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Violation of Listing Requirements and Company Value: Evidence from Bursa Malaysia

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This paper examines the stock market's reaction towards violation of Bursa Malaysia Listing Requirements. Failure to comply with the Listing Requirements may result in a number of sanctions including a public reprimand. Hence, the reflection of whether a firm has good corporate governance was identified through public reprimand imposed on the firm. Media releases of public reprimand on directors for public listed companies were collected from Bursa Malaysia online media releases database. A sample of 41 observations from the period of August 2005 to May 2009 was identified. Using the event-study methodology, average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) for the sample are calculated to examine the stock price effect. Empirical results reveal that there is a negative impact of public reprimand imposition on the company's stock price, which suggests poor corporate governance will lead to downward stock price performance.

Field of Research: Regulatory Compliance, Corporate Governance, Securities Listing Requirements, Event study.

1. Introduction

Poor corporate governance has been often seen as one of the causes of the 1997 Asian financial crisis (Harvey and Roper, 1999; Stiglitz 1998). The financial crisis has adversely affected the economic performance of many East Asian countries including Malaysia. Particularly, it is an interesting case for Malaysia as it has been experiencing continuous economic growth and social development for a number of years prior to crisis. The downfall of worldwide corporate giants like Enron witnessed that most corporate failures may be caused by the lack of good corporate governance. The U.S. accounting scandals set off the understanding that poor corporate governance can tremendously impact a country's economy through the effects on the capital markets. Such incidents have adversely affected public confidence in the reliability of corporate reporting.

Following the Asian Financial Crisis, the Malaysian government has taken substantial effort to improve the corporate governance system. For good governance in the capital market, Bursa Malaysia ─ formerly known as Kuala Lumpur Stock Exchange (KLSE) ─ has joined the effort of enhancing corporate governance by revamping its Listing Requirements, a move widely seen as a major effort to strengthen the capital market and the securities industry in Malaysia. The revamped Listing Requirements were released by the KLSE on 22 January 2001, bringing the effect of creating an environment that demands higher quality of conduct and disclosures from companies, management and boards of directors. The new Listing Requirements are seen to be highly effective in the area of financial reporting, disclosure of corporate governance matters and continuation of listing obligations.

The revamped Listing Requirements specifically address key corporate governance issues, including issues e.g. substantial and related-party transactions, board composition,

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the role and function of Audit Committees, directors' rights and training, disclosures in relation to the state of internal controls and compliance with the MCCG, in addition to providing the conditions to be eligible for listing, and requirements and standards to be maintained for continued listing. Failure to comply with the Listing Requirements of the KLSE may result in a number of obligations including a public reprimand or a fine of up to RM 1 million or both. The revamped Listing Requirements of the KLSE have devoted an entire chapter i.e. Chapter 15 to corporate governance and require the listed issuer and its directors to comply with it. Violation of the Bursa Malaysia's Listing Requirements may result in a number of sanctions including a public reprimand, bringing the reflection on whether a firm has good corporate governance. Hence, this research seeks to find out whether public reprimand imposed on a firm's directors would serve as bad publicity towards the company's reputation.

From previous studies, it is found that failure to comply with financial market laws will have dampening effect on the company's stock price; tarnished reputation may attract penalty from the general investing public. As investors are dissatisfied and unconfident with a firm's management board, they would be triggered to dump the firm's shares. As such, the share price of the firm may experience a contraction in the short run and therefore become more volatile. This research seeks to investigate the price impact for the shares of companies that are imposed public reprimand by Bursa Malaysia.

2. Literature Review

Numerous studies have been carried out to investigate the impact of financial market law violation on the companies' share price and performance in particular in the United States. It is found that failure to comply with financial market laws will have dampening effect on the company's stock price (Cloninger 2000; Jia 2009; Wallace 1988) ; tarnished reputation may attract penalty from the general investing public (Wu 1998; Cox 2002; Wen 2010). For instance, Wallace (1988) studied market reaction to the announcement of SEC allegations published in the Wall Street Journal (WSJ) in the United States. They found statistically significant negative abnormal returns. Feroz (1991) conducted a study on the abnormal returns for 58 companies which were under investigation by the Securities and Exchange Commission (SEC) from year 1982 to 1989 in the U.S market. Karpoff (1993) studied companies that had been alleged and convicted for corporate fraud in 132 observations from 1978 to 1987 in the United States. Francis (1994) conducted a study over the share price effects on companies announced misleading financial statements and thereby shareholders had sued the company. Likewise, Bhagat (1998) studied the stock price reactions to filings and settlements of lawsuits towards the defendant (a corporation) by using data between the years 1981 and 1983 in the U.S. market. Johnson (2003) studied on the stock price reaction to firms with fraud events in the U.S. market. Those studies found that the negative event impacted involved firms negatively.

