

Continuous Disclosure Practices in the Korean Equity Market

Jin Young Yang, Research Fellow*

The rationale for continuous disclosure is to provide the market with material information about corporations' activities on a timely basis so that market participants can make informed investment decisions at all times. The Korean equity market is unique in that its continuous disclosure rule provides a list of disclosure categories that describe types of information required to be disclosed in detail, while most developed markets provide clear statements of intent but lack detailed implementation guidelines. This study examines recent trends in continuous disclosure in the Korean equity market to extend understanding of the economics of the Korean continuous disclosure regime.

I. Introduction

The separation of management and ownership means that shareholders have limited access to day-to-day operations of corporations. Other stakeholders' (including bondholders, suppliers, customers, etc.) access to information is even more limited. Particularly, in a financial market setting, investors need information about corporations such as financial performances, capital structure, and business plans to determine the values of corporations' securities and make informed investment decisions. Corporate disclosure plays a critical role in mitigating such information asymmetry between management and outside stakeholders. Corporate disclosure is defined as the release of relevant information by corporations to their stakeholders. Corporations are required

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as the Korea Capital Market Institute's official position.

Tel: 02-3771-0874, E-mail: jinyang@kcmi.re.kr

to disclose information according to a specific set of corporate disclosure rules. These rules are enforced by financial regulatory authorities, exchanges, or both.

Corporate disclosure is generally classified into periodic and continuous disclosures in most disclosure regimes. Periodic disclosure includes annual reports and quarterly reports that mainly show financial performances in a given time period. In contrast, continuous disclosure is the immediate release of relevant information as soon as corporations become aware of that information. The theoretical rationale for continuous disclosure is to provide investors with market-sensitive information about corporations' activities on a timely basis so that all investors are equally informed. Also, in theory, this enables market participants to make informed decisions about their financial investments at all times.

The primary functions of financial markets are price discovery and liquidity provision (O'Hara, 2003), and they are related to the economics of continuous disclosure. Price discovery is defined as the process through which new information gets incorporated into securities prices (Madhavan, 2000). The timeliness and quality of continuous disclosure determine the speed of price discovery, which, in turn, directly affects the level of market efficiency. In an efficient market, securities prices fully reflect all available information (Fama, 1970). Market efficiency is an important issue because it leads to: (a) optimal allocation of ownership of the economy's capital stock and (b) a level playing field for investors. Thus, timely disclosure of price-sensitive information is critical for price discovery, and ultimately for market efficiency.

Numerous academic studies find evidence that information asymmetry greatly affects liquidity. In perfect markets, the Walrasian equilibrium ensures that all potential investors' competitive demands are correctly reflected in prices (Bias, Glosten, and Spatt, 2005). However, in practice, transaction prices could deviate from equilibrium values due to non-synchronous arrivals of buyers and sellers, which necessitates the presence of liquidity providers (such as designated market makers), who stand ready for immediate transactions. In the presence of information asymmetry, liquidity providers require even higher premiums for their services (e.g. Easley and O'Hara, 1987). This implies that an improvement in continuous disclosure policy is likely to

result in an increase in liquidity.

Continuous disclosure, however, is a challenging issue for policy makers and exchange officials. For example, there is a choice between rules-based and principals-based approaches. Principals-based disclosure systems are typically characterized as containing clear statements of intent but lacking detailed implementation guidelines, while rules-based disclosure systems are generally characterized as providing greater details regarding implementation and compliance. This implies that principals-based disclosure policies require corporations to exercise judgment, while rules-based disclosure policies require corporations to follow the detailed rules with minimal judgment.

Most corporate disclosure regimes employ the principles-based disclosure approach, which provides clear statements of intent. For example, the Australian disclosure rules state that: “once an entity is or becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of the entity’s securities, the entity must immediately tell ASX that information” (ASX, 2013). By contrast, rules-based disclosure systems are used in only a few countries including Japan, Singapore, and Korea. In particular, the Korean continuous disclosure system provides a list of disclosure categories that describe types of information required to be disclosed in detail. For example, corporations listed on the KOSPI market are required to disclose “information on fine, penalty, extra charge, or surcharge imposed (5% or more of net worth, 2.5% or more in the case of large-sized company)” (KRX, 2012).

