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CORPORATE GOVERNANCE AND THE COST OF DEBT AT EMERGING MARKETS: THE CASE OF MALAYSIAN LISTED FIRMS*

This paper investigates the effect of corporate governance on the cost of debt of Malaysian listed firms. This study draws on an agency theory from the perspectives of debt agency and traditional manager-shareholder agency costs to demonstrate that debt holders are sensitive to the quality of firm corporate governance. We utilise a comprehensive corporate governance index, covering 139 items in 6 broad categories, for evaluating corporate governance quality. Using the panel sample between 2003 and 2007, we argue that corporate governance lowers the cost of debt. Debt holders tend to be sensitive to corporate governance practices that affect the extent of expropriation tendencies of managers or shareholders, the validity of financial reports that they use in managing lending agreements and default risk. They view board structure and procedures, board compensation practices, shareholder rights and relations, accountability and audit and social and environmental activities as integral components of a good corporate governance framework.

Keywords: *corporate governance index; agency theory; cost of debt; agency cost of debt.*

Зулкуфлі Рамлі

КОРПОРАТИВНЕ УПРАВЛІННЯ ТА ВАРТІСТЬ ПОЗИКОВОГО КАПІТАЛУ НА РИНКАХ, ЩО РОЗВИВАЮТЬСЯ (ЗА ДАНИМИ МАЛАЙЗІЇ)

У статті досліджено вплив корпоративного управління на вартість позикового капіталу фірм, що котируються на малайзійської фондовій біржі. Розглянуто агентську теорію з точки зору вартості позикового капіталу і традиційних агентських витрат у системі "менеджер – акціонер", продемонстровано, що кредитори чутливі до якості корпоративного управління фірмою. Для оцінювання якості корпоративного управління використано комплексний індекс корпоративного управління, що охоплює 139 елементів у 6 категоріях. За даними 2003–2007 рр. встановлено, що корпоративне управління знижує вартість позикового капіталу. Кредитори виявляються чутливими до практики корпоративного управління, яка впливає на ступінь відчуження капіталу менеджерами або акціонерами і обгрунтованість фінансових звітів, що використовуються в управлінні договорами кредитування та ризиками невиконання зобов'язань. Як невід'ємні компоненти якісного корпоративного управління розглянуто структуру ради директорів і процедури управління, практику нарахування премій керівникам, права акціонерів і ставлення до них, підзвітність та аудит, соціальну та екологічну діяльність.

Ключові слова: *індекс корпоративного управління, агентська теорія, вартість позикового капіталу, агентські витрати.*

Табл. 2. Форм. 3. Літ. 27.

Зулкуфли Рамли

КОРПОРАТИВНОЕ УПРАВЛЕНИЕ И СТОИМОСТЬ ЗАЕМНОГО КАПИТАЛА НА РАЗВИВАЮЩИХСЯ РЫНКАХ (ПО ДАННЫМ МАЛАЙЗИИ)

В статье исследовано влияние корпоративного управления на стоимость заемного капитала фирм, котирующихся на малазийской фондовой бирже. Рассмотрена агентская

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* An earlier version of this paper was presented at the 12th Asian Academic Accounting Association (AAAA) Conference held from 8-12 October 2011 in Bali, Indonesia. We would like to thank the conference participants for valuable comments and suggestions.

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теория с точки зрения стоимости заемного капитала и традиционных агентских издержек в системе "менеджер – акционер", продемонстрировано, что кредиторы чувствительны к качеству корпоративного управления фирмой. Для оценки качества корпоративного управления использован комплексный индекс корпоративного управления, охватывающий 139 элементов в 6 категориях. По данным 2003–2007 г.г. установлено, что корпоративное управление снижает стоимость заемного капитала. Кредиторы оказываются чувствительными к практике корпоративного управления, которая влияет на степень отчуждения капитала менеджерами или акционерами и обоснованность финансовых отчетов, используемых в управлении договорами кредитования и рисками неисполнения обязательств. В качестве неотъемлемых компонентов хорошего корпоративного управления рассматриваются структура совета директоров и процедуры управления, практика начисления премий управляющим, права акционеров и отношение к ним, подотчетность и аудит, социальная и экологическая деятельность.

