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**THE EFFECT OF CAPITAL STRUCTURE ON FIRM'S
PERFORMANCE: EVIDENCE FROM MALAYSIAN
CONSTRUCTION INDUSTRY**



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PERFORMANCE: EVIDENCE FROM MALAYSIAN
CONSTRUCTION INDUSTRY**



BY
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Thesis submitted to
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(Finance)



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ABSTRACT

The main objective of this study is to examine the effect of capital structure on firm's performance specifically focusing on the Malaysian construction firms. This study also attempted to highlight the theories of capital structure that closely related to the Malaysian construction firms. This study uses 21 sample firms listed on the Main Market of Bursa Malaysia with at least 10 years trading experience. The period of study is 7 years (2009-2015). A few series of regressions has been conducted and the final results are reported based on fixed effect model with robust standard error. The findings show that all variables; long term debt, total debt, size and sales growth have an effect on firm's performance except the short term debt. The long term debt and sales growth have a positive relationship with firm's performance. The results indicate that an increase in the long term debt and sales growth are associated with an increase in the firm's profitability. Meanwhile, the total debt and size show a negative and significant relationship with firm's performance. Therefore, the negative relationship between debt and firm's performance is fits the trade-off theory. The trade-off theory explains that overleverages firm's capital structure will cause the difficulties to meet the interest payment obligation which later would jeopardise the firm's value.

Keywords: capital structure, construction firms, firm's performance, trade-off theory

ABSTRAK

Objektif utama kajian ini adalah untuk mengkaji kesan struktur modal ke atas prestasi firma khususnya kepada syarikat pembinaan Malaysia. Kajian ini juga cuba untuk mengetengahkan teori-teori struktur modal yang berkait rapat dengan firma-firma pembinaan Malaysia. Kajian ini menggunakan 21 contoh firma yang disenaraikan di pasaran utama Bursa Malaysia dengan sekurang-kurangnya 10 tahun pengalaman dagangan. Tempoh kajian ini adalah 7 tahun (2009-2015). Beberapa siri regresi model telah dijalankan dan keputusan akhir dilaporkan berdasarkan *robust fixed effect model*. Hasil kajian menunjukkan bahawa semua pembolehubah; hutang jangka panjang, jumlah hutang, saiz and pertumbuhan jualan mempunyai kesan ke atas prestasi firma kecuali hutang jangka pendek. Hutang jangka panjang dan pertumbuhan jualan mempunyai hubungan positif dengan prestasi firma. Keputusan menunjukkan peningkatan pertumbuhan jualan dan hutang jangka panjang adalah berkaitan dengan peningkatan dalam keuntungan firma. Sementara itu, jumlah hutang dan saiz menunjukkan hubungan yang negatif dan signifikan dengan prestasi firma. Oleh itu, hubungan negatif antara hutang dan prestasi firma adalah sesuai dengan teori *trade-off*. Teori *trade-off* menjelaskan struktur modal firma yang menggunakan terlalu banyak hutang akan menyebabkan kesukaran untuk memenuhi kewajipan pembayaran faedah yang kemudiannya akan menjejaskan nilai firma.

Kata kunci: struktur modal, firma pembinaan, prestasi firma, teori *trade-off*

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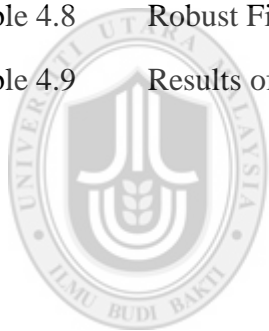
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LIST OF ABBREVIATIONS

| | |
|------|-----------------------------------------|
| ROA | Return on assets |
| STD | Short term debt |
| LTD | Long term debt |
| TD | Total debt |
| TOT | Trade-off theory |
| POT | Pecking order theory |
| ACT | Agency cost theory |
| MM | Modigliani and Miller |
| GDP | Gross Domestic Product |
| GST | Good and Service Tax |
| CIDB | Construction Industry Development Board |
| BNM | Bank Negara Malaysia |



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CHAPTER ONE

INTRODUCTION

1.0 Introduction

Studies on capital structure are one of the most critical areas in academia as well as in industries around the globe. Generally, capital structure is referred to the firm's financing decision that used to support the firm's daily operation. In other words, capital structure is firm's capital that primarily obtained either from debt or equity. There are few sources of debt that preferably used such as bonds and banks borrowing. Meanwhile, sources of equity include common stocks and preferred stocks. As the firm expands it needs more capital in order to support the expansion. Thus, financing decision plays an important role in helping a firm to achieve better performance.

Since firm's financial decision is directly related to its risk and return, the firm has to make sure that it chooses the right capital structure. Implementing immature capital structure leads to high cost of capital, which decreases the firm's value. On the contrary, choosing the right capital structure increases the firm's value. Later, it helps firm to deal with the competitive environment (Ahmad, Abdullah & Roslan, 2012).

Many modern theories related to the capital structure have been introduced by different scholars like Modigliani and Miller (1958), Modigliani and Miller II (1968), agency cost theory (1976), trade-off theory (1977) and pecking order

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