Several studies were conducted outside U.S. Klapper (2004) used the firm-level corporate governance rankings provided by Credit Lyonnais Securities Asia (CLSA) to compare the performance of a sample of 374 firms across 14 emerging markets (Brazil, Chile, Hong Kong, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Singapore, South Africa, Taiwan, Thailand, and Turkey). Performance is measured by equity valuation using Tobin Q and ROA. Their findings indicate that better corporate governance is highly correlated with better operating performance and market valuation.

On the other hand, Voon (2008) performed a study on the effects of announcement of corporate crime on stock market performance among public listed companies in Malaysia. A sample of 7 large and established public listed companies charged for committing corporate crime by Securities Commission from the period of 1999 to 2005 were taken into analysis. Using the event-study, monthly average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) for the sample of 8 announcements of separate crimes ranging from 12 months prior to and 6 months after the announcement dates were determined. The results indicated that Malaysian stock market is informational inefficient towards the announcement effect for corporate crime.

As results obtained from previous studies are inconclusive, hence this study is essential to investigate and verify the effects of public reprimands on a company's stock price performance.

3. Methodology

3.1 Data

Data analysed in this study consist of a sample of the public reprimands — in particular, public enforcement on directors — released from August 2005 to May 2009. Public reprimand data were obtained from the official website of Bursa Malaysia. Such information included company name, public reprimand's release date, and the type of public reprimand. Apart from that, daily stock price and FTSE Bursa Malaysia KLCI (FBM KLCI) were obtained from a sophisticated financial statistical database called Thomson Financial Datastream. However, only 41 public reprimands are included in the sample as they are the only information available at Bursa Malaysia's website that fulfil the criterion of having continuous daily stock price data of companies over a period of 180 days before and after the initial imposition date. Table 1 lists out the public reprimand imposed on companies, their release date and type of sector attributed to the companies.

3.2 Return Analysis

An event study as described by Rao (1997), Rao (1996) and adopted by Voon et al (2008) is adopted in this research. Various event studies provide insights pertaining to the degree of market efficiency. In this research, the estimation window consists of 165 days of the trading preceding the event window, i.e. t = -180 to -16. Besides, event window which is used to estimate the abnormal and cumulative abnormal return consists 31 days period surrounding the public reprimand imposition date, i.e. t = -15 to + 15, whereby t = 0 is the public reprimand imposition date.

In calculating the abnormal return, the market model is used to predict stock return with the assumption of a linear relationship between the return of any stocks to the return of market portfolio. The market model used is presented below:

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it} \quad \textbf{(1)}$$

Where t is the time index, i = 1,2,….., N stands for R_{it} return on share i on period t; R_{mt} are the return on market index during period t, whereby the FTSE Bursa Malaysia KLCI (FBM

KLCI) is used as the market index in this study; α_i and β_i are market model parameters and ε_{it} is the error term for share *i*.