Ключевые слова: *индекс корпоративного управления, агентская теория, стоимость заемного капитала, агентские издержки.*

Introduction

Malaysian listed firms have unique ownership structure due to highly concentrated ownership as opposed to highly dispersed in most Western countries and the majority of the firms are built on a family businesses (Claessens, Djankov, Lang, 2000). In such environment, it is common to have one large or controlling shareholder and a fringe of minority shareholders. The nature of Malaysian corporate ownership structure influences the type of agency problems that exists in listed firms. The classic owner-manager conflict in diffused ownership (Berle, Means, 1932; Jensen, Meckling, 1976) is mitigated due to controlling shareholders' greater incentive to monitor the managers. However, another type of agency conflict appears, in which controlling shareholders can use their controlling position to extract private benefits at the expense of minority shareholders and debt holders through managerial entrenchment or various other forms of self-interested related party-transactions (Morck, Yeung, 2003; Singam, 2003). The inclination to expropriate occurs because the controlling shareholders have more clout in determining the manner the firm is managed and the way profits are distributed to common shareholders. The impact of expropriation tendency may be revealed when the controlling shareholders also serve in management capacity (Wiwattanakantang, 2001).

We posit that debt holders consider agency cost as a risk in four ways. First, self-interested controlling shareholders may expropriate wealth by using their voting power to influence managers to undertake riskier investments such as mergers and acquisitions. Whilst riskier investments may be beneficial to shareholders, it does not necessarily benefit debt holders (Asquith, Wizman, 1990; Warga, Welch, 1993). Instead controlling the shareholders stand to benefit from most of the gains when the risky investments payoff but the debt holders bear most of the cost (Jensen, Meckling, 1976). The cost, in this instance, is higher then the default risk and there is a likelihood of bankruptcy if the risky investment fails (Jensen, Meckling, 1976). In this situation, a conflict of interests between the controlling shareholders and the debt holders arises (Anderson, Mansi, Reeb, 2004). Debt holders may impose lending agreements and loan covenants to protect their interest. However, in general, debt covenants are rarely effective in completely eliminating the conflict between shareholders and debt holders (Anderson et al., 2004).

Second, debt holders do not usually have effective control over the use of the funds they provide. Hence opportunistic managers and/or controlling shareholders may possibly divert these funds from the intended objective to the detriment of the debt holders. Third, debt holders rely on firms' financial reports to assess the true financial standing of the firms and the extent of default risk. Naturally they are very concerned about the financial reporting validity, which could be doubtful due to information asymmetry (DeFond, Jiambalvo, 1994). Debt holders may be harmed when managers issue misleading financial reports to hide adverse information for the managers' self-interested purposes (Dechow, Sloan, Sweeney, 1996). Finally, controlling shareholders can enter into the financing arrangements that may upset the seniority of the current debt holders (Aslam, Kumar, 2009). Therefore, in return for accepting such risks and the trouble to successfully defend their interest against expropriation by controlling shareholders and managerial opportunism, debt holders require higher risk premium for the funds provided (Myers, Majluf, 1984).

In view of the risks associated with the agency cost of debt, the extent to which debt holders are willing to accept lower risk premium (i.e. impose lower cost of debt) depends on the effectiveness of the firms' corporate governance mechanisms. In this study, we define corporate governance as "the ways through which suppliers of capital to corporations assure themselves of getting return on their investment" (Shleifer, Vishny, 1997). Debt holders, for example, may consider board structure and board procedures as critical elements in delivering credible and reliable financial reporting (Anderson et al., 2004). Further, board of directors can potentially resolve the conflict between the shareholders and the debt holders. On the other hand, debt holders may impose higher cost of debt if the firm's board of directors strengthens the position of shareholders in relation to to the debt holders. Board of directors that are pro-shareholders may be engaged in risky projects that may benefit shareholders but expropriate wealth from debt holders.

The aim of this study is to investigate the effect of corporate governance on the cost of debt of Malaysian listed firms using the panel data analysis. In this study, we utilise a corporate governance index (hereafter the CG Index) developed by Ramly (2012) for the purpose of assessing firms' corporate governance quality. The CG Index consists of 139 items in 6 categories, namely board structure and procedures, board compensation practices, shareholder rights and relations, accountability and audit, transparency, and social and environmental activities. We have revealed that higher quality corporate governance reduces the cost of debt. The finding implies that debt holders take into account the extent of firms' corporate governance quality in pricing the debt. They are willing to impose lower interest rate in return for the protection accorded to them by firms' corporate governance.

This paper is structured as follows. Section 2 provides a snapshot of corporate governance development in Malaysia. Section 3 reviews the most relevant literature related to the study and develops the hypothesis. Section 4 covers the research methodology. Section 5 presents the results, discusses the findings and illustrates the main conclusions of this research.