Despite the importance of continuous disclosure in the Korean equity market, there is no comprehensive study that provides an overview of continuous disclosure practices in either KOSPI or KOSDAQ markets.¹⁾ This study extends understanding of the economics of the Korean continuous disclosure regime by examining recent trends in continuous disclosure in the Korean equity market. The remainder of this study is structured as follows. Section 2 briefly describes corporate disclosure rules in Korea. Section 3 examines recent trends in continuous disclosure in Korea. Section 4 concludes.

1) These are the two main exchanges operated by the Korea Exchange (KRX).

II. Corporate Disclosure Rules in Korea

Corporate disclosure is defined as the release of relevant information by corporations to their stakeholders. Periodic and continuous disclosures are the two main disclosure types in the secondary market for Korean public equities.²⁾ Periodic disclosure includes the publication of annual, semi-annual, and quarterly reports that mainly show financial performances in a given time period. These reports are easily accessed via the disclosure systems of the KRX and Financial Supervisory Service (FSS). An annual report includes management's discussion and analysis, financial statements, notes to financial statements, auditor's report, summary financial data, and corporate information. Listed corporations are required to file annual reports with the KRX and FSC within 90 days of the end of a financial year. Semi-annual (quarterly) reports are produced on a half-yearly (quarterly) basis to show financial performances and corporate activities in a timelier manner. Listed corporations are given 45 days to prepare semi-annual and quarterly reports after the closing date of each quarter.

With respect to continuous disclosure, the Korean equity market employs the rules-based corporate disclosure approach, while most developed equity markets use the principles-based disclosure approach. The Korean corporate disclosure system is an extreme version of the rules-based approach in that corporations' disclosure processes involve minimal judgments. This is possible because: (a) each category in the disclosure rule is clearly stated, and (b) corporations are not required to disclose information that does not belong to any of the categories. By contrast, most developed markets' disclosure rules provide clear statements of intent with some basic implementation guidelines. For example, Section 3.1 of the ASX Listing Rules requires that corporations notify the ASX immediately of any information of which they become aware that could have 'a material effect on the price or value of securities of the company' (ASX, 2013). Also provided is a list of information types that fall within this category as a guideline.

2) The other corporate disclosure types are "report on material facts", "other disclosures", "disclosure on equity holdings", and "fair disclosure".

III. Recent Trends in Continuous Disclosure

1. Distribution of announcement frequencies

This section sheds light on recent trends in continuous disclosure practices in both KOSPI and KOSDAQ markets. Figure 1 depicts the year-by-year announcement frequencies from 2009 to 2012 for KOSPI and KOSDAQ markets. The annual average announcement frequency for KOSPI-listed stocks had remained largely constant with the highest frequency of 11,204 in 2009 and the lowest frequency of 10,755 in 2010. On the contrary, announcement frequencies for KOSDAQ-listed stocks had decreased steadily from 18,233 in 2009 to 13,293 in 2012, a drop of 27%. Figure 2 presents the annual average number of (both KOSPI-listed and KOSDAQ-listed) corporations that made continuous disclosure announcements from 2009 to 2012. The number of announcing corporations had been largely constant in both KOSPI and KOSDAQ markets. This indicates that the drop of 27% in the announcement frequencies for KOSDAQ-listed stocks did not result from a decrease in the number of announcing KOSDAQ-listed corporations.

