CHAPTER 1: INTERNET FINANCIAL REPORTING: AN OVERVIEW OF RESEARCH

1.1 Introduction

Accounting has been a catalyst for constant change in the business environment (Lymer, 1999) in that efforts to regulate accounting have been continuous since 1966, when dissatisfaction was first voiced by the American Accounting Association concerning corporate accounting activities. There have been calls for change to current accounting practices regarding how the corporations should report their business activities. The information technology issues and their influence on accounting activities form part of this fast and strong change in the reporting practices. The major changes of technology innovation are the development of computer-to-computer communication infrastructures via the Internet.

In 1995, businessmen began to take serious notice of the Internet technology with the development of the World Wide Wide (the Web) (Lymer, 1999). The Web enables businessmen to promote their products and services effectively, speedily and widely, as there has been increasingly rapid growth in users' numbers all over the world. Since the software required to access the Web-based services are freely available, the Internet is becoming a wealth creation tool, as it offers new methods of doing business through business information communication within and between businesses. Therefore, the business information management has become the main critical activity determining the success of the business.

This technology development is also changing the way companies disseminate information to their stakeholders (Pircheggar and Wagenhofer, 1999; Gowthorpe and Amat, 1999; Craven and Marston, 1999; Xiao et al., 2002; Bonson and Escobar, 2006;

Kelton and Yang, 2008). Large quantities of information on variety of financial matters are provided on companies' Web sites. The Internet offers more opportunities to disseminate financial information compared to traditional hardcopy printed reports and the importance of the Internet in this aspect are rapidly increasing. Healy and Palepu (2001, p.432) predict that "…the increasing use of the Internet by investors is likely to continue, reducing the costs of providing voluntary disclosures and presumably increasing their supply".

The majority of Internet Financial Reporting (IFR) practices are unregulated and voluntary in nature. Although this reporting practice varies significantly across companies, many companies still voluntarily disseminate information via the Internet. Hodge et al. (2004) argue that variation in the level of transparency via the Internet affects investors' decision process. Investors frequently use the Internet to obtain financial information when looking for current and potential investment opportunities. According to Economist Intelligence Unit (2003), the Internet has fundamentally improved the manner in which companies disseminate financial information, and thus IFR may increase the transparency level. In comparison with the traditional hard copy annual reports, IFR permits companies to disclose information not required by regulatory bodies. At the same time, companies can reach a broader audience in timely manner. In addition, Internet technologies allow companies to use alternative format to disseminate sophisticated information, for example, multimedia, multiple file formats and hypertext that may improve the access and understanding of information by investors. Therefore, technologies improve the level of transparency, and allow alternative sophisticated information dissemination formats, thus, facilitating investor gathering information, which affects their investment decision process (Hodge et al., 2004).

1.2 Background to the Research

Many listed companies around the world disseminate financial information dissemination via the World Wide Web (Lymer et al., 1999; Marston and Polei, 2004), because the Internet enables corporations to enhance, supplement and replace the traditional communication methods with investors and stakeholders.

The supervisory bodies such as the Securities Exchange Commission (SEC) of the U.S. and European Union (EU) have implied the urgent need for companies to adopt transparent practices. They have enacted measures that regulate the disclosure of Internet information, such as the Sarbanes-Oxley Act (Sarbanes and Oxley, 2002) and the harmonisation of transparency requirements from issuers in Directive 2004/109/EC (2004). Section 302 of the Act mandates a set of internal procedures designed to ensure adequate internal control over the accuracy of financial disclosure. Directive 2004/109/EC (2004) promotes high standards of transparency in financial markets because there is an urgent need to ensure confidence in financial markets among investors. Therefore, companies need to provide a wide range of disclosure and protection tailored to their circumstances. The supervisory bodies developed these series of norms with the objective of increasing the transparency of both the financial market and companies through the diffusion of company information via the Web sites. These requirements exert pressure on the companies to increase the transparency of information for the financial market and motivate them to increase the provision of voluntary information on the Internet for the investors in both quantity and quality. Additionally, companies are providing information via the Internet as a method of establishing their own identity in the face of all the other economic agents in the present technological environment and the need to offer a modernised image.