Corporate Governance in Malaysia

The Asian financial crisis of 1997—1998 provides an impetus for the development of corporate governance in Malaysia. Prior studies suggest that the poor corporate gov-

ernance was one of the contributing factors to companies' downfall (Abdul Rahman, Mohammed Haniffa, 2005; Mitton, 2002). Following up the financial crisis the Malaysian government established a High Level Finance Committee to conduct a detailed study on the state of corporate governance of listed firms. The Committee found that in general, listed firms had poor corporate governance practices and a low understanding of the need to establish a robust financial control mechanism.

The Committee established the MCCG in 2000, which consisted of various recommendations to strengthen the statutory and regulatory framework for corporate governance and enhance the checks and balances and self-regulatory mechanisms. The MCCG (2000) placed utmost importance on the governance role of board of directors; thus established various best practices for improving board structure and procedures (Liew, 2007). In 2001, the Malaysian Bourse Securities adopted the MCCG (2000) in its listing requirements and imposed a mandatory obligation for listed firms to disclose in their annual reports the way they have applied the principles of the MCCG (2000) and the extent of compliance with the best practices.

The Securities Commission Malaysia (hereafter the SC) revised the MCCG (2000) in 2007 incorporating changes amongst others the setting up of an internal audit department that reports directly to the audit committee and making it mandatory to have only non-executive directors in audit committee. In 2011, the SC introduced a 5-year Corporate Governance Blueprint (hereafter the Blueprint), which covered the action plan to raise the quality of corporate governance by strengthening self and market discipline and promoting greater internalisation of the culture of good governance. The Blueprint focused on 6 corporate governance ecosystems: shareholder rights, the roles of institutional investors, boards, gatekeepers and influencers, disclosure and transparency, public and private enforcement. The recommendations were to be implemented over a 5-year period.

Recently, the SC launched the Malaysian Code on Corporate Governance (2012) [(MCCG (2012)], which incorporated the recommendations of the Blueprint and superseded the MCCG (2007). The MCCG (2012) focuses on clarifying the role of the board in providing leadership, enhancing board effectiveness through strengthening its composition and reinforcing its independence. Firms are also encouraged to establish corporate disclosure policies and to make public commitment to respecting shareholder rights. The MCCG (2012) came into effect on 31 December 2012 and listed firms were required to report their compliance with its principles and recommendations in their annual reports.

Literature Review

Using U.S. data on all industrial bond issues during 1991–1996, Bhojraj and Sengupta (2003) examined the link between corporate governance mechanisms and bond ratings and yields. They utilised two corporate governance attributes, i.e. the role of institutional shareholders and the ratio of outside directors in the board. They found out that firms having stronger external monitoring through greater institutional investor ownership and stronger outside directors' control enjoy lower yields and superior bond ratings. This finding suggests that independent directors have a powerful role, where other corporate governance mechanisms for curbing self-interested behaviour are weaker. However as institutional ownership gets concentrated, firms have lower ratings and higher yields.

Anderson et al. (2004) investigated the relationship between audit quality attributes and cost of debt using a sample of Standard and Poor's 500 firms over the period of 1993–1998. The governance attributes of this study were board independence, board size and audit committee independence, size and meeting frequency. They observed that board and audit committee's monitoring effectiveness gave bondholders some assurance on the integrity of the firms' accounting information, thus they accepted a reduction in their risk premium (i.e. allowing firms to enjoy a lower cost of debt).

Using a sample of U.S. firms that went public during 1977–1988, Pittman and Fortin (2004) examined the relationship between external auditor reputation and firms' cost of debt. External auditor reputation is an important determinant of the quality of financial reporting. The appointment of one of the Big Six auditors is a proxy for audit quality. They measured the cost of debt by dividing the interest expense for the year by the average short- and long-term debt during the year. They observed that firms that retained Big Six auditors enjoyed a lower average cost of debt, suggesting that auditor's reputation was a significant factor in determining the quality of financial information.

Using firm-level data from the Investor Research Responsibility Center for the period of 1990–2000, Klock et al. (2005) examined the relationship between a governance index and the cost of debt. They utilised the GIM Index that contained various anti-takeover and shareholder protection provisions as a measure of corporate governance. They found out strong anti-takeover governance factors lower the cost of debt. On the other hand, weak anti-takeover provisions were associated with higher cost of debt. The results suggested that whilst the anti-takeover provisions may be costly to shareholders, they are beneficial to protect bond holders' interest.

