FIRM VALUE AND THE TAX BENEFITS OF DEBT: A STUDY ON PUBLIC LISTED COMPANY IN MALAYSIA

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ABSTRACT

This study has three main objectives. First, to empirically defines the relationship between firm value and debt of Public Listed Company in Malaysia once endogeneity of contemporaneous debt is corrected. Secondly the study looks into the possibility impact of alternative theories such as Free Cash Flow and Debt Signaling Hypotheses to the relationship between firm value and debt. Finally, it examines the influence of managerial ownership towards firm value and how it affects the benefits of debts.

This study uses interest expense scaled by total assets as proxy of debt. The relationship between firm value and debt is statistically tested by running Ordinary Least Square Estimation on the primary equation. Other primary variables used are the market value of equity, with other control variables of earnings, research and development, dividend and capital expenditure, scaled by total assets. This study then documented that the primary equation is not consistent with Miller and Modigliani theorem and suggested that contemporaneous of interest expense is indeed endogenous. Two-Stage Least Square Estimation is used to test the endogeneity of contemporaneous interest expense and to estimate the predicted value of interest expense that was then use for the later analysis.

The study found that there is a positive relation between firm value and debt once endogeneity of contemporaneous debt is corrected. Further into the study, it also found that firms with managerial alignment have higher tax benefits of debt of 63 cents compare to average firms which is 38 cents per ringgit.

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