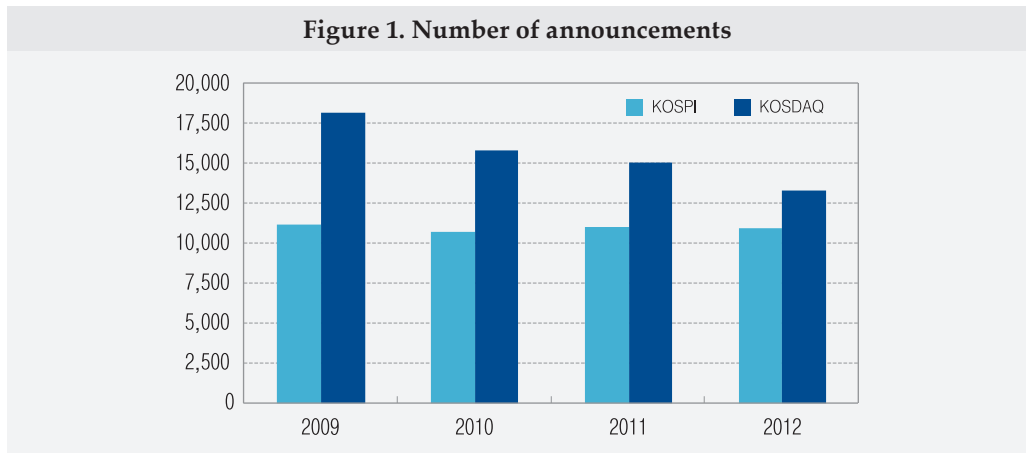
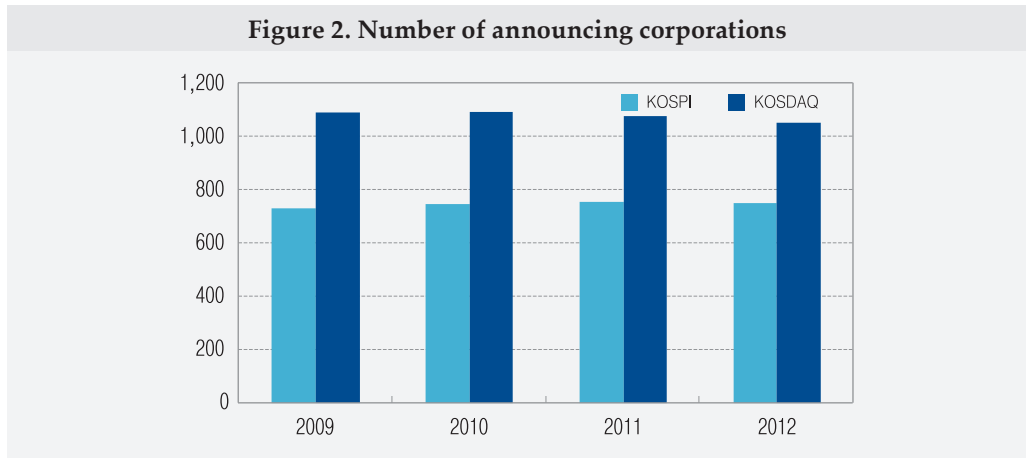


Figure 2. Number of announcing corporations



2. Announcement categories

This section delves into the most frequently announced disclosure categories in both KOSPI and KOSDAQ markets. Table 1 shows the distribution of announcement categories for KOSPI-listed stocks. Among 178 announcement categories identified during the sample period, “shareholder meeting schedule” is the most frequently announced category with the frequency of 4,680 (10.7%), and the top 10 most frequently announced categories account for more than 60% of all announcements during the 4-year sample period. “Shareholder meeting schedule”, “IR events”, and “closing account announcement schedule” simply reveal the details of upcoming announcement events. The other top 10 categories may contain information that could possibly affect market participants’ investment decisions.

Table 1. Announcements by category for KOSPI-listed stocks

Announcement category	Frequency	Percentage (%)
Shareholder meeting schedule	4,680	10.7%
Sales, income, etc., changing more than 30%	4,209	9.6%
Receipt of audit report	3,366	7.7%
Results of shareholder meeting	3,341	7.6%
IR (Investor Relation) events	3,323	7.6%
Decisions on dividend payments	2,370	5.4%
Other business matters	2,227	5.1%
Liability endorsement	2,007	4.6%
Sole supplier contracts	1,330	3.0%
Closing account announcement schedule	1,078	2.5%
Others	15,988	36.4%