Blom and Schauten (2006) examined the situation when debt holders took firm's corporate governance in assessing risk profiles and estimating default risk. The risk profile determines the required return by debt holders, which in turn is the firm's cost of debt. When default risk is high, so is the cost of debt (Sengupta, 1998; Francis, Khurana, Pereira, 2005). Deminor Rating is a proxy for the quality of corporate governance. The rating has 4 attributes: (1) rights and duties of shareholders (2) range of takeover defence, (3) disclosure on corporate governance and (4) board structure and functioning. The proxy for cost of debt is the yield of 77 bonds. The results show that firms with high corporate governance quality have lower cost of debt while firms with a relatively weak corporate governance quality are associated with higher cost of debt, with a difference of about 1.4%.

In France, Piot and Missonier-Piera (2007) reported that corporate governance quality and auditing structure of public firms had a significant reducing effect on the cost of debt. Corporate governance is represented by the ratio of independent directors on the board, a compensation committee that is composed of non-executive directors and institutional shareholders' ownership of more than five percent. They observed that board involvement in the monitoring of corporate governance issues, the monitoring power of institutional shareholders and board independence and ability to challenge manager's power significantly reduce cost of debt.

Using the same corporate governance index and sample firms as in Byun, Kwak and Hwang (2008), Byun (2007) investigated the effect of corporate governance practices on the default risk and firm cost of debt in South Korea. The proxies for the cost

of debt are the weighted average of bond rating and the weighted average spread. It was revealed that dividend policies, board of directors, shareholder rights protection and audit committee had reduced the cost of debt. The link between quality corporate governance and cost of debt is more pronounced in larger firms than smaller firms.

Fields, Fraser and Subrahmanyam (2010) examined the link between board quality and the cost of debt from the perspective of bank loans. They utilised a large set of quality measures such as board size, board member independence, experience, busyness, diversity, compensation, share ownership and board members' capacity to serve in an advisory role. Higher board quality signifies a robust governance system, which the creditors may take comfort from and impose lower lending costs. The research showd that firms with higher quality boards borrow at lower interest rates. Bank lenders are confident with the larger, higher independent directors' ratio and more experienced boards with advisory members. However, any significant effect of the number of board diversity, board compensation or board ownership on the cost of debt was found.

In summary, there seems to be growing but limited empirical investigations conducted on the effect of corporate governance on firms' cost of debt. Relevant prior studies revealed the support for the idea that when making investment decisions debt holders took into account firms' corporate governance attributes in their assessment of firm's risk profile. The risk profile determines the required return by debt holders. However in view of the limited prior studies further empirical investigation into this strand of research is inevitable, particularly in an important emerging markets like Malaysia. The theoretical argument and prior empirical findings discussed above lead us to expect that the quality corporate governance reduces the cost of debt; thus we predict that corporate governance quality is negatively associated with cost of debt.

Methodology

Our sample comprised 101 firms listed on the Main Board of the Malaysian Bourse between 2003 and 2007. We collected corporate governance data from each firm's 5-year annual reports (2003–2007). We chose the sample period from 2003 to 2007 to represent the period after the implementation of MCCG (2000) and the revamp of Malaysian Bourse Securities listing requirements as well as to capture the changes in firms' corporate governance. Further, we chose 2003 as the start of the sampling period because it was reasonable to expect that firms would have adequate time to implement the best practices of the MCCG (2000) during the first three years of its implementation. Further the extent of the implementation would have been observable after 3 years of introducing the code.

Research Variables. Cost of debt. Following Byun (2007), Fields et al. (2010); Piot and Missonier-Piera (2007); Pittmann and Fortin (2004), we used interest rate (hereafter IntRate) as proxy for cost of debt. We computed interest rate by dividing interest expenses by average short-term and long term debt for a given year.

Corporate governance. The independent variable is corporate governance score (hereafter CGSC). We used the CG Index developed in Ramly (2012) to assess firms' corporate governance quality. The CG Index consists of 139 items in 6 categories: board structure and procedures, board compensation practices, shareholder rights and relations, accountability and audit, transparency and social and environmental. A summary listing of the six corporate governance categories of the CG Index is shown in Table 1 below.

