THE EFFECT OF CAPITAL STRUCTURE ON FIRM'S PROFITABILITY: A CASE OF LISTED MALAYSIAN INDUSTRIAL FIRMS

by

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In the name of Allah, the most Beneficent, the most Merciful

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ABSTRACT

This paper attempts to examine the influence of capital structure, particularly in the presence of market imperfections on firm's profitability. The effect of corporate taxes, interest expense, debt level and equity size is analyzed using OLS estimates and correlation analysis. The research model justifies that capital structure changes in response to market imperfections which subsequently affect profitability. This findings empirically implies that:

(a) higher debt level result in a lower profitability;

(b) higher profitability associates positively with taxation expense but negatively with interest expense.

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CHAPTER 1: INTRODUCTION

1.1 General Discussion

Firms experiencing poor performance respond either operationally, by making changes in top management (Gilson, 1989) or in organizational strategy and structure (Chandler, 1980 and Wruck, 1990), or financially through capital restructuring (Aharoni, 1971). The capital structure of a company is an important element influencing on its profitability and stability. While a high proportion of debt may make a company highly profitable as it is growing, it also increases the probability of bankruptcy and ruin, especially if that growth slows down or temporarily becomes negative. Why firms choose capital restructuring over other responses, however, is largely unexplored. (Hanapi, 1993). Analyzing this response may shed light on how to hasten a firm's reaction to distress, (specifically, given the alleged differences in capital structure among firms in Malaysia, especially compared to such relations in OECD countries). To what extent do these considerations regarding capital structure apply to Malaysian companies? What factors influence debt ratios among these companies? For example, is capital structure in Malaysia influenced by factors such as size and industry classification? If so, to what extent? This paper attempts to answer these questions.

The contents of the thesis is for internal user only

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