CHARACTERISTICS OF BOARD OF DIRECTORS AND COST OF DEBTS: A CASE OF UNITED ARAB EMIRATES LISTED COMPANIES

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DECLARATION

I certify that the substance of this thesis has never been submitted for any degree and is not currently being submitted for any other qualifications.

I certify that any assistance received in preparing this thesis and all sources used have been acknowledged in this thesis.

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ABSTRACT

Cost of debt provides signals not only on how the firms are financed but it also indicates managers' ability to increase the bottom line-income statement item. Thus, with a good corporate governance practice, firms are expected to experience optimum level of cost of debt. However, there is a general lack of studies that investigate this issue in the Gulf Council Countries (GCC), particularly the United Arab Emirates (UAE). Therefore, this research is conducted to investigate the relationship between characteristics of board of directors and cost of debts in UAE setting. The characteristics tested include board size, board independence, duality, board meetings, multiple directorships and major director ownership. This paper reports the results from a multivariate analysis on a dataset collected from the 2009 company annual reports of 62 non-financial UAE companies listed on the Dubai Financial Market and Abu–Dhabi Securities Exchange. The empirical results of this study found that the relationship between board size and board independence with cost of debts was in a negative direction but not significant. However, the results found that there was a positive relationship between CEO duality and cost of debts. Board meetings and multiple directorships of the board were the new variables discussed by this study, and the results found that there was a negative relationship between board meetings and multiple directorships with cost of debts. Although, the results of this study found a negative relationship between major director ownership and cost of debts, this relationship was not significant statistically.

Key words: Cost of debts, corporate governance, board of directors characteristics, United Arab Emirates.

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LIST OF ABBREVIATIONS

CEO	:	Chief Executive Officer.
UAE	:	United Arab Emirates.
DCM	:	Dubai Capital Market.
ADX	:	Abu Dhabi Securities Exchange.
GCC	:	Gulf Council Countries.
GDP	:	Gross Domestic Product.
OECD	:	Organization for Economic Co-operation and Development.
WWW	:	World Wide Web.
NED	:	Non-Executive Directors.
SPSS	:	Statistical Package for Social Science.
VIF	:	Variance Inflation Factor.

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

Internal capital is one of important financial sources for companies regardless of their size and legal form. It represents about 40 percent of total funding even among the most successful companies in the world. The other source of financing is through external borrowing which companies sometimes raise to increase its capital. This method helps companies to expand its business or to ensure the smooth running of the business (Abdulhafedh, 2006). Braunstein (2002) argues that companies that can borrow have much greater value than those companies that source their financing internally and several models have evaluated companies that used mixed financing as having more weight in the marketplace than companies use internal funds.

It should however, be noted that excessive debts by companies lead to increase risks and would sometimes affect their operating profits and eventually will affect the shareholder's wealth. Cost of debts is one of the burdens a company will be exposed to as it raises its debt exposure; this cost is reflected in the interest charged on the money borrowed, which is the amount of money the company pays for the privilege of using borrowed money to expand its business. Moreover, cost of debt is the interest that is paid on bank loans, bond options, and similar types of financial transactions (Ertugrul & Hegde, 2008).

It is well recognized that cost of debts is considered an important issue for all companies due to several reasons. Firstly, companies can manage their finance effectively when they obtain the best interest rate. Secondly, calculating the cost of debt capital as it applies to incurring more debt can assist companies to weigh the

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