



INFORMATION CONTENT OF ANALYSTS' REPORT:
MALAYSIAN EVIDENCE

BY

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ABSTRACT

This research aimed to empirically investigate the following: (i) information content of analyst report on stock return; (ii) degree of informativeness in analyst report; (iii) accuracy of analyst recommendation; and (iv) enhancement of information disclosure in the analyst report. Samples of analyst reports collected for the purpose of analysis were 657 daily basis reports dating from January 4th, 2010 to December 24th, 2015. The study employed a market-adjusted method for the calculation of cumulative abnormal return (CAR) and panel regression to test the research objectives. Based on the models developed, the empirical finding revealed the following outcomes: (i) model one showed that 66.67% of the variables had significant relationship with the return (target price or TP, and earnings forecast or EF) out of three information contents, (ii) model two hypothesised that only 16.67% of the variables had momentous explanatory power (return of equity or ROE, and market capitalization or MC) over the CAR, and (iii) finally, model three which was a combination of model one and model two showed that 33.33% of the variables (target price or TP, earnings forecast or EF, return on equity or ROE, cash flow to price or CFP, and sales to price ratio or SPR) had substantial relationship with the CAR. Therefore, it was concluded that not all of the information contained in the report had explanatory power in explaining returns. The result remained the same even though the models were controlled according to different segmentations such as industries, age, and beta classifications. In terms of accuracy of recommendation, the study found that the percentage of accuracy was 57% based on selected report, evidenced by the differing target price and ending price. Hence, it can be concluded that analyst reports possess less informational role among investors. With respect to the enhancement of information disclosure, the current study found that Malaysian analysts tended to rely heavily on statistical justification alone in making recommendations. The qualitative result suggested that analysts should consider incorporating both quantitative and qualitative information which will lead to a fuller disclosure of information, an improvement which is deemed necessary as the analyst report continues to constitute a salient agent in the investors' decision-making repertoire in the local context.

ملخص البحث

هذا البحث يهدف إلى التحقيق العملي من الآتي: (i) محتوى المعلومات التي يحتويها تقرير عائد الأسهم، (ii) معدل المعلومة التي يحتويها تقرير المحلل، (iii) دقة توصيات المحلل، (iv) تعزيز الإفصاح عن المعلوم في تقرير المحلل. تم تجميع عدد 657 تقريراً من تقارير المحللية على أسس يومي وضعها عينات محايدة لغرض تحليلها للفترة من 4 يناير 2010م إلى 24 ديسمبر 2015. الدراسة استخدمت طريقة السوق المعدل بهدف حساب تراكم العوائد غير الطبيعية (CAR)، وكذلك استخدمت الانحدار الخطي لاختبار أهداف الدراسة اعتماداً على النماذج المطورة في هذه الدراسة، النتائج العملية أظهرت الآتي: (i) الأنموذج الأول ظهر أن معدل 66% من المتغيرات لديها علاقة مع العائد (السعر المستهدف والعائد المتوقع) من إجمالي ثلاثة محتويات للمعلوم، (ii) الأنموذج الثاني افترض أن 16.67% من المتغيرات لديه قوة تفسيرية لحظية آنية (العائد على حقوق الملكية والرأسمال السوقي) من إجمالي العوائد غير الطبيعية (CAR)، iii أخيراً الأنموذج الثالث والذي يجمع ما بين الأنموذج الأول والثاني أظهر أن 33.33% من المتغيرات (السعر المستهدفة والعائد المتوقع والعائد على الملكية والعائد الداخل بالنسبة للسعر والمبيعات إلى معدل السعر) لديها علاقة جوهرية مع إجمالي العوائد غير الطبيعية (CAR). لذا يمكن أن نستخلص أنه ليس بالضرورة كل المعلومات التي يحتويها تقرير المحلل لديها قوة توضيحية. نتيجة الدراسة ما زالت متشابهة على الرغم أن الأنموذج يحتوي جزئيات عدت مثل الصناعات، العمر وتصنيفات بيتا. من حيث دقة التوصية، وجدت الدراسة أن نسبة الدقة كانت 57% بناءً على تقرير مختار، يتضح من السعر المستهدف المختلف والسعر النهائي. لذا يمكن أن نستخلص من ذلك تقرير المحلل لديه دور معلوماتي منخفض بين المستثمرين. واستجابة لتعزيز الإفصاح للمعلومة الدراسة وجدت أن تقارير المحلل في ماليزيا تعتمد فقط على تبريرات إحصائية في توصياتها. وكذلك النتائج الاستقرائي أظهرت أن المحللين يجب أن يضمنوا في تحليلاتهم المعلومات الكمية أو النوعية الاستقرائية والتي تقود الإفصاح الكامل للمعلومة، وكذلك يجب أن يضمنوا التحسينات التي تبدو ضرورية حيث إن تقرير المحلل يُعدّ بوصفه وكيلاً صامتا ومرجعاً مساعداً بالنسبة لقرارات المستثمرين على المستوى المحلي.

APPROVAL PAGE

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DECLARATION

I hereby declare that this dissertation is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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Signature.....