At the time of this study first started in July 2006, Malaysian companies' financial reporting on the Internet was not regulated. To date, there are no mandatory guidelines prescribing the presentation and content of Web-based information in a comprehensive way, except that the stock exchange, Bursa Malaysia requires every listed company to have its own Web site, which is current, informative and contains all relevant information based on the Listing Requirements 9.21. In December 2006, Bursa Malaysia approved an Investor Relations Policy for all listed companies. It encourages all public listed companies to maintain a Web site to provide main company background and data on company's finances, products, services and operations. It is crucial that the company Web sites contain the right information and are easy to navigate, as analysts and investors increasingly conduct their preliminary research via company Web sites. It is also important that all announcements, press releases and new presentation materials given out at briefings for analysts, investors or the media are immediately updated on the company Web site.

Bursa Malaysia requires all listed companies to have its own Web site, but there is no specific requirement to the content and presentation of information. Thus, IFR by Malaysian companies is, to a large extent, still voluntary despite the recommendation of Bursa Malaysia describing the investor-related information for company Web sites. The researcher expects that these regulatory recommendations will lead to an increasing amount of Internet financial reporting and an improvement in the presentation technologies used by Malaysian companies.

1.3 Problem Statement

"Can greater transparency prevent future crisis?" In October 1998, the G22 Working Group on Transparency and Accountability, International Monetary Fund (IMF) called for greater transparency and regulatory reform. Transparency is "a process by which information regarding existing conditions; decisions and actions are made accessible, visible and understandable" (Sheng, 2009, pp.2). After the crisis, many reforms were made in accounting and disclosure. The Web sites of Lehman Brothers Holdings Inc., American International Group Inc. (AIG), the Federal Reserve (the Fed), International Monetary Fund (IMF), European Central Bank and the Bank of England warned about the risks, however, the crisis still happened.

Ghazali and Weetman (2006) also argue that one of the main causes of the 1997 Asian Financial Crisis in most countries of the region is the lack of accountability and transparency. Malaysian companies are also adversely affected as they have been subject to political interference since 1990 (Satkunasingam and Shanmugam, 2004). Evidence shows that businessmen return favours to politicians who are involved in awarding contracts to them. Politicians or their family businesses also obtain contracts for government projects easily. According to Gomez and Jomo (2002), these politicians will be unlikely to compel the introduction of transparency and accountability in the corporation. This kind of relationship-based capitalism places the transparency reforms in a different context in comparison with the developed market-based capitalism in the West (Rodan, 2004; Adhikari et al., 2006), as the close link between business and politics are well documented in Malaysia. Therefore, Malaysia presents an important and interesting study in relationship-based capitalism (Gomez and Jomo, 1997).

Since 1998, the introduction of various measures by the Malaysian government through institutions such as the Malaysian Institute of Corporate Governance, Securities Commission and Bursa Malaysia, which were aimed at raising the standards, is increasing the frequency of corporate disclosures and greater transparency of information (Gomez, 2001). These measures are in line with the directive by Former Prime Minister Tun Abdullah Ahmad Badawi that, "Good governance and transparency are two pre-requisites if Malaysia were to improve its competitiveness and inspire confidence against increasing globalisation" (Emmanuel, 1999, p.26).

According to Anwar and Tang (2003), there were national reforms to address lack of transparency in corporate reporting after the Asian Financial Crisis, due to the influence of the family dominated corporate boards who tend to only disclose the minimum information required to meet the mandatory requirements (Ghazali and Weetman, 2006). The researcher wants to determine whether the subsequent actions of reform by the Malaysian government, as discussed above, increased the disclosure awareness as a tool of corporate governance, and whether the reforms reduced the influence of family domination of corporate boards on voluntary disclosure via the Internet in Malaysia.