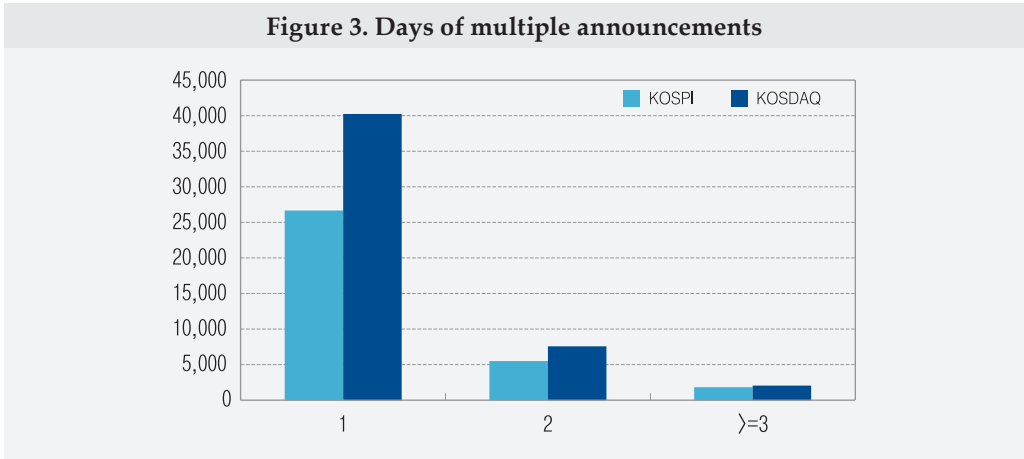
Table 2 presents the distribution of announcement categories for KOSDAQ-listed stocks. There were 164 categories that had been announced at least once during the sample period. Similar to the announcement category distribution for KOSPI-listed stocks, “shareholder meeting schedule” is the most frequently announced category with the frequency of 7,619 (12.2%), and the top 10 most frequently announced categories account for greater than 60% of all announcements during the 4-year sample period. Unlike the KOSPI announcement category distribution, “shareholder meeting schedule” is the only category that simply provides the details of upcoming announcement events among the top 10 categories. Also noted is the presence of a voluntary disclosure category, “sole supplier contract”. The other top 10 categories may provide market-sensitive information.

Table 2. Announcements by category for KOSDAQ-listed stocks

Announcement category	Frequency	Percentage (%)
Shareholder meeting schedule	7,619	12.2%
Sales, income, etc., changing more than 30%	5,026	8.0%
Receipt of audit report	4,642	7.4%
Results of shareholder meeting	4,432	7.1%
Sole supplier contracts (Voluntary Disclosure)	4,090	6.5%
Sole supplier contracts	3,691	5.9%
Other business matters	3,240	5.2%
Patent acquisitions	2,884	4.6%
Results of securities issues	2,860	4.6%
Decisions on dividend payments	1,975	3.2%
Others	22,024	35.2%

3. Announcement clustering

This section examines the extent to which multiple announcements are made by a single firm on a given day. Figure 3 presents the number of days of multiple announcements per corporation in both KOSPI and KOSDAQ markets. Most corporations make one announcement on a given day: the number of days of a single announcement by KOSPI-listed (KOSDAQ-listed) companies was 26,809 (40,378). Though relatively small, the market observed some listed corporations making multiple announcements on a given day during the sample period. The number of days of two announcements was 5,443 (7,575) in the KOSPI (KOSDAQ) market. There were 1,820 (2,057) days in which three or more announcements were made by a particular corporation in the KOSPI (KOSDAQ) market. This has important implications for those who observe and interpret equity market trends and developments because analyzing market reactions to multiple events (as opposed to a single event) is a lot more challenging.

