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**RELATED PARTY TRANSACTIONS, INDEPENDENT  
DIRECTORS AND FIRM PERFORMANCE:  
MALAYSIAN EVIDENCE**



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Universiti Utara Malaysia

**DOCTOR OF PHILOSOPHY  
UNIVERSITI UTARA MALAYSIA  
APRIL 2019**

**RELATED PARTY TRANSACTIONS, INDEPENDENT DIRECTORS AND  
FIRM PERFORMANCE: MALAYSIAN EVIDENCE**



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**Thesis Submitted to  
Tunku Puteri Intan Safinaz School of Accountancy,  
Universiti Utara Malaysia,  
in Fulfilment of the Requirement for the Degree of Doctor of Philosophy**



**TUNKU PUTERI INTAN SAFINAZ**  
**SCHOOL OF ACCOUNTANCY**  
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Universiti Utara Malaysia

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(Title of the Thesis / Dissertation)

: RELATED PARTY TRANSACTIONS, INDEPENDENT DIRECTORS AND  
FIRM PERFORMANCE: MALAYSIAN EVIDENCE

Program Pengajian  
(Programme of Study)

: Doctor of Philosophy

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## ABSTRACT

Related party transactions (RPTs) have been identified as the most common tool used by corporate insiders to expropriate firm's resources, particularly in companies with weak governance mechanisms. In order to mitigate the problem, theorist argued that independent directors (INEDs), who are not beholden to the management, are better suited in protecting minority shareholders' interests. Therefore, this study aims to examine the effect of RPTs on firm performance and to determine whether this effect is moderated by the proportion of INEDs and their human capital (HC) and social capital (SC). Firm performance is measured by return on assets (ROA), while RPTs are measured based on total RPTs and types of related parties. INEDs' HC are captured by INEDs' functional knowledge in accounting and finance and INEDs' firm-specific knowledge, while INEDs' SC is proxied by INEDs' external networking. Using proportionate stratified random sampling, 300 non-financial firms listed on Bursa Malaysia in the year 2013 are randomly selected. The results reveal that in general, RPTs have a positive effect on firm performance and this effect varies according to the types of parties involved in RPTs. The findings support the efficient transactions hypothesis that RPTs can be used for sound business reasons. The proportion of INEDs and all constructs for INEDs' HC and SC are revealed to not have any moderating effect on the relationship between RPTs and firm performance. Therefore, the results are not in line with the predictions from the agency, resource dependence, human capital, and social capital theories. The unexpected findings raise questions of whether INEDs in Malaysia are truly independent or just fulfilling the Malaysian Code on Corporate Governance and Bursa Malaysia Listing Requirements. Hence, any efforts undertaken by the Malaysian regulators to strengthen the roles of INEDs should focus on the substance rather than the form.