Table 1: List of Public Reprimands Imposed on Companies

No.	Company Name	Sector	Release Date
1	Antah Holdings Berhad	Trading/Services	19-Dec-2006
2	ARKResources Berhad	Construction	20-Apr-2007
3	Astral Asia Berhad	Construction	7-Jun-2006
4	Ayer Molek Rubber Company Berhad	Plantation	22-Nov-2007
5	Ayer Molek Rubber Company Berhad	Plantation	24-Jan-2008
6	BTM Resources Berhad	Industrial Products	29-Sep-2008
7	Cepatwawasan Group Berhad	Plantation	27-Oct-2005
8	COMSA Farms Berhad	Consumer Products	7-Aug-2006
9	COMSA Farms Berhad	Consumer Products	6-Mar-2007
10	Concrete Engineering Products Berhad	Industrial Products	28-Jan-2009
11	Datuk Keramat Holdings Berhad	Trading/Services	24-Nov-2006
12	Datuk Keramat Holdings Berhad	Trading/Services	28-Feb-2007
13	Datuk Keramat Holdings Berhad	Trading/Services	4-Apr-2007
14	Datuk Keramat Holdings Berhad	Trading/Services	6-Jul-2007
15	DCEIL International Berhad	Trading/Services	20-Dec-2006
16	DCEIL International Berhad	Trading/Services	19-Apr-2007
17	DCEIL International Berhad	Trading/Services	9-May-2007
18	Energreen Corporation Berhad	Industrial Products	16-Jun-2008
19	Englotechs Holding Berhad	Industrial Products	31-Mar-2009
20	George Town Holdings Berhad	Trading/Services	28-Feb-2007
21	George Town Holdings Berhad	Trading/Services	4-Apr-2007
22	George Town Holdings Berhad	Trading/Services	6-Jul-2007
23	Gold Bridge Engineering & Construction Berhad	Property	17-Jun-2008
24	Gold Bridge Engineering & Construction Berhad	Property	31-Mar-2009
25	Industronics Berhad	Technology	10-Dec-2008
26	KFC Holdings (Malaysia) Berhad	Trading/Services	8-Mar-2006
27	Kimble Corporation Berhad	Consumer Products	11-Dec-2008
28	Megan Media Holdings Berhad	Industrial Products	4-Aug-2008
29	MEMS Technology Berhad	Technology	6-Oct-2008
30	Multi Vest Resources Berhad	Plantation	8-Mar-2006
31	Nasioncom Holdings Berhad	Trading/Services	18-Dec-2007
32	Oilcorp Berhad	Trading/Services	14-Nov-2008
33	Oilcorp Berhad	Trading/Services	28-May-2009
34	QSR Brands Berhad	Trading/Services	8-Mar-2006
35	Satang Holdings Berhad	Trading/Services	31-Mar-2009
36	Seal Polymer Industries Berhad	Industrial Products	13-Nov-2006
37	Talam Corporation Berhad	Property	9-Apr-2007
38	Tanah Emas Corporation Berhad	Plantation	9-Aug-2005
39	Wimems Corporation Berhad	Technology	1-Nov-2007
40	Wonderful Wire And Cable Berhad	Industrial Products	12-Apr-2007
41	YCS Corporation Berhad	Construction	9-Aug-2005

Sources: Bursa Malaysia.

The daily return of any stock can be calculated by using following formula:

$$R_{it} = \text{In}\ (P_{it}/P_{i(t-1)}) \quad \textbf{(2)}$$

Where:
R_{it} = The return on security *i* for day *t*
P_{it} = The price of share *i* for day *t*
$P_{i(t-1)}$ = The price of share *i* for the day before day *t*

The daily market return also can be calculated by using the formula below:

$$R_{mt} = \text{In}\ (I_{mt}/I_{m(t-1)}) \quad \textbf{(3)}$$

Where:
R_{mt} = The return on market index for day *t*
I_{mt} = The market index for day *t*
$I_{m(t-1)}$ = The market index for the day before day *t*

To test whether the public reprimand affect returns for each day in the event period, the actual returns are compared to market model expected stock returns. The difference between these two returns is abnormal return of a stock. The following formula can be used to calculate the market model expected stock return:

$$E\ (R_{it}) = \alpha_i + \beta_i(R_{mt}) \quad \textbf{(4)}$$

To calculate the difference between actual returns and market model expected returns, the abnormal return (AR_{it}) can obtain from following formula:

$$AR_{it} = R_{it} - E\ (R_{it}) \text{ or} \quad \textbf{(5)}$$
$$AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mt})$$

The average abnormal return (AAR_t) is calculated after computing the abnormal returns for all stocks in the sample. It can be calculated by taking the cross-sectional mean of daily abnormal return:

$$AAR_t = \frac{1}{N} \cdot \sum_{i=1}^{N} AR_{it} \quad \textbf{(6)}$$

Where:
AR_{it} = The abnormal return of share *i* for day *t*
N = The number of security in the sample

After AAR_t is known, Cumulative Average Abnormal Return $(CAAR_t)$ is calculated.

$$CAAR_t = \sum_{t-k}^{t} AARi \quad \textbf{(7)}$$

Whereby,

k = The number of event days before day t

Lastly, AAR_t and CAAR_t need to be tested for their statistical significance by using t-test. The formula of t-test for AAR_t is:

$$\mathrm{AAR}_t \text{, t-stat} = \frac{\bar{X}-\mu}{\frac{S}{\sqrt{N}}} \quad \textbf{(8)}$$

