

**BOARD GOVERNANCE CHARACTERISTICS,
CAPITAL STRUCTURE DECISIONS AND
COMPANY PERFORMANCE IN MALAYSIA**

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CAPITAL STRUCTURE DECISIONS AND
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By

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**Thesis Submitted to the Othman Yeop Abdullah
Graduate School of Business,
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in Fulfillment of the Requirement for the Degree of Doctor of Philosophy**

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ABSTRACT

The separation of ownership and control in public listed companies limits the involvement of shareholders in management decision making, including capital structure decisions. In the capital structure decision-making process, managers always get to push through their preferences, which focus on debt instead of equity. Shareholders rely on the board of directors to evaluate and challenge management decisions. This study examines the effect of board governance on company leverage that focus on how directors discharge their duties, referred to as the board process. Four variables of board process are analysed: performance of independent directors, board's risk oversight, Chief Executive Officer (CEO) performance evaluation, and directors' accessibility to information. Besides, the interaction between the manager's ownership and the board process on company leverage is examined. This study also investigates the mediation effect of capital structure decisions on the relationship between board process and company performance. The study uses two types of data which are questionnaire survey of Malaysian directors and the companies' annual reports. Based on returned questionnaires representing 175 companies, results of the regression analysis indicate that directors with lower risk appetite and a more effective board are more likely to make less risky capital structure decisions. Moreover, owner-managers with large ownership influence the board's capital structure decisions. The results also show that effective independent directors and boards who monitor company risks vigorously are more likely to monitor management from adopting excessive leverage, which results in positive company performance. The findings provide several implications for policymakers in terms of assessing existing guidelines, particularly related to board effectiveness.

Keywords: Corporate Governance, Board Process, Capital Structure Decisions, Company Performance

ABSTRAK

Pengasingan di antara pemilikan dan penguasaan dalam syarikat penyenaiaan awam menghadkan pembabitan pemegang saham dalam proses pembuatan keputusan termasuklah keputusan berkenaan struktur modal syarikat. Dalam proses pembuatan keputusan struktur modal syarikat, pengurus kebiasaannya berkeupayaan untuk memenuhi kecenderungan mereka iaitu fokusnya adalah kepada hutang berbanding ekuiti. Pemegang saham bergantung kepada ahli lembaga pengarah bagi menilai dan mencabar keputusan pihak pengurusan. Kajian ini mengkaji kesan daripada tadbir urus ahli lembaga terhadap hutang syarikat yang menfokuskan terhadap pelaksanaan tugas oleh pengarah dan ia merujuk kepada proses ahli lembaga. Empat pembolehubah yang dikaji di bawah proses ahli lembaga adalah prestasi pengarah bebas, pengawasan risiko oleh ahli lembaga, penilaian prestasi ketua eksekutif dan kebolehcapaian maklumat oleh pengarah. Selain itu, interaksi di antara pemilikan oleh pengurus dan proses ahli lembaga terhadap hutang syarikat turut dikaji. Kajian ini turut mengkaji akan kesan hutang syarikat sebagai pembolehubah penengah terhadap hubungan di antara proses ahli lembaga dan prestasi syarikat. Kajian ini menggunakan dua jenis data iaitu soal-selidik kepada pengarah di Malaysia dan laporan tahunan syarikat. Berdasarkan kaji selidik yang diterima yang mewakili 175 buah syarikat, hasil analisis regresi mendapati pengarah yang mempunyai kecenderungan terhadap risiko yang rendah dan lembaga pengarah yang lebih efektif akan lebih cenderung untuk membuat keputusan berkenaan struktur modal yang kurang berisiko. Kajian ini turut mendapati bahawa pemilik-pengurus yang mempunyai pemilikan yang besar dalam syarikat mempengaruhi keberkesanan ahli lembaga dalam membuat keputusan struktur modal syarikat. Hasil kajian turut menunjukkan pengarah bebas yang efektif dan ahli lembaga yang mengawasi risiko syarikat dengan teliti akan lebih mengawasi pihak pengurusan daripada mengambil hutang yang berlebihan dan ini memberi kesan positif terhadap prestasi syarikat. Hasil kajian menyumbang kepada beberapa implikasi terhadap penggubal polisi dalam menilai garis panduan sedia ada khususnya terhadap keberkesanan lembaga pengarah.