**Keywords:** human capital, independent directors, related party transactions, resource dependence, social capital

## ABSTRAK

Urusniaga pihak berkaitan (UPB) telah dikenalpasti sebagai alat yang paling biasa digunakan oleh pihak dalaman korporat untuk menguasai sumber firma, terutamanya bagi syarikat yang mempunyai mekanisme tadbir urus yang lemah. Bagi menangani masalah tersebut, ahli teori berpendapat bahawa pengarah bebas (PB), yang tidak mempunyai hubungan dengan pihak pengurusan, lebih sesuai untuk melindungi kepentingan pemegang saham minoriti. Oleh itu, kajian ini bertujuan untuk mengkaji kesan UPB ke atas prestasi firma dan untuk menentukan sama ada kesan tersebut disederhanakan oleh perkadaran PB serta modal insan (MI) dan modal sosial (MS) mereka. Prestasi firma diukur melalui Pulangan atas Aset (ROA), dan UPB pula diukur berdasarkan jumlah UPB dan jenis-jenis pihak berkaitan. MI PB diwakili oleh pengetahuan fungsian dalam perakaunan dan kewangan serta pengetahuan khusus berkaitan firma, manakala MS PB pula diwakili oleh hubungan luar PB. Dengan menggunakan persampelan rawak strata berkadaran, sejumlah 300 buah syarikat bukan kewangan yang tersenarai di Bursa Malaysia dalam tahun 2013 telah dipilih secara rawak. Hasil kajian mendedahkan bahawa secara umumnya, UPB mempunyai kesan positif terhadap prestasi firma dan kesan ini berbeza bergantung kepada jenis-jenis pihak yang terlibat dalam UPB. Penemuan kajian ini menyokong hipotesis urusniaga efisien bahawa UPB boleh digunakan untuk alasan perniagaan yang baik. Perkadaran PB serta semua konstruk MI dan MS PB didapati tidak mempunyai kesan penyederhanaan ke atas hubungan di antara UPB dan prestasi firma. Oleh yang demikian, keputusan kajian ini tidak selari dengan jangkaan teori agensi, pergantungan sumber, modal insan dan modal sosial. Penemuan yang tidak dijangka ini menimbulkan persoalan sama ada PB di Malaysia benar-benar bebas atau hanya memenuhi Kod Tadbir Urus Korporat Malaysia dan Keperluan Penyenaraian Bursa Malaysia. Justeru, sebarang usaha yang dilakukan oleh badan kawal selia di Malaysia untuk mengukuhkan peranan PB perlulah memberi tumpuan kepada isi pokok dan bukannya bentuk.

**Keywords:** modal insan, pengarah bebas, urusniaga pihak berkaitan, pergantungan sumber, modal sosial



## ACKNOWLEDGEMENT

In the name of Allah, the most gracious and most merciful.

Alhamdulillah, all praises and thanks be to Allah, for giving me the strength, patience, and courage to complete this thesis.

The successful completion of this thesis is due to the help of literally hundreds of people and therefore, the debt of gratitude is too immense to adequately recognize here. However, I would like to express my special appreciation to my supervisor, Prof. Dr. Ku Nor Izah Ku Ismail, for guiding me through every step of my PhD journey; her continuous support and encouragement made this thesis possible.

Appreciation also goes to Prof. Dr. Wan Nordin Wan Hussin, Associate Prof. Dr. Zuaini Ishak, and Prof. Dr. Zulkarnain Muhammad Sori for their valuable comments and suggestions during my proposal and viva voce defense.

I would like also to express my special appreciation to the people who mean the world to me: my parents, Hajjah Jenab Tahil and Haji Md Nor Murus, for their endless love, prayers and supports. For this and much more, I am forever in their debt. To my husband, Roslan Taib and my children, Muhd Farid Amjad and Nurhusna Kamilah, thank you for the love, understanding, and support given to me throughout this long and challenging journey. I also must admit and thank for the continuous support that I received from my brothers, sisters, and my entire family.

Last but not least, my sincere appreciation goes out to all those involved in making this thesis a reality and those who have contributed towards this profound learning experience.

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## LIST OF ABBREVIATIONS

BMLR	Bursa Malaysia Listing Requirements
CAR	Cumulative Abnormal Return
CEO	Chief Executive Officer
CFA	Chartered Financial Analyst
CGB	Corporate Governance Blueprint
CGG	Corporate Governance Guide
GAAP	Generally Accepted Accounting Principles
HC	Human Capital
IFRS	International Financial Reporting Standards
INEDs	Independent Directors
IPO	Initial Public Offering
MCCG	Malaysian Code on Corporate Governance
MFRS	Malaysian Financial Reporting Standards
MIA	Malaysian Institute of Accountants
MSWG	Minority Shareholder Watchdog Group
OECD	Organization for Economic Co-operation and Development
OLS	Ordinary Least Square
PLC	Public-listed Company
ROA	Return on Assets
RPTs	Related Party Transactions
SC	Social Capital
SME	Small and Medium Enterprise
SOX	Sarbanes-Oxley Act
UAE	The United Arab Emirates
UK	The United Kingdom
US	The United State of America