Whereby,

$$S = \sqrt{\frac{\sum_{t=1}^{N}(X_i - \bar{X}_i)^2}{N-1}}\text{, and}$$

$\bar{X}$ = The mean of abnormal return for stock i on day t
μ = The hypothesised mean
S = The standard deviation of the sample
N = The number of securities in the sample

The formula of t-test for CAAR_t is:

$$\mathrm{CAAR}_t \text{, t-stat} = \frac{\bar{X}-\mu}{\frac{S}{\sqrt{N}}} \quad \textbf{(9)}$$

Whereby,

$$S = \sqrt{\frac{\sum_{t=1}^{N}(X_i - \bar{X}_i)^2}{N-1}}\text{, and}$$

$\bar{X}$ = The mean of cumulative average return for stock i on day t
μ = The hypothesised mean
S = The standard deviation of the sample
N = The number of securities in the sample

To conduct the above test, hypotheses are developed as follows:

H_0 : There is no significant difference on the price of company's stock before and after the imposition of public reprimand.

H_1 : There is significant difference on the price of company's stock before and after the imposition of public reprimand.

4. Results and Analysis

An event study with 31-day event window surrounding the introduction day (t = -15 to +15, whereby day 0 is the day of public reprimand imposition) has been employed to examine the stock price effect. Table 2 presents the results of the behaviour of average abnormal returns (AARs) and the cumulative average abnormal returns (CAARs) with the associated t-statistics. It is then followed by Figure 1, which shows the movement of CAARs over the event window days.

As exhibited in Table 2, the value of AARs and CAARs are shown. Besides, t-statistics of AARs and CAARs are reported and asterisk (*) is used to indicate those with statistical significance at 5% level. AARs for the day before and after public reprimand imposition are calculated to test whether they affect stock price. In column 2 of Table 2, AARs show negative value before and on the day of public reprimand imposition, represented by Day -1 and Day 0, that are -0.032% and -0.0070% respectively. However, on Day 1 (after the actual day of public reprimand imposition) AARs turn positive to 0.0199%. After that, it declined to -0.0240% on the following day. However, these AARs values are found to be non-significant.

Additionally, number of days in which AARs show negative values are being identified. As a result, there are 14 days out of the 31 event days represent negative AARs, about 45% in terms of percentage. Meanwhile, column 4 presents the t-statistics of AARs significant at 5% level. Critical value for a two-tailed test i.e. 2.0211 is identified to examine whether to accept or reject the null hypothesis. From column 4, it displays all t-statistics of AARs fall into the non-rejection region. None of the results are statistically significant.

On the other hand, CAARs are a more pronounced indicator as returns are cumulated over an interval that encompasses the actual event day. This approach has been seen widely adopted by researchers (e.g. Wallace and Worrell 1988; Bhagat et al. 1998). CAARs across all event windows are observed to analyse the pattern and speed of price adjustments to the event. Figure 1 illustrates the CAARs for companies charged for public reprimand. It depicts the movement of CAARs over the 31-day event window. As observed, CAARs are trending upwards between Day -15 and Day -7; it continues to fall until the day of public reprimand imposition, which shows a negative value (-0.4820%). However, it rises drastically to 1.5046% on Day 1 and fall tremendously on Day 2 to -0.8963%, which is at the lowest point. Then, CAARs continue to fluctuate on an upward trend. The movement of CAARs are further explained below in detail.

