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Institutional ownership and information transparency: Role of technology intensities and industries

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ABSTRACT

Information disclosure is a necessary activity in corporate governance; information transparency plays a unique role in corporate governance in the era of knowledge-based economy. Lack of transparency can lead to confusion, misinformation, and distrust. With this in mind, we examine the factors that influence corporate information transparency in terms of two dimensions: technology intensity and institutional ownership. Drawing on data from a 2005–2012 cross-section sample of 1391 public firms evaluated by the official 'information disclosure and transparency ranking system' (IDTRS), we find that increases in domestic institutional ownership for firms in high-tech industries, relative to foreign institutional ownership, lead to a current-year upgrade in information transparency, but not for firms in other industries. We also find that firms with increased foreign institutional ownership and high-tech firms with both increased governmental institutional or corporate ownership and high R&D intensity can sustain a longer-run upgrade in corporate transparency. Pushing further we also investigate whether corporate transparency in high-tech industries is negatively affected if governmental institutional or corporate shareholders are involved in corporate governance, but cannot find strong evidence for such a tendency. Our results suggest that institutional shareholders promote good corporate governance practices which gradually improve at the pace of high technology development.

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1. Introduction

A good corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company (OECD, 2004[1]). With an eye towards corporate governance framework and technological knowledge characteristics we investigate the joint effects of research and development (R&D) intensity and the four categories of institutional ownership on corporate information transparency for the three tiers of industries (i.e., high-tech, medium-high-tech and traditional) and the three categories of firms (i.e., government-involved, group-affiliated and manager-governed) over a sample period from 2005 to 2012.

Proponents of 'Asian value' argue that companies led by governmental institutions have better performance in terms of influencing the course of economic development and income distribution, especially in knowledge-based innovative services and industries (Lee, 2003). Asian countries have a long tradition of governments exerting a lot of authority in various matters. Do governmental institutions intervening in business affairs of high-tech firms influence corporate transparency? By contrast, following the democratization of Taiwan and Korea, universalism claims that the Asian experience is not exceptional at all. Stock markets in Taiwan are 'plate-form' markets that are significantly influenced by the international contagion effect. The stock price fluctuations are seen to exhibit signs of increasing foreign

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[1] In conjunction with national governments, other relevant international organizations and the private sector, the Organization for Economic Cooperation and Development (OECD) has developed a set of corporate governance standards and guidelines, 'The OECD Principles of Corporate Governance'. We quote the foreword of its principle V: 'Disclosure and Transparency', one of the six main principles, as our writing motivation.

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investments acting as a critical factor in swaying capital markets. Does foreign institutional ownership have significant influence on disclosure quality of firms in the plate-form stock markets? Prior studies have provided inconsistent explanations for the mixed evidence on the influence of institutional ownership. Since every category of institutional ownership has its different competing effects on information asymmetry, it is unclear whether it is practicable to generalize the results of prior studies to other institutional shareholders.

Using the IDTRS evaluation from 2005 to 2012, we investigate the direct causal relations between institutional ownership and corporate transparency in Taiwan, where national policies are seen as serving as a hub for the technology industries. Based on the different characteristics in diversified industries, we correct standard errors for industry-level clustering because information transparency is likely to be correlated within an industry since some industry-specific attributes are mandated by accounting and disclosure rules (De Franco, Kothari, & Verdi, 2011). For instance, the accounting standards regarding R&D expenditures, intangible assets, and impairment of assets are highly correlated with technology-oriented industries. We preliminarily find that firms and industries operating at a higher technology level tend to have higher R&D intensity and information transparency. We also find that domestic institutional ownership is positively correlated with corporate transparency. However, in pursuit of their maximum interest, the dual roles of stakeholder and shareholder may eventually conflict by controlling managers' decisions that are in conflicts with shareholders' interests including transparent information. We find the correlation coefficient of institutional ultimate controlling ownership is significantly negative, suggesting that a possible role duality conflict may affect the ownership–transparency relationship.

