedicated; Transient; Malaysia

1. INTRODUCTION

Institutional investors are professional investors who act on behalf of beneficiaries, such as individual savers or pension fund members. They are thought to be sophisticated investors and given their substantial stakes, have the power, resources, and ability to monitor, as well as stronger incentives to discipline and influence managers behaviour (Shleifer & Vishny, 1986; Coffee, 1991; Hartzell & Starks, 2003). As institutional ownership increases, the exit decision becomes more costly, thus encouraging them to be actively involved in the monitoring process.

Several studies have recognised the heterogeneity of institutional investors based on their investment horizons. Long-term dedicated investors are characterised by low portfolio turnover, investing mainly for longer-term dividend income or longer-term capital appreciation. On the other hand, the transient investors are characterised by high degrees of portfolio turnover and diversification, reflecting their short-term focus with little or no interest in long-term capital appreciation or dividends (Porter, 1992; Bushee 1998; Koh, 2007).

Although, a few studies have examined the association between types of institutional investors (transient versus dedicated) and the accounting outcomes such as financial reporting conservatism and earnings management (Lin & Manowan, 2012; Bamahros & Wan-Hussin, 2015a; Lin, 2016), we are not aware of prior studies that examine empirically whether institutional holdings matter in promoting timely financial reporting. The important role of institutional investors in the financial reporting process is recognised by the capital market regulators in Malaysia with the launch of The Malaysian Code for Institutional investors in 2014, to make institutional investors more accountable:

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> *"The formulation of a new industry-driven code can strengthen the accountability of institutional investors to their members and investors. The new code will require institutional investors to explain how corporate governance has been adopted as investment criteria and the measures they have taken to influence, guide, and monitor investee companies. It is also important for institutional investors to include governance analysis in their investment appraisal to help identify better governed companies."*

We expect long-term dedicated institutional investors are more likely to demand timely dissemination of financial information than transient institutional investors, in tandem with their better shareholder activism engagement. Consistent with our expectation, we provide some evidence that dedicated institutional investors enhance financial reporting timeliness, whereas transient institutional investors have no such observable impact. We also echo Abdul Wahab, How and Verhoeven (2007) that institutional investors in Malaysia are not homogeneous in the way they influence corporate governance in investee companies.

The rest of this paper is organised as follows. The next section describes the literature review and development of hypotheses, followed by research method and discussion on the results. In the last sections, we explain the findings and highlight the policy implications and avenues for future research.

2. LITERATURE REVIEW

According to Koh (2003), institutional investors include "*insurance companies (life and non-life), superannuation and pension funds, investment trusts (including unit trusts), financial institutions (including banks and bank nominee companies, finance companies, building societies, and credit cooperatives), investment companies, and other nominee companies associated with the above categories of institutions*." Institutional investors have a unique position to exercise influence over firms in which they invest. Therefore, institutional investors may hold the firms accountable for good governance. This may be done through demands for meetings with senior management of firms, discussion on strategies for achieving firms goals and objectives, and to lead the voice of shareholders in demanding for corrective action when there exist any wrongdoings by the management (Securities Commission Malaysia, 2011). Therefore, the existence of institutions in corporate ownership is for the monitoring purposes, as the institutions will have good access to information and resources to build a necessary monitoring capabilities. The Malaysia Code for Institutional Investors 2014 under principle 2 reiterates that Institutional investors should monitor their investee companies, and the monitoring process should be conducted in an active manner, to include the monitoring of the quality of corporate reporting.

Prior research classifies institutional investors into two groups; dedicated institutions are described as firms with large stakes which have their positions unchanged for a considerable length of time and have a low portfolio turnover, and transient institutions which buy and sell their investments more frequently and exhibit a high portfolio turnover. According to Dong and Ozkan (2008), prior research highlights the choices that institutional investors face between exerting monitoring effort for shared gain versus simply trading for private gain. They further argue that whether institutional investors undertake monitoring is determined by the trade-off between the benefits of monitoring and its costs to institutional investors. Monitoring costs arise from activities in gathering firm-specific information and building a relationship with the management. They posit that long-term institutions with significant ownership in firms are more likely to exert monitoring and influencing efforts in firms rather than trading. Consistent with their expectation, they find that long-term dedicated institutions are more involved in corporate governance and serve a better monitoring and disciplining role than short-term institutions. In the same vein, Lin (2016), Lin and Manowan (2012) and Bamahros and Wan-Hussin (2015a) find that transient (dedicated) institutional investor have lower (higher) accounting conservatism and higher (lower) accruals-based earnings management.