Many corporations in Malaysia publish their company financial information via the company Web site (Hassan et al., 1999; Ismail and Tayib, 2000; Abdul Hamid, 2005). In the near future, Internet reporting practice is expected to grow to the level that financial reporting will move totally from the present hardcopy financial statement to using the Internet as the main communication mode (Lymer et al., 1999; Bagshaw, 2000). The growth of IFR, together with the Internet's multimedia capacity and capability for interactive communication, may challenge the nature, boundaries and framework of financial reporting. Substantial accounting literature focuses mainly on voluntary reporting through the traditional hardcopy based financial statements, however, the recent Internet development as the channel for disseminating financial report creates a different financial reporting environment that may be different from the traditional print-based one (Oyelere et al., 2003).

Investors are pressured to look beyond the annual reports because they are interested in assessing the innovative firms' potential economic performance and to obtain potential future benefits from innovations-in-progress. The management have the opportunity to update daily important information and to gain access to their investors via the Internet. The popularity of IFR is causing the accounting standard setters and regulators to question the quality and acceptability of Internet-based reporting (Khadaroo, 2005). For example, the FASB (2000) sponsored a major study to establish the business information reporting of Fortune 100 companies in addition to traditional financial statements and to examine notable current practices. Additionally, during the in-depth semi-structured interview with Bursa Malaysia senior management, the respondents expressed their concern over the variation of Internet reporting practices among the Malaysian companies discussed in Chapter 7. Thus, it is important to investigate the Internet disclosure to provide a better understanding of the present state of financial information delivery via the Internet.

1.4 Research Questions and Objectives

This study looks at the development of Internet financial disclosure in light of the transparency reform following the 1997 financial crisis. Specifically, the researcher attempts to answer the following research questions:

1st: To what extent do Malaysian listed companies voluntarily disclose financial information on companies' Web sites? What are the types and characteristics of such voluntary disclosure?

2nd: Which are the factors (corporate governance mechanisms, ownership structures and Internet visibility) that influence the Internet disclosure practices of Malaysian listed companies? Which are the factors (corporate governance mechanisms and ownership structures) that influence the Internet visibility of Malaysian listed companies?

3rd: Do theories on disclosure and accounting choice such as agency theory and institutional theory apply to Malaysian listed companies' Internet reporting practices?
4th: What are the preparers' views regarding Internet financial reporting?

The purpose of this study is: (1) To examine Malaysian listed companies' use of the Internet to present financial and investor-related information; (2) To identify the factors that influenced Internet disclosure; (3) To examine the application of relevant theories of disclosure and accounting choice on the factors identified in objective (2) and; (4) To study the views of preparers regarding Internet financial reporting practices.

1.5 Justification for the Research

Since 1995, IFR has been the topic of academic study; however, the IFR literature is dominated by empirical studies in the developed economies from Europe and the U.S. It is dangerous to generalise the results of these studies to developing economies, because the economic development stage is likely to be a main factor influencing IFR practices. Furthermore, national and cultural differences are likely to influence accounting practices in general (Gray, 1988) and IFR practices in particular (Xiao et al., 2004).

One unique institutional feature of other developing economies, which is different and distinguishes itself from the agency problem, is the relationship-based capitalism and ownership concentration, as differed from the arms-length market-based systems and the diverse shareholding in the developed economies (Tsui and Shieh, 2002). This unique ownership structure and relationship-based capitalism places the transparency reforms of developing countries in a different context in comparison with the developed market-based capitalism in the West (Rodan, 2004; Adhikari et al., 2006). The institutional differences in Malaysia include concentrated share ownership (Shleifer and Vishny, 1997; Claessens et al., 2000), significant government ownership in listed companies (Lemmon and Lins, 2003; Mak and Li, 2001) and a weak market for corporate control (Lins, 2003; Gibson, 2003). At the corporate level, these institutional differences may influence how the board and management govern their companies. Although the Internet literature is still developing, only two studies linked the ownership structure to IFR in emerging markets such as Malaysia (Gan and Susela, 2006; and Haniffa, 2004). Therefore, this study addresses the scarcity of research in this environment and its influence on Internet disclosure in Malaysia.

