Corporate fraud and information asymmetry in emerging markets: Case of firms subject to enforcement actions in Malaysia

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Abstract: Purpose
The purpose of this study is to examine changes in firms' level of information asymmetry in emerging market of Malaysia for the period of 2000-2016. Specifically, the study focuses on changes in the quoted spread and quoted depth following the fraud announcement.

Design/methodology/approach
The study uses a unique set of fraud sample using enforcement action releases (EARs) identified from the Security Commission of Malaysia and Bursa Malaysia. To estimate the result, the authors use event study methodology, OLS regression and simultaneous model on a set of 67 fraudulent firms.

Findings
The results of event study, OLS regression and simultaneous equation models suggest that information asymmetry increases on fraud discovery. The authors also use the analysis on subsamples classified by the type of regulator (who issued the enforcement release) and type of fraud committed. However, the authors find no evidence of a difference in information asymmetry across these groups. Overall, the results support the reputational view of fraud that it damages the firms’ reputation and increases uncertainty in the capital market.

Research limitations/implications
These findings provide valuable insights into understanding the information asymmetry around fraud announcements, especially for Malaysia, where the majority of the public-listed companies are family-controlled and under significant state control. The results of this study call for the active role that regulators can play to achieve a transparent and liquid capital market.

Practical implications
The research has practical implications. Specifically, for Malaysia, fraud is the primary area for National Results Areas (NKRA) in the Government Transformation Program (GTP). Therefore, for regulators and policymakers to ensure a liquid and transparent capital market, identifying the factors that elicit the fraudulent behavior and improving the related governance mechanism are necessary steps to prevent the fraudulent practices.

Social implications
Due to increased information asymmetry on fraud announcements, the demand for equity decreases that may affect not only the fraudulent firms but also results in negative externality for non-fraudulent firms, thus impairing their ability to fund equity.

Originality/value
A significant majority of studies have focused on corporate frauds in developed countries such as the USA that is characterized by dispersed ownership system and a strong capital market. One of the vocal critics of the agency theory is that it neglects the social and institutional framework within which companies operate. In emerging markets, such as Malaysia, the published academic papers on fraud...
and information asymmetry are very limited. As emerging markets practice different cultures, corporate governance mechanisms and market regulations, the study is significant to investigate the behavior of investors in such markets.

Keywords: Malaysia, Information asymmetry, Fraud, Enforcement action releases (EARs), M480, D4, K4, K20, G140

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