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UNIVERSITI TEKNOLOGI MARA
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"A Study on the Relationship between SIZE, TIE, DER, DR, MKT, PE, CR, DPR, TAX, OWNERSHIP and NATURE with the Notional Amount of Derivatives Used by the Companies that are Listed in the Main Board of Bursa Malaysia Stock Exchange"

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"IN THE NAME OF ALLAH THE MOST GRACIOUS, THE MOST MERCIFUL"

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ABSTRACT

There a lot of research done on the relationship between financial ratios such as the market to book value ratio (MKT), price to earnings ratio (PE), times interest earned (TIE), dividend payout ratio (DPR), current ratio (CR), debt to equity ratio (DER) and debt ratio (DR) with the extent of firms' derivatives usage. Besides that, there were also other measures such as the firms' size (SIZE), tax loss carry forward (TAX), ownership structure (OWNERSHIP) and nature of operation (NATURE). The extent firms using derivatives was measured by the notional Ringgit Malaysia (RM) amount of derivatives position which can be defined as the sum of contract values (forward, swap and option contracts) outstanding at a balance date. These researches were done in order to determine the impact of those ratios and the other measures as mentioned above to the extent of firms using derivatives. Almost all of the studies were conducted in the overseas especially in New Zealand. So, this study is conducted in order to see whether in Malaysia situation, the same results are obtained or not. As a result, out of eleven independent variables those are representing various proxies of firms' performance; eight of them which are the SIZE, TIE, MKT, DR, CR, PE, TAX and OWNERSHIP are parallel with the previous studies. While, three of them which are DER, NATURE and DPR are contrary to the prior studies. In other words, most of the variables used in this study have signs that are consistent with theory but are not statistically significant. The suitable reason that apply to defend this situation is that because there may be differences in Malaysia financial practices with the overseas' and because there are data constraints, so that the results are not very powerful.

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1.0 INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The use of derivative securities by corporations has seen a dramatic increase in the last decade. There has been a similar increase in the number of research studies addressing if, and how, firms should engage in risk management. Financial theory has traditionally considered that corporate risk management makes no sense in perfect financial markets. Nevertheless, there exists today wide theoretical support and substantial empirical evidence that justify this activity. Imperfections in markets, conflicts of interest and/or information asymmetries explain hedging as a mechanism that contributes to the maximization of firm value and to the mitigation of agency problems. Derivatives constitute the main off-balance-sheet instruments used by companies to hedge the risks faced in their daily activity.

The increasing numbers of corporations using derivatives in order to manage their risks are because of the roles or functions of the derivatives itself. The presence of derivatives market is vital as it determines the direction and covers the exposure of the underlying markets. Besides that, by trading procedures, it serves to provide the two economic functions, namely, the price discovery and hedging mechanism. Price discovery can be referred as the ability of the derivatives market to reveal information about the future cash market prices. The revealing of those prices today can provide significant information to the market participants about the prices of physical instruments in the