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Structural Factors Influencing Private Companies Financing Behaviour

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Abstract: This article is on the structural factors surrounding private firms and their effect on financing behaviour and financing amount approved by banks. Capital is known for its significant in the well being of any business organisations, and maintaining a good structure of capital is vital to ensure that business firms can survive and prosper. Therefore this study is an attempt to understand which factors influencing the most in Malaysia environment. Utilising mixed methods approach, secondary data has been collected and analysed, hypotheses were tested for relationship and interview were also done to confirm the findings. Results indicate that while type of financing, age of business, number of directors and type of shareholdings have strong influenced on the financing amount, location of business and type of industry or business line do not.

Key word: structural factors, private firms, financing behavior, business structure

INTRODUCTION

Capital structure decision is crucial function for the financial well-being of any organization. Financial constraints, bankruptcy and liquidation are among the consequences if the organization mistakenly evaluate and decide on the capital mixture to support their operations, and minimize risks (Suhaila *et al*., (2009). Lowering the weighted average cost of capital (WACC) is one of many strategies that organizations normally adopt to remain competitive and stable Modigliani and Miller (1958). This strategy will increase the net economic return which eventually increases the firm value. Maximizing firm's value is the important point for every financing decision whether internal or external financing (Suhaila *et al*., 2009). The top management of firms operating in uncertain economies hold tough task in achieving the best decision of capital structure and maximizing firm's value (Suhaila *et al*., 2009). Many theories and empirical evidence in yielding to maximum capital structure have been forwarded by literatures, but dynamic economies have always cause difficulties in attaining efficient mixture of debt and equity. Thus, a combination of evidence, calculated judgment, knowledge in financial theories are possible tools for application in determining the best financing mix and lower the risk to firm's value (Al-Shubiri, 2008). Conceptually, firms financed their operations either through internal financing (i.e. revenues, retained profits, sales of assets) or external financing (i.e. borrowing from financial institutions or issuance of new shares). External financing is generally costly because the firm will either incur transaction cost when obtaining finance from financial institutions or increase the share in equity and decision making (Inderst *et al*., 2003). The topic of financing behavior has been widely researched and discussed by academicians especially on the developed economies. Various determinants of financing structure have been identified which includes internal and external factors such as age of the business, type of financing applied, number of directors, shareholding or managerial ownership, location, line of business and etc. This paper will present an attempt made at understanding the financing behavior of companies in Malaysia and to identify what factors influenced the financing decisions.

MATERIALS AND METHODS

Access to Capital, Capital Structure, and the Funding of the Firm:

Capital structure theory is closely related to the firm's cost of capital. Capital structure is the mix of the long-term sources of funds used by the firm to maximize market value. This mix, called the optimal capital structure, will minimize the firm's overall cost of capital. However, there are arguments about whether an optimal capital structure actually exists (Besley *et al*., 2000; Ross *et al*., 2002). Theories of corporate capital structure have offered a number of expectations concerning the characteristics, elements and composition of the securities that firm's issue (Brav, 2009). Empirical studies examining these expectations and predictions focus almost exclusively on their validity in the context of private and publicly traded firms, in large part due to data availability. As a result from the theories of corporate capital structure, relatively little is known about the determinants factor of financing behavior of privately held firms, Brav (2009). There are many factors that affect private firms especially SMEs' ability to get financing from bank. Hongjiang *et al*., (2006) study on SMEs' financing in Chengdu city, capital of Southwestern China's Sichuan province, documented that the influencing factors are whether SMEs can provide collateral or guarantee, firm size, age of business, location of business, line of business, willingness to accept bank's clauses, line of business and close relationship with

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bank. But in contrast, regression analysis and correlation analysis result has shown that SMEs' financial variables such as asset-debt, net profit, ratio income and credit score is not obvious to affect their ability to get financing from the financial institution bank, Hongjiang *et al*, (2006). Consistent and in line with the theory prediction and qualitative analysis given, firm size is the most important factor to affect SMEs' ability to get financing from financial institution, Farinas, (2000). The regression results reflect information asymmetry between SMEs and banks, and that banks had taken a simple way to protect them, Hongjiang *et al*., (2006).

