



UNIVERSITI PUTRA MALAYSIA

***ASSOCIATION BETWEEN DISCLOSURE QUALITY AND STOCK
RETURN WITH THE MODERATING EFFECTS OF CORPORATE
GOVERNANCE PRACTICES AND OWNERSHIP STRUCTURE IN
MALAYSIA***

NAZRATUL AINA BINTI MOHAMAD ANWAR

GSM 2015 6



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By

NAZRATUL AINA BINTI MOHAMAD ANWAR

**Thesis Submitted to the Graduate School of Management,
Universiti Putra Malaysia, in Fulfilment of the
Requirements for the Degree of Doctor of Philosophy**

September 2015

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DEDICATION

TO MY PRECIOUS FAMILY

Mohd Redzuan Hj Shariff

Main Sarah Hj Mat Dom

Mohd Rizaudin Mohd Redzuan and family

TO MY BELOVED PARENT-IN-LAW

Ramini Laiman

Kamarudin Abd. Hamid

TO MY TREASURED HUSBAND AND SONS

Dr Fakarudin Kamarudin

Muhammad Fateh Arish Fakarudin

Muhammad Firas Azhad Fakarudin

...With you, hopes are always there...

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfillment of the requirements for the degree of Doctor of Philosophy

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NAZRATUL AINA BINTI MOHAMAD ANWAR

September 2015

Chairman : Ahmed Razman Abdul Latiff, PhD
Faculty : Graduate School of Management, UPM

This study is motivated by three main study by Beretta and Bozzolan (2008), Bozzolan *et al.*, (2009) and Wang and Hussainey (2013). Nevertheless, this study will extend their studies by specifically look into the quality effect of forward looking disclosure, stock return of the firm and proposing two moderating factors, namely ownership structure and corporate governance practices. Thus, objectives of this study are to investigate whether or not the disclosure, disclosure level, and disclosure quality of forward-looking information will significantly affect stock return of the firm. This study also proposed two moderating factors, namely corporate governance practices and ownership structure of the firm to ascertain whether these moderating factors can either weaken or strengthen the relationship between the disclosure quality of forward-looking information and stock return of the firm.

The sample in this study consists of 300 Malaysian public listed firms with the highest market capital in the Malaysian stock market from nine main industries listed on Bursa Malaysia in year 2013. Using modified abnormal return model, earnings-return model, and price model as valuation models to investigate the relationship between disclosure, disclosure level, and disclosure quality of forward-looking information on firm's stock return, this study hypothesized that all of the disclosure effects will positive and significantly affects stock return of the firm. The proposed moderating factors are hypothesized to significantly moderate the relationship between disclosure quality of forward looking information and firm's stock return.

Based on cross sectional regression analysis, findings show that the disclosure and disclosure quality of forward looking information is positive and significantly related with firm's stock return under earnings-return model. Corporate governance practices and ownership structure also play a significant role in moderating the relationship between disclosure quality of forward looking information and firm's stock return.

Both factors have strengthening the relationship based on findings that show the positive and significant relationship between interaction variables with firm's stock return under abnormal return model at week 4 and price model respectively. However, relationship between disclosure level of forward-looking information and firm's stock return is not significantly related in any of the valuation models. The empirical findings suggest that disclosure quality of forward-looking information is significant to improve firm's stock return instead of focusing on the disclosure level of forward-looking information.

From the findings, accounting standard setters and regulatory bodies could improve and make some renewal on corporate disclosure guide by outlining specific criteria of information that can be considered as quality information in preparing forward-looking statement and to promote corporate transparency. In addition, this result can contribute in assisting the family owned firms on how to entice back the attention of investors upon their perception towards information asymmetry issue caused by the agency problems that commonly exist in this type of ownership structure. At the same time, good corporate governance practices can be a better solution to attract investors' attention towards the quality disclosure of forward-looking information to solve the information asymmetry issue and minimize the agency problems.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia
Sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

**HUBUNGKAIT ANTARA KUALITI PENDEDAHAN DAN PULANGAN STOK
DENGAN KESAN PENYEDERHANA OLEH AMALAN URUS TADBIR
KORPORAT DAN STRUKTUR PEMILIKAN DI MALAYSIA**

Oleh

NAZRATUL AINA BINTI MOHAMAD ANWAR

September 2015

Pengerusi : Ahmed Razman Abdul Latiff, PhD
Fakulti : Sekolah Pengajian Siswazah Pengurusan, UPM

Kajian ini termotivasi dari tiga kajian utama oleh Beretta dan Bozzolan (2008), Bozzolan *et al.* (2009) dan Wang and Hussainey (2013). Namun, kajian ini akan melanjutkan kajian-kajian mereka dengan melihat secara spesifik terhadap kesan kualiti pendedahan maklumat terkehadapan, pulangan stok firma dan mencadangkan dua faktor-faktor penyederhana, iaitu struktur pemilikan dan amalan urus tadbir korporat. Oleh yang demikian, objektif-objektif kajian ini adalah untuk menyiasat sama ada kepentingan pendedahan, tahap pendedahan dan kualiti pendedahan maklumat terkehadapan akan mempengaruhi pulangan stok firma. Kajian ini juga mencadangkan dua faktor-faktor penyederhana iaitu amalan urus tadbir korporat dan struktur pemilikan firma untuk melihat sama ada faktor-faktor penyederhana ini akan melemahkan atau menguatkan hubungan antara kualiti pendedahan maklumat terkehadapan dan pulangan stok firma.