This study extends prior research by examining the influence of corporate governance mechanisms and the effects of Malaysia's unique ownership structure on the Internet voluntary disclosure for Malaysian listed companies. It is important to study Malaysia, as the corporate governance mechanisms practiced by the listed companies is likely to be different from those used in developed economies. While prior studies provide evidence from sophisticated and strong developed economies (Abdelsalam et al., 2007; Kelton and Yang, 2008), very few studies have been conducted in countries where the capital market is developing and the corporate governance practices are still evolving (Alarussi and Selamat, 2007).

The review on prior Malaysian literature presented in Chapter 3 shows that explanatory research on the determinants of IFR for Malaysian companies is limited. This is surprising since Standard and Poor's Southeast Asia 40 Index reported the weight of the market capitalisation of 22 leading Malaysian companies as the highest at 39.53%. The balance of 18 leading companies is from the emerging markets of Indonesia (23.09%), the Philippines (8.20%) and Thailand (29.18%) (Standard and Poor's, 2008). Moreover, the market capitalisation of listed companies in Malaysia was reported as 84.23% of GDP in 2008 (World Bank, 2008). Malaysia achieved 10.1% Gross Domestic Growth in the 1st quarter of 2010. The number of listed companies had risen to 962 as at 31st March 2010, with a market capitalisation of RM1.044 trillion. In comparison, the number of companies listed on the Singapore Exchange amounted to 761 and on the Indonesia Stock Exchange, 401 companies were listed (Najib, 2010). With such substantial growth in the country, it is important to examine the voluntary Internet disclosure of Malaysian listed companies, as the research in this area is limited.

This study also included another important variable of IFR, which is Internet visibility. It attempts to capture the importance of a company on the Net. It is a non-financial variable, as it does not appear in annual reports. The researcher has to extract this indicator by calculating the number of incoming links to the Web sites of companies (Dreze and Zufryden, 2004; Brock and Zhou, 2005; Serrano-Cinca et al., 2007; Gutierrez-Nieto et al., 2008). With the development of electronic transactions, Internet visibility is becoming an important intangible asset for corporations. In this Internet age, online users will pressure companies with a high Internet visibility to increase disclosure and disseminate better information.

Prior studies of IFR placed strong emphasis on the economic aspects of the determinants of IFR. Many studies examined the association between IFR and firms' characteristics such as firm size, profitability, and leverage. Several studies investigate limited governance factors as determinants of IFR, such as ownership concentration and CEO characteristics. In view of the current emphasis on corporate governance to improve the transparency of disclosure and the recent findings that link corporate governance factors to voluntary disclosure, an examination of whether governance factors influence IFR is important (Gul and Leung, 2004; Ajinkya et al., 2005; Cheng and Courtenay, 2006).

In addition to the economic-based theories, this study uses institutional theory to examine companies' IFR practices. It could help to explain companies' reporting practices, especially via the Internet, including the most current advanced stages of reporting. From the institutional sociological perspective, Malaysian organisations exist in a unique ownership structure and relationship-based capitalism institutional environment, thus, their reporting practices tend to reflect models or forms originating from the environment that are different from other developed economies.

With the increasing availability of electronic forms of information exchange, Bursa Malaysia is encouraging listed companies to disclose investor-related information on their Web sites. However, not all listed companies practise such voluntary disclosure, and this lack of uniformity raises questions on IFR that this study seeks to address.

1.6 Literature Summary

There are three main types of international studies on Internet reporting. First, the studies that are mainly descriptive in nature (see for examples, Lymer and Tallberg, 1997; Gowthorpe and Amat, 1999; Lymer et al., 1999). Most of these earlier studies focused on the existence of Web sites for top listed companies of stock exchanges and whether these companies disseminated some type of financial information via the Internet. These studies provided a general overview of the present level of Internet corporate reporting.

Second, many researchers take a further step to identify the determinants associated with the differences among the companies' Web reporting. They tried to relate certain independent variables such as firm characteristics and corporate governance structures to the extent of voluntary Internet disclosure (Craven and Marston, 1999; Brennan and Hourigan, 2000; Debreceny et al., 2002; Marston and Polei, 2004; Abdelsalam et al., 2007; Kelton and Yang, 2008). Most of these studies used agency theory to hypothesise their research. Many have tested the size hypothesis, and in most studies, firm size has been found to be a significant explanatory variable. However, other findings, varying by country or exchange listing, clearly indicate that IFR determinants differ according to the institutional environment.