Fazzari *et al*., (1988), listed many empirical literatures emerged to estimate financing constraints of firms (Schiantarelli, 1995; Blundell *et al*., 1996; Hubbard, 1998; Bond and Reenen,1999). These literatures rely on the assumption that an external finance or debt financing is more costly and expensive than an internal finance or equity financing due to asymmetric information and agency problems, and that the "premium" on external finance is an inverse function of a borrower's net worth. A firm is defined to be financially constrained if a windfall increase in the supply of internal funds results in a higher level of investment spending, Beck *et al*., (2003). Significant development in Malaysia financial industry since 2008 world economic crisis is the reduction in the banking institutions' credit exposure to businesses and the greater focus on debt financing, Endut and Toh (2009). In recent years, there has been a growing trend among corporation i.e private and listed companies of securing longer-term financing, in larger amounts, from the debt financing markets, (Bank Negara Annual Report, 2010). As the corporate sector turns to the debt financing market to meet its financing needs, banking institutions are robust their strategy to met these opportunities and they are focusing their sales and give financing to the corporations customer as part of their business diversification strategy, Endut and Toh (2009). The debt financing market segment accounted for one third of the banking sector's total loan exposure before the crisis; it now accounts for more than half. With the shift towards high-volume, low-value loans, the banking sector has diversified credit risks and minimized the potential for large losses stemming from the failure of a few large borrowers. At the same time, as lending to corporations' customer becomes a larger segment of the financial system, it is crucial for policymakers to be aware of the implications for monetary policy and financial stability, Endut and Toh (2009).

Determinants of Capital Structure:

Age of the Firm is one of the important determinant factors of capital structure and financing behavior (Loderer and Waelchli, 2010). Age of the firm is a standard evaluation and measurement of reputation and credibility in capital structure models, Abor (2008). To overcome the problems associated with the evaluation and measurement of creditworthiness, The same perspective has also been established within the context of small business, Ang (1991). Petersen *et al*., (1994) wrote that older firms should have higher debt since they should be higher quality firms to support their operation and produce good quality of output. Hall *et al*. (2004) agreed that age is positively related to long-term debt but negatively related to short-term debt. Esperança *et al*. (2003), however, found that age is negatively related to both long-term and short-term debt. Green *et al*., (2002) also found that age has a negative influence on the probability of incurring debt in the initial capital equation, no relationship on financing behavior and no impact in the additional capital equation. In examining the length of the firm and lender relationship, it is important to account for the potentially confounding effect of firm age, which previous studies have shown to be highly correlated with the length-of-relationship variable, Cole (1998). Berger and Udell (1995) wrote that age reflects public information whereas the length of relationship reflects private information available only to the potential lender, and corresponds to the difference between information obtained as a result of reputation versus information obtained from monitoring. Diamond (1999) suggests the use of firm's age and reputation. The age of the firm should influence whether a firm receives credit because firms in business for longer periods of time have established that they can survive the critical start-up period and have generated reputational effects, Diamond (1999). Thus, lenders should be more likely to extend credit to older firms.

Managerial Ownership:

Directors, top management, officers, support staff and other management may have different perspective about the decision to get financing from external sources since many of them have large portions of their personal wealth invested in the firm (Amihud and Lev, 1981; Friend and Hasbrouck, 1988). The personal wealth managerial insiders have invested in their employer is composed largely of their employer's common stock and the firm-specific human capital they have accumulated while working for their employer. Since these items tend to represent a large proportion of an insider's total wealth, the bankruptcy of the employer would have a major impact on their personal wealth. As a result, Friend and Hasbrouck (1988) argue, managerial insiders should be more sensitive to the bankruptcy risk that debt financing induces and more inclined to minimize this risk by using less than the shareholder wealth maximizing amount of debt in the firm's capital structure. Further, the more wealth a managerial insider has invested in the employer, the greater the incentive they have to minimize the use of debt financing. Noe and Rebello (1996) argue that the locus of control within a firm is an important determinant of choice of finance. When corporate decisions are dictated by the manager, equity issues will be

favoured over debt because of the managers' inclination to protect their undiversified human capital and to avoid the performance pressure associated with debt commitments, Berger *et al*., (1997). However, if the locus of control rests with substantial shareholders that are not represented on the management board, especially of quoted firms, the company may take on more debt to limit the scope for managerial discretion. Previous empirical studies suggest that managerial ownership should be negatively related to debt use, Noe and Rebello (1996).