Sampel kajian ini terdiri dari 300 buah firma-firma senaraian awam di Malaysia dengan modal pasaran tertinggi di pasaran stok Malaysia dari sembilan industri-industri utama yang tersenarai di Bursa Malaysia pada tahun 2013. Menggunakan model pulangan tidak normal, model pendapatan-pulangan dan model harga yang telah diubah suai sebagai model-model penilaian untuk menyiasat hubungan ini, kajian ini membuat hipotesis bahawa semua kesan-kesan pendedahan akan memberi kesan positif dan penting ke atas pulangan modal firma. Kesan-kesan penyederhana telah di hipotesis untuk menyederhanakan dan penting dalam hubungan antara kualiti pendedahan maklumat terkehadapan dan pulangan stok firma.

Berdasarkan analisis regrasi keratan rentas, penemuan menunjukkan bahawa pendedahan dan kualiti pendedahan maklumat terkehadapan berhubung secara positif dan penting terhadap pulangan stok firma di bawah model pendapatan-pulangan. Amalan urus tadbir korporat dan struktur pemilikan juga memainkan peranan yang

penting dalam menyederhanakan hubungan antara kualiti pendedahan maklumat terkehadapan dan pulangan stok firma. Kedua-dua faktor telah menguatkan hubungan tersebut berdasarkan penemuan yang menunjukkan hubungan positif dan penting antara interaksi pembolehubah-pembolehubah dengan pulangan stok firma, masing-masing di bawah model pulangan tidak normal pada minggu keempat dan model harga. Walau bagaimanapun, hubungan antara tahap pendedahan maklumat terkehadapan dan pulangan stok firma tidak penting dalam mana-mana model penilaian. Penemuan-penemuan empirikal mencadangkan bahawa kualiti pendedahan maklumat terkehadapan adalah penting untuk meningkatkan pulangan stok firma disebalik memberi tumpuan terhadap tahap pendedahan maklumat terkehadapan.

Hasil dari penemuan ini, penatap-penetappiawaian perakaunandan badan-badankawal selia boleh meningkatkan dan membuat pembaharuan terhadap panduan pendedahan korporat dengan menggariskan kriteria tertentu bagi maklumat yang boleh dikira sebagai maklumat berkualiti dalam menyediakan kenyataan terkehadapan dan mempromosikan ketelusan korporat. Tambahan pula, keputusan ini boleh menyumbang dalam membantu firma-firma milikan keluarga tentang bagaimana untuk menarik kembali perhatian pelabur-pelabur berkenaan persepsi mereka terhadap isu asimetri maklumat yang disebabkan oleh masalah-masalah agensi yang biasa wujud dalam jenis struktur pemilikan ini. Dalam masa yang sama, amalan-amalan urus tadbir korporat yang baik boleh menjadi solusi yang lebih baik untuk menarik perhatian pelabur-pelabur terhadap kualiti pendedahan maklumat kehadapan bagi menyelesaikan isu asimetri maklumat dan meminimumkan masalah-masalah agensi.

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I certify that a Thesis Examination Committee has met on **22 September 2015** to conduct the final examination of Nazratul Aina Binti Mohamad Anwar on her thesis entitled "**Association Between Disclosure Quality and Stock Return with the Moderating Effects of Corporate Governance Practices and Ownership Structure in Malaysia**" in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1998. The Committee recommends that the student be awarded the Doctor of Philosophy degree

Members of the Examination Committee are as follows:

Foong Soon Yau, PhD

Professor
Putra Business School
University Putra Malaysia
(Chairman)

Nazli Anum Mohd Ghazali, PhD

Professor
Kuliyah of Economics and Management Sciences
International Islamic University Malaysia
(External Examiner)

Romlah Jaafar, PhD

Associate Professor
Faculty of Economics and Management
University Kebangsaan Malaysia
(Internal Examiner)

Zabihollah Rezae, PhD

Professor
Fogelman College of Business and Economics
University of Memphis
USA
(External Examiner)

PROF. DATUK DR. MAD NASIR SHAMSUDIN

Deputy Vice Chancellor (Academic & International)
Universiti Putra Malaysia

Date:

On behalf of,
Graduate School of Management
Universiti Putra Malaysia

This thesis submitted to the Senate of Universiti Putra Malaysia has been accepted as partial fulfilment of the requirement for the degree of Doctor of Philosophy.

The members of the Supervisory Committee are as follows:

Ahmed Razman Abdul Latiff, PhD

Senior Lecturer
Putra Business School
Universiti Putra Malaysia
(Chairman)

Bany Ariffin Amin Noordin, PhD

Associate Professor / Deputy Dean
Faculty of Economics and Management
Universiti Putra Malaysia
(Member)

Hisham Dato Haji Yahya, PhD

Senior Lecturer
Faculty of Economics and Management
Universiti Putra Malaysia
(Member)

PROF. DATUK DR. MAD NASIR SHAMSUDI

Deputy Vice Chancellor (Academic & International)
Universiti Putra Malaysia

Date:

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Chairman of Supervisory Committee

Signature : _____
Name : Dr. Ahmed Razman Abdul Latiff
Faculty : Putra Business School

Member of Supervisory Committee

Signature : _____
Name : Assoc. Prof. Dr. Bany Ariffin Amin Noordin
Faculty : Faculty of Economics and Management, UPM

Signature : _____
Name : Dr. Hisham Dato Haji Yahya
Faculty : Faculty of Economics and Management, UPM

