UNIVERSITI TEKNOLOGI MARA

EFFECT OF CEO OVERCONFIDENCE, INTERNATIONAL DIVERSIFICATION ON CAPITAL STRUCTURE AND THE MODERATING EFFECT OF BOARD COMPOSITION

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PhD

January 2021

AUTHOR'S DECLARATION

I declare that the work in this thesis was carried out in accordance with the regulations of Universiti Teknologi MARA. It is original and is the results of my own work, unless otherwise indicated or acknowledged as referenced work. This thesis has not been submitted to any other academic institution or non-academic institution for any degree or qualification.

I, hereby, acknowledge that I have been supplied with the Academic Rules and Regulations for Post Graduate, Universiti Teknologi MARA, regulating the conduct of my study and research.

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Thesis Title	:	Effect of CEO Overconfidence, International Diversification on Capital Structure and the Moderating Effect of Board Composition
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Date	:	January 2021

ABSTRACT

Previous research on the determinants of capital structure of Shariah-Compliant Firms (SCFs) assume that managers are always rational. Nevertheless, the findings from these studies are not able to conclusively pinpoint the traditional theories that could best explain the capital structure decisions. In fact, there are studies found in most cases capital structure decisions as less than fully rational, which lead CEOs' characteristics to deal with it. The characteristics possess by CEOs are associated with the act of overconfidence in choosing debt financing. This is where the role of board of directors is needed to monitor the overconfidence CEOs when it involves capital structure decisions. In addition, a lot of Malaysia public listed firms have started to engage in international diversification strategy. Involvement in international diversification is said to influence on decision to use debt financing. Therefore, this study intends to study the effects of CEO overconfidence and international diversification strategy on capital structure decision of SCFs. Furthermore, this study also intends to investigate the moderating effect of board composition on the relationship between CEO overconfidence and capital structure decision across different sectors of SCFs on the main board of Bursa Malaysia for the period 2009 to 2017. This study applies a two-step system of GMM estimation for the samples SCFs, SC industrial, and SC trading and services sector. Due to small sample size of SC consumer, SC construction and SC property sectors, the two-stage least squares (2SLS) is applied. Both methods are used to address the endogenous biases.

Empirical findings indicate that the dispersion of CEO overconfidence varies across sectors during the sample period. When using debt ratio as the dependent variables, the relationship between CEO overconfidence seems not to be significant. However, when using short term debt and long-term debt as the dependent variables respectively, the relationship between the two is obvious for certain SCF sectors. CEOs from consumer, industrial, trading and services, and property sectors are found to have stronger managerial overconfident as they prefer to use short-term debt relative to long-term debt. From the theoretical perspective, they seem to follow the prediction of Pecking Order Theory. Besides, SC of trading and services sectors use debt financing when they decided to diversify internationally, while SC industrial sector prefers other form of financing. In relation to the moderating effect of board of directors, interestingly, the findings show that internal corporate governance have greater influence for those sectors where CEOs overconfidence are more prevalent. This means that board of directors play a crucial internal corporate governance role to moderate the CEOs overconfidence relating to debt financing decisions. Consistent with the Agency Theory, most of the results show that independent and female directors emphasize the use of long-term debt instrument to moderate and discipline the overconfident CEOs.

Keywords: Overconfidence, international diversification, board composition, capital structure.

ACKNOWLEDGEMENT

In the name of Allah, the Most Gracious and the Most Merciful.

All praises to Allah and His blessings for the completion of this thesis. I thank God for all the opportunities, trials and strength that have been showered on me to finish writing the thesis. I experienced so much during this process, not only from the academic aspect but also from the aspect of personality. My humblest gratitude to the holy Prophet Muhammad (Peace be upon him) whose way of life has been a continuous guidance for me.

This thesis is the culmination of my journey of PhD which was just like climbing a high peak step by step accompanied with encouragement, hardship, trust, and frustration. However, this journey would not have been possible without the support of my supervisors, family, and friends.

At this moment of accomplishment, my appreciation goes to my supervisors Professor Dr Hajah Noryati Ahmad and Dr Haji Nizam Jaafar for the continuous support of my PhD study and related research. I am tremendously fortunate to have both of my supervisors for their patience, motivation, dedication and immense knowledge.

My sincere thanks also go to the Faculty of Business Management and all its member for providing the facilities and assistance.

I would like to express my deepest gratitude to my husband, Mohd Khamsani Mohd Azami, as for his continued and unfailing love, support and compassion during my pursuit of PhD degree, those made the completion of thesis possible. He is always around at times when I thought that it is impossible to continue and helped me to keep things in perspective. I greatly value his contribution and deeply appreciate his faith in me. I appreciate my little boys and girl, Aqil Zarish, Ariq Fahish and Ayra Fareesya for abiding my ignorance and the patience they showed during my thesis writing. Words would never say how grateful I am to all of you. I consider myself the luckiest in the world to have such a lovely and caring family, standing beside me with love and unconditional support. That was a sweet moment when my 6 years little girl, motivates me by calling me Dr Mama.

My appreciation also extends to my siblings and friends for their endless supports and genuine kindness.

Last but not least, this thesis is dedicated to my beloved parents Shahar Mokhtar and Zaanorlia Zahari. I am blessed to have their moral support, valuable prayer, encouragement and motivation to accomplish my thesis. This piece of victory is dedicated to both of you. Alhamdulillah, may Allah s.w.t bless both of you.

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