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The Monitoring Effect of Information Disclosure: Institutional and Retail Investors

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Abstract

Huang and Zhang (2012) provide evidence that enhanced information disclosure helps reduce the agency cost from the U.S.A. stock market that is dominated by institutional investors. This study attempts to explore if the supervision and disciplinary effect of capital market still exists in Taiwan's stock market that is dominated by retail investors. We use the empirical model of Huang and Zhang (2012) to verify whether cash holdings are valued differently depending on information disclosure levels. The empirical results show that the cash holdings of companies with better disclosure quality are not valued significantly higher than those of companies with poorer disclosure quality. This finding is inconsistent with the evidence of Huang and Zhang (2012) from an institutional investor dominated stock market. This study further divides the sample into two sub-samples, one consisting of firms with high institutional trading percentage and the other consisting of firms with low institutional trading percentage, to examine the monitoring effect of institutional and retail investors. Results indicate that for firms with a higher institutional trading percentage, the relation between the product of ratio of change in cash and disclosure level and abnormal returns is significantly positive; for firms with a lower institutional trading percentage, the relation is not significant. This explains the external monitoring in the capital market is mainly provided by institutional investors, and the effect of enhanced disclosure on corporate governance is more pronounced in the stock market dominated by institutional investors.

Keywords: Information disclosure, Institutional investors, Agency cost, Retail investor, Cash holdings.