CORPORATE GOVERNANCE IN SIMULTANEOUS MODELLING OF CASH HOLDINGS AND LEVERAGE

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CORPORATE GOVERNANCE IN SIMULTANEOUS MODELING OF CASH HOLDINGS AND LEVERAGE

By

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This study investigates the simultaneity of cash holdings and leverage decisions in the presence of ownership and board structures using all listed companies in the Main Market of Bursa Malaysia over a three-year period from 2008 to 2010. Five measures of ownership structures are identified: family, business group, foreign, private domestic institutional investors, government link investment companies (GLICs), and state. Four characteristics of board of directors are specified: board size, board independence, managerial ownership, and CEO duality. The study opted for two stage least squares (2SLS) to estimate the regression models. This is among the earlier studies in Malaysia to consider simultaneity of cash holdings and leverage decisions using 2SLS as an estimation technique. The result showed cash holdings and leverage affect each other negatively. Business group, foreign ownership, board size and CEO duality affect cash holdings and leverage positively while state affects cash holdings and leverage negatively. However, private domestic institutional investors only affect cash holdings positively while GLICs have a positive relationship with leverage. The results did not change when three stage least squares (3SLS) method was used. The major contributions of this study are one, the consideration of both leverage and cash holdings decisions must be done simultaneously and two, policy makers should focus on improving board independence to better protect minority shareholders as this will enhance investors’ confidence to invest in a concentrated ownership environment such as Malaysia.

**Keywords:** cash holdings, leverage, ownership structure, board of directors, 2SLS.

Kata kunci: pegangan tunai, laveraj, struktur kepemilikan, lembaga pengarah, 2SLS.
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# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Title</th>
<th>page</th>
</tr>
</thead>
<tbody>
<tr>
<td>THESIS TITLE</td>
<td>i</td>
</tr>
<tr>
<td>CERTIFICATION OF THESIS</td>
<td>ii</td>
</tr>
<tr>
<td>PERMISSION TO USE</td>
<td>iv</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>v</td>
</tr>
<tr>
<td>ABSTRAK</td>
<td>vi</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENT</td>
<td>vii</td>
</tr>
<tr>
<td>TABLE OF CONTENTS</td>
<td>viii</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>xiii</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xv</td>
</tr>
<tr>
<td>LIST OF ABBREVIATIONS</td>
<td>xvi</td>
</tr>
<tr>
<td>CHAPTER ONE BACKGROUNDS OF STUDY</td>
<td>17</td>
</tr>
<tr>
<td>1.0 Introduction</td>
<td>17</td>
</tr>
<tr>
<td>1.1 Background</td>
<td>17</td>
</tr>
<tr>
<td>1.1.1 Cash Holdings and Leverage Decisions</td>
<td>17</td>
</tr>
<tr>
<td>1.1.2 Corporate Governance</td>
<td>19</td>
</tr>
<tr>
<td>1.1.3 Corporate Governance, Cash Holdings and Leverage</td>
<td>21</td>
</tr>
<tr>
<td>1.2 Problem Statement</td>
<td>25</td>
</tr>
<tr>
<td>1.3 Research Questions</td>
<td>32</td>
</tr>
<tr>
<td>1.4 Research Objectives</td>
<td>33</td>
</tr>
<tr>
<td>1.5 Scope of the Study</td>
<td>33</td>
</tr>
<tr>
<td>1.6 Significance of the Study</td>
<td>34</td>
</tr>
<tr>
<td>1.7 Structure of the Thesis</td>
<td>37</td>
</tr>
</tbody>
</table>

viii
CHAPTER TWO LITERATURE REVIEW ..................................................38

2.0 Introduction .........................................................................................38

2.1 Overview on Theories ...........................................................................39

2.1.1 Theories Related to Cash Holdings and Leverage .........................39

2.1.1.1 Agency Theory ........................................................................39

2.1.1.2 Information Asymmetries .........................................................41

2.1.2 Trade off Theory for Cash Holdings .............................................42

2.1.3 Tax Saving Theory for Leverage .................................................43

2.2 The Simultaneous Relationship between Cash Holdings and Leverage ....43

2.3 Corporate Governance Reforms in Malaysia .....................................44

2.4 The Determinant of Cash Holdings and Leverage ............................46

2.4.1 Ownership Structure .....................................................................46

2.4.1.1 Family Ownership ...................................................................47

2.4.1.2 Business Group and Pyramid Structures ...............................52

2.4.1.3 Government Linked Investment Companies (GLICs) and State Ownership .......................................................57

