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FIRM CHARACTERISTICS, CORPORATE RESTRUCTURING AND PERFORMANCE IN MALAYSIA

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This study examined the relationship between specific characteristics of the firm such as board of directors' ownership, institutional ownership, concentrated ownership, debt ratio and levels of diversification which had been identified in the literature as the determinants of corporate restructuring and corporate performance before and after restructuring. Ninety three debt restructuring firms and ninety six asset restructuring firms listed on the Bursa Malaysia (formerly known as Kuala Lumpur Stock Exchanges) between 1990 and 2002 firms were selected as the final samples.

The findings of the study showed that the presence of board of directors in the ownership of the firm prior to debt restructuring and asset restructuring did not support the argument that when board of directors become owners, the ownership would lead to improved performance of the firm in terms of return on total assets (ROA) and return on operating cash flow (RCF). Also, prior to debt restructuring, institutional ownership and concentrated ownership had negative

relationship on performance. However, prior to asset restructuring, institutional ownership had significant positive relationship while concentrated ownership had negative relationship on performance. The findings also revealed that the ownership structure had no significant relationship with firm's performance following debt restructuring but had significant relationship with performance following asset restructuring. In conclusion, in Malaysia, the firm's ownership structure played a role in determining performance only following asset restructuring but not debt restructuring.

This study showed that there is negative relationship between debt ratio and firm's performance prior to debt restructuring and asset restructuring. Furthermore, debt restructuring and asset restructuring did not improve firm's performance with increased use of debt. In conclusion, this study does not support the argument that the presence of debt following corporate restructuring would increase monitoring activity which leads to improved performance.

This study also found that prior to debt restructuring and asset restructuring, the levels of diversification as measured by the degree of revenues concentration had significant positive relationship with performance. However, debt restructuring resulted in no significant relationship between the levels of diversification and performance while asset restructuring resulted in significant positive relationships between the firm's levels of diversification and performance measured in return on operating cashflow.

In conclusion, in Malaysia, it is asset restructuring and not debt restructuring that led the firms to benefit from the reduced level of diversification.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

CIRI-CIRI , PENSTRUKTURAN SEMULA DAN PRESTASI FIRMA DI MALAYSIA

Oleh

NORAZLAN ALIAS

Pengerusi: Professor Annuar Mohd. Nassir, PhD.

Fakulti : Sekolah Pengajian Siswazah Pengurusan

Kajian ini memeriksa hubungan antara ciri-ciri spesifik firma seperti pemilikan ahli lembaga pengarah, pemilikan institusi, pemilikan berpusat, nisbah hutang dan tahap pempelbagaian seperti yang telah dikenalpasti di dalam kajian lepas sebagai penentu penstrukturan semula dan prestasi firma sebelum dan selepas penstrukturan semula. Sebanyak sembilan puluh tiga firma yang telah menstruktur semula hutang dan sembilan puluh enam firma yang telah menstruktur semula aset yang tersenarai di Bursa Malaysia(dulu dikenali sebagai Kuala Lumpur Stock Exchanges) di antara tahun 1990 dan 2002 telah dipilih sebagai sampel akhir.

Dapatan kajian ini menunjukkan kehadiran pemilikan ahli lembaga pengarah sebelum penstrukturan semula hutang dan penstrukturan semula aset tidak menyokong hujah bahawa apabila ahli lembaga pengarah juga menjadi pemilik, persamaan kepentingan ini akan membawa kepada prestasi firma yang meningkat dalam pulangan atas aset dan pulangan atas alirtunai operasi. Sebelum penstrukturan semula, pemilikan institusi menunjukkan hubungan

positif manakala pemilikan berpusat menunjukkan hubungan negatif dengan prestasi. Selanjutnya, pemilikan ahli lembaga pengarah, institusi dan berpusat ini tidak ada hubungan signifikan dengan prestasi selepas penstruktusan semula hutang tetapi ada hubungan yang signifikan dengan prestasi selepas penstrukturan semula aset. Kesimpulannya, di Malaysia penstrukturan semula aset dan bukan penstrukturan semula hutang telah menjurus struktur pemilikan firma berperanan dalam menentukan prestasi firma.

Dapatan kajian ini menunjukkan wujud hubungan negatif antara nisbah hutang dan prestasi firma sebelum penstrukturan semula hutang dan penstrukturan semula aset. Tambahan pula, penstrukturan semula hutang dan penstrukturan semula aset telah tidak menjurus firma untuk meningkatkan prestasi mereka dari pertambahan penggunaan hutang. Kesimpulannya, di Malaysia kehadiran hutang selepas penstrukturan semula tidak konsisten dengan hujah bahawa kehadiran hutang akan meningkatkan aktiviti pengawasan yang menjurus kepada peningkatan dalam prestasi.