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LIST OF ABBREVIATIONS

AIMR	Association For Investment Management And Research
ASB	Accounting Standard Board
BMLR	Bursa Malaysia Listing Requirement
KLSE	Kuala Lumpur Stock Exchange
CEO	Chief Executive Officer
ED	Exposure Draft
IASB	International Accounting Standard Board
IFRSs	International Financial Reporting Standards
MASB	Malaysian Accounting Standard Board
MCCG	Malaysian Code Of Corporate Governance
MD&A	Management Discussion And Analysis
MIA	Malaysian Institute Of Accountants
MICPA	Malaysian Institute Of Certified Public Accountants
MIM	Malaysian Institute Of Management
MNCS	Multinational Companies
MSWG	Minority Shareholders Watchdog Group
OFR	Operating And Financial Review
SOP	Statement Of Principles
UK	United Kingdom
US	United States

CHAPTER 1

INTRODUCTION

This chapter contains six sections. Section one describes the background of the study, section two outlines the problem statement, section three explains the objectives of the study, and section four outlines the contribution of this study. These are followed by section five which presents the research framework. Section six concludes the chapter with an explanation on the organization of this study.

1.1 Background of the study

Accounting information is one of the vital data sources for many financial users. It is useful for the purpose of 1) measuring firms' financial positions, 2) comparing past and current firms' performances, and 3) predicting future firms' plans and activities. According to Scott (1997), relevant information is information that is able to affect investors' belief about future returns. Reliable information also affects belief of the investors on what it claims to measure by presenting it truthfully. In general, before investors make any investment decisions, they need dependable relevant information in order to decide on future investment activities. This also implies that value relevance of accounting information is important be it 1) financial or 2) nonfinancial accounting information. In the end, only when both characteristics are fulfilled, can we claim that the reported information has excellent quality. It is the most searchable criteria that investors look at in investment activities to have a better picture of a firm.

In the United Kingdom in 2006, the Accounting Standard Board (ASB) published a new financial reporting statement that recommended rather than insisted on the adoption of a revised voluntary Operating and Financial Review (OFR). This was distantly more comprehensive than the earlier versions, in which, the OFR was mandatory to be disclosed. The ASB emphasizes that OFR statements should be *“addressed to members, setting out their analysis of the business, with a forward-looking orientation in order to assist members to assess the strategies adopted by the entity and the potential for those strategies to succeed”* (ASB, 2005: summary, b). In addition, the OFR should *“focus on matters that are relevant to the interest of members”* (ASB, 2006: principle 6). The ASB considers information relevant *“if it is capable of making a difference in the decisions made by users”* (FASB, 2010: 17). FASB (2010b: 17) states that information would have a predictive value *“if it can be used as an input to processes employed by users to predict future outcomes”*.

In East Asia countries, the quality of corporate reporting has attracted the attention of many especially after Asian financial crisis in 1997, due to a) information asymmetry and b) agency problem between the preparers and users of information (Healy and Palepu, 2001). The extant literature commonly articulates the effect of ownership concentration on reporting disclosure (Jaggi *et al.*, 2009) and firm value (Jensen and Meckling, 1976) in terms of Type 1 or Type 2 agency problems. Type 1 problems are concerned with conflict between managers and shareholders and may be described as 'manager opportunism' or the 'misalignment effect' (Wan-Hussin, 2009). In firms with external dispersed ownership, information asymmetry favors management rather than external shareholders. Management can hold back the information or use the firms' wealth in its own, rather than the shareholders' interest. This problem is reduced in family firms, because the separation between ownership and control is reduced or non-

existent. Major shareholders, who are the family members are able to directly monitor managers (Ali *et al.*, 2007). However, high concentration of ownership in the hands of family members can lead to Type 2 agency problems, or known as 'entrenchment effect'. In such firms, boards of directors tend to be dominated by family members and resulted in less independent directors (Ali *et al.*, 2007). Type 2 agency problem that arises between major and minority shareholders of firms is common in East Asia. This is especially true in Malaysia since the ownership structure of Malaysian firms has been dominated by family or, what is known as, pyramid firms (Fan and Wong, 2002; Bany *et al.*, 2010). Family companies are dominant in Malaysia (Tam and Tan, 2007). For example, 67.2% of Malaysian firms in 1996 were family controlled and 85% of these were managed by owner-managers or managers related to the controlling family (Claessens *et al.*, 1999). Claessens *et al.* (1999) add that 39.3% and 14.9% of firms were characterised by pyramid and cross ownership structures, respectively, and that a quarter of the corporate sector in Malaysia is controlled by the ten largest families. Minority shareholders tend not to engage in decision making (Lopez, 2010), probably because of weak participation mechanisms and a lack of incentives (Zhuang *et al.*, 2000). In contrast with other common law countries, investors' legal rights are not effectively enforced (Zhuang *et al.*, 2000). These features suggest that the greater the number of family members on companies' boards, the higher the family's ability to extract benefits at the expense of minority shareholders (Milleret *et al.*, 2007).

Finding by Fan and Wong (2002) is also supported by Yeo *et al.* (2002) and Francis *et al.* (2005). They conclude that the value relevance of earnings information in East Asian firms is typically low due to the common and significant presence of pyramidal ownership structure in East Asian firms. La Porta *et al.* (1999), Claessens *et al.* (2000), Faccio and Lang (2002), Andres (2008), Jaggi *et al.* (2009) and Bany *et al.* (2010) support the significant presence of pyramid firms in East Asia. They find that more than half of East Asian corporations and economies, measured in terms of total corporate assets, are controlled by pyramid firms. All of the findings show that quality of accounting information has been affected by the low value relevance of the information reported due to the ownership structure of firms that exist in many South East Asian countries, including Malaysia. Their findings also suggest that; despite the 1) closer devotion to international disclosure rules, 2) efforts to enforce stricter reporting rules and 3) improved standards with the adoption of international accounting standards, the quality issue of the information being reported is still being questioned by users.

