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Delisting of firms in Malaysia; what the financial conditions and auditor reports reveal?

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ABSTRACT

The study examines the financial conditions and auditor's reports in relevance with the delisting of firms from the Malaysian stock market. The dataset comprised of the period of 5 years from 2012 to 2016 and finds out that total 69 companies were delisted from the exchange. By using the descriptive and univariate analysis techniques we find out that poor financial condition is a major reason of delisting of firms in Malaysia. The mean difference between unclean and clean audit opinion groups demonstrate that auditor's role to evaluate the going concern assumption is also very important as more then 1/3 of the firms received unclean audit opinion due to going concern uncertainty. The unclean group delisted firms on average showed high losses, high negative ROA, high leverage and low total assets as compared to clean group. The study is useful for investors and other stakeholders to make their investing decisions efficiently.

Keywords: Delisting, Going Concern opinion, Capital Market, Bursa Malaysia

INTRODUCTION

Delisting has become a circumstance of crucial significance in recent years; it is defined as the removal of a listed company from the stock exchange (Martinez & Serve, 2017). According to Kenton W. (2018) the delisting of a company can be voluntary for example mergers, seeks to become private or involuntary when declare bankruptcy, cease operations and does not meet listing necessities. Often a company voluntarily request for delisting when other private equity firm acquires the stocks and new shareholders reorganized the company. Usually, when the cost of being publically traded exceeds from its benefits, the companies also prefer to become privately traded. Bharath and Dittmar (2010) argue that the trade-off between listing benefits and costs explicate the decision to go public, and in reverse the decision to exit from a public market also elucidate by this assessment. The companies which operate individually into the stock market as well can call for voluntary delisting when merge and operate as a new entity.

On the other hand a company possibly delisted involuntarily, from the stock exchange it's operating in. In general the listed companies have to follow definite rules and regulations which are imposed by the stock exchanges (Kennon J., 2018). For example if a company wants its shares to be traded in the Bursa Malaysia (Malaysian stock exchange), it would be required to hold a minimum share price, certain number of shareholders and a minimum market cap.

The listed companies also have to provide certain financial reports to the shareholder or prospective shareholders. If at any moment the companies fail to fulfill such criteria they would no longer be traded on the stock exchange and must be delisted. Often the managerial or financial troubles also cause the stock price to fall which eventually leads to delisting. The delisting of a firm by the stock exchange due to the financial reasons is a painful process; it hurts the shareholders who invested in the company. When delisting occurs the share price falls in half roughly as examined by (Macey et al., 2008).

As the poor financial condition is a major cause of the involuntary delisting and harms the investors, the role of external auditor is very important to properly evaluate the financial statements. While preparing the financial statements the going concern basis is widely used by management that the firm will continue its operations in the foreseeable future. The going concern assumption is commonly understood and accepted by the accounting experts; and follows the conceptual framework of the IFRS (international financial reporting standards). If there is going concern uncertainty and the management fails to provide sufficient evidence regarding this assumption the auditor's convey their reservations through audit opinion. Usually auditors showed their concern about going concern assumption by adding emphasis of matter paragraph or in more serious cases issue disclaimer opinion.

Despite the importance of the issue not many studies have examined the delisting of companies especially in relevance with the going concern opinion. As the capital market of Malaysia have very important role in Asia pacific region and an emerging market, this study tries to determine what factors leads the firms to be delisted from the Bursa Malaysia. The auditor's role to evaluate the financial statements also investigated. The study will be very useful for stakeholders and investors as they would better analyze the situation before making investing decisions. The rest of the paper follows the background and literature review. Then dataset and methods are explained in the third section. Forth section presents the descriptive statistics and discusses the results. And finally fifth section concludes the study.

BACKGROUND OF STUDY

The most important purpose for firm's to get the stock listed into the market, is to increase funds and spread risk amongst large number of shareholders. According to Kim and Weinsbach (2008), there are at least three main reasons for listing the stock; to increase the liquidity, to transfer the wealth from prospective shareholders to existing shareholders, and to finance the ongoing projects or investments. Especially when a company grows, the shareholders want to cash in some of their profits while still owning the percentage of shares. In addition to these benefits companies can enjoy additional leverage on loans from the financial institutions and attracts top talent by offering stock option programs.