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Related party transactions<sup>1</sup> (RPTs) refer to the transfer of resources, services, or obligations between related parties, regardless of whether a price is charged, while a related party is a person or entity that is related to the entity that is preparing its financial statements (Malaysian Financial Reporting Standards [MFRS] 124, 2011). These transactions are a common business feature as firms frequently carry out their operations through subsidiaries, associates, and joint ventures. Thus, it is the companies' responsibility to ensure that RPTs are conflict-free and are conducted at arm's length.

However, many abusive cases of RPTs in Asia, including Transmile Group Berhad (Malaysia), Satyam Computers Ltd (India), CNOOC Ltd (Hong Kong), Shinsegae Group (the Philippines), Asia Pulp and Paper (Indonesia), and others, demonstrate how RPTs ultimately benefited the company insiders (i.e. top management or controlling shareholders). Abusive RPTs refer to the situation where a controlling party<sup>2</sup> of a firm enters into a transaction that is detrimental to non-controlling shareholders<sup>3</sup> (Organization for Economic Co-operation and Development [OECD], 2009).

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<sup>1</sup> Some jurisdictions use different terms to refer to RPT. For instance, Australia uses the term "transaction with persons in position of influence", Hong Kong uses the term "connected transaction", and Singapore uses the term "interested person transaction".

<sup>2</sup> The term "controlling party" is used interchangeably with "controlling owner" and "controlling shareholder".

<sup>3</sup> The term "non-controlling shareholders" is used interchangeably with "minority shareholders".

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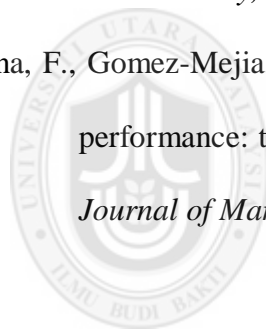
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Universiti Utara Malaysia



## APPENDIX A

### LIST OF SAMPLE COMPANIES

1	BINA DARULAMAN	37	JERASIA CAPITAL
2	DKLS INDUSTRIES	38	JT INTERNATIONAL
3	FAJARBARU BUILDER GROUP	39	KHIND HOLDINGS
4	FUTUTECH	40	KOTRA INDUSTRIES
5	GABUNGAN AQRS	41	LAY HONG
6	GAMUDA	42	LII HEN INDUSTRIES
7	HOCK SENG LEE	43	MAXWELL INTERNATIONAL
8	IJM CORPORATION	44	MULTI SPORTS HOLDINGS LTD
9	JAKS RESOURCES	45	NEW HOONG FATT HOLDINGS
10	KIMLUN CORPORATION	46	NI HSIN RESOURCES
11	PESONA METRO HOLDINGS	47	ORIENTAL HOLDINGS
12	PRINSIPTEK CORPORATION	48	PADINI HOLDINGS
13	SYCAL VENTURES	49	PCCS GROUP
14	TRC SYNERGY	50	POH KONG HOLDINGS
15	TRIPLC	51	PPB GROUP
16	TSR CAPITAL	52	REX INDUSTRY
17	ZECON	53	SINARIA CORPORATION
18	AMTEK HOLDINGS	54	SPRITZER
19	APEX HEALTHCARE	55	SYF RESOURCES
20	APOLLO FOOD HOLDINGS	56	TAFI INDUSTRIES
21	ASIA BRANDS	57	TAN CHONG MOTOR HOLDINGS
22	BIOSIS GROUP	58	TEO SENG CAPITAL
23	BONIA CORPORATION	59	TOMEI CONSOLIDATED
24	C.I. HOLDINGS	60	TPC PLUS
25	CCK CONSOLIDATED HOLDINGS	61	UMW HOLDINGS
26	CHEE WAH CORPORATION	62	UPA CORPORATION
27	EMICO HOLDINGS	63	WANG-ZHENG
28	EURO HOLDINGS	64	XINGQUAN INTERNATIONAL
29	EUROSPAN HOLDINGS	65	SPORTS HOLDINGS LIMITED
30	FEDERAL FURNITURE HOLDINGS (M)	66	Y.S.P.SOUTHEAST ASIA HOLDING
31	FORMOSA PROSONIC INDUSTRIES	67	YEE LEE CORPORATION
32	FRASER & NEAVE HOLDINGS	68	YOONG ONN CORPORATION
33	GOLDIS	69	ZHULIAN CORPORATION
34	HONG LEONG INDUSTRIES	70	GRAND CENTRAL ENTERPRISES
35	HUAT LAI RESOURCES	71	LANDMARKS
36	HWA TAI INDUSTRIES	72	ABM FUJIYA
			AE MULTI HOLDINGS

