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

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JUNE 2016

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

BY

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Thesis submitted to

School of Economics, Finance and Banking

UNIVERSITI UTARA MALAYSIA

In Partial Fulfilment of the Requirement for the Master of Science (Finance)

Pusat Pengajian Ekonomi, Kewangan dan Perbankan
SCHOOL OF ECONOMICS, FINANCE AND BANKING
Universiti Utara Malaysia

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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 21sample 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 regrasi 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*

ACKNOWLEDGEMENT

Alhamdulillah, first and foremost thank to Allah S.W.T for His bless and chance for me to finish my project paper. It is impossible for me to finish this project paper without the great support from a number of people. Frankly, I owe these people my deepest gratitude and thankfulness.

I would like to express my profound appreciation to my supervisor, **Dr Sabariah Binti Nordin** for her invaluable support, encouragement and supervision throughout the period of finishing this project paper. Her continuous guidance, moral support and conservative comments caused me to keep patient and stay strong.

Not forgetting, I would also like to thank my examiner and chairperson who provide good and conservative comments to my project paper. Besides that, I also owe my sincere appreciation to all my MSc. Finance lecturers who had given me a good lecture. I will forever cherish your aids.

My deepest gratitude also goes to all my fellow friends who are always supporting and advising me to complete this project paper. I would also like to thank my former lecturer during my Degree who keeps supporting me from the past until now.

My special appreciation I would like to dedicate to my parents and siblings who never fail to love and support me throughout my study. They are my strength, and I devote this project paper to them.

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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

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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