Sebelum penstrukturan semula hutang dan penstrukturan semula aset, tahap pempelbagaian seperti yang diukur oleh darjah pemusatan perolehan mempunyai hubungan positif dengan prestasi. Bagaimanapun, penstrukturan semula hutang menjurus kepada hubungan tak signifikan antara tahap pempelbagaian dan prestasi manakala penstrukturan semula aset menjurus kepada hubungan positif yang signifikan antara tahap pempelbagaian dan prestasi yang diukur dalam pulangan alirtunai operasi. Kesimpulannya, penstrukturan semula aset dan bukan penstrukturan semula hutang di Malaysia telah menjurus firma-firma Malaysia mendapat faedah dari pengurangan tahap pempelbagaian.

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

CDRC	Corporate Debt Restructuring Committee
SC	Securities Commission
UNDP	United Nations Development Programme
DR	Debt Restructuring
AR	Asset Restructuring
BODOWN	Board of Directors' Ownership
INSOWN	Institutional Ownership
CONOWN	Concentrated Ownership
LEV	Debt Ratio
DIV	Levels of Diversification
LOGTA	Log Total Assets
LOGGDP	Log Gross Domestic Products
GLS	Generalized Least Square
ROA	Return on Total Assets
RCF	Return on Operating Cashflow
AR(1)	First Order Autoregressive Model of Serial Correlation

DEFINITION OF TECHNICAL TERMS

Corporate Restructuring
Refers to a major alteration or reconfiguration in the composition of firm's assets combined with a major alteration or reconfiguration in its corporate strategy.

Scope of corporate restructuring
Refers to financial restructuring, portfolio restructuring , operational and organizational restructuring.

Debt Restructuring
Refers to a transaction in which current debt is replaced with new debt that results in a reduction of interest payment or principal payment or extension of repayment period or exchanges equity for debt.

Corporate Divestitures
Refers to sell-off or asset sales, spin off and equity carveout. Spinoff involves share distribution to the existing shareholders while equity carveout involves new share issuance for a newly created subsidiary.

Involuntary Restructuring and Voluntary Restructuring
Involuntary restructuring is forced by external mechanisms due to default while involuntary restructuring involves no intervention by external mechanisms.

Financial Distress
A situation where cashflow or liquidation value is less than current financial obligation.

Firm specific characteristics
Refers to ownership structure internally and externally, levels of diversification and financial leverage as portrayed by ratio of debt to total asset.

CHAPTER 1

INTRODUCTION

This chapter introduces the background of this study regarding internal and external factors that influence a firm's performance. It also briefly links the firm's performance with the event of corporate restructuring, scope of corporate restructuring and the arguments or reasons for restructuring. Next, the study discusses the corporate restructuring background in Malaysia, the problem statement, its objectives and the importance of this study. This chapter concludes with expected contributions of this study.

1.1. Background of Study

The growth and performance of the business firm has always been an issue of considerable interest to scholars especially those from business-related disciplines such as finance and strategic management. In this context, as agent of the shareholders, the management of a firm influences the growth and performance of a firm because it is actively involved in decision making and in formulating the firm's corporate policy. The market environment, for example, changing regulations and state of competition, also have influence on the growth and performance of a firm. Therefore, poor corporate performance may be due to operating an unprofitable line of business, overdiversification, stiff competition and unfavourable changes in regulation, which allude to the increasing likelihood of becoming the target for takeover threats (see, Morck et al.,1990, and Mitchell & Lehn,1990). A long period of poor performance may ultimately bring firms into financial distress. Consequently, financial distress will put the firm into financial constraint that requires operating and financial responses (Ofek, 1993) to restructure the troubled firms.

1.2 Problem Statement

There are a few reasons for undertaking restructuring exercise i.e. to increase their presence in the market, correct past mistake in strategy (Markides, 1990), reduce financial commitment and generate cash proceed(Gibbs,1993), and financial distress (Wruck,1990;Ofek,1995). Other reasons are a drop in corporate performance (Jain,1985; Hoskisson and Turk,1990), poor and declining profits at the business level, corporate level, or both (Ravenscraft and Scherer,1987). Some firms restructure to improve poor corporate performance caused by over diversification, unprofitable capital investment, poor corporate governance and overleveraging (Markides and Singh, 1997). In other words, the firm's characteristics such as ownership structure, level of diversification and debt ratio affect the firm's decision to undergo corporate restructuring.