Location and Geographic of Business:

Based on the previous study, the corporate finance literature is not very clear on the effect of location and geographical of the business and the choice and decision of finance. However, it is expected and determined that firms where located close to the capital city especially industrial area and golden triangle are or urban centre would have easier and available access to debt finance and external sources of financing than those located at the outside the capital city and rural area (Abor, 2008).

Line of Business:

Based on the previous study done by Ferri *et al*., (1979) about the capital structure determinants, they have considering the factor of industry type. They have found that, the independent variable which is the Industry type or line of business; have a weak or negative relationship on the financing behavior among the firms. In a comparing study, across U.S. and Japanese companies, Kester (1986) found and considers the industry type as independent variable. Aggarwal (1981) expresses that some important variables such as industry type have been ignored.

Other factors besides those listed above which are not typically included in conventional financial models are also thought to affect and influenced capital structure decisions of firms. Green *et al*., (2002), included factors such as industry, location of the firm, entrepreneur's educational background, gender of the entrepreneur, form of business and export status in explaining the financing decisions of small enterprises in Kenya. Bolton, (1971) identified type of industry as more pronounced, where Hisrich, (1989) and Riding *et al*., (1994) suggested that service businesses are less likely to be candidates for bank financing because they are often lacking in assets that can be used as security and collateral. Businesses with high capital allowance such as construction, transportation and manufacturing may be more likely and prefer to use external capital from financial institution. Furthermore Bradley *et al*. (1984) have found that industry or line of business classification and grouping accounted for 25% of the variation in firm leverage and debt, with capital allowance and intensive firms showing it was significantly shown higher leverage ratios among the other factors. Scherr *et al*. (1993) also has found industry effects in a study of the financing behavior of capital structure of start-ups and argued that firms' choice of external financing from financial institution depends on type of business and how fast the business provides return and profit. In their study, service industry are found to provide returns faster than other industry which means that service industry may be in a position and opportunity to repay their installments and debt due on time (Scherr *et al*., 1993). Form of business also affecting financing decisions of the firms. The shareholders of limited companies, private companies and corporations have limited liability against losses obliged by the firms, whereas the partnerships and owners of sole proprietorships have unlimited liability against losses obliged by the firms, Brewer *et al*., (1996). Consequently, the shareholder–creditor conflicts issues are more likely among limited companies, private companies and corporations than they are for partnerships and sole proprietorships. Thus, limited companies, private companies and corporations may be more likely to finance their business or project with internal equity, while partnerships and sole proprietors are more likely to employ debt financing from external sources in the form of financing, Brewer *et al*., (1996).

Research Methodology:

Several contexts have been established for this study: (i) the financing facilities considered are confined to those offered by only one bank with 113 branches throughout Malaysia; (ii) the companies chosen for analysis are 400 non-listed (private) companies from 17 industries); (iii) the structural factors data obtained are from January 2008 to March 2011 involving private companies granted financing facilities from one of the prestigious financial institutions. The period was chosen to exclude financial crisis year 2007. The financial market had recovered quickly due to the aggressive measure taken by the government of Malaysia. The exclusion of this period will portray a better perspective of Malaysia financial market and industrial sector in that period. All the information relating to structural factor of financing these Malaysian companies were obtained from the pipeline report of Corporate & Investment Banking Department and Commercial Banking Department of one of the financial institutions in Malaysia which has branches all over the country and has been established for almost 30 years. Specific identity of the institution is kept confidential for ethical reasons.