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This thesis is dedicated to my parents, Mohd Thas Thaker and Ummul Nabisha Beevi and to my wife, Nur Hajirah

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LIST OF ABBREVIATIONS

AR	Abnormal Return
APT	Arbitrage Pricing Theorem
BAB	Betting Against Beta
BursaMKTPLC	Bursa Market Place
CAPM	Capital Asset Pricing Model
CAR	Cumulative Abnormal Return
CBRS	Bursa Malaysia Research Scheme
CFP	Cash Flow to Price
CMT	Capital Land Malaysia
CSR	Corporate Social Responsibility
DBT	Direct Business Transaction
DPS	Dividend Per Shares
EF	Earnings Forecast
EMH	Efficient Market Hypothesis
EPS	Earnings Per Shares
FEM	Fixed Effect Model
GDP	Gross Domestic Product
ISIN	International Securities Identification Number
KLCI	Kuala Lumpur Composite Index
MBV	Market to Book Value
MC	Market Capitalisation
MD&A	Management Discussions and Analysis
NPV	Net Present Value
OLS	Ordinary Least Square
OMT	On Market Trades
Pages	The Number of Pages
PDT	Proprietary Day Traders
P/E	Price to Earnings Ratio
POLS	Pooled Ordinary Least Square
R&D	Research and Development
REIT's	Real Estate Investment Trust
REM	Random Effect Model
ROE	Return of Equity
SA	Size of Analysis
SE	Stock Exchange
SH	Number of Shareholders
SIDC	Securities Industry Development Corporation
SPKLCI	Share Price Relative to Kuala Lumpur Composite Index
SPR	Sales to Price Ratio
TP	Target Price
TVOL	Trading Volume
VIF	Variance Inflation Factor

CHAPTER ONE

INTRODUCTION

1.0 INTRODUCTION

This chapter explicitly discusses the background of the study. The first section provides an overview with regards to the subject matter. The next section explains the problem statements, objectives, and research questions in order to describe the current research's nature in an in-depth manner. Finally, this chapter also addresses the scope and contribution of the study.

1.1 BACKGROUND OF THE STUDY

The role of financial analysts in the security market seems to be very important in promoting market efficiency as they are bringing in new information to market players pertaining to a company's financial and management highlights. The usual practice among analysts is to use certain key information to decide whether to recommend the buying, selling, or holding of shares. Information which are commonly disclosed in the report consist of target prices, earnings forecasts, and managerial information. A majority of literatures claim that by disclosing such information, analysts help in speeding up price discoveries (Baule & Wilke, 2004; Haely & Palepu, 2003).

Furthermore, one of the reasons why investors place assurance in analyst reports is because they believe that analysts typically have a strong relationship with the company. This subsequently increases the investors' confidence level towards the information shared in the report. This is also consistent with the view that analysts in general are well-informed in assessing information related to a company. Although a

significant advantage of the analyst report is that it helps investors in outperforming the market by using the information given, it nevertheless still contradicts to the Efficient Market Hypothesis (EMH). This contradiction is due to the analyst reports' tendency in speeding up price discovery, obviously conflicting with the theory of informationally-efficient markets. As stated in the EMH, stock prices always incorporate all of the available information which are appropriate to the investors. By taking this consideration into account based on the view of an informationally-efficient market, the role of analysts appears to be insignificant as an information intermediary since each and every information relevant to the investors have been incorporated into the stock prices (Baule & Wilke, 2014).

According to the basis of EMH, the market is assumed to be efficient, in which stock prices incorporate all available information that can then be used to determine the intrinsic value of the stock prices. Given this, should any new information is made available and is then processed further by market players, this causes share prices to reach another level of equilibrium. The Capital Market Theory (CMT) requires certain conditions to be met in order to fulfil its criteria. For one, all market players must have equal knowledge or the same information, and there must be an ease of access to all available information. If we are to follow the EMH, the role of the analyst report is insignificant. However, this does not mean that the analyst reports should be totally ignored as some investors still make use of the reports as one of their sources of information. This is evident in many literatures such as those by Womack (1996), Frankel et al. (2006), and many others. Closer inspection of the empirical literature makes noticeable that one of the major questions which studies have often posed is to what degree analysts are able to accomplish their role as market intermediaries and in

supplying all information related to firms to the investors. This matter remains unambiguous and vigorously discussed and debated among scholars in the field.

Various empirical investigations are carried out to capture the significant extent to which the analyst influences stock price movements, as well as to see whether the analyst report distributes all of the information needed by investors and vice versa. A majority of the investigations, such as but not limited to Ryan and Taffler (2006), Altinkilic and Hansen (2009), and a more recent study by Gerritsen and Lotter (2014) focused their analysis on price discovery and the movement of share prices a day before and after an analyst recommendation takes place by using a sophisticated methodology known as the “Event Study” in order to elucidate the contents of the analyst report.

Another research scope on the use of analyst report concerns information content, which has also been explicitly researched by many scholars in the past. From a theoretical paradigm, the informational content in the analyst report influences a change in stock prices due to the arrival of new information in the market. For example, if a company announces the firm’s recorded positive earnings, this information will lead to a positive change in stock prices. This announcement does not only affect the positive direction of share prices, but may also lead to an adverse direction if the information related to a company is negative. Negative information may be in terms of mismanagement and the company encountering a reduction in sales revenue, which may signal undesirably to the investors and subsequently lead to a decrease in share prices.

The importance of information content has been extensively disclosed in various literatures and not limited to Frankel et al. (2006). Several identified key importance of the analyst report such as: (i) analyst report tends to promote