THE IMPACT OF CAPITAL STRUCTURE ON FIRMS OPERATING PERFORMANCE

by

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DECLARATION

I hereby declare that the project paper is based on my original work except for quotations and citations that have been duly acknowledged. I also declare it has not been previously or concurrently submitted for any other master's programme at UUM or other institutions.

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ABSTRAK

Kajian ini bertujuan untuk menyiasat kesan daripada struktur modal pada prestasi syarikat dengan menganalisis hubungan antara prestasi operasi syarikat Malaysia, yang diukur dengan pulangan ke atas aset dan pulangan ke atas ekuiti dengan hutang jangka pendek, hutang jangka panjang dan jumlah hutang. Empat pembolehubah yang ditemui oleh sebahagian besar kajian untuk mempunyai pengaruh terhadap prestasi operasi syarikat, iaitu, saiz, pertumbuhan aset, pertumbuhan jualan dan kecekapan yang digunakan sebagai kawalan pembolehubah. Kajian ini merangkumi empat sektor utama dalam pasaran ekuiti Malaysia yang mana terdiri daripada sektor pengguna, industri, perdagangan atau perkhidmatan dan hartanah. 240 syarikat yang dikenalpasti sebagai contoh syarikat dan data kewangan dari tahun 2002 hingga 2007 adalah digunakan sebagai pemerhatian untuk kajian ini, sehingga jumlah pemerhatian 1440. Serangkaian analisis regression di laksanakan ke atas setiap model, dimana salah satu menjadi struktur modal menjadi proksi termasuk dalam setiap analisis. Nilai lag untuk proksi digunakan untuk menggantikan nilai-nilai non lag untuk menentukan dan menyemak sejauh mana kesan struktur modal ke atas perlaksanaan syarikat. Kajian ini mendapati hanya hutang jangka panjang yang mempunyai hubungan kepentingan dengan pulangan aset tetapi bukan pulangan ke atas ekuiti. Analisis dengan nilai-nilai lag menunjukkan bahawa bukan dari nilai-nilai lag untuk jumlah hutang, hutang jangka pendek dan hutang jangka panjang mempunyai hubungan yang penting dengan prestasi. Oleh kerana itu kajian menyimpulkan bahawa struktur modal tidak menjejaskan prestasi operasi syarikat di Malaysia.

Kata Kunci: prestasi operasi, struktur modal, pasaran saham Malaysia

ABSTRACT

This study seeks to investigate the impact of capital structure on firm performance by analyzing the relationship between operating performance of Malaysian firms, measured by return on asset (ROA) and return on equity (ROE) with short-term debt (STD), long-term debt (LTD) and total debt (TD).). Four variables found by most literature to have an influence on firm operating performance, namely, size, asset grow, sales grow and efficiency, are used as control variables. This study covers four major sectors in Malaysian equity market which are the consumers, industrials, trading or services and properties sectors. 240 firms were identified as the sample firms and their financial data from the year 2002 through 2007 are used as observations for this study, resulting in a total number of observations of 1440. A series of regression analysis were executed for each model, where either one of the capital structure proxies is included in each analysis. Lag values for the proxies were also used to replace the non lag values in order to ensure that any extended effect of capital structure on firm performance is also examined. The study finds that only long term debt has significant relationship with ROA but not with ROE. The analysis with lagged values shows that non of lagged values for total debt, short term debt and long term debt has significant relationship with performance. The study therefore concludes that capital structure does not affect operating performance of Malaysian firms.

Keywords: operating performance, capital structure, Malaysian stock market

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LIST OF ABBREVIATIONS

ROA:	Return on asset
ROE:	Return on equity
STD:	Short term debt
LTD:	Long term debt
TD:	Total debt
SIZE:	Size
AGROW:	Asset growth
SGROW:	Sales growth
EFF:	Efficiency
(D_{t-1}):	Last year debt
(D_{t-2}):	Last two years debt

CHAPTER ONE

BACKGROUND OF THE STUDY

1.1 INTRODUCTION

Capital structure decision is the mix of debt and equity that a company uses to finance its business (Damodaran, 2001). Hence, the relationship between capital structure decisions and firm value has been extensively investigated in the past few decades. Modigliani and Miller (1958) suggested that, in a world without friction, there is no difference between debt and equity financing as regards the value of the firm. Thus, financing decision add no value and are therefore of no concern to the managers. Evidence would suggest that this does not hold in reality.

However, today, capital structure is one of the important financial decisions for any business organization. This decision is important because the organization need to maximize return to various organization' and also have an effect on the value of the firm. Besides that, the impact from the decision will help the firm's ability to deal with its competitive environment. Furthermore, the capital structure of a firm is a mix of debt and equity that is used by a firm to enhance its operation. Thus, a firm's specific strategy should deal with the appropriate mix of debt and equity to finance the firm's assets.

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