There are certain rules the companies have to follow who wish to list their shares for trading. In Malaysia a company is listed on the Bursa Malaysia Berhad which is an exchange holding company established under the capital markets and services act of 2007. Bursa Malaysia is a fully integrated stock exchange in Malaysia, which offers a complete range of related services including trading, clearing, depository and settlement of stocks. As like the other stock exchanges e.g. NYSE, NASDAQ; the bursa Malaysia also impose certain requirements for listing related to the number of shareholders, share price and market cap. The stock exchange have the right to delist any company who violates the set rules or unable to fulfill the requirements at any stage. Involuntary Stock delisting is a painful process for the company itself and for the shareholders also because it cause the shares price fall enormously (Martinez & Serve, 2017).

Several recent studies noticed the falling number of listed companies in US since the last two decades e.g. (Gao et al., 2013; Doidge et al., 2015 & Grullon et al., 2015). In this regard Martinez and Serve (2017) reported that over the period of five years (2008-2012) more than six thousands firms delisted in the 42 countries. The study further shows that the delistings happened mostly in three geographical regions including US, UK and Continental Europe where 75 percent of the total delistings occurred. The stock market of UK exhibited almost the same pattern as the US market. This decline is explained by many reasons for example Doidge et al. (2015) highlights that the fall in US listed companies is linked with the "listing gap" a term refer to the difference of listing and delisting ratios. They find that high rate of delistings and low rate of new listings cause the decline of listed firms and this rate has been negative since 1997.

The literature explains several causes of high rate of delistings; the delisting can be voluntarily on the request of the firm by self or involuntarily when the action taken by the stock exchange. The voluntary delisting occurred when company decide to go private or merge with another equity. In this regard Bharath and Dittmar (2010) argued that the chances of going private enhances with the corporate bonds default risk premium. They recommend that the costs of bankruptcy have an affirmative impact on the choice to go private. In the favor of voluntary delisting Weir et al. (2008), concludes that financial distress may not be central to the decision to go private and didn't find any evidence that the companies with poor financial performance only go private. Further Leuz et al. (2008) finds that going private transaction (GPT) usually involves takeovers that concentrate company ownership in the hands of new shareholders or investors who are not interested to have their equity traded publically.

On the other hand, the main causes for involuntary delistings are liquidation, bankruptcy, or financial restructuring of the companies (Macey et al., 2008). Involuntary delisting literature mainly focused on the US because it has such institutional settings which suit this sort of delisting. A study by Martinez and Serve (2011) employ financial ratios to illustrate that delisted firms performed more badly than their listed counterparts earlier to delisting. Thomsen and Vinten (2014) also confirm this result and reported negative ROA on average of the firms that go private. Usually the financial statements revealed the information related to the financial position of the company.

Another cause of involuntary delisting is due to the regulation as finds out by Kashefi Pour and Lasfer (2013), because some of the companies may breach the listing requirements. In Europe the listing regulations are less strict and the main reason of delisting is the failure to accomplish least requirements imposed by market. The EU directive 2004/39/EC basically specifies that "the operator of the regulated market may suspend or remove from trading a financial instrument which no longer complies with the rules of the regulated markets unless such a step would be likely to cause significant damage to the investor's interest or the orderly functioning of the market".

As previous studies suggested that financial troubles are a major cause of delisting, the role of auditor is very significant to properly evaluate the financial statements of the company. While preparing the financial statements management may use the assumption of going concern. Under the going concern assumption, a firm is normally observed as ongoing in business for the likely future with nor the intention neither the necessity of liquidation. The going concern is a basic assumption in the preparation of financial statements and widely accepted by the accountants. It is supposed that the firm will be able to discharge its liabilities, realize its assets and get refinancing (if needed) in the normal course of business.

The auditor has the responsibility to evaluate whether there is substantial doubt about the firms' ability to continue as a going concern for a rational period of time. The auditor's evaluation is based on his or her knowledge of relevant conditions and events that exist at or have occurred prior to the date of the auditor's report. If the auditor conclude that there is considerable doubt, he or she then consider the adequacy of disclosure about the firms' possible inability to continue as a going concern for the mentioned period of time, and include an explanatory paragraph (following the opinion paragraph) or issued the disclaimer opinion in his audit report to reflect his or her concern (ISA, 2015).