Table 1. **Definition of Corporate Governance Categories of the CG Index**

Category	Symbol	Number of items	Definition
Board structure and procedures	CGM1	68	The structural elements of the board and the process of governing by the directors
Board compensation practices	CGM2	14	The practices adopted by the board in determining and deciding the remuneration for the directors
Shareholder rights and relations	CGM3	6	The empowerment of shareholders and shareholder communication
Accountability and audit	CGM4	17	The accountability mechanisms and process of the board of directors
Transparency	CGM5	23	The ability of stakeholders to assess the true position, prospect and performance of the company
Social and environmental	CGM6	11	The company's ethical and socially responsible activities

Developed by the author.

Similar to Ramly (2012) we applied a dichotomous procedure in scoring firm corporate governance. We gave a "1-point" score for each item that is in line with good corporate governance practices as indicated on the CG Index and otherwise, we gave a "0-point" score. A high CGSC implies a high quality of corporate governance. The approach of scoring is additive, giving a measure of CGSC for firm i based on an equal weighting scheme used for the 6 categories:

$$CGSC_j = \frac{1}{139}\sum_{j=1}^{139} X_j \times 100, \qquad (1)$$

where X_j is equal to 1 if the *j*th governance provision is adhered to and 0 if it is not so that $0 < CGSC_i < 100$. We also compute the governance measure for each of the 5 years of the study period. The computation of the scores of the individual categories of the CG Index is as follows:

$$\begin{aligned} CGM1_i &= \frac{1}{68}\sum_{j=1}^{68} A_j \\ CGM2_i &= \frac{1}{14}\sum_{j=1}^{14} B_j \\ CGM3_j &= \frac{1}{6}\sum_{j=1}^{6} C_j \\ CGM4_i &= \frac{1}{17}\sum_{j=1}^{17} D_j \\ CGM5_i &= \frac{1}{23}\sum_{j=1}^{23} E_j \\ CGM6_i &= \frac{1}{11}\sum_{j=1}^{11} F_j, \end{aligned} \qquad (2)$$

where A_j, B_j, C_j, D_j, E_j and F_j are equal to 1 if the *j*th governance provision is adhered to and 0 if it is not so that $0 < CGM1_j, CGM2_j, CGM3_j, CGM4_j, CGM5_j$ *and* $CGM6_j < 100$.

Control variables. The control variables that we have selected are standard for the literature that examines the link between corporate governance and cost of debt. The control variables are firm size, return on asset, market-to-book ratio, interest coverage ratio, Gross Domestic Product (hereafter GDP) rate, industry and year dummies.

Empirical model. We tested our hypothesis using one basic specification that relates the corporate governance scores to firm cost of debt. We also controled the effects of company size, leverage, and return on assets, market-to-book ratio, interest coverage ratio, industry and time. According to our theoretical framework, the hypothesis is supported when β_j is negative and significant. The model is as follows:

$$IntRate_{it} = \beta_0 + \beta_j CGSC_{jit} + \sum_{l=1}^{6} \beta_1 Control_{lit} + \mu \quad (3)$$

We also examined the individual effect of corporate governance categories on the cost of debt. We detected non-normality of distribution problem after examining the skewness and/or kurtosis values of the CGSC and all the control variables except GDP rate. Thus we transformed CGSC and all our control variables into natural algorithm. We also examined multicollinearity between explanatory variables using Variance Inflation Factor. The results have revealed that the multicollinearity problem does not exist.

Results and discussion

Table 2 Model 1 presents the regression results on the impact of the log of CGSC on the cost of debt after controlling for the effects of a set of control variables. We observed that corporate governance has a significant inverse relationship with the cost of debt at one percent level; thus supporting our prediction. This result indicates that firms having higher quality corporate governance enjoy lower cost of debt; thus supporting the theoretical proposition that high quality corporate governance can serve as an effective control mechanism. High quality corporate governance reduces debt holders' exposure to the risks associated with the agency costs of debt and the traditional shareholder-manager agency conflicts.

Table 2 Model 2 reports the results of the regression of the individual effects of corporate governance categories on the cost of debt after controlling for the effects of a set of control variables. Board structure and procedures, board compensation practices, accountability and social and environmental activities are significant at one percent level in explaining the level of cost of debt. Transparency and shareholder rights and relations categories are not significant, implying that the extent of firm disclosure and shareholder empowerment and communication do not affect the cost of debt.

We found out that debt holders view corporate governance as an important element in the pricing of debt. Further our findings imply that debt holders are sensitive to corporate governance practices that affect the extent of expropriation tendencies of firm controlling shareholders or opportunistic managers as well as the validity of the reports that they use in managing lending agreements. In short, debt holders value the importance of corporate governance in protecting their interest. Hence, debt holders are willing to forego higher risk premium if they have confidence on the quality of firms' corporate governance.

