UNIVERSITI TEKNOLOGI MARA

MACROECONOMIC FACTORS AND CORPORATE FINANCIAL FRAGILITY IN MALAYSIA

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ABSTRACT

Financial fragility is a priority topic for many policymakers, practitioners, and researchers due to its impact on the economy. Financial fragility is also termed as financial instability leading to financial crisis. Most of the researcher believed that the increase in financial fragility is caused by the vulnerability in banking sector. Besides, majority of previous studies were only concentrated in firm level data; and only a few researchers took into consideration the influence of macroeconomic variables to corporate failures. Similarly, in Malaysia not many studies have paid attention on using macroeconomic variables as explanatory variables for corporate financial fragility. Therefore, the purpose of this study is to fill gap by examining the relationship between macroeconomic variables and corporate financial fragility in Malaysia. Corporate financial fragility is measured by corporate failure rate. Meanwhile, macroeconomic variables consist of gross domestic product (GDP), inflation rate (consumer price index), interest rate (average lending rate), unemployment rate, birth of new company, corporate profits and real wages. The data set was taken from years 1998 to 2015 on a quarterly basis. By employing Autoregressive Distributed Lag (ARDL) bounds approach, the analysis found that there is a significant long-run and short-run relationship between macroeconomics and corporate financial fragility in Malaysia. Interestingly, before GFC 2008 found that most of the macroeconomic have significant long-run and short-run relationship with corporate financial fragility. However, after Global Financial Crisis 2008 revealed that most of macroeconomics found does not have long-run relationship, still, there is a significant short-run relationship. As a conclusion, based on the whole period of study found that birth of new companies and real wages have a positive long-run relationship, while interest rate has a negative short-run relationship and real wages has mixed short-run relationship with corporate failure rate in Malaysia.

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CHAPTER ONE

INTRODUCTION

1.1 Research Background

A growing study on financial fragility has proven its importance towards firms. An increasing attention has been highlighted by the economists and policymakers whether a country's economy is exposed to the financial instability. For more decades in the economics literature, financial fragility is presumed as a root of financial crises in banking or corporate sector alike (Penas & Tümer-Alkan, 2010). Financial fragility is also known as financial instability which leads to the financial crisis (Radelet & Sachs, 1998; Kaminsky & Reinhart, 1999). Minsky (1977), an important persona in financial fragility has provided understanding on the characteristics of financial crises by undertaking several key factors in the economy. Minsky defines financial fragility with three different degrees when economic units are indebted, namely hedge, speculative and Ponzi finance. Hedge finance refers to the ability of the economic units to pay its liability commitments. Meanwhile, speculative finance refers to economic units that need to borrow funds or sell liquid assets in order to pay its liability commitment. On the other hand, Ponzi finance refers to the inability of economic units to pay its outstanding debts due to lack of routine cash flows and cash reserves. Due to the firms' (sector) transition from one level to another (hedge to speculative and speculative to Ponzi), their balance sheet becomes more illiquid and firms (sectors) also become more vulnerable to changes in economic conditions, which in turn increases the financial fragility in the country.

Over the past decades, many researchers attempted to investigate the financial fragility by evaluating the performance of the banking sector. The major cause of increase of financial fragility in a country is believed to be due to the failure of the financial system. However, a few studies have evaluated the performance of corporate sector as a measurement for financial fragility (Vlieghe, 2001; Bruneau, de Bandt, & El Amri, 2012). According to Vlieghe (2001), a high rate of corporate failure rate might be an evidence of financial fragility in corporate sector. As firms use banks as a lender to provide funds for their operations, financially fragile firms will give negative impact to the banks, thereby weakening the banking system. Thus, it is important to understand