This study adopted a mixed method data collection which has been recognized as useful in seeking answers to social sciences issues (Tashakkory 1998; Creswell 2007). Secondary data from selected databases and documents of selected firms were collected and analysed. The quantitative data collected have been regressed to

confirm six hypotheses. Interviews with credit officers leading commercial banking division of one local bank was also done to confirm on the data that have been gathered. Questions asked during the interview revolve around exploring the financing behavior of private companies in Malaysia. The guide questions were: (1) what are the existing guidelines in assessing (credit assessment) the financing application from the private companies?; (2) how does your bank consider the structural factor like type of facility, age of the firm, location of business, number of directors, type of shareholding and line of business in credit assessment process?; (3) what are among the main factors your bank focuses in credit assessment process? (4) are there any special treatments for certain cases?

Hypetheses Development:

Whilst the dependent variable is the level of financing amount obtained from this financial institution, the independent variables are (1) Type of Financing; (2) Age of Business; (3) Location of Business; (4) No. of Director; (5) Shareholding; and (6) Line of Business.

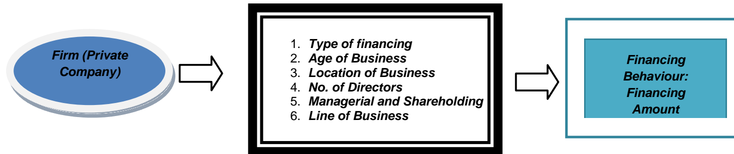

Fig. 1: Research Framework

The dependent variable for this study is the amount of financing approved. Six (6) hypotheses have been formed and tested based on the variables in the framework above. The independent variables are:

1. Type of finance – several financing terms used in the banking industry which represent the financing amount, in this study they are divided to 5 major types of finances plus one for variety of finances. Among others are working capital finance, refinancing, restructuring financing, hedging, project / bridging financing and contract financing.
2. Age of Business – computed as the difference between the calendar year at *t* and the birth-year reported by the firm (Farinas and Moreno, 2000). Five age classes are considered: less than 5 years, 6–10 years, 11–25 years, 26–50 years and more than 50 years.
3. Location of Business – divided by location of business which is it was Central Region, Northern Region, Eastern Region, Southern Region and East Malaysia Region.
4. Number of Directors –any person occupying the position of director by whatever name called and any person in accordance with whose directions or instructions the directors are accustomed to act. In this study, the sample of 400 companies has been analyzed which ranges from seated between 2 to 10 directors.
5. Shareholdings – two types, private exempt and subsidiary.
6. Line of business – the 400 companies was divided to 15 line of business depending on their industry from publishing to healthcare and other.

RESULTS AND DISCUSSION

Financing Amount:

Financing amount is the dependent variable in this study to test the determinant of the financing behavior among the private companies. Table 1 below shows percentages of sample companies and financing amount. Majority private companies in the sample of the study have obtained financing facilities in the range of the financing amount of RM1,000,000 to RM10,000,000 because normally the amount are big enough to support the business operation or to acquire asset or property for private company entity and also less evaluation in term of documents requirement and less security requirement from financial institution and the banks. But for the financing amount more than RM50,000,000, only 3.00% from the sample size obtained financing from the financial institutions and banks due to normally the financial institutions and the banks will request a high security to secure the financing given to their customer like assets i.e property, corporate guarantor and debenture. A credit officer responded that bank only granted high finance amount to established companies and for projects that will give high return to company or supported by the government like government linked company.

Table 1: Financing Amount in term of Percentage (%) on the sample

Financing Amount	No. of Customer	Percentage of Customer
Less than RM100,000.00	14	3.50%
RM100,000.00 to RM1,000,000.00	143	35.75%
RM1,000,000.00 to RM10,000,000.00	178	44.50%
RM10,000,000.00 to RM50,000,000.00	53	13.25%
More than RM50,000,000.00	12	3.00%
Total	**400**	100.00%

Purpose of Financing:

Table 2 below shows that mainly (69%) the reason private companies obtained financing from the financial institutions and banks is for working capital purposes. The requirements of the working capital purposes normally to support the company's business and daily operation.