Jaggi *et al.* (2009) examines whether family control influences the association between independent non-executive directors and earnings quality. Their finding suggests that the effectiveness of monitoring role of independent non-executive directors is reduced in family-controlled firms (where the family members are part of the board of directors). Their finding also implies that the negative effect of the ownership increases if family is involved in boards. Previous study by La Porta *et al.* (1999) find that, across countries, the most important factor that contributes to the development of the a) financial market and b) firm value is corporate governance. Prior to the reforms of corporate governance in most of East Asian countries, including Malaysia (from 2001 to 2002), the ultimate shareholder is able to expropriate the minority shareholder easily due to the weak legal system in the countries. Expropriation can come in many forms, including, manipulation of earnings information. When manipulation of earnings information occurs, the earnings information will not meet the relevant and reliability criteria, which, will lead to a lesser quality of information. In such situation, investors

will not be able to a) determine the actual value of the firm and b) measure the actual performance of the firm. This situation has forced public listed companies and standard setters to increase their corporate reporting quality from time to time to attract and bring back the attention of the information users (Beretta and Bozzolan, 2005). The urgency to reduce information asymmetry and agency cost, has provided the impetus for a sound and improved reporting practice.

The value destruction issue on reporting quality has also increased the demand for better quality disclosures from public listed companies due to insolvencies of large companies listed on most important stock exchanges. In Malaysia, several events have been taken by professional accounting bodies to encourage a better quality of reporting. For instance, the Malaysian Institute of Management (MIM), Malaysian Institute of Certified Public Accountants (MICPA) and Malaysian Institute of Accountants (MIA) organize the National Annual Corporate Report Awards (NACRA) to encourage high quality and transparent financial reporting in Malaysia. Their aims are to encourage better and more effective communication by corporations through the timely, informative, accurate and reader-friendly publication of annual reports. It is also their intention to distinguish and support reliability in the presentation of financial and business information.

In line with the quality issue discussed on financial reporting and information disclosed by the firms, there are also concerns that business reporting models need to report more than the traditional financial reporting model (which basically highlights more on backward-looking, quantified, financial information, in order to satisfy market information desires), and yet present information with high corporate transparency and accountability (Beattie *et al.*, 2004). Good financial reporting system should not be restricted to reporting only past financial information. Moreover, information disclosed in financial statements is based on certain accounting standards, and this usually fulfils only the minimum and basic requirements. Evidence on value destruction of the financial reporting model is verified by the increasing demand for nonfinancial information requested by institutional investors and financial analysts in their effort to identify the drivers of long-term value formation (Robb *et al.*, 2001). This is where nonfinancial information or narrative information fills the gap that cannot be captured by financial information. This is achieved through the amplification of quantitative financial measures and recognition of value-generation drivers which are not clearly represented in financial statements (Lev and Zarowin, 1999; Cole and Jones, 2004). Narrative information contributes a lot on the documentation of value-generation drivers that is not made clear in financial statements (Cole and Jones, 2004). Firms need to offer supplementary information, which is, prepared on voluntary basis to investors. Usually, financial statements, management discussion and analysis, and other regulatory filings are some of the information that is usually disclosed by firms in their regulated or publish annual report (Healy and Palepu, 2001). Users' preference of voluntary information items needs to be the highlighted since these groups are wide-ranging and each has its own set of information needs. In Malaysia, corporations are encouraged to report afar the mandatory disclosure in corporate reporting. At the same time, external users' crave for voluntary information in the corporate annual reports.

In the current vibrant economic atmosphere, it is also inadequate to only rely on historical information. Corporate managers can help the investors and other financial information users in their decision making by providing more reliable forward looking information (Aljifri and Hussainey, 2007). The accuracy of the analyst forecast can also

be achieved by the firms that provide forward-looking information (Bozzolan *et al.*, 2009). Other prior literature also supports that provision of non-financial information or narrative information. For example, the information on future outlooks or forward-looking information of firms needs to be considered since this information is relevant in investors' decisions making (Wang and Hussainey, 2013; Uyar and Kilic, 2012; Deegan and Rankin, 1997).

Forward-looking information in this context involves projections (not predictions) that are based on present information. These projections do not represent assurance but rather rely, in part, on certain postulations. Disclosing forward-looking information can reduce information asymmetry between firms and stakeholders (Uyar and Kilic, 2012). Allowing stakeholders to make healthier decisions about firms can be made as this information can close the information gap between the two parties. Stakeholders would like to know manager's projections for the future actions and activities besides providing mandatory information that is more backward-looking which is mainly provided by financial statements and narrative sections of annual reports. Investors need such information in making investment decisions for a given firm. Firms which promise high future performance and return will attract investors' attention to invest. Presenting forward looking information through different communication channels such as annual reports, corporate web sites, and press releases, can be one way of letting investors to discover such prospects.