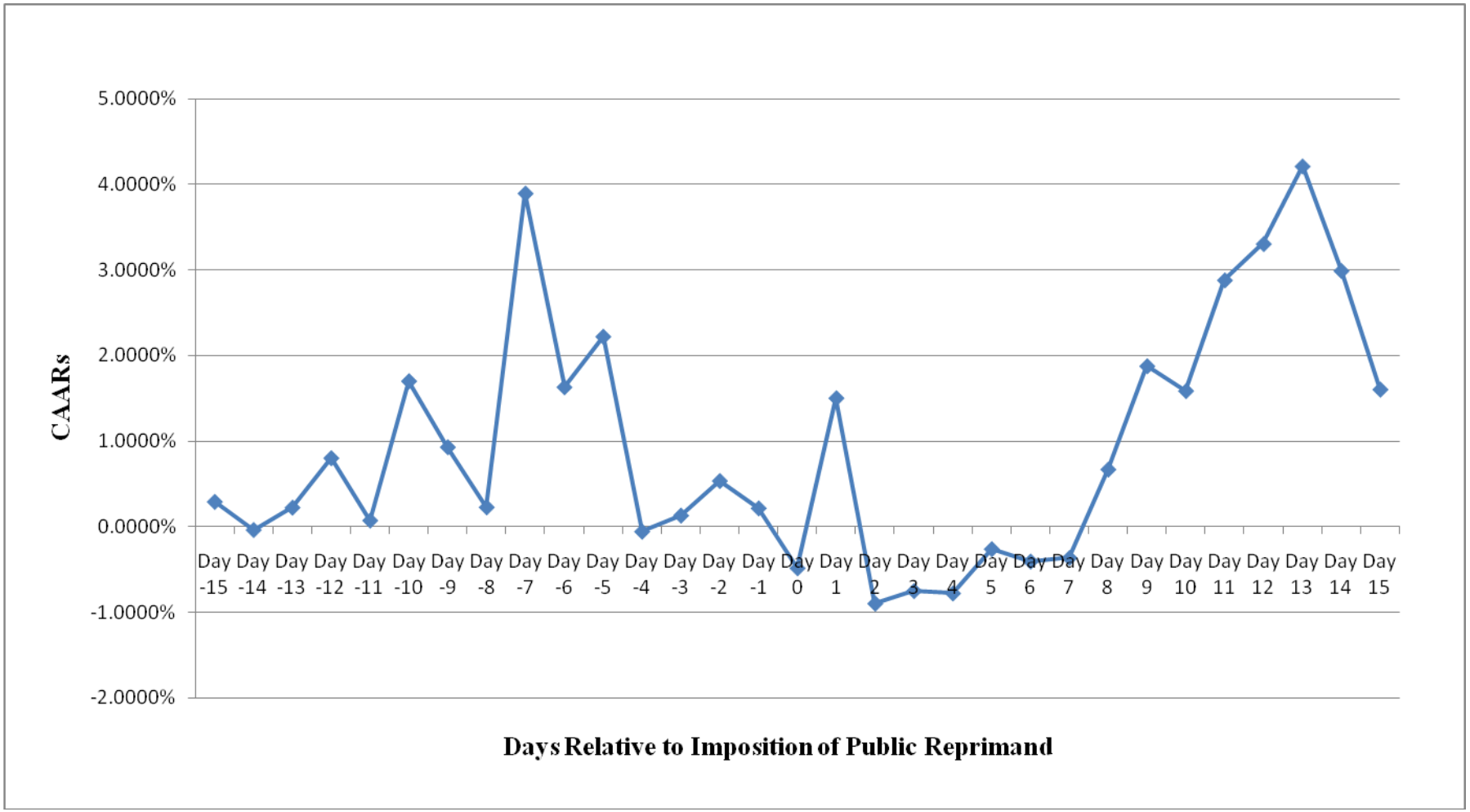
To find out whether an imposition of public reprimand has effects on company's underlying stock price, CAARs of the closest event days surrounding the introduction day, namely interval Day -2 and Day 2, should be statistically significant. From column 5 in Table 2, it exhibits a statistically significant downward trend over the 2 days before the actual date of imposition, from Day -2 to Day -1 at 0.5376% to 0.2175 respectively. Since a query will be held by Bursa Malaysia prior to charging a company, this may indicate stock penalties done by investors following rumours or news pertaining to the public reprimand leaked to the market. This conjecture is in line with Voon (2008).

Table 2: Average Abnormal Returns (AARs) and Cumulative Average Abnormal Returns (CAARs) and Their Respective t-statistics Around the Day of Public Reprimand Imposition