Table 2: Type of financing in term of Percentage (%) on the sample

Type of Financing	No. of Customer	Percentage of Customer (%)
Asset/Property Acquasition	43	10.75%
Working Capital	276	69.00%
Contract Financing	40	10.00%
Restructuring	11	2.75%
Refinancing	10	2.50%
Equipment Procurement	7	1.75%
Project Financing	2	0.50%
Hedging	5	1.25%
Others	6	1.50%
Total	**400**	**100.00%**

Age of Business:

Based on the Table 3 below, most of the financing was given to matured company, company that has been operated around 11 to 25 years. The reason is these companies already established and has strong condition in term of operation, brand, image and financial support. Also, normally the matured company already has a long relationship with financial institutions and banks and good past track record and the financial institutions and the banks has extended this relationships with give them additional financing. Also, based on the sample, the financial institutions and the banks have reducing the financing facilities to the old companies which is 26 to 50 years old companies due to these companies required less financing due to strong financial support and they could to obtain financing from internal sources like shareholding or retain earning.

Table 3: Age of business and percentage (%) of the sample

Age of Business	No. of Customer	Percentage of Customer %
Less than 5 years	70	17.50%
6 years - 10 years	107	26.75%
11 years - 25 years	176	44.00%
26 years - 50 years	47	11.75%
More than 50 years	0	0.00%
Total	**400**	**100.00%**

Location of Business:

Table 4 shows that 59.75% and most of the private companies have obtained financing came from Central Region which is this region of location comprise Klang Valley area and state of Negeri Sembilan as well. As confirmed by the credit officer during the interview session, these factors due to Klang Valley area known as an industrial area and lots of new project areas have been developed to support the country vision of 2020 and centre of the country as well. 11% of the private companies came from Northern Region which is directly it was support of the new mega project launched by the government which is Northern Economics Corridor Region (NECR) on 2008. 14% of the private companies came from Eastern Region which is through Eastern Coast Economics Region (ECER) where it was a master plan that has been developed and will be the basis for guiding the development of this region over the next 12 years where it will be transformed into a major international and local tourism destination, an exporter of resource based and manufactured products, a vibrant trading centre, and an infrastructure and logistics hub. Furthermore, 8% of the sample is located at Southern Region and 7.25% of the sample is located at East Malaysia.

Table 4: Location of business and percentage (%) of the sample

Region	No. of Customer	Percentage of Customer (%)
Central	239	59.75%
Northern	44	11.00%
Southern	32	8.00%
Eastern	56	14.00%
East Malaysia	29	7.25%
Total	**400**	**100.00%**

Number of Directors:

Previous study indicated that number of directors also determined financing behavior among private and listed company. Table 5 shows 76.25% the sample of the study has less than 3 directors. It was shown that, most of the private companies which have less than 3 directors prefer to obtain financing from financial institution and the banks. It was happened due to easy to get majority voices from the directors where they are the authorized person to give direction whether the external financing is required or not and also the possibility of the private companies have less than 3 directors is private exempt entity where the shareholders are individual which is the financial sources are limited and not strong. From the sample of the study also has shown that 20% of the private companies have 4-6 directors and 3.75% has 7-10 directors.

Table 5: No. of the directors and percentage (%) of the sample

No. of Directors	No. of Customer	Percentage of Customer %
Less than 3 directors	305	76.25%
4 to 6 directors	80	20.00%
7 to 10 directors	15	3.75%
More than 10 directors	0	0.00%
Total	**400**	**100.00%**

Type of Shareholdings:

Table 6 shows 73% of the sample obtained financing from financial institution and banks is private exempt which is the shareholders are individual whereas 27% of the sample is subsidiary of the parent or holding company. This result has shown that private exempt company required more external financing from the other sources like the banks to support their business and operations due to the shareholders are individual which is the financial sources are limited and not strong compare than subsidiary which is they have financial support and capital injection from their parents or holding company and also the restriction, controls and policy of the parents or holding company to excess external financing.