2.4.1.4 Foreign Ownership .................................................................64

2.4.1.5 Domestic Institutional Ownership ...........................................68

2.4.2 Board Characteristics ....................................................................73

2.4.2.1 Board Size ..............................................................................73

2.4.2.2 Board Independence ...............................................................78

2.4.2.3 Managerial, or Inside Director, Ownership ..........................84

2.4.2.4 CEO Duality ...........................................................................88

2.4.3 Instrumental Variables .....................................................................93
2.4.3.1 Corporate Tax Rate .......................................................... 93
2.4.3.2 Non-Debt Tax Shield ...................................................... 94
2.4.3.3 Non-Cash Liquid Assets .................................................. 94
2.4.3.4 Inventories ................................................................. 95
2.4.4 Control Variables ................................................................ 95
  2.4.4.1 Profitability ................................................................. 95
  2.4.4.2 Firm Size .................................................................... 96
  2.4.4.3 Growth Opportunity .................................................... 97
2.5 Summary of the Chapter ....................................................... 98

CHAPTER THREE RESEARCH METHODOLOGY ...................... 100

3.0 Introduction .......................................................................... 100
3.1 Theoretical Framework ......................................................... 100
3.2 Hypotheses Development ....................................................... 103
  3.2.1 Cash holdings and Leverage ........................................... 103
  3.2.2 Ownership Structure ...................................................... 104
    3.2.2.1 Family Ownership .................................................. 104
    3.2.2.2 Business Group ..................................................... 105
    3.2.2.3 Government-Linked Investment Companies (GLICs)
      and State Ownership ...................................................... 107
    3.2.2.4 Foreign and Domestic Institutional Ownership .......... 108
  3.2.3 Board Characteristics ....................................................... 110
    3.2.3.1 Board Size ............................................................ 110
    3.2.3.2 Board Independence .............................................. 111
    3.2.3.3 Managerial Ownership ........................................... 113
4.3.4 Additional Analysis ................................................................. 160
4.4 Summary of the Chapter .............................................................. 166

CHAPTER FIVE CONCLUSION AND RECOMMENDATION .......... 170
5.0 Introduction ................................................................................. 170
5.1 Overview of the Study ................................................................. 170
5.2 Summary of Findings ................................................................. 171
5.3 Contributions and Implications of the Research ......................... 174
5.4 Limitations and Recommendations for Future Research ............... 177
5.5 Summary of the Chapter .............................................................. 177