Another reason for restructuring is as management's strategy to resist a takeover threat [Jensen(1986)]. However, Hoskisson et al (1990) argue that takeover threat is likely to be related to the incidence of corporate restructuring only if diversification results in loss of strategic control and poor performance. Wruck (1990) posits that however, poor performance without leverage does not lead to financial distress but financial distress is often followed by organizational restructuring. Organizational restructuring requires comprehensive organizational changes in management, governance, and structure to create value by improving the use of firms' resources. In conclusion, motives of restructuring may differ.

According to Hoskisson et al (1990) corporate restructuring probably results in correcting inadequate governance pattern, creation of a more focused diversification strategy, increase in strategic control and reduction in dependence on bureaucratic control via reduced corporate staff and increase firm performance and shareholder wealth. Specific on debt restructuring, Stone (1998) states that the goal is the timely and orderly transformation and reduction of debt with a view to enhancing profitability, reducing leverage, and restoring credit to viable enterprises.

Corporate restructuring exercise has long been considered as one of the approaches used by firms to resolve the operational and financial constraints within firms due to unforeseen and foreseen circumstances in the business environment. However, the impacts and consequences on firm stakeholders vary. The various focuses of different types of restructuring namely portfolio, financial and organizational as defined by Gibbs(1993) and Bowman et al.(1999) are clear. The question is why does restructuring have positive or negative outcomes? What factors lead to positive or negative outcome? Bowman et al. further elaborates (1999, p48) "not all forms of financial restructuring work equally well though financial restructuring improves economic performance with the largest returns coming from leveraged and management buyouts ……”.

These inconsistent empirical evidences lead to various unresolved questions as posted in Bowman et al. (1999) on why similar types of restructuring have different returns to shareholders.

In this context, Lai and Sudarsanam (1997,p) also emphasize that “….. any restructuring strategy has different implications for different stakeholders-shareholders, lenders, managers and employees often leading to conflicts of interests among them.” In support of this argument, Bowman et. al (1999) advocate that the diversity in restructuring outcomes is due to selection of diverse actions by firms.

The Asian financial crisis in 1997 had largely affected the current economic scenario that caused many firms in Malaysia to experience difficult time in their business operations and financial position due to rising interest rates, depreciating Ringgit against foreign currencies and declining share values. Following the financial crisis the number of firms that defaulted or undergoing restructuring and the amount of debt involved in debt restructuring increased sharply. However, it can be argued that firms restructure for several reasons such as poor corporate governance, overdiversification and overleveraging.

Consistent with the argument that corporate restructuring is meant to correct firm specific characteristics due to overdiversification, poor corporate governance and overleveraging, some firms in Malaysia had undertaken debt restructuring and asset restructuring such as operating asset divestment before the financial crisis but the financial crisis in July 1997 escalated the amount of restructured debt and number of firms involved in debt restructuring.

However, these characteristics do not reflect the firm's motivation to do correction or adjustments on weaknesses such as weak governance, over diversification and high leveraging to improve performance. Rationally, corporate restructuring will give meaning when firms make adjustments or corrections on specific characteristics that exhibit weak governance, over diversification and high leveraging to improve performance. This argument has led to unresolved questions with respect to corporate restructuring of which some will be the research questions of this thesis.

In other words, firms that experience business difficulties in the short and long period must find a way to be back on track and continue to gain the confidence of the shareholders and marketplace. Thus, a restructuring exercise must be able to drive the firm's management to improve the firm's efficiency and increase shareholders wealth. Thus, firms that have undergone the restructuring exercise should remain efficient and enjoy synergistic effect after the restructuring.

1.3 Objectives of This Study

In this study, three different elements of the firm, i.e the corporate governance mechanism as depicted by its ownership structure, the firm's corporate strategy as depicted by its level of diversification in business activities, and the firm's capital structure as depicted by its debt ratios are used to investigate their influence on corporate restructuring.

Thus, the objectives of this study are as follows:

(i) To examine the profile of ownership structure, level of diversification, debt ratio, firm's size and economic performance before and after the debt restructuring.

(ii) To examine the profile of ownership structure, level of diversification, debt ratio, firm's size and economic performance before and after the asset restructuring.

(iii) To examine the effects of ownership structure, level of diversification, debt ratio, firm's size and economic performance on firm's performance before and after debt restructuring

(iv) To examine the effects of ownership structure, level of diversification, debt ratio, firm's size and economic performance on firm's performance before and after asset restructuring

1.4 Research Questions

(i) Do characteristics of the firm such as ownership structure, level of diversification and debt ratio differ before and after corporate