Continued

73	AJIYA	109	HIL INDUSTRIES
74	ANCOM	110	HO WAH GENTING
75	A-RANK	111	IMASPRO CORPORATION
76	ASTRAL SUPREME	112	INGRESS CORPORATION
77	B.I.G. INDUSTRIES	113	JOHORE TIN
78	BOUSTEAD HEAVY INDUSTRIES	114	KECK SENG (MALAYSIA)
79	BOX-PAK (MALAYSIA)	115	KIAN JOO CAN FACTORY
80	BP PLASTICS HOLDING	116	KNM GROUP
81	BRIGHT PACKAGING INDUSTRY	117	KOMARKCORP
82	CB INDUSTRIAL PRODUCT HOLDING	118	KOSSAN RUBBER INDUSTRIES
83	CENTRAL INDUSTRIAL CORPORATION	119	KUMPULAN H & L HIGH-TECH
84	CHINA AUTOMOBILE PARTS HOLDING	120	KUMPULAN POWERNET
85	CME GROUP	121	KYM HOLDINGS
86	CN ASIA CORPORATION	122	LCTH CORPORATION
87	CONCRETE ENGINEERING PRODUCTS	123	LEADER STEEL HOLDINGS
88	CSC STEEL HOLDINGS	124	LEWEKO RESOURCES
89	CYL CORPORATION	125	LION CORPORATION
90	DELLOYD VENTURES	126	LUSTER INDUSTRIES
91	DENKO INDUSTRIAL CORPORATION	127	MALAYSIA SMELTING
92	D'NONCE TECHNOLOGY	128	MALAYSIA STEEL WORKS (KL)
93	DOLOMITE CORPORATION	129	MAXTRAL INDUSTRY
94	DRB-HICOM	130	METROD HOLDINGS
95	DUFU TECHNOLOGY CORP.	131	MIECO CHIPBOARD
96	EG INDUSTRIES	132	MINETECH RESOURCES
97	EKSONS CORPORATION	133	NARRA INDUSTRIES
98	EP MANUFACTURING	134	NWP HOLDINGS
99	FAVELLE FAVCO	135	PENSONIC HOLDINGS
100	FIBON	136	PETRONAS GAS
101	FOCUS LUMBER	137	RAPID SYNERGY
102	GLOBALTEC FORMATION	138	RUBBEREX CORPORATION (M)
103	GOH BAN HUAT	139	SAM ENGINEERING & EQUIPMENT
104	GOLSTA SYNERGY	140	SARAWAK CABLE SARAWAK CONSOLIDATED
105	GSB GROUP	141	INDUSTRIES
106	HALEX HOLDINGS	142	SEACERA GROUP
107	HEVEABOARD	143	SEREMBAN ENGINEERING
108	HIBISCUS PETROLEUM	144	SINO HUA-AN INTERNATIONAL