Aljifri and Hussainey (2007) point out that there is lack of studies that explore the disclosure of forward-looking information in developing countries. This holds true for Malaysia as forward looking information has been strongly encouraged by Bursa Malaysia in Corporate Disclosure Guide 2011 to be disclosed in annual report under management discussion and analysis section. However, the guideline to disclose such information can be enhanced by incorporating additional criteria and topics that should be covered to improve the quality of the information. Even though Chapter 5 of Corporate Disclosure Guide 2011 discusses about quality of disclosure, but the chapter focuses or highlights are more on financial disclosure than non-disclosure information such as cash flow statement and financial indicators. In addition, this type of information disclosure has not been studied as much as other areas of information disclosure, such as, corporate social responsibility, environmental, and intellectual capital. Prior literature also tend to focus more on the association between level or extend of forward looking information as the most appropriate measure for good reporting practices or disclosure with other aspects, for instance, corporate governance practices (Wang, M. and Hussainey, K., 2013; Uyar, A. and Kilic, M., 2012; Al-Najjar, B. and Abed, S., 2014). Study by Uyar and Kilic (2012) determine the extent of forward-looking information disclosure in publicly traded Turkish corporations and their results also indicate that firm size and auditor size are the significant variables in explaining forward-looking information disclosure.

Similar study by Al-Najjar and Abed (2014) aims to ascertain the importance of corporate governance mechanisms and investigates the relationship between the quality of disclosure of forward-looking information in the narrative sections of annual reports and the governance mechanisms. However, disclosure level of forward-looking information is a measurement used to proxy the quality of disclosure. Wang and Hussainey (2013) also examines the impact of corporate governance on the 1) level of voluntary disclosures of forward-looking statements in the narrative sections of annual reports and 2) whether the forward-looking statements that are motivated by

governance are useful about future earnings. Their study find that corporate governance influences companies' decisions to voluntarily disclose forward looking statements among UK FTSE All-Share companies from 1996 until 2007.

This study is motivated by three main study by Beretta and Bozzolan (2008), Bozzolan *et al.*, (2009) and Wang and Hussainey (2013). In studying the simple index of disclosure quantity, Beretta and Bozzolan (2008) show that the proposed measure of disclosure quality has a) a stronger positive statistical connection with precision and b) a stronger negative connection with the distribution of financial analysts' earnings forecasts. They also conclude that quantity is not a good proxy for quality in assessing narrative disclosure. In addition, Bozzolan *et al.* (2009) claim that share price, followed by market capitalisation will rise if better assessment and belief of the firm's future wealth and performance is provided by the firm. Recently, Wang and Hussainey (2013) investigate whether voluntary forward looking disclosures (driven by governance) which improve the stock market's capability to foresee future earnings can decrease information asymmetry. Other empirical literature show that voluntary forward-looking statements improve investors' capability to look forward to future earnings (Hussainey, K., Schleicher, T. and Walker, M., 2003; Schleicher, T., Hussainey, K. and Walker, M., 2007; Hussainey, K. and Walker, M., 2009).

However, this study differs from Bozzolan (2008), Bozzolan *et al.*, (2009) and Wang and Hussainey (2013) by associating four aspects, a) quality effect of voluntary forward looking information, b) stock return, c) corporate governance practices and d) ownership structure of the firm. This study aims to investigate whether disclosing forward looking information can help to increase stock return of the firm. Then, this study aims to look at the relationship between stock return and the quality effect of the forward looking information to investigate the different quality dimension of forward looking information (as level of disclosure is not a good proxy of quality measure). Furthermore, the main function of information itself is to influence investors' belief and perception towards the future benefits of their investment in a firm. This study intends to investigate if the investors think that the information is reliable and relevant to predict their future return on current investment. It will examine whether quality information will affect the investors' belief and act through their response on the stock price. This study also proposes two moderating factors that may influence the firms to disclose quality of forward looking information that may also have significant effect on the stock return of the firm. The moderating factors proposed in this study are a) the ownership structure of the firm and b) corporate governance practices of the firm. In the context of emerging economies, previous literature on corporate governance and financial reporting clearly highlight the need to consider the moderating role of corporate governance mechanisms (Ahrens *et al.*, 2011).

In Malaysia, the Minister of Finance announced the establishment of a high level finance committee to look into establishing a framework for corporate governance and setting best practices for the industry in 1998 after economic crisis in 1997. The Malaysian Government believed that enhancing corporate governance would be another good way to attract and capture investors' confidence in the Malaysian market. In 2000 the Malaysian Code on Corporate Governance (MCCG) was issued to the public, where Part 1 of the Code sets out broad principles of good corporate governance in Malaysia while Part 2 sets out guidelines intended to assist firms in designing their approach to corporate governance. During that time, the compliance with the code was not mandatory. However, the revised Bursa Malaysia (then Kuala Lumpur Stock

Exchange (KLSE) Listing Requirements now required disclosure of the extent of compliance with the Code in the annual reports. In January 2001, the revised Listing Requirements is announced, where listed companies with financial years ending after 30 June 2001 are required to disclose Statement of Corporate Governance stating how they applied the principles in their annual reports. Some of the principles on this Listing Requirements are to ensure that the listed firms will be of a certain quality and have a record of operations of adequate duration, the investors and the public will be kept fully informed by the listed firms of all facts or information that might affect their interests. In particular, full, accurate and timely disclosure will be made of any information which may reasonably be expected to have a material effect on the price, value or market activity in the securities of listed firms and directors, officers or management of the listed firms will maintain the highest standards of integrity, accountability, corporate governance and responsibility.