This study is unique to explore the role of auditor in evaluation of the financial statements of the delisted firms. Further we didn't find any study which examined the causes of delisting of public companies in Malaysia. The next section will shed light into the dataset and method used in this study.

DATA SAMPLE AND METHOD

The data sample used for this study is comprised of all the companies delisted from Bursa Malaysia. According to the information available on the Bursa Malaysia website, on the whole 69 firms were delisted from the stock exchange during the period from 2012 to 2016. The financial information of these firms is collected from the DataStream, however for some companies the values were missing then we used annual reports to complete the dataset. Further the independent auditor reports of these companies are analyzed to identify the type of audit opinion each delisted company received in the consequent year.

Like Doidge et al. (2015), this study measures the listing and delisting ratios, that is to divide the new firms listed and delisted during the year divided by the total number of firms on the market. We use univariate analysis methods to examine the data and to draw conclusion. There are many reasons which can cause delisting as discussed above; we use financial variables including net profit, ROA, financial leverage and total assets of the firm, by following the prior studies (Martinez & Serve, 2011 and Thomsen & Vinten, 2014).

DESCRIPTIVE ANALYSIS AND RESULTS

Table 1 demonstrates the total number of companies listed in the Bursa Malaysia over the period of five years from 2012 to 2016. Around 900 companies on average were listed including the main and Ace markets of Bursa Malaysia. There is no any drastic change in the number of companies listed or delisted on the exchange. According to the company announcement on Bursa website, we identify that 69 companies were delisted from the market during 2012 to 2016. In the year 2012 the number of delisted firms was 19 but in 2016 only 9 companies were delisted. The number of delisted companies is not high as in US, UK or other European regions, and the market is almost consistent throughout the years. The capital market of Malaysia is considered one of the most established and regulated market in the Asia pacific region.

Table 1
Total number of companies in Bursa Malaysia

Market	**Year**					**Total**
	2012	**2013**	**2014**	**2015**	**2016**	
Delisted	19	15	11	15	9	69
Listed	891	889	888	877	892	4437
Total	910	904	899	892	901	4506

Table 2 below demonstrates the newly listed and delisted firm's ratios. In Malaysia new list ratio on average is 1.42% in comparison with average delisting ratio 1.53%. But in the year 2016 only, new list ratio is above the delisting ratio (2.66% to 1.0% respectively). The results clearly defines that there is no huge listing gap in Malaysia as in the US or UK. In US the new lists vs. delisted firms' ratios were on average 4.3% and 10.4% respectively, during the period 2008-2012 as reported by (Doidge et al., 2015). The similar pattern was observed in the UK as 6.8% new firms were listed with compare to 14.4% firms delisted. Martinez and Serve (2017) also documented that in continental Europe new list ratio is slightly above the delisting ratio (5.1% vs. 4.7%).

Table 2
Newly listed and delisting firms ratios

Year	Listing Ratio	Delisting Ratio
2012	-	2.09
2013	1.44	1.66
2014	1.11	1.22
2015	0.45	1.68
2016	2.66	1.0

The table 3 below shows the descriptive statistics for the financial variables examined in this study. Total 34 companies in the sample showed loss in the consequent year and the variable net profit/loss ranges from MYR 1173687/= thousand loss to MYR 1432648/= thousand profit. The average value is just 8029.32/= thousand profit which is very low in comparison with average profit value of other public listed companies. The median value is also negative which is -186. Next 31 firms in the data set shows the negative return on assets, the difference is huge between negative ROA percentage as compared to maximum ROA (-4024.45 to 70.73). The mean ROA is -75% almost, which illustrate that negative ROA is an important determinant of delisted firms. This result is consistent with the (Thomsen & Vinten, 2014) who documented that most of the delisted firms shows the negative return on assets.

Further, the leverage is an important indicator of a firm's financial health measure as debt to asset ratio. The mean percentage (124.87) of leverage in the table below shows that the delisted firms were facing very high leverage as a whole. More than 1/3 delisted firms have the leverage more than 50% as examined in this study. The data set comprised of all delisted firms shows that mean value of total assets is MYR 1074995/= thousands. Somehow, these statistics are showing that most of the delisted firms in Malaysia were facing poor financial conditions.

