

Institutional investor preferences

Do internal auditing function and audit committee effectiveness matter in Malaysia?

Internal
auditing

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Abstract

Purpose – This study aims to examine the institutional investors' preferences for internal governance mechanisms (internal audit function and audit committee effectiveness) in an emerging country like Malaysia.

Design/methodology/approach – A sample of 2,020 yearly firm observations in Bursa Malaysia over the period 2009-2012 is used. The two-stage least squares using instrumental variables (IV-2SLS) analysis is used to examine the relationships. To corroborate the findings of this study, a regression based on a one-year lag of the independent variables is used. Furthermore, ordinary least square regression and Generalized Method of Moments using instrumental variables (IV-GMM) are used.

Findings – Positive associations are found between the internal audit function and audit committee effectiveness and the institutional ownership.

Research limitations/implications – These findings imply that institutional investors gravitate to firms that have high investment in internal audit function and effective audit committee. These findings are consistent with the conjecture that institutional investors try to minimize monitoring and exit costs and meet their fiduciary responsibility by investing in better internal audit firms.

Practical implications – This study offers insights to policymakers interested in enhancing internal governance mechanisms to attract institutional investors.

Originality/value – Limited empirical studies have examined the relation between internal governance mechanisms (internal audit function and audit committee effectiveness) and institutional ownership. This study adds to the existing literature on the importance of internal governance mechanisms by documenting an association between internal audit function and audit committee effectiveness and institutional ownership in an emerging country like Malaysia.

Keywords Corporate finance, Corporate governance, Malaysia, Institutional ownership, Audit committee, Internal audit function, Emerging country

Paper type Research paper

1. Introduction

Over the recent decades, corporate governance has received great attention and significant public and regulatory concern due to financial crises and firms scandals. Furthermore, regulators aim to enhance the firm's governance by encouraging institutional investors as a monitoring body. However, the impact of the regulators' amendment in corporate