Bursa Malaysia in their published Practical Guide to Listing on Bursa Malaysia also supports the disclosure of Statement of Corporate Governance since strong corporate governance is a reflection of commitment towards sustainable growth. They believed that regulators of the Malaysian capital market are committed to ensuring high standards of corporate governance. In addition, good corporate governance is one of the attributes for listing on the main market. According to Securities Commission (SC), they believe that the attributes listed already make consideration whether the firm has met the standards in terms of quality, size, operations, as well as management experience and expertise. The SC will also look at the integrity of the firm's directors and key personnel and ascertain if the listing proposals are against public interest. Hence, it is vital that the listed company has a robust corporate governance policy in place and adhered to company-wide. This also suggest the ability of the corporate governance practices to strengthen the relationship between disclosure quality of forward looking statement and firm's stock price and thus, play the moderating role in the relationship.

Besides corporate governance practices, another important characteristic of the economies in Asia, specifically Malaysia, is the existence of concentrated ownership and predominance of family firms. Family firms are dominant in Malaysia (Tam and Tan, 2007). For example, 67.2% of Malaysian firms in 1996 were family controlled and 85% of these were managed by owner-managers or managers related to the controlling family (Claessens et al., 1999). Claessens et al. (1999) add that 39.3% and 14.9% of firms were characterized by pyramid and cross ownership structures, respectively, and that a quarter of the corporate sector in Malaysia is controlled by the ten largest families. Theoretically, Jensen and Meckling (1976) argued that, as ownership separates from management, firm value may decrease due to growing divergence in interests between the two. on the other hand, as ownership is concentrated in a single shareholder, there will be closer alignment of interests and this could affect firm value. Lins (2003) find that ownership concentration is positively related to firm performance in Thailand and Asia especially pronounced in countries where investor protection is low, because ownership concentration is found to mitigate conflicts between owners and managers. However, concentration of ownership and control could lead to managerial entrenchment and domination of the controlling shareholders' interests. A U-shape relationship between ownership concentration and firm value is found by Nagar *et al.* (2000) where firms at both extreme ends of ownership concentration level outperform firms where shareholders hold a medium level of shareholdings because "*expropriation is low if the controlling shareholder owns a large ownership stakes,*

thus internalising most of the expropriation costs, or if no shareholder is large enough to unilaterally expropriate in the first place” (Nagar et al., 2000, p. 3)..

The rapid growth of Malaysia’s economy has not diluted the concentrated ownership structure in Malaysian firms. According to Claessens et al. (2000a), two-thirds of 2980 firms in East Asia, and about 40.4 per cent of the 238 among the sample firms in Malaysia, are closely held by a single large shareholder (Claessens *et al.*, 2000a) and individual/family shareholders are predominant as large shareholders in Malaysia (Zhuang *et al.*, 2001a). Many of the closely held firms by family shareholders are founded on the financial and human capital of the founding family (McConaughy, 2000). As a result, these shareholders sustain intimate relationships with their businesses, even after these companies are publicly listed. Redding (1996) has shown that they often connect their families’ wealth to their firms’ performance. With their huge initial endowment, they have found it important to concentrate shareholding to preserve the voice domination in the policies and decisions of the firm. In addition, family shareholders want to continue the control of their firms so that they could pass the businesses down to coming generations (Anderson and Reeb, 2002; Schulze *et al.*, 2001). Consequently, family shareholders often have longer-term prospects with their investments. Family members may also wish to protect family reputation for the benefit of future generations, which may reduce incentives for earnings management (Hasnan et al., 2013 and Lim et al., 2014). However, if the family lacks board representation, family firms (in Asian countries in particular) will face agency-problems similar to other companies with large block holders (Andres, 2008). Based on the above discussion, this study expect the ownership structure, specifically family owned firms is significant in this investigation of disclosure quality. In addition, Eng, L. and Mak, Y., (2003) also find that quality of financial reporting process is affected by ownership structure and the structure determines the level of monitoring, and thereby, the level of disclosure.

1.2 Problem statement

Over the decades, the competency issue of corporate disclosure practices has received huge attention from researchers and professionals. The increasing difficulty of regulations, business perspectives and firm’s strategies make it relatively difficult to digest the substance of financial statements without supplementary narrative explanations. In Malaysia, corporations are encouraged to report afar the mandatory disclosure in corporate reporting and, at the same time, external users’ crave for selected items of voluntary information in the corporate annual reports.

Surprisingly, the importance of disclosing such information does not seem to attract the attention of the firms to disclose it. Hossain et. al. (1994) report a mean score of 15.8 per cent, Haniffa and Cooke (2002) at 31.3 per cent, Ghazali and Weetman (2006) at 31.4 per cent and Hashim and Saleh (2007) at only 10-11 per cent from total voluntary disclosure items which are identified as important. This proves that the extent of voluntary disclosure, including forward looking information in annual reports documented, are low in Malaysia. Some probable reasons are a) limited budget and cost and b) fear of releasing too much information to their competitors (Ghazali, 2009). Although it is not mandatorily required, some of most important information is still not disclosed even though prior literatures show that this type of information is helpful for investors and analysts. In addition, Bany *et al.* (2010), Jaggi *et al.* (2009), Andres (2008), Faccio and Lang (2002), Claessens *et al.* (2000) and La Porta *et al.* (1999)

support the significant presence of pyramid firms in East Asian, where they find that more than half of East Asian corporations and economies (measured in terms of total corporate assets) are controlled by pyramid firms. Based on information effect hypothesis (Fan and Wong, 2002), it is argued that concentrating ownership avoid leakage of proprietary information when decision privileges are limited to specific persons. This strategy can prevent competitors from accessing proprietary information for example, their rent seeking activities. This strategy works in East Asian environment where it is common to have political lobbying activities with pyramid ownership structure. In other words, this strategy works in an ownership concentration environment by restraining the information flow to the public and reduces the possible competition of the political rent-seekers.