R&D intensity is more characteristic of industrial technology firms than other indicators (Hsu, Lai, & Li, 2015). We use both R&D-based industry classification and a firm's R&D intensity as the technology factors to moderate the linkages between institutional ownership and corporate transparency. We further implement multivariate changes regressions to examine the effect of ownership on transparency at the level of both industry and firm. Our regression analysis of the above relationship leads to four findings. First, we find that technology industry classification is, in general, more indicative than technology intensity magnitude. Second, increases in domestic institutional ownership help high-tech firms increase their current-year information transparency, while the positive effects of increases in foreign institutional ownership on corporate transparency are deferred to the following year. Third, firms with a higher R&D intensity which are experiencing increased governmental institutional or corporate ownership tend to continuously improve their information transparency in the following year. Finally, by comparing changes in the controlling ownership of government-involved firms and group-affiliated firms with manager-governed firms, we cannot find a negative effect of increased controlling institutional ownership on corporate transparency.

The contributions which this research makes to the field are summarized in the following. First, we integrate the IDTRS evaluation and the OECD industry classification (OECD, 2011) into our research; this includes fairly new data in the literature on corporate governance. Second, this is the first paper that uses industry-level and firm-level technology intensity together to determine the moderating effect of various institutional ownership on information transparency. Third, though related research is abundant, in this paper we perform an analysis through a multivariate changes regression model to provide a deeper insight into the causal relation between institutional ownership and corporate transparency. We believe that our focus on official data and standards, direct causality relationship, and counterevidence can provide more convincing results than previous research has managed to achieve. Research background and hypotheses development are explained in the next section; data and methodology in the third section; empirical research findings in the fourth section; and the conclusion in the final section.

2. Background and hypotheses

2.1. Background description

In this paper, institutional shareholders are operationally defined as the shareholders of domestic institutions which are governed by the Taiwan Securities Exchange Act,[2] and foreign institutions and funds.[3] Depending upon their backgrounds, trading tendencies and regulatory restrictions, various economic consequences can be caused by institutional ownership (Choi, Lam, Sami, & Zhou, 2013). Shareholders who focus on a firm's short-term performance tend to be concerned with market-price volatility but not the firm's prospects and management, and therefore, no positive impact of their shareholdings on corporate governance is expected. Inversely, expectations regarding a firm's future development, long-term institutional shareholders will have a greater influence on firms. They use different means to monitor the firm's decision-making. Transparent accounting information facilitates institutional shareholder monitoring and the effective exercise of shareholder rights under existing securities laws (Bushman & Smith, 2003).

According to Black (1991), institutional shareholders can be categorized into 'Institutional voice' and 'Institutional control'. The former does not participate in management but can pressure and challenge firm managers. By contrast, the latter participates in the firm's business by holding key positions, such as directors or managers. Many prior studies (i.e., Chen, Harford, & Li, 2007; Ferreira & Matos, 2008; Aggarwal, Erel, Ferreira, & Matos, 2011) classify institutional investors according to the potential for business ties to a firm, referring to those with strong ties as "grey institutions"[4] and those with weak ties as "independent institutions".

Corporate shareholders have a strong underlying purpose for building business ties to a corporation. Their tight business and monitoring capability can result in efficient monitoring or strategic alignment (Pound, 1988). The shareholdings of governmental institutions usually can represent governmental policy objectives and implementation. In the same vein, financial institutional shareholders may play a role like governmental institutions, or may be able to make direct fund transfers to firms just as corporate shareholders and grey institutions are able to.

[2] In this paper, our domestic institutions comprise all institutions other than foreign ones. The composition of institutional shareholders is different according to the country's related law. According to the trading proportion statistics of shareholder categories of the Taiwan 'Securities Exchange Act', the institutional shareholders in a broad sense are the category relative to human shareholders. However, in a narrow sense, the Act also categorizes financial institutions, investment and trust companies and some specific funds as the 'professional institutional shareholders'.

[3] The qualified foreign institutional shareholders (QFII) in this paper include all institutional shareholders who are not domiciled in Taiwan, including foreign institutions, foreign mutual funds, and foreign corporate shareholders and other institutions.

[4] Grey institutions refer to those investors who have, whether actual or only potential, business relationships with firms in which they invest. The ownership is mainly the percentage of shares held by bank trust departments, insurance companies, and other institutions (e.g., pension funds, endowments).

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