THE IMPACT OF CAPITAL STRUCTURE ON FIRMS
OPERATING PERFORMANCE

by

ZURAIDAH BINTI AHMAD
801927

A Dissertation Submitted in Partial Fulfillment of the Requirements for the Degree of Master of Science in Finance at the Graduate School of Management,
Universiti Utara Malaysia
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.

ZURAIMAH BINTI AHMAD

25 NOVEMBER 2009
PERMISSION TO USE

In presenting this dissertation in partial fulfillment of the requirements for a postgraduate degree from University Utara Malaysia, I agree that the university's library may take it freely available for inspection. I further agree that permission for copying of this dissertation in any manner, in whole or in part, for scholarly purposes may be granted by my supervisor or in other absence by the Dean, Postgraduate studies, and College of Business. It is understood that any copying or publication or use of this dissertation or parts thereof for financial gain shall not be allowed without my written permission. It is also understood that due to recognition should be given to me and to University Utara Malaysia for any scholarly use which may be made of any material from my dissertation.

Request for permission to copy or to make other use of materials in this dissertation, in whole or in part should be addressed to:

Dean
College of Business
University Utara Malaysia
06010 Siniok
Kedah
ABSTRAK


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
ACKNOWLEDGMENTS

All my praises and gratitude to Allah, the Merciful, for His kindness and for meeting me with many wonderful people, who with His Grace, have had helped me tremendously in the successful completion of this research.

First of all, I would like to take this opportunity to extend my sincere gratitude and deepest appreciation to my dearest family especially my parents, my brothers and my sister who has been very supportive and understanding throughout my M.Sc. Finance program in University Utara Malaysia since June 2008.

Most of all, I would like to thank my supervisor Associate Professor Dr. Yusnidah Ibrahim, for her valuable advice, guidance and support throughout the preparation of this research, subsequently made this a reality.

I am also grateful to my roommate, course mate and close friends who have helped me sincerely and had brought joy and new light upon my life in UUM.

To all those people, thank you so much.
LIST OF TABLES

Table 2.3  Summary of Empirical Literature

Table 3.2  Expected Relations of Variables

Table 4.2  Summary of Sample Descriptive Statistic

Table 4.3  Pearson Correlation Matrix of Variables
(p-value is given in the parentheses)

Table 4.4  Output for Regression Analysis with ROA as the dependent variable

Table 4.5  Output for Regression Analysis with ROE as the dependent variable

Table 4.6  Serial Correlation and Heteroscedasticity Diagnostic Tests (ROA and ROE as dependent variables)
CHAPTER 5: CONCLUSION

5.1 Introduction 66
5.2 Overview of the Research Process 66
5.3 Summary of the Findings 68
5.4 Implications of the Study 68
5.5 Direction for Further Studies 70
5.6 Conclusion 71

REFERENCES 72

APPENDICES
# TABLE OF CONTENTS

## CHAPTER 1: BACKGROUND OF THE STUDY

1.1 Introduction .................................................. 1  
1.2 Problem Statement ........................................ 5  
1.3 Objective of the Study ...................................... 8  
1.4 Significance of the Study ................................... 9  
1.5 Limitations of the Study ..................................... 10  
1.6 Conclusion .................................................. 11

## CHAPTER 2: LITERATURE REVIEW

2.1 Introduction .................................................. 12  
2.2 Theoretical Literature ...................................... 12  
2.3 Empirical Literature ........................................ 17  
2.4 Summary .................................................... 43

## CHAPTER 3: RESEARCH METHOD

3.1 Introduction .................................................. 44  
3.2 Research Framework ........................................ 44  
3.2.1 Independent Variable ................................... 45  
3.2.2 Control Variable ......................................... 46  
3.3 Sample Description and Data Collection ................. 48  
3.4 Data Analysis ................................................ 48  
3.4.1 Return on Asset ......................................... 48  
3.4.2 Return on Equity ......................................... 49  
3.5 Measurement of Variable ................................... 49  
3.6 Conclusion .................................................. 51

## CHAPTER 4: ANALYSIS AND FINDINGS

4.1 Introduction .................................................. 52  
4.2 Descriptive Analysis ........................................ 52  
4.3 Correlation Analysis ........................................ 55  
4.4 Regression Analysis ........................................ 58  
4.5 Conclusion .................................................. 65
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.
The contents of the thesis is for internal user only
LIST OF REFERENCES