Table 6: Type of shareholdings and Percentage (%) of the sample

Type of Shareholdings	No. of Customer	Percentage of Customer (%)
Private Examp	292	73.00%
Subsidiary	108	27.00%
Total	**400**	**100.00%**

Line of Industry:

From the sample of the study, 20.50% and most of the private companies in the general construction industry. Transformation program and development of economics region i.e. Northern Economics Corridor Region (NECR), East Coast Economics Region (ECER), Wilayah Pembangunan Iskandar (Iskandar), Sarawak Corridor of Renewable Energy (SCORE) and Sabah Development Corridor (SDC) has helped constructions industry prosper. 15% of the private companies are from industrial manufacturing which is also related to the transformation program and economics corridor region in support for the construction industry, supplying supply raw material for construction purposes. Trading and services industries have comprised 19% and 9.25% from the sample of the study whereas it was common industry in this country as a middle party between producer and end consumer and definitely these industries required financial support from external due to any financial constrain and the unavailability fund from inside will interrupt the business chain.

Table 7: Type of industry by Percentage (%) of the sample

Line of Business	No. of Customer	Percentage of Customer (%)
Publishing & Advertising	5	1.25%
Industrial Manufacturing	60	15.00%
Food Manufacturing	13	3.25%
General Construction	82	20.50%
General Work	18	4.50%
Agriculture	5	1.25%
Education	5	1.25%
Information Technology	6	1.50%
Telecommunication	8	2.00%
Trading	76	19.00%
Services	37	9.25%
Hospitality	6	1.50%
Healthcare	6	1.50%
Transportation	6	1.50%
Power & Utility	9	2.25%
Real Estate	16	4.00%
Plantation	6	1.50%
Others	36	9.00%
Total	**400**	**100.00%**

Table 8 below presents result of test done on relationship among variables.

Table 8: Results for Relationship test

No.	Hypotheses	Results
H1	There is a significant positive relationship between financing amount and type of facilities approved of the firm.	Supported (p= 0.00; B = 0.116)
H2	There is a significant positive relationship between financing amount and age of the firm.	Supported (p= 0.00; B = 0.213)
H3	There is a significant positive relationship between financing amount and location of business of the firm.	Not Supported (p=0.09;B = -0.074)
H4	There is a significant positive relationship between financing amount and number of directors of the firm.	Supported (p= 0.00; B = 0.445)
H5	There is a significant positive relationship between financing amount and shareholding of the firm.	Supported (p= 0.00; B = 0.766)
H6	There is a significant positive relationship between financing amount and line of business of the firm.	Not Supported (p= 0.417; B = 0.07)

Results indicate that financing amount are related to the type of facilities (H1), age of the firm (H2), number of directors (H4 and shareholdings of the firm (H5). Location of the business (H2) and line of business (H6) do not seem to be related to the amount of financing approved by bank. Interview respondent also emphasis that type of facilities are the main evaluation criteria. Petersen and Rajan (1994) reported that older firms should have higher debt since their firm quality is higher. Hall *et al*. (2004) also agreed that age is positively related to long-term debt. Interview result also shows that banks look at the capacity of the borrower, i.e. age of business, track record with other lenders and reputation in the industry which these factors will influence credit assessment by the credit officer. Noe and Rebello (1996) reported that locus of control i.e by the directors within a firm is an important determinant of choice of finance. Location of business are not significant although have positive relationship. Several prior studies indicated unclear effect of location and geographical of the business and choice of finance, but Abor (2008) reported expectation on firms located closer to the capital city especially industrial area and golden triangle or urban centre would have easier and available access to debt finance and external sources of financing than those located at the outside the capital city and rural area. These could be dependent on the geographical structure of countries, and respondent from interview also said that they focus on the development area or any new development project launched by the government like Northern Economics Corridor Region (NECR) and Eastern Region which is through Eastern Coast Economics Region (ECER). Ferri and Jones (1979) also reported weak or negative relationship of industry type or line of business on the financing behavior.

Conclusion:

Financing amount which reflected the financing behavior of firms as well as approval of banks are found to be dependent and related to type of financing, age of business, number of directors and type of shareholdings. Location of business and type of industry or business line do not seem to have significant relationship to the financing amount. The results are consistent with several previous study but contradict with a study by Abor (2008) in terms of business location. This could be true for the geographical differences of Africa and Malaysia.

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