Third, studies concerning the views of various interested parties such as users, preparers, auditors, academics and regulators concerning newly emerging practices and issues that need to be considered by U.K. companies (see for examples, Beattie and Pratt, 2003; Jones and Xiao, 2004). The findings show that financial reporting packages would evolve into a core of general purpose and standardised information in both the hard copy and soft copy versions. Auditors will be cautious and reactive, while regulators will adopt a minimalist approach. The fundamental dilemma of the IFR will be between standardisation and customisation.

The above studies mainly focused on the descriptive aspect of corporate reporting on the Internet. The studies applied economic-based theories to examine very limited factors that affected Internet reporting. The objective of this study is to examine the relationship of IFR with the corporate governance mechanisms and unique ownership structures of Malaysian listed companies. In addition to economic-based theories, this study uses institutional theory to generate hypotheses about factors specific to the

Malaysian context. Other important factor such as Internet visibility is included to examine the Internet financial disclosure practices of Malaysian listed companies.

1.7 Brief Description of Methodology

A mixed research method is employed in this study with the content analysis method and in-depth semi-structured interviews comprising the two phases of investigation. It begins with a quantitative research through data obtained from the Internet and analysed using SPSS 15 in the first phase of the study. The researcher examines the content of listed companies' Web sites to assess the nature and level of Internet financial disclosure practices. It extends the prior literature by analysing the financial disclosure on company Web sites, adapting the list of Attributes for Electronic Distribution of Business Reporting Information by the Financial Accounting Standards Board (2000) and the timeliness by dimensions (Abdelsalam and Street, 2007). Each item will be assigned a score of 1 for the presence of the attribute and 0 for the absence of the attribute. The primary measure is a total disclosure score [AllAtt] across all items for each sample company. The study examines the relationship between the level of Internet financial disclosure with the corporate governance mechanisms and unique ownership structure, such as listed companies by family-concentrated ownership, government-linked companies and institutional investor ownership.

Many theories have been proposed to explain companies' practice on voluntary disclosure of corporate information. These include agency theory (Watt and Zimmerman, 1978); political costs theory (Holthausen and Leftwich, 1983), signalling theory (Ross, 1977; Morris, 1987), proprietary costs theory (Dye, 1985; Verrecchia, 1983; Darrough and Stoughton, 1990; Wagenhofer, 1990); legitimacy and institutional theory (Mezias, 1990; Guthrie and Parker, 1990; Carpenter and Feroz, 2001); cultural relevance theory (Gray, 1988) and contingency theory (Fechner and Kilgore, 1994; Doupnik and Salter, 1995). Such theories generally use intangible concepts that cannot be measured directly such as, “visibility”, “transparency”, “performance”, “legitimacy” and “culture” (Lopes and Rodrigues, 2007). This study included Internet visibility as the independent variable in Model 1 and as the dependent variable in Model 2. This study uses multiple regression analysis to analyse the relationship between a dependent (criterion) variable and several independent (predictor) variables.

The second phase of the study involves in-depth semi-structured interviews with ten (10) senior managers of the sample companies. The main purpose of the second phase of the study is to determine the managers’ perception concerning Internet reporting to test the applicability of disclosure theories and to identify factors that motivate local companies to engage in Internet reporting. The prior Malaysian studies are largely descriptive; there are relatively few research studies that examine the applicability of disclosure theories to explain the Malaysian reporting companies’ motivation. The concern is to understand the company behaviour in Internet reporting and to determine what motivates them to be more transparent. This research, therefore, has most relevance to the Malaysian regulator and others that have the same desire to promote greater transparency via the Internet.

1.8 Significance of the Study

As financial reporting on the Internet is becoming widerspread, accounting standard setters and regulators are beginning to question the quality and acceptability of such reporting practices. It is important for the regulators to understand the Internet reporting practices for regulation purposes. The main objective of this study is to examine the Internet reporting practices of Malaysian listed companies. Findings of this study provide a better understanding of the current level of financial and investor information delivery, as the content of Web pages are ever changing and dynamic.