Continued

145	SKP RESOURCES	181	UNITED MALACCA
146	SLP RESOURCES	182	A & M REALTY
147	SMIS CORPORATION	183	AMCORP PROPERTIES
148	SOUTHERN STEEL	184	BERTAM ALLIANCE
149	STONE MASTER CORPORATION	185	DAMANSARA REALTY
150	SUCCESS TRANSFO	186	ENCORP
151	SUPPORTIVE INTERNATIONAL	187	GRAND HOOVER
152	TAS OFFSHORE	188	I-BERHAD
153	TECNIC GROUP	189	IJM LAND
154	TEKALA CORPORATION	190	KELADI MAJU
155	TIEN WAH PRESS HOLDINGS	191	KSL HOLDINGS
156	TURIYA	192	LAND & GENERAL
157	UCHI TECHNOLOGIES	193	LBI CAPITAL
158	VTI VINTAGE	194	LBS BINA GROUP
159	WHITE HORSE	195	LIEN HOE CORPORATION
160	WONG ENGINEERING CORPORATION	196	MAGNA PRIMA
161	YI-LAI	197	MALAYSIA AICA
162	YLI HOLDINGS	198	MALAYSIA PACIFIC CORPORATION
163	YOKOHAMA INDUSTRIES	199	MKH
164	LINGKARAN TRANS KOTA HOLDINGS	200	MUI PROPERTIES
165	SILK HOLDINGS	201	NAIM HOLDINGS
166	DUTALAND	202	ORIENTAL INTEREST
167	FAR EAST HOLDINGS	203	OSK PROPERTY HOLDINGS
168	GENTING PLANTATIONS	204	PERDUREN (M) BERHAD
169	GOPENG BERHAD	205	PETALING TIN BERHAD
170	INNOPRISE PLANTATIONS	206	PJ DEVELOPMENT HOLDINGS
171	KLUANG RUBBER COMPANY	207	SELANGOR DREDGING
172	KRETAM HOLDINGS	208	SHL CONSOLIDATED
173	KWANTAS CORPORATION	209	SYMPHONY LIFE
174	MHC PLANTATIONS BHD.	210	TA GLOBAL
175	RIVERVIEW RUBBER ESTATES	211	TAHPS GROUP
176	SARAWAK OIL PALMS	212	TIGER SYNERGY
177	SARAWAK PLANTATION	213	TRINITY CORPORATION
178	TDM BERHAD	214	TROPICANA CORPORATION
179	TSH RESOURCES	215	UEM SUNRISE
180	UNICO-DESA PLANTATIONS	216	Y&G CORPORATION

Continued

217	SONA PETROLEUM BERHAD	248	DIALOG GROUP
218	AMTEL HOLDINGS	249	EASTLAND EQUITY
219	CBSA BERHAD	250	EDEN INC. BERHAD
220	D&O GREEN TECHNOLOGIES	251	EFFICIENT E-SOLUTIONS
221	DIGISTAR CORPORATION	252	EITA RESOURCES
222	ELSOFT RESEARCH	253	EMAS KIARA INDUSTRIES
223	EXCEL FORCE MSC	254	FIAMMA HOLDINGS
224	GLOBETRONICS TECHNOLOGY	255	GEORGE KENT (MALAYSIA)
225	KESM INDUSTRIES	256	HARBOUR-LINK GROUP
226	MALAYSIAN PACIFIC INDUSTRIES	257	IHH HEALTHCARE
227	THETA EDGE	258	INTEGRATED LOGISTICS
228	VITROX CORPORATION	259	INTEGRAX
229	WILLOWGLEN MSC	260	KAMDAR GROUP (M) BERHAD
230	AEON CO. (M) BHD	261	KBES BERHAD
231	AIRASIA X BERHAD	262	KELINGTON GROUP BERHAD
232	AMWAY (MALAYSIA) HOLDINGS	263	KNUSFORD BERHAD
233	ASTRO MALAYSIA HOLDINGS	264	KPJ HEALTHCARE
234	ATLAN HOLDINGS	265	KPS CONSORTIUM
235	AYS VENTURES	266	LFE CORPORATION
236	BERJAYA CORPORATION	267	LUXCHEM CORPORATION
237	BERJAYA MEDIA	268	MALAYSIAN AIRLINE SYSTEM
238	BHS INDUSTRIES	269	MALAYSIAN BULK CARRIERS
239	BORNEO OIL BERHAD	270	MASTERSKILL EDUCATION GROUP
240	BOUSTEAD HOLDINGS	271	METRONIC GLOBAL
241	CENTURY LOGISTICS HOLDINGS	272	MY E.G. SERVICES
242	CHEETAH HOLDINGS	273	NATIONWIDE EXPRESS COURIER SERVICES
243	COMPLETE LOGISTIC SERVICES	274	NCB HOLDINGS
244	COMPUGATES HOLDINGS	275	OCB BERHAD
245	CYCLE & CARRIAGE BINTANG	276	OGAWA WORLD BERHAD
246	DAYA MATERIALS BERHAD	277	OLDTOWN BERHAD
247	DESTINI BERHAD	278	OLYMPIA INDUSTRIES