REFERENCES ...................................................................................... 179
### LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 2.1</td>
<td>Summary of the Literature on the Relationship between Family Ownership and Cash Holdings</td>
<td>50</td>
</tr>
<tr>
<td>Table 2.2</td>
<td>Summary of the Literature on the Relationship between Family Ownership and Leverage</td>
<td>51</td>
</tr>
<tr>
<td>Table 2.3</td>
<td>Summary of the Literature on the Relationship between Business Group Ownership and Cash Holdings</td>
<td>55</td>
</tr>
<tr>
<td>Table 2.4</td>
<td>Summary of the Literature on the Relationship between Business Group Ownership and Leverage</td>
<td>56</td>
</tr>
<tr>
<td>Table 2.5</td>
<td>Summary of the Literature on the Relationship between GLICs and State Ownership and Cash Holdings</td>
<td>62</td>
</tr>
<tr>
<td>Table 2.6</td>
<td>Summary of the Literature on the Relationship between GLICs and State Ownership and Leverage</td>
<td>63</td>
</tr>
<tr>
<td>Table 2.7</td>
<td>Summary of the Literature on the Relationship between Foreign Investors and Cash Holdings</td>
<td>66</td>
</tr>
<tr>
<td>Table 2.8</td>
<td>Summary of the Literature on the Relationship between Foreign Investors and Leverage</td>
<td>67</td>
</tr>
<tr>
<td>Table 2.9</td>
<td>Summary of the Literature on the Relationship between Domestic Institutional Ownership and Cash Holdings</td>
<td>71</td>
</tr>
<tr>
<td>Table 2.10</td>
<td>Summary of the Literature on the Relationship between Domestic Institutional Ownership and Leverage</td>
<td>72</td>
</tr>
<tr>
<td>Table 2.11</td>
<td>Summary of the Literature on the Relationship between Board Size and Cash Holdings</td>
<td>76</td>
</tr>
<tr>
<td>Table 2.12</td>
<td>Summary of the Literature on the Relationship between Board Size and Leverage</td>
<td>77</td>
</tr>
<tr>
<td>Table 2.13</td>
<td>Summary of the Literature on the Relationship between Board Independence and Cash Holdings</td>
<td>81</td>
</tr>
<tr>
<td>Table 2.14</td>
<td>Summary of the Literature on the Relationship between Board Independence and Leverage</td>
<td>82</td>
</tr>
<tr>
<td>Table 2.15</td>
<td>Summary of the Literature on the Relationship between Managerial Ownership and Cash Holdings</td>
<td>86</td>
</tr>
<tr>
<td>Table 2.16</td>
<td>Summary of the Literature on the Relationship between Managerial Ownership and Leverage</td>
<td>87</td>
</tr>
<tr>
<td>Table 2.17</td>
<td>Summary of the Literature on the Relationship between CEO Duality and Cash Holdings</td>
<td>90</td>
</tr>
<tr>
<td>Table 2.18</td>
<td>Summary of the Literature on the Relationship between CEO Duality and Leverage</td>
<td>92</td>
</tr>
<tr>
<td>Table 3.1</td>
<td>Summary of the Measurements of the Variables</td>
<td>118</td>
</tr>
<tr>
<td>Table 3.2</td>
<td>Derivation of Sample</td>
<td>127</td>
</tr>
<tr>
<td>Table 4.1</td>
<td>Descriptive Statistics</td>
<td>130</td>
</tr>
<tr>
<td>Table 4.2</td>
<td>Ownership Interest by GLICs</td>
<td>133</td>
</tr>
<tr>
<td>Table 4.3</td>
<td>Descriptive Analysis of Controlling Ownership by Families in Malaysian Firms</td>
<td>134</td>
</tr>
<tr>
<td>Table 4.4</td>
<td>The Correlation Coefficient</td>
<td>137</td>
</tr>
<tr>
<td>Table 4.5</td>
<td>OLS Regression Results for Cash Holdings</td>
<td>141</td>
</tr>
<tr>
<td>Table 4.6</td>
<td>OLS Regression for Leverage</td>
<td>142</td>
</tr>
</tbody>
</table>
# LIST OF FIGURES

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 1.1</td>
<td>Control Via Pyramidal Structure for Yeoh’s Family Ownership.</td>
<td>24</td>
</tr>
<tr>
<td>Figure 2.1</td>
<td>Investments of Khazanah Nasional Berhad (2010)</td>
<td>58</td>
</tr>
<tr>
<td>Figure 3.1</td>
<td>Determinants of Cash Holdings and Leverage</td>
<td>101</td>
</tr>
</tbody>
</table>
**LIST OF ABBREVIATIONS**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>GLICs</td>
<td>Government-Linked Institutional Investors</td>
</tr>
<tr>
<td>OLS</td>
<td>Ordinary Least Squares</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small Medium Enterprises</td>
</tr>
<tr>
<td>2SLS</td>
<td>Two Stage least Squares</td>
</tr>
<tr>
<td>3SLS</td>
<td>Three Stage least Squares</td>
</tr>
<tr>
<td>UAE</td>
<td>United Arab Emirates</td>
</tr>
<tr>
<td>UK</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>US</td>
<td>United States</td>
</tr>
<tr>
<td>VIF</td>
<td>Variance Inflation Facto</td>
</tr>
</tbody>
</table>
CHAPTER ONE
BACKGROUND OF STUDY

1.0 Introduction

This chapter starts with background of corporate finance and corporate governance. Section 1.2 examines the problem statement of the study. Section 1.3 identifies the research questions. Section 1.4 determines the research objectives of this study. Section 1.5 examines the scope of the study. Section 1.6 discusses the significance of this study. Section 1.7 presents structure of the thesis.

1.1 Background

Corporate finance and corporate governance are closely related. Corporate finance deals with investment and financing decisions of a firm while corporate governance is concerned with protecting interests of all parties associated with the firm.

1.1.1 Cash Holdings and Leverage Decisions

In corporate finance, there are three important financial decisions: 1) the capital structure decision (how to acquire the money), 2) the working capital decision (the management of short term assets and liabilities), 3) the capital budgeting decision (where to invest). This study focuses on capital structure (leverage) and working capital (cash holdings).

Cash holdings are one of the major financial decisions made by managers. In occurrence of inflow of cash, a manager must decide whether to distribute the cash
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