

The Effects of Country Idiosyncrasies on Capital Structure: An Optimal Case in ASEAN-5

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Abstract— The main purpose of this study is to study the effect of country idiosyncrasies on the determinants of capital structure in ASEAN-5. By applying panel data methods to a sample of firms from five ASEAN countries—Indonesia, Malaysia, Philippines, Singapore and Thailand for the period 2001-2010, the results are conclusive in supporting the effects of country idiosyncrasies. This highlights the necessity of adopting the contingency approach in formulating the optimal capital structure.

Keywords— Determinants of capital structure, Optimal Capital Structure, Trade-off Theory, Pecking Order Theory

I. INTRODUCTION

THE capital structure studies in the early age had focused on firm characteristics in a single country. This has prevented earlier studies from answering the effects of country idiosyncrasies on firms' capital structure. The absence of study on listed firms in ASEAN creates unique opportunity to shed light on the applicability of traditional capital structure theories and to unveil the actual factors affecting the capital structure. Being relatively less efficient and incomplete than the developed country, firms in ASEAN may not be able to rationalize their financing decisions to follow a clear theoretical approach. It may well be that firms in ASEAN are creating completely new capital structure formulation to suit their own distinct environment.

This study contributes to the literature by adding fresh empirical evidence to the determinants of capital structure in ASEAN. It has useful implication of how listed firms in the ASEAN countries decided the debt financing in the aftermath of Asian Financial Crisis 1997 and provides reference basis for the governments to evaluate the effects of the policy undertaken and to formulate related policy in addressing future crisis. The knowledge gained about the effects of country idiosyncrasies helps to benchmark and comprehends the conclusion that is drawn about the determinants of capital structure in each country. This provides an insight to the finance managers and policy makers into the optimal financing policy that fits the firms' characteristics with the demands of the environment.

Understanding what lies behind the contrasting findings with the traditional theory is essential for furthering our

insight into the capital structure and financing choices of firms. This study reports some determinants with contrast effects as compared to the theories and attempts to provide new evidence to the possible explanations of the discrepancy. It is found that the leading theories of capital structure can explain some but not all aspects of the data. Reality is more complicated than even the leading theory is unable to provide adequate description on its own. Hence, it is hoped that the empirical findings in this study will assist in the development of new sophisticated theories in the future.

Unlike prior studies which ignore the non-contemporaneous effects on capital structure decision, the determinants used in estimating the optimal capital structure in this study are lagged by 1 year. This will unveil a more comprehensive understanding on the capital structure formulation as the determinants are well-known by the finance managers at the time of decision. Finally, prior researches tend to limit their analysis to certain estimation models which may lead to significant results bias. Therefore, different estimation models are employed to gain more insight into the robustness of the capital structure determinants.

The rest of this paper is organized as follows. Section II presents the research design and empirical model. The data and variables are described in Section III. Finally, the findings and conclusion are included in Section IV and V respectively.

II. RESEARCH DESIGN AND EMPIRICAL MODEL

With the adoption of quantitative method that relies on deductive reasoning, the first step is to propose a hypothesis based on the existing theories (Trade-off Theory and Pecking Order Theory). The second step tests the operational hypothesis and finally, modifying the theory in light of findings if necessary.

In the literature, the estimation of optimal capital structure is complicated as it is not observable and a proxy has to be used. In the recent literature, the most popular approach adopted has been to estimate the optimal debt ratio as the fitted value from a regression of observed debt ratios on a set of important determinants [1]. This study adopts and modifies the model as in equation (1):

$$D^*_{i,t} = \lambda_0 + \sum_{k=1}^n \lambda_k X_{k,i,t-1} + v_i + \varepsilon_{i,t} \dots\dots\dots(1)$$

In which $D^*_{i,t}$ is the optimal capital structure for the i th firm at time t and $X_{k,i,t-1}$ refers to the k -th set of explanatory variables of firm i -th at time $t-1$, v_i is the company's non-observable individual effect and $\varepsilon_{i,t}$ correspond to the error.

It is important to highlight here that two distinct features are incorporated into the econometric model. First, traditional

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