The level of voluntary disclosure, including forward looking information is low in Malaysia due to the lack of awareness, efforts and knowledge among Malaysian firms on costs and benefits of such additional disclosures. To ensure that the information disclosed is favorable to the firm, the repayment of disclosing it must offset the efforts and costs that is being borne by the firms. Users' preference of voluntary information items seems to be the highlighted issue since this group is wide-ranging with each having its own set of information needs. Hashim and Saleh (2007), in their study regarding voluntary annual disclosures by Malaysian multinational corporation, claim that the information provided by management on forward-looking information is important to professional investors and analysts. Uyar and Kilic (2012) also claim that disclosing forward-looking information can lessen the information asymmetry between firms and stakeholders. This will allow them to make better decisions about the firms by reducing the information gap between the two parties as compared to other information disclosure fields. From there, decisions can be made whether to invest in the firms or not. All of these findings may well contribute to the efforts made by the International Accounting Standards Board to provide a broad, non-binding framework for the presentation of management commentary in relation to the financial statements that have been prepared in accordance with International Financial Reporting Standards (IFRSs). In this light, the Malaysian Accounting Standard Board (MASB) has issued MASB ED 76 Management Commentary (Guidance) for public comment on 30th April 2012 and has then been issued (on 28th February 2013) as Statement of Principles 3 (SOP 3) Management Commentary. This SOP is set out to guide the Management on the presentation of commentary that is consistent with the principles to a) provide management's view of the entity's performance, position and progress, b) to supplement and complement information presented in the financial statements. In aligning with those principles, management commentary shall include forward looking information and information that possesses the qualitative characteristics described in the Conceptual Framework for Financial Reporting. Issuance of SOP 3 has bring an awareness to the firms to provide information that is forward looking and future-oriented to complement and balance the investors' needs on the accounting information in the annual report

At the same time, arguments that new accounting rules and promotion on disclosing narrative information only increase the quantity, not the quality of accounting information, since many of prior studies generally assumed that the extent of disclosure is an adequate measure of the quality of disclosure. This situation has shifted the increasing role of narrative disclosure in financial reporting and the quality issue of narrative information disclosure onto a different level. Most of empirical studies do not make a clear division between the quantity and quality of disclosure. As it is generally

assumed that the quantity of information has an implication in determining its quality, quantity measures are often used as proxies to measure quality of the disclosure. Nevertheless, the measurement of the disclosure quality is documented as an important question that still lingers and the significance of developing measures for disclosure quality is emphasized in literature. As the measurement of disclosure quality is fundamentally complex, its measurement cannot be carried out by implementing a simplistic approach, such as, the suggestion that the use of the extent of disclosure be used as a proxy of its quality. Study by Beretta and Bozzolan (2008) contributes to the discussion on the usefulness and reliability of different measures on narrative information, specifically on forward looking disclosure. In particular, their findings indicate that multidimensional frameworks of disclosure quality capture the scope of disclosure that is considered useful by financial analysts in forecasting earnings.

In the context of forward looking information, most of the prior literature concentrate on the disclosure level of forward looking information and link it with other factors and effect. The studies assume that level of disclosure represents quality of the forward looking information disclosed (Al-Najjar and Abed, 2014; Wang and Hussainey, 2013; Uyar and Kilic ,2012). Other literature that covered disclosure quality issues are Al-Tuwaijri et al. (2004) and Baesso and Kumar (2007). However, the quality measure discussed by them did not focus or highlight on forward looking information. Thus, this study focuses on the other side of forward looking information, which is, the quality of forward looking information by adopting the measurement quality developed by Beretta and Bozzolan (2008). This study will also look at how the quality of forward-looking information disclosed effect the stock returns of a firm. Stock returns have been the focus of many studies since it capture the investors' reaction and perception on every moves or steps taken by the firm; in this case, the information disclosed by the firm (Bar-Yosef and Prencipe, 2013; Wang and Hussainey, 2013).

This study will also identify the moderating roles that might influence the disclosure quality of forward looking information of a firm; a) ownership structure and b) corporate governance practices by the firm. In the context of emerging economies, prior literature on corporate governance and financial reporting highlight the need to consider the moderating role of corporate governance mechanisms (Ahrens et al., 2011). Furthermore, Alves and Morey (2012) find that some of the corporate governance mechanisms are the determinants of disclosure level for corporate reporting. Quality of financial reporting process is also considered to be affected by ownership structure. According to Eng and Mak (2003) the structure of ownership determines the level of monitoring, and thereby the level of disclosure. Adelopo (2011) and Al-Akra and Hutchinson (2013) also argue that in concentrated ownership system like family owned firm, which are commonly presence in Malaysia, the demand for corporate disclosure would have significant impact on corporate disclosures, either mandatory or voluntary disclosure. Since ownership structure of a firm and corporate governance practices have significant impact on disclosure level of voluntary information, this study expects that both variables may also have significant impact on the disclosure quality of forward looking information, where they play a role as a moderating factor which can lead or influence the stock return of firm.