Based on the above arguments and prior empirical evidence where dedicated institutions are expected to be more involved in the monitoring of management than transient institutions, we expect the dedicated institutions are more likely to demand faster release of audited financial reports than their counterparts. Thus, the following hypotheses are formulated:

- H1: There is a negative relationship between audit report lag and long-term (dedicated) institutional ownership.
- H2: There is no relationship between audit report lag and short-term (transient) institutional ownership.

3. RESEARCH DESIGN

3.1 Sample selection

Our tests on the association between types of institutional investors and audit report lag are based on the year 2009. We use the year 2009 to capitalise on the mandatory disclosure of internal audit function in Malaysia (Wan-Hussin & Bamahros, 2013). The five main institutional investors in Malaysia are the Government-linked Investment Companies (GLICs) namely EPF, PNB, LTH, LTAT, and SOCSO[1]. The EPF, the largest fund, held around RM356 billion representing more than 60% of the market capitalisation of the Kuala Lumpur Composite Index (KLCI) component stocks. The PNB operated several unit trust funds and controlled some 60% of the local unit trust market. As of December 2008, the LTAT's assets were reported to be RM7.2 billion, and it had 116,000 members. In 2009, LTH managed some RM21.4 billion in funds, representing investments in equity interests in many Bursa Malaysia-listed companies (Malaysia Business, 2009). Other government-owned institutions that have investments in listed companies are Khazanah, Kumpulan Wang Persaraan (KWAP), Ministry of Finance Incorporated, Felda, Petronas, Amanah Raya, ValueCAP and the various State Economic Development Corporations. In this study, holdings by the above-mentioned government-owned institutions and their investment trusts are classified as long term dedicated ownership. Whereas, other ownerships by financial institutions, insurance companies, and private mutual funds are classified as transient investors.

3.2 Regression model

To examine the effect of types of institutional ownership on audit report lag, we fit ordinary least square (OLS) models as depicted below:

$$AUDLAG = \alpha + \beta_1 LNDEDICATED + \beta_2 LNTRANSIENT + \beta_3 LNIAFINV + \beta_4 IAFSOU + \beta_5 LNFEE + \beta_6 LNNAS + \beta_7 VARIANCE + \beta_8 LNASSET + \beta_9 SEGMENT_P + \beta_{10} SEGMENT_G + \beta_{11} LOSS + \beta_{12} BANKRUPT + \beta_{13} INVREC + \beta_{14} OPINION + \beta_{15} BIG4 + \beta_{16} TENURE + \beta_{17} ACAUDP + \beta_{18} ACINDP + \beta_{19} LNACMEET + \beta_{20} ACSIZE + \beta_{21} RESTATED + \beta_{22} SECTOR + error\ term$$

Our variables of interest are the two types of institutional investors (DEDICATED and TRANSIENT, in log form) and we include control variables which have been used in previous studies (Wan-Hussin & Bamahros, 2013; Bamahros & Wan-Hussin, 2015b). We also include variable RESTATED, which takes the value of 1, if the observation firm restated prior year financial statements (2008) in the current year (2009), following Pizzini et al. (2015).

4. EMPIRICAL RESULTS

Table 1 shows the descriptive statistics for the dependent and test variables. The audit report lag ranges from 33 days to 127 days with one company exceeding the mandatory 4-month reporting deadline. As for institutional ownership, on average dedicated institutional investors hold 8.30% ownership in the sample firms and transient institutions hold 2.26%.

Table 1. Descriptive Statistics

Variable	Mean	Median	Minimum	Maximum	Std. Dev.
AUDLAG	97.81	107.00	33	127	22.57
DEDICATED (%)	8.30	0.00	0	88.51	15.32
TRANSIENT (%)	2.96	0.39	0	69.56	6.66

Table 2 presents the OLS regressions, based on White's (1980) standard error corrected for heteroscedasticity. Due to the high correlation between variables LNASSET and LNFEE, in Panel A (B), all variables are included except for LNASSET (LNFEE). In Panel C (D), both LNASSET and LNFEE are excluded (included). The audit report lag models have a good explanatory power with adjusted R^2 of between 26% and 27%, which is comparable to Ettredge et al. (2006), Abbott et al. (2012) and Pizzini et al. (2015). In this study, the test variable LNDEDICATED is negatively significant, which indicates that companies with higher ownership by long-term institutional investors have shorter audit delays. This result is consistent with our argument that long-term institutional investors are active monitors and demand managers and auditors to provide timely financial information through accelerated audit reports. However, the association between the variable LNTRANSIENT and audit lag is not statistically significant, in support of H2.

[1] EPF is the Employees Provident Fund, PNB is Permodalan Nasional Berhad (National Equity Corporation), LTH is Lembaga Tabung Haji (Pilgrimage Board), LTAT is Lembaga Tabung Angkatan Tentera (Armed Forces Fund Board), and SOCSO is Social Security Organisation (also known as Pertubuhan Keselamatan Sosial or PERKESO).