Our finding reinforces the view of Monks and Minnow (1995) that corporate governance can improve the quality of managerial decision-making and lead to better firm performance; implying that better firm performance results in lower cost of debt. This result reaffirms the importance of corporate governance to debt holders as documented in prior studies.

Table 2. **Panel Data Regression Results**

Variable	Interest Rate	
	Model 1	Model 2
	Coefficient Estimate	Coefficient Estimate
Log corporate governance score	-.20 (-6.90)**	-
Board structure and procedures score		-.01 (-2.11)*
Board compensation practices score		-.01 (-13.19)**
Shareholder rights and relations score		-.00 (-1.69)
Accountability and audit score		-.01 (-3.59)**
Transparency score		-.00 (-1.61)
Social and environmental score		-.01 (-3.20)*
Log Total assets	-.00 (-.90)	- .00 (-.02)
Log Leverage	.00 (.27)	.00 (1.32)
Log Return on assets	-.00 (-.85)	-.00 (-.83)
Log Market-to-book ratio	-.01 (-4.25)**	-.01 (-2.60)*
Log Interest coverage ratio	-.00 (-1.03)	-.00 (-.22)
GDP rate	-.01 (-5.46)**	-.01 (-2.68)**
Industry_dummy	Included	Included
Year_dummy	Included	Included
Chi-Square	235.91	272.07
Prob > Chi-Square	.00	.00

z-statistics are reported in parentheses below coefficient estimates.
* $p < .01$. ** $p < .001$
Developed by the author.

Turning to the individual effect of a specific category of the CG Index, we found out that debt holders view effective board monitoring as an important element in pricing of firm's debt. It seems that debt holders are sensitive to board attributes that affect reporting validity because they rely on financial reports to assess the extent of default risk. Next, debt holders also consider board compensation practices as an integral aspect of corporate governance.

Board compensation practices represent the responsibility and commitment of the board members to ensure that the remuneration of executive directors is not excessive and open to manipulation. Excessive remuneration is a waste and it affects firm value and ability to honour its debt commitment. Hence, debt holders may be willing to impose lower cost of debt if a firm has transparent compensation practices that serve their interest.

We also observed that accountability and audit category is significant in lowering the cost of debt, suggesting that debt holders value a credible financial reporting process and an internal control system that could safeguard firms' assets. Further, debt holders exhibit interest in the elements such as the monitoring role of an inde-

pendent audit committee and external auditors that potentially could enhance board accountability. The effectiveness of audit monitoring has a reducing effect on the cost of debt because debt holders rely on accounting numbers to assess the extent of debtors' compliance to debt covenants and to monitor lending agreements (DeFond, Jiambalvo, 1994).

Finally, we documented an interesting finding that social and environmental is significantly associated with lower cost of debt. This finding indicates that investment in improving employee's welfare and effective environmental practices contributes to lower cost of debt. Further, it appears that debt holders are willing to accept lower risk premium if firms undertake activities that protect stakeholders' well-being, perhaps due to the fact that debt holders are also an important stakeholder group.

Overall, our study reaffirms the relevance of the MCCG (2000) and confirms that in general, it appears to be effective in strengthening corporate governance standards of Malaysian corporations. Although the MCCG (2000) seems to focus on the interest of equity shareholders, our results underscore the point that debt holders are equally concerned with corporate governance quality. They assess firms' corporate governance quality in their investment decisions. They seem to demand lower cost of debt from firms with good corporate governance.

Conclusions and Implications

Our study shows that corporate governance is a great concern to debt holders. They consider board structure and procedures, board compensation practices, shareholder rights and relations, accountability and audit, and social and environmental activities as integral components of a good corporate governance framework. Our research contributes to both theory and practice in four important ways. First, we provide systematic preliminary evidence linking corporate governance to firm cost of debt in Malaysia, an important emerging market. Second, our study contributes to the emerging literature that investigates the association between corporate governance and cost of capital from the theoretical perspectives of both debt agency costs and the traditional shareholder-manager agency conflicts. Third, we highlight that debt holders are not only a factor in firm corporate governance in their lending decisions and pricing of the debt but also seem to value broad based corporate governance mechanisms to better protect their interests. Finally, our study shows that Malaysian listed firms could benefit from adopting the MCCG's (2000) recommendations and other global standards of corporate governance.

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Стаття надійшла до редакції 31.01.2013.