Kata kunci: Tadbir Urus Korporat, Proses Ahli Lembaga, Keputusan Struktur Modal, Prestasi Syarikat

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LIST OF ABBREVIATIONS

AOB	Audit Oversight Board
AGM	Annual General Meeting
CACG	Commonwealth Association for Corporate Governance
CBI	Confederation of British Industry
CCM	Companies Commission of Malaysia
CDO	Collateralized debt obligation
CEO	Chief Executive Officer
CMP	Capital Market Master Plan
COB	College of Business
DBR	Disclosure Based Regulation
EPF	Employee Pension Fund
EPS	Earnings per Share
ERM	Enterprise Risk Management
EVA	Economic Value Added
FCCG	Finance Committee on Corporate Governance
FOB	Faculty of Business
FPLC	Federation of Public Listed Companies
ICGN	The International Corporate Governance Network
KMO	Kaiser-Meyer-Olkin
KLSE	Kuala Lumpur Stock Exchange
KPI	Key Performance Indicator
KPMG	Klynveld Peat Marwick Goerdeler
MACD	Malaysian Alliance of Corporate Directors
MAICSA	Malaysian Institute of Chartered Secretaries and Administrators
MBS	Mortgage Backed Securities
MCCG	Malaysian Code on Corporate Governance
MIA	Malaysian Institute of Accountants
MICG	Malaysian Institute of Corporate Governance
MICPA	Malaysian Association of Certified Public Accountants
MID	Malaysian Institute of Director
MIDA	Malaysian Investment Development Authority
MSWG	Minority Shareholder Watchdog Group
MVA	Market Value Added
NYSE	New York Stock Exchange
OECD	Organization for Economic Development and Co-operation
OLS	Ordinary Least Squares
PLUS	Projek Lebuhraya Utara Selatan
PN17	Practice Note No. 17
REIT	Real Estate Investment Trust
ROA	Return on Asset
ROE	Return on Equity
ROI	Return on Investment
SPSS	Social Package for Social Sciences
UEM	United Engineers Malaysia
UK	United Kingdom
UNISEL	Universiti Selangor
US	United States
UUM	Universiti Utara Malaysia

VIF	Variance Inflation Factor
*ZRESID	Standardized residuals
*ZPRED	Standardized predicted

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

This study examines the relationship between board characteristics and capital structure decisions in Malaysia. Capital structure decisions are influenced by managers' self-interests; thus, it is expected that their decisions might increase a company's risks (Brailsford, Oliver, & Pua, 2002), which could also affect a company's performance. Ownership structure also influences capital structure decisions (Arshad & Safdar, 2009; Lundstrum, 2009, Lin, Ma, Malatesta, & Xuan, 2011). In light of such influences, it would be interesting to examine boards function and ownership structures as monitoring mechanisms for management decisions and actions, particularly in terms of influencing capital structure decisions. Capital structure decisions refer to decisions made about financing sources in which company leverage is represented. Four main attributes of board governance are identified as being associated with capital structure: board structure, composition, characteristic and process. Four elements that relate to board process are the performance of independent directors, the board's risk oversight, the chief executive officer (CEO) performance evaluation, and the directors' accessibility to information.

The high leveraging of companies became particularly acute in 1997 and 1998, when it served as one of the factors resulting in the Asian financial crisis (Thomas, 2002; Driffield, Mahambare, & Pal, 2007). The crisis caused severe damage for Thailand, Indonesia, South Korea, and Malaysia. In the context of Malaysia, many companies were highly dependent on debt financing with banking institutions before the crisis

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