Continued

279	PANSAR BERHAD
280	PANTECH GROUP HOLDINGS BERHAD
281	PARKSON HOLDINGS BERHAD
282	PDZ HOLDINGS BHD
283	PHARMANIAGA BERHAD
284	PRESTARIANG BERHAD
285	PROGRESSIVE IMPACT CORPORATION
286	SALCON BERHAD
287	SAMCHEM HOLDINGS BERHAD
288	SAPURAKENCANA PETROLEUM
289	SCOMI ENERGY SERVICES BHD
290	SCOMI GROUP BERHAD
291	SHIN YANG SHIPPING CORPORATION
292	SIME DARBY BERHAD
293	STAR PUBLICATIONS
294	SYMPHONY HOUSE BHD
295	TANJUNG OFFSHORE BERHAD
296	TELEKOM MALAYSIA BERHAD
297	TH HEAVY ENGINEERING BERHAD
298	THE STORE CORPORATION BERHAD
299	TURBO-MECH BERHAD
300	WARISAN TC HOLDINGS BERHAD

## APPENDIX B

### Types of Related Parties

Description
<p>Related entities include the following:</p> <ul style="list-style-type: none"><li>• Transaction with subsidiaries</li><li>• Transaction with associates</li><li>• Transaction with joint ventures</li></ul> <p>Related persons include the following:</p> <ul style="list-style-type: none"><li>• Transaction with directors</li><li>• Transaction with major shareholders</li><li>• Transaction with persons connected with directors or major shareholders</li><li>• Transactions with director related entities</li></ul>



## APPENDIX C

### An Example of Related Party Transactions Classifications

The partial information is extracted from the annual report of ANCOM Berhad for the financial year 2013:

#### 36. RELATED PARTY DISCLOSURES

##### (a) Identities of related parties

Parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties could be individuals or other entities.

The Company has controlling related party relationship with its direct and indirect subsidiaries as disclosed in Note 41 to the financial statements.

(b) In addition to the transactions detailed elsewhere in the financial statements, the Group and the Company had the following transactions with related parties during the financial year:

	2013 RM'000	2012 RM'000
Sales to a company in which a Director of the Company has substantial indirect shareholding	4,053	-
Purchase from a company in which a Director of the Company has substantial indirect shareholding	641	-
Sales to associates: Nufarm Technologies (Malaysia) Sdn. Bhd.	-	70
Magiqads Sdn. Bhd	-	89
Purchases from associates: Magiqads Sdn. Bhd	2,152	1,987
Services rendered by a company in which certain Directors of the Company have substantial indirect shareholding	-	2,300
Professional legal fees paid to a firm of which a Director of the Company is a Partner	1,118	1,143
Insurance premium paid to a company in which a Director of the Company has a substantial indirect shareholding	28	56