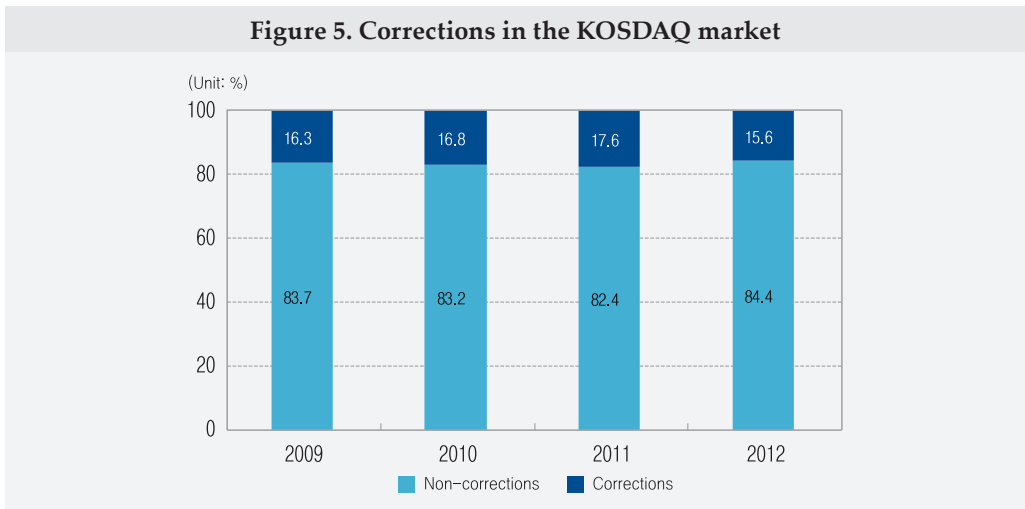
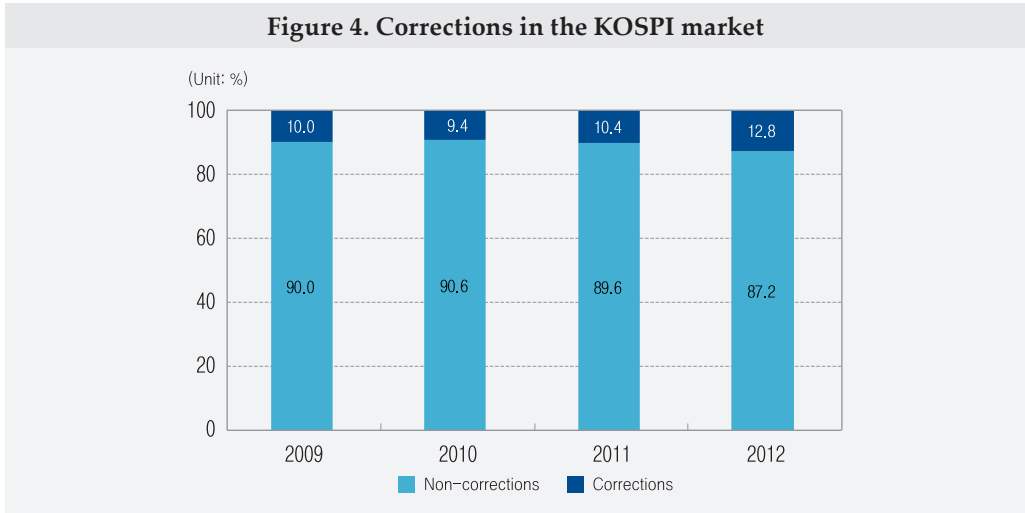


4. Disclosure corrections

This section examines announcement corrections made by both KOSPI-listed and KOSDAQ-listed corporations from 2009 to 2012. Figure 4 depicts proportions of announcement corrections in the KOSPI market from 2009 to 2012. The proportion of announcement corrections had remained largely constant during the 4-year sample period with the highest proportion of 12.8% in 2012 and the lowest proportion of 9.4% in 2010. Proportions of announcement corrections in the KOSDAQ market are presented in Figure 5. Similar to the figures for the KOSPI stocks, the proportion of corrections in the KOSDAQ market had not changed considerably in the sample period. Note that KOSDAQ-listed corporations make announcement corrections more often than KOSPI-listed corporations.

Given that accurate and timely disclosure is critical for market participants to make informed investment decisions, the presence of a large number of announcement corrections can be troubling. If announcement corrections include further developments since the original announcement date, they can be regarded as new announcements. In this case, a particular announcement correction is called “correction” simply because it is closely related to a previous announcement. On the other hand, announcement corrections that contain corrections of errors could result in losses for market participants

who have not considered the possibility of announcement corrections. Unfortunately, this study is unable to identify the reasons for the announcement corrections included in the sample.