There is a lack of explanatory research covering the Internet reporting practices of Malaysian companies. This study used regression analysis to analyse the relationship between a dependent (criterion) variable and several independent (predictor) variables in Phase 1. It contributes to the IFR, ownership structures and corporate governance literature in several ways. First, there is limited evidence that tests the impact of corporate governance mechanisms on IFR except in the developed economies. This study addresses the effect of the unique ownership structure and impact of corporate governance mechanisms specific to the Malaysian context, including certain board and audit committee characteristics adopted by the Securities Commission. The influence of audit committee characteristics on the IFR are a new governance variable to Malaysian IFR studies. Therefore, it adds to the existing literature of Internet disclosures and corporate governance. Second, as companies' Internet usage is constantly evolving, rapid changes in the Internet reporting environment warrant continual investigation. This study provides additional information regarding the Internet disclosure choices made by reporting companies in Malaysia. As Internet disclosure is mainly voluntary and unregulated in Malaysia, the findings provide empirical evidence to regulators concerning the current Internet reporting practices.

Phase 2 reports the findings of views from the reporting companies/preparers regarding their perception concerning Internet reporting to test the applicability of disclosure theories and to identify factors that motivate local companies to engage in Internet reporting. The findings are most relevant to Malaysian regulators in promoting greater transparency via the Internet.

1.9 Organisation of the Study

This thesis is divided into eight chapters organised as follows:

Chapter 1: Internet Financial Reporting: An Overview of Research. This chapter discusses the research problem, the objectives of the study, and provides a brief description of the methodology and significance of the study.

Chapter 2: Internet Financial Reporting: International Scenario. This chapter provides definitions and incentives of IFR, followed by literature review that examines the practices and issues relating to the recent development of Web sites as a means for corporate financial information dissemination.

Chapter 3: Internal Financial Reporting: Malaysian Scenario. This chapter briefly discusses the relationship-based capitalism in Malaysia and reforms since the financial crisis. This is followed by a review of the Malaysian literature on Web reporting, corporate governance and other voluntary disclosure studies.

Chapter 4: Research Framework. This chapter discusses various theories used by previous research with reference to the trends of IFR. It then discusses the development of a research framework and formulation of hypotheses to achieve the objectives of this study.

Chapter 5: Methodology. The chapter discusses the research paradigm. It outlines the research method, which includes a discussion of content analysis and in-depth semi structured interviews. The units of analysis, sampling design, data collection procedure and data analysis techniques are discussed in this chapter.

Chapter 6: Discussion of Content Analysis Results: Phase 1. This chapter discusses the data analysis by using statistical techniques to test the hypotheses developed in Chapter 4. This chapter elaborates on the descriptive analysis and multivariate analysis. The results from the data analysis provide evidence to support or reject the hypotheses. Finally, this chapter discusses the application of disclosure theories on the significant variables.

Chapter 7: Discussion of Interview Results: Phase 2. This chapter reports the results of the in-depth semi-structured interviews, the second phase of this study. It discusses the perception and awareness of the managers, the individual firm motives and determinants of IFR. The disclosure theories are used in the data interpretation process. IFR issues highlighted by the respondents are discussed.

Chapter 8: Summary and Conclusion. This chapter makes concluding remarks concerning the research questions and contributions to theory and practice. The chapter ends by highlighting some limitations of the study and suggesting certain recommendations to improve future research.

1.10 Conclusion

This chapter introduces the current phenomenon of IFR as an area to be studied. This study adds to the prior research by analysing the development of Internet financial disclosure of Malaysian listed companies. It investigates whether the decision to voluntarily disclose financial information via the Internet is influenced by the corporate governance mechanisms and unique ownership structure of Malaysian listed companies. Information provided on the companies' Web sites are content analysed to determine the extent of Internet voluntary disclosures. Voluntary disclosure theories are used to develop hypotheses about determinants specific to the Malaysian context. This chapter also discussed the significance of this study, which includes filling the research gap concerning corporate governance variables in IFR. The next chapter provides a literature review on Web reporting.