1.3 Objectives of the Study

Based on the shortfalls of these previous studies, the objectives of this study are:

- 1) To investigate the disclosure effect of forward looking information on firm's stock return
- 2) To investigate the level effect of forward looking information on firm's stock return
- 3) To investigate the quality effect of forward looking information on firm's stock return
- 4) To identify the potential moderating roles for quality of forward looking information that will affect the firm's stock return:
 - a) ownership structure
 - b) corporate governance practices

1.4 Contributions of the study

This study, which is based on disclosure quality of forward looking information in Malaysia, provides a useful contribution to the existing accounting reporting and voluntary disclosure literature in the following ways:

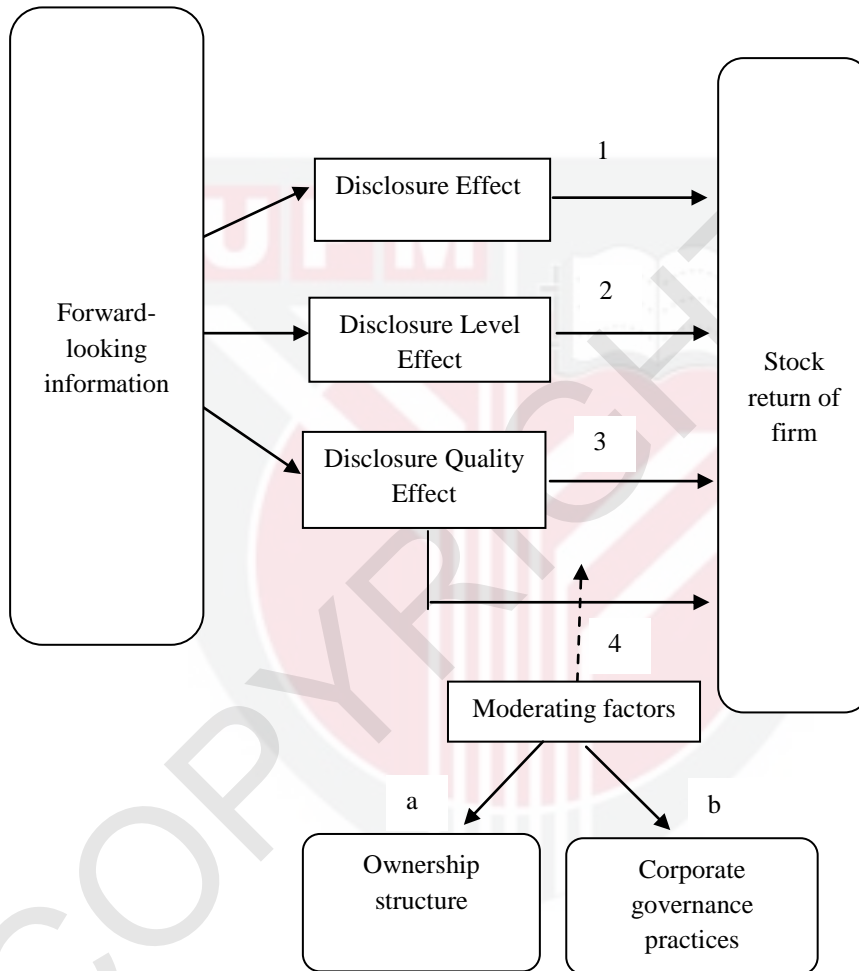
Firstly, this study can guide and help practitioners or managers on how to effectively disclose forward looking information, so that it is informative to the users and bring benefits to them. It also will bring awareness about the advantages of disclosing forward looking information despite the cost incurred in disclosing it.

Secondly, this study will strengthen or produce some additional criteria and suggestion to the policy makers, regulators and standard setters in increasing transparency of corporate reporting and encouraging more firms to disclose forward looking information from outlining additional items or topics to be highlighted during reporting as the additional topics or items considered in the quality measure used may increase quality of the information. At the same time, this study might as well suggest the BMLR to include forward looking information as part of information to be presented in CEO or Chairman Statement in the forthcoming corporate disclosure guide despite of encouraging to presenting the information in MD&A section.

Thirdly, this study may give a different perspective about the ownership structure in Malaysia, specifically family-owned firms on how this ownership structure may contribute on disclosure quality of forward looking information by either using their entrenchment effect increase or decrease stock return of the firm through signaling theory. Thus, this study might contribute in theory by suggesting how family-owned firms might reduce the negative perception of investors towards their agency problems through disclosing quality of forward looking information as a signal of being transparent and increasing their stock price at the end.

Finally, this study contributes to the academic literature and researchers on the extent of voluntary disclosure of forward looking information, especially in the Malaysian context, by suggesting new ideas or solution on measuring the quality of forward looking information that is very subjective and complicated to measure. This study also explores the other dimension or aspect of forward looking disclosure instead of focusing only on the quantity aspect.

1.5 Research framework



1.6 Organization of the research

This research is divided into four main parts. The first part of the study investigates the presence of forward looking information disclosed voluntarily effect on stock return of the firm. The second part of the study investigates the level effect of forward looking information on stock return of a firm. The third part will study the quality effect of forward-looking information voluntarily disclosed on stock return of the firm. The last part of this study will investigate the moderating factors that may help the firms to disclose high quality of forward looking information in their annual report, which is expected to have some bearing over the stock returns of the firms.

This dissertation is divided into five chapters. Chapter 1 provides the background of the study, problem statements, objectives of the study, possible contributions, research framework and organization of this study. Chapter 2 discusses the theoretical framework of this study by outlining the related theories used in this study and providing literature review of forward looking information, quality measures, stock return and the two moderating factors proposed; ownership structure and corporate governance practices, thus develop the hypotheses for this study. Chapter 3 explains the methods of data collection and research design. Chapter 4 discusses the findings and Chapter 5 summarizes important conclusions, limitation of the study and suggestions for future research.

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