5. Announcements by time interval

This section looks at how announcement frequencies spread across intraday time intervals for both KOSPI-listed and KOSDAQ-listed stocks. Figure 6 shows year-by-year distributions of announcement frequencies across intraday time intervals for KOSPI-

listed corporations from 2009 to 2012. The composition of announcement times had remained largely constant during the sample period. The most preferred announcement times are “non-trading hours” (from 18:00 until 7:30 next day) in which transactions are not allowed to occur. The proportion of non-trading time announcements ranges from a low of 60.4% in 2011 to a high of 65.2% in 2012. During the regular trading session (9:00 – 15:00), the second half (12:00 – 15:00) is preferred for announcements. Announcements in the first half of the regular trading session account for around 20%: it ranges from 16.2% in 2012 to 21.3% in 2010. The contribution of the second half of the regular trading session is about 13% with the lowest proportion of 12.4% in 2012 and the highest proportion of 14.5% in 2010.

Figure 6. Announcements by time interval in the KOSPI market

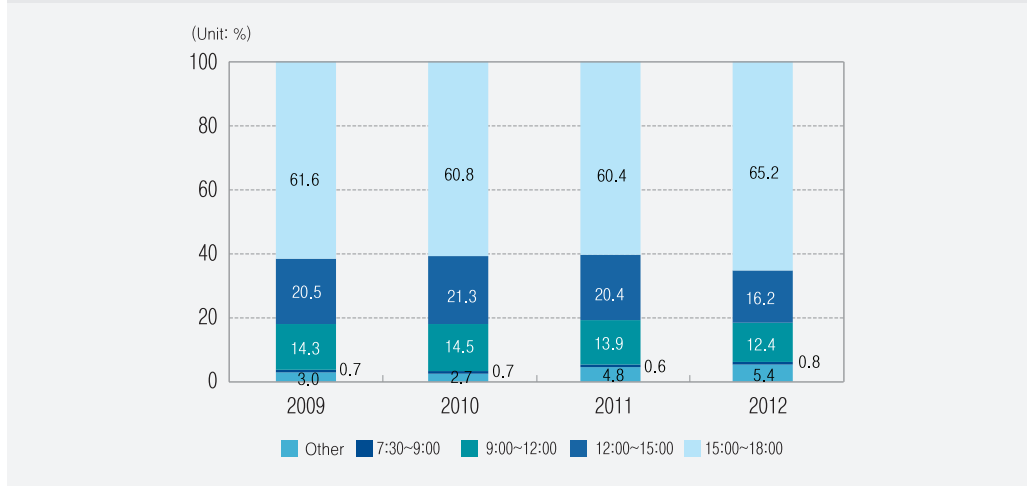
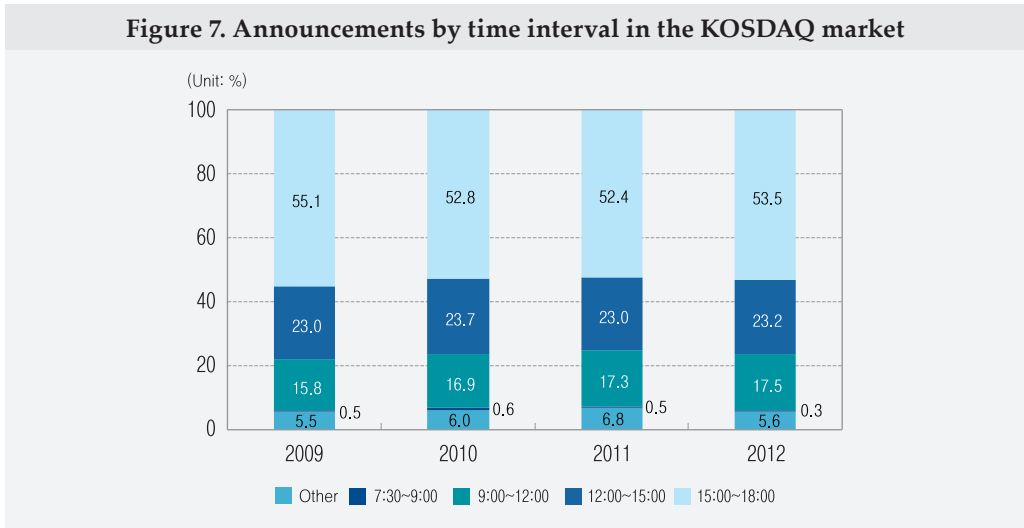