Table 2. Main Regression Results on Institutional Ownership and Audit Report Lag

Variables	Sign	Panel A			Panel B			Panel C			Panel D		
		Coeff	t-stat	p-value (2-tailed)	Coeff	t-stat	p-value (2-tailed)	Coeff	t-stat	p-value (2-tailed)	Coeff	t-stat	p-value (2-tailed)
LNDEDICATED	-	-0.029	-2.82	0.005	-0.026	-2.48	0.014	-0.030	-2.86	0.004	-0.025	-2.45	0.015
LNTRANSIENT	?	0.002	0.16	0.871	0.002	0.2	0.844	0.002	0.16	0.876	0.002	0.20	0.843
LNIAFINV	-	-0.043	-3.25	0.001	-0.035	-2.45	0.015	-0.047	-4.15	0.000	-0.036	-2.53	0.012
IAFSOU	+	0.014	0.53	0.596	0.014	0.52	0.602	0.015	0.58	0.565	0.014	0.55	0.583
LNFEE	-	-0.010	-0.63	0.529							0.009	0.50	0.618
LNNAS	-	0.004	0.5	0.617	0.005	0.63	0.531	0.004	0.48	0.63	0.005	0.63	0.526
VARIANCE	+	0.115	1.26	0.207	0.113	1.23	0.22	0.113	1.27	0.206	0.112	1.23	0.221
LNASSET	-				-0.024	-1.59	0.112				-0.028	-1.59	0.112
SEGMENT$_P$	-	0.029	3.83	0.000	0.030	3.99	0.000	0.028	3.75	0.000	0.029	3.97	0.000
SEGMENT$_G$	-	0.005	0.89	0.375	0.006	1.04	0.298	0.004	0.73	0.466	0.005	0.84	0.403
LOSS	-	0.011	0.43	0.668	0.009	0.34	0.734	0.013	0.52	0.605	0.010	0.38	0.703
BANKRUPT	-	-0.017	-3.86	0.000	-0.017	-3.84	0.000	-0.016	-3.84	0.000	-0.016	-3.7	0.000
INVREC	-	0.088	1.57	0.116	0.061	1.06	0.288	0.089	1.59	0.112	0.057	0.99	0.323
OPINION	+	0.074	1.72	0.086	0.071	1.62	0.105	0.075	1.74	0.082	0.071	1.61	0.107
BIG4	+	-0.006	-0.22	0.828	-0.002	-0.07	0.948	-0.009	-0.32	0.752	-0.003	-0.11	0.915
TENURE	-	-0.005	-1.13	0.261	-0.004	-0.94	0.348	-0.005	-1.1	0.272	-0.004	-0.88	0.381
ACAUDP	+	0.039	0.73	0.465	0.027	0.52	0.606	0.040	0.74	0.458	0.026	0.49	0.628
ACINDP	+	-0.161	-2.26	0.024	-0.145	-2.02	0.044	-0.163	-2.29	0.022	-0.144	-1.99	0.047
LNACMEET	+	0.128	2.06	0.04	0.127	2.01	0.045	0.125	2.02	0.044	0.125	1.99	0.048
ACSIZE	-	-0.023	-0.82	0.413	-0.017	-0.6	0.548	-0.024	-0.84	0.400	-0.017	-0.58	0.564
RESTATED	+	-0.054	-1.12	0.262	-0.054	-1.14	0.256	-0.055	-1.14	0.256	-0.055	-1.15	0.251
SECTOR	-	-0.132	-2.64	0.009	-0.132	-2.62	0.009	-0.133	-2.69	0.007	-0.134	-2.63	0.009
Constant		4.788	33.53	0.000	4.968	28.64	0.000	4.770	34.41	0.000	4.986	28.53	0.000
R-Squared			0.30			0.30			0.30			0.30	
Adjusted R-squared			0.26			0.27			0.26			0.27	
F Value			8.11			8.18			8.35			7.85	
Sig F			0.00			0.00			0.00			0.00	

5. CONCLUSION

We examine whether types of institutional investors can influence financial reporting timeliness in Malaysian listed firms for the year 2009. We find a negative relationship between long-term dedicated institutional investors and audit delay and the insignificant association between short-term or transient institutional ownership with audit delay. Therefore, the recent introduction of the Malaysian Code for Institutional Investors in 2014 to encourage Malaysian institutional investors to adopt a more long term strategy to share ownership and be more responsible augurs well for the betterment of corporate governance. The classification of institutional investors into dedicated and transient may be arbitrary, and future research is encouraged to use a more competent measure by looking at the holding period, which can be inferred from the investors' portfolio turnover.

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