Table 3
Descriptive statistics of the dataset

Variable	Min	Max	Mean	Median	St. Dev
Net Profit	-1173687.0	1432648.0	8029.319	-186.000	274559.432
ROA	-4024.45	70.73	-75.536	1.090	486.807
Leverage	.03	5113.66	124.869	36.030	611.964
Total Assets	2225.000	21854008.000	1074995.145	217935.000	2866906.277
N					**69**

The type of audit opinion delisted firms received is presented in the table 4. After inspecting the auditor reports we find out that, 25 delisted firms out of 69 received unclean audit opinion which is more than 1/3 of the total sample. Almost all of the unclean opinions except one are on the basis of going concern uncertainty. The auditors showed their concern that there is a considerable doubt that the company will continue its operations in the foreseeable future. This result also confirms that large number of delisted firms was facing ambiguity about their survival because of the bad financial conditions.

Table 4
Types of audit opinions delisted firms received

Type	**Frequency**	**Percentage**
Clean	44	63.8
Disclaimer	14	20.3
Emphasis of Matter	10	14.5
Qualified	1	1.4
Total	69	100.0

To further analyze the role of auditor about the delisting of firms, we run the individual t-test which determines whether there is a statistical difference between the means of clean and unclean audit opinion groups. The table 5 shows that all the 4 financial variables are significant at 10% level. The firms which received unclean audit opinion are financially weaker as compared to the clean group. Delisted firms in the unclean group bear huge losses in the consequent year, and very high negative return on assets as compared to clean group. The average percentage of financial leverage is also significantly high. The table below illustrates that average total assets of unclean opinion firms are too low in comparison with clean opinion group (MYR 211842.36 thousands vs. MYR 1565422.86 thousands).

Table 5
Test of difference between clean and unclean audit opinion groups

Variable	**Clean AO**	**Unclean AO**	**t-test (Sig. 2-tail)**
Net Profit	51936.795	-69247.840	1.791*
ROA	5.344	-217.885	1.864*
Leverage	27.953	295.441	-1.772*
Total Assets	1565422.864	211842.360	1.922*

Note: *Significant at p_0.1 level

This result clearly depicts that the auditor opinion is an important indicator to be consider in respect of delisting of firms. The result also indicates that a considerable number of companies in Malaysia were involuntary (poor financial condition) delisted from the stock exchange. As like US the Malaysian capital market is also highly regulated; the results of the study are consistent with the (Martinez & Serve, 2011; Macey et al., 2008 and Thomsen & Vinten, 2014).

CONCLUSION

The study aims to examine the role of auditor and poor financial performance in relevance with the delisting of firms from the Bursa Malaysia. The findings are complied with the previous studies that delisting companies shows negative return on assets and high leverage. By comparing the mean of clean and unclean groups, we find out that there is a significant difference between both groups. The unclean group companies shows negative profitability or losses, negative rate of return on assets, high debt to assets leverage and low value of total assets. This results confirmed that almost 1/3 of the Malaysian listed firms delisted because of the financial problems. The percentage of listing and delisting ratios are not high in Malaysia and the market is overall consistent in terms of the firms listed on the bursa Malaysia. Overall the results explained that most of the firms delisted in Malaysia voluntarily e.g. (mergers or cost benefit analysis or going private). But there is also a considerable proportion of firms delisted due to poor financial performance.

Further, the auditors' evaluation of going concern assumption also important as almost 36% of the firms received unclean opinion. They showed their concerns about the going concern uncertainty. Auditors issued going concern opinion when companies fail to provide strong evidence that it can continue operations, and there is high uncertainty that the firms could fulfill its financial obligations. The result shows that the auditor's opinion is also an important indicator of delisting of firms from bursa Malaysia. The findings have several implications for the stake holders and investors. The financial statements of the company and the auditors' opinion on the firm's financial statements are very important to look into before making investing decisions.

As far as importance there are some limitations of the study. First, the study just analyzes the company announcement on the Bursa Malaysia website to identify the delisted firms; the number may not be concise. Second the study didn't employ any multivariate or regression analysis due to the lack of data. The future studies in this regard can evaluate this topic further by introducing more precise methodology. The study contributes into the literature of delisted firms and motivates for further examination.

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