Transactions with  
Related Entities

Transactions with  
Related Persons

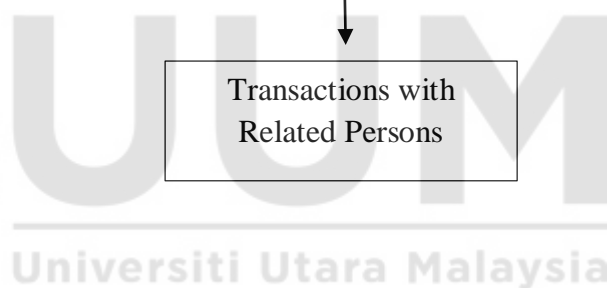
## Appendix C Continued

### (d) Compensation of key management personnel

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the activities of the entity, directly and indirectly, including any Director (whether executive or otherwise) of the Group.

The remuneration of Directors and other key management personnel of the Group and of the Company during the financial year was as follows:

	2013	2012
	RM'000	RM'000
Short term employee benefits	28,596	30,939
Contributions to defined contribution plan	1,396	1,917
Benefits-in-kind	1,651	261
	31,643	33,117



Transactions with  
Related Persons



## APPENDIX D

### VIF Tests

VIF for Table 5.3

	VIF
RPTs	1.091
BIG4	1.264
BSIZE	1.196
FSIZE	1.723
LEV	1.172
CSOWN	1.090
CSTYPE	1.503
MOWN	1.317

Notes: VIF less than 10 indicates that there is no multicollinearity problem (Gujarati, 2003)

VIF for Table 5.3a

	VIF
RPTRE	1.044
RPTRP	1.077
BIG4	1.264
BSIZE	1.196
FSIZE	1.729
LEV	1.172
CSOWN	1.095
CSTYPE	1.505
MOWN	1.318

Notes: VIF less than 10 indicates that there is no multicollinearity problem (Gujarati, 2003)

Appendix D Continued

VIF for Table 5.4

	VIF	VIF
RPTs	1.095	
RPTRE		1.078
RPTRP		1.094
INEDPROP	1.258	1.283
BIG4	1.271	1.272
BSIZE	1.408	1.421
FSIZE	1.739	1.748
LEV	1.193	1.199
CSOWN	1.128	1.136
CSTYPE	1.504	1.507
MOWN	1.352	1.356

Notes: VIF less than 10 indicates that there is no multicollinearity problem (Gujarati, 2003)

VIF for Table 5.5

	VIF	VIF
RPTs	1.096	
RPTRE		1.045
RPTRP		1.089
INEDFUNK	1.087	1.088
BIG4	1.264	1.265
BSIZE	1.219	1.219
FSIZE	1.726	1.733
LEV	1.172	1.179
CSOWN	1.094	1.100
CSTYPE	1.516	1.523
MOWN	1.343	1.344

Notes: VIF less than 10 indicates that there is no multicollinearity problem (Gujarati, 2003)

Appendix D Continued

VIF for Table 5.6

	VIF	VIF
RPTs	1.105	
RPTRE		1.049
RPTRP		1.086
INEDSPEK	1.088	1.143
BIG4	1.299	1.299
BSIZE	1.199	1.202
FSIZE	1.733	1.739
LEV	1.180	1.183
CSOWN	1.090	1.096
CSTYPE	1.504	1.509
MOWN	1.319	1.320

Notes: VIF less than 10 indicates that there is no multicollinearity problem (Gujarati, 2003)

VIF for Table 5.7

	VIF	VIF
RPTs	1.116	
RPTRE		1.077
RPTRP		1.082
INEDNET	1.160	1.160
BIG4	1.297	1.297
BSIZE	1.206	1.208
FSIZE	1.767	1.775
LEV	1.184	1.189
CSOWN	1.098	1.104
CSTYPE	1.511	1.522
MOWN	1.320	1.321

Notes: VIF less than 10 indicates that there is no multicollinearity problem (Gujarati, 2003)