

UNIVERSITI TEKNOLOGI MARA

**FAILURE PREDICTION MODEL IN
DETERMINING BUSINESS
INSOLVENCY OF CONSTRUCTION
COMPANIES IN MALAYSIA**

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Thesis submitted in fulfillment
of the requirements for the degree of
Doctor of Philosophy
(Civil Engineering)

Faculty of Civil Engineering

February 2023

ABSTRACT

In today's competitive business environment, an increasing number of businesses are experiencing economic and financial challenges, which may result in bankruptcy. As a result, there has been a rise in research conducted on the causative factors, effects, and forecasts of business insolvency and bankruptcy. Therefore, predicting business failure is one of the most basic concepts to consider when assessing solvency, especially in a turbulent economy. Due to the importance of construction companies to the country's economy, it is essential to predict business failure to avoid future failure or distress of these companies. Thus, this study's primary objective is to create a prediction model that may be used to analyse and detect the likelihood of financial distress and bankruptcy of a construction firm in some construction companies in Bursa, Malaysia. Furthermore, the study also determined the crucial elements that would enable early detection of the signs of impending financial failure of businesses in the construction sector. Due to the need for accurate financial distress prediction, the Statistical Package for Social Sciences (SPSS) and partial least squares (PLS) analysis were employed for data screening, assessment, and validation of the measurement and structural model. The data used in this study consisted of historical financial statements when the selected construction companies entered PN17 status before being listed by Bursa Malaysia. Software for model prediction was developed to analyse the failure and health status of the companies. The advantage of this software is obtaining failure status with the faster result. By incorporating construction businesses data from year 2015 to 2020 from Bursa Malaysia, it is possible to measure these businesses' failure and health status with an accuracy of 83% based on the proposed model. The proposed model's outcomes show excellent prediction with a moderate and substantial coefficient of the determinant (R^2). The finding of this study establish relationship between financial ratios, macroeconomic indicators, and company conditions. Only profitability demonstrated a considerable ability to forecast the firm situation among many types of financial ratios studied. Profitability makes sense as the key factor in the prediction since a company may experience debt if it cannot make any profit. The results of this ratio show negative effects between issues related to debt levels and company's financial health several years before it fails. Therefore, the proposed model able to identify each variable's function in the prediction model and select the most appropriate financial measures to predict insolvency. Thus, this study findings of the business insolvency factors would help to identify a crucial aspect that the Malaysia National Construction Policy 2030 should consider to expedite technology adoption in all building work processes and align the sector with the nation's long-term decarbonization agenda.

ACKNOWLEDGEMENT

Firstly, I wish to thank God for allowing me to embark on my Ph.D. and for completing this long and challenging journey successfully. My gratitude and thanks go to my supervisor Dr. Sulaiman bin Abdul Malik for his encouragement, suggestions, guidance, and great support throughout my thesis writing and co-supervisor Dr. Siti Rashidah bin Mohd Nasir for her support and constructive suggestions which have helped improve the quality of this thesis.

I also would like to thank the Ministry of Higher Education (MOHE) and the Research Management Institute of UiTM (RMI) for sponsoring my study. My special appreciation to all the staff of the Faculty of Civil Engineering UiTM and Institute of Postgraduate Studies (IPSiS) UiTM who were involved directly or indirectly in making my study a very great success nationally and internationally. Thanks also to Bursa Malaysia, especially Mr. Ravi from the Knowledge Centre Department for providing the information, facilities, and knowledge and helping me in the journey of understanding Bursa Malaysia and also in data collection especially. Special thanks to my colleagues and friends for helping me with this project.

Last but not the least, I would like to thank my family, especially my parents (Abdullah bin Mamat and Robiah binti Jusoh), my husband (Zamri bin Hamed), my kids (Muhammad Danial Haikal, Nur Alya Qaisara, and Nur Alisha Qasrina) and to my sibling for being very supportive to me during the period I was carrying out this study and for supporting me spiritually throughout writing this thesis and my life in general. Without their sacrifice, love, and patience, I will never have gotten to where I am today.

To the people mentioned above and to those who have not been mentioned, I owe everything to who I am today. So, I sincerely dedicate this thesis to all of them.

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CHAPTER ONE

INTRODUCTION

1.1 Research Background

A nation's prosperity is connected to its rate of economic growth, where all sectors, including the primary, secondary, and tertiary institutions, contribute to maintaining economic stability. The citizens' prosperity, well-being, and standard of living are directly linked to the construction sector's influence (Alaloul et al. 2021a; Lean 2001). The construction industry influences every sector's involvement at all levels in an economy because it serves as the backbone of economic growth in any nation (Alaloul et al. 2021b; Hillebrandt 2000). For the most part, developing nations such as Malaysia rely on the building industry to carry out their sustainable development (Alaloul et al. 2021c). The construction industry directly impacts socioeconomic growth and money flow. Therefore, the lack of significant growth of the firms leading to insolvency and bankruptcy can undermine the country's economic growth, a decline in the standard of living, and uneven money circulation, leading to the nation's economic failure. Therefore, it is noteworthy that the construction sector is a crucial and productive sector of the Malaysian economy as well (Khan et al. 2014).

The construction sector has been playing a significant role in the aggregate economy of Malaysia in terms of its contribution to revenue generation, capital formation, and employment creation which ultimately support the gross domestic product (GDP) and the socio-economic development of Malaysia. As a developing nation, Malaysia has steadily realised the pivotal role that the construction sector plays not regarding economic growth but also in improving the quality of life and living standards of the Malaysian population (Hadi et al. 2017). As a result, Malaysia's gross domestic product (GDP) grew 4.3% in 2019 and was forecast to remain slightly above 5% for the medium term. Over the last two decades, this sector has contributed between 3% and 5% in aggregate towards the economy (i.e. gross domestic product) (Khan et al. 2014).