Figure 7 depicts announcement time interval distributions for KOSDAQ-listed corporations from 2009 to 2012. As for the KOSPI-listed corporations, the composition of announcement times for KOSDAQ-listed corporations had not changed considerably during the sample period. The proportion of non-trading time announcements ranges from a low of 52.4% in 2011 to a high of 55.1% in 2009. During the regular trading session (9:00 – 15:00), the second half (12:00 – 15:00) is preferred for announcements. Announcements in the first half of the regular trading session account for around 23%: it ranges from 23.0 (in 2009 and 2011) to 23.7% (in 2010). The contribution of the second

half of the regular trading session is about 16% with the lowest proportion of 15.8% in 2009 and the highest proportion of 17.5% in 2012. All in all, the results for KOSDAQ-listed corporations are similar to those for KOSPI-listed corporations.



IV. Conclusion

This study extends understanding of the economics of the Korean continuous disclosure system by examining recent trends in continuous disclosure in the Korean equity market. The Korean equity market employs the rules-based corporate disclosure approach, while most developed equity markets use the principles-based disclosure approach. The Korean corporate disclosure system is an extreme version of the rules-based approach in that corporations’ disclosure processes involve minimal judgments. This is possible because: (a) each category in the disclosure rule is clearly stated, and (b) corporations are not required to disclose information that does not belong to any of the categories.

Results reveal that the annual average announcement frequency for KOSPI-listed stocks had remained largely constant, while those for KOSDAQ-listed stocks had

decreased steadily from 18,233 in 2009 to 13,293 in 2012. Among 178 announcement categories for KOSPI-listed corporations identified during the sample period, “shareholder meeting schedule” is the most frequently announced category with the frequency of 4,680 (10.7%), and the top 10 most frequently announced categories account for more than 60% of all announcements during the 4-year sample period. There were 164 categories for KOSDAQ-listed corporations that had been announced at least once during the sample period. For KOSDAQ-listed stocks, “shareholder meeting schedule” is the most frequently announced category with the frequency of 7,619 (12.2%), and the top 10 most frequently announced categories account for greater than 60% of all announcements during the 4-year sample period.

Results also show that the proportion of announcement corrections has remained largely constant during the 4-year sample period with the highest proportion of 12.8% in 2012 and the lowest proportion of 9.4% in 2010. Similar to the figures for the KOSPI stocks, the proportion of corrections in the KOSDAQ market had not changed considerably in the sample period. Note that KOSDAQ-listed corporations make announcement corrections more often than KOSPI-listed corporations.

Looking at the announcement frequency distributions across intraday time intervals, the composition of announcement times had remained largely constant from 2009 to 2012 for both KOSPI-listed and KOSDAQ-listed corporations. The most preferred announcement times are “non-trading hours” (from 18:00 until 7:30 next day) in which transactions are not allowed to occur. During the regular trading session (9:00 – 15:00), the second half (12:00 – 15:00) is preferred for announcements.

References

- ASX, 2013, *Continuous Disclosure: Listing Rules 3.1-3.1B*, ASX listing rules guidance note 8.
- Bias, B., Glosten, L., Spatt, C., 2005, Market microstructure: a survey of microfoundations, empirical results, and policy implications, *Journal of Financial Markets* 8, 217-264.
- Easley, D., O'Hara, M., 1987, Price, trade size, and information in securities markets, *Journal of Financial Economics* 19, 69-90.
- Fama, E.F., 1970, Efficient capital markets: a review of theory and empirical work, *Journal of Finance* 25, 383-417.
- KRX, 2012, *Guide to the Disclosure System of the KOSPI Market*.
- Madhavan, A., 2000, Market microstructure: a survey, *Journal of Financial Markets* 3, 205-258.
- O'Hara, M., 2003, Presidential address: liquidity and price discovery, *Journal of Finance* 58, 1335-1354.