Event Day	AARs	Standard Deviation	AARs (t-stat)	CAARs	CAARs (t-stat)
Day -15	0.0029%	0.0344	0.5473	0.2938%	49.5657*
Day -14	-0.0033%	0.0194	-1.0855	-0.0352%	38.7942*
Day -13	0.0026%	0.0354	0.4701	0.2247%	69.8034*
Day -12	0.0058%	0.0641	0.5785	0.8039%	40.3986*
Day -11	-0.0073%	0.1193	-0.3916	0.0744%	52.7154*
Day -10	0.0163%	0.0728	1.4322	1.7039%	7.5464*
Day -9	-0.0077%	0.0778	-0.6356	0.9319%	13.2241*
Day -8	-0.0070%	0.1640	-0.2743	0.2293%	284.6332*
Day -7	0.0367%	0.1714	1.3707	3.8981%	1.9425
Day -6	-0.0227%	0.1729	-0.8388	1.6331%	4.4164*
Day -5	0.0059%	0.0555	0.6824	2.2245%	2.8443*
Day -4	-0.0228%	0.1149	-1.2710	-0.0556%	28.6029*
Day -3	0.0019%	0.0342	0.3533	0.1331%	522.2581*
Day -2	0.0040%	0.0304	0.8516	0.5376%	10.9845*
Day -1	-0.0032%	0.0261	-0.7859	0.2175%	39.2452*
Day 0	-0.0070%	0.0580	-0.7734	-0.4829%	6.9680*
Day 1	0.0199%	0.1167	1.0908	1.5046%	2.7127*
Day 2	-0.0240%	0.1253	-1.2265	-0.8963%	3.6661*
Day 3	0.0015%	0.0394	0.2395	-0.7488%	4.1072*
Day 4	-0.0003%	0.0314	-0.0594	-0.7780%	3.7885*
Day 5	0.0052%	0.0492	0.6757	-0.2592%	9.2254*
Day 6	-0.0014%	0.0256	-0.3632	-0.4042%	6.1951*
Day 7	0.0004%	0.0180	0.1490	-0.3623%	6.5437*
Day 8	0.0103%	0.0357	1.8548	0.6711%	4.4847*
Day 9	0.0121%	0.0648	1.1927	1.8790%	1.4333
Day 10	-0.0029%	0.0462	-0.4018	1.5889%	1.6378
Day 11	0.0129%	0.1120	0.7398	2.8832%	0.8530
Day 12	0.0042%	0.0246	1.1032	3.3077%	0.7146
Day 13	0.0091%	0.0368	1.5776	4.2144%	0.5392
Day 14	-0.0122%	0.0528	-1.4839	2.9917%	0.7378
Day 15	-0.0139%	0.0781	-1.1356	1.6058%	1.3499

* Denotes significance at the 5% level.

Figure 1: Movement of CAARs over the 31-day Event Window



CAARs continue to decline on the actual public reprimand imposition day to -0.4829%. However, it increases enormously to 1.5046% on Day 1. Both movements are statistically significant. As stock prices are easily observable, it is suspected that the company being charged for public reprimand will try to rescue its stock value by buying back the shares, thus causing the stock price to rise above its true value — that is artificially high. Supposedly, this is caused by an insider system of corporate governance since the corporate sector in Malaysia has high degree of ownership concentration and significant participation of owners in management (Khatri 2001).

Following the enormous rise on Day 1, the CAARs on Day 2 plummeted drastically to -0.8963, the lowest point of the 31-day event window which is statistically significant. It is implausible that stock prices can deviate from their true values. It implies that investors eventually learn the truth about firm value that they remove their investment from the affected stock and thus adjusting share prices downward (Johnson 2003).

In sum, all CAARs from Day -2 to Day 2 are statistically significant at the 5% level. The results are significant enough to reject the null hypothesis. Thus, from the perspective of CAARs, it is concluded that there is significant difference on the price of company's stock before and after the imposition of public reprimand. The results imply a downward price effect around the day of public reprimand imposition although there is a huge increase between Day 0 and Day 1, which is believed to be a false representation created by the company insiders.

5. Conclusions

5.1 Summary

This research seeks to investigate the effects of a poorly governed company that violates the Listing Requirements — as indicated by imposition of public reprimand — on its stock price in Malaysian equity market. A sample of 41 cases of companies imposed with public reprimand between year 2005 and 2009 has been employed to conduct the research. By using event study methodology, average abnormal returns (AARs) and cumulative average abnormal returns (CAARs) are calculated to examine the stock price effect. The findings of the study are consistent with most of the prior studies that suggests the violation of financial market laws has an impact towards the company's stock price. It also implies a downward price effect on the intrinsic value of the company's stocks around the introduction day. Thus, it is concluded that poorly governed companies will have a negative impact on the company's stock price.

5.2 Limitation and Recommendation for Future Research

The major drawback of this research is that it involves a small sample size. In this research, there are only 41 cases are qualified to be employed in testing the impact of public reprimand. Hence, the results might not reflect the true situation. Continuous research should be conducted to test the validity of the result. In addition, companies that were not practicing good governance were solely judged on the public reprimand imposed on directors. A bigger sample size and a variety of corporate governance measurement may provide different results.

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