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**THE EFFECT OF COMPANY-SPECIFIC FACTORS ON FINANCIAL LEVERAGE:
EVIDENCE FROM MALAYSIAN INDUSTRIAL SECTOR**



MASTER OF SCIENCE (FINANCE)

UNIVERSITI UTARA MALAYSIA

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THE EFFECT OF COMPANY-SPECIFIC FACTORS ON FINANCIAL
LEVERAGE: EVIDENCE FROM INDUSTRIAL SECTOR MALAYSIA



Thesis Submitted to School of Economics, Finance and Banking, Universiti Utara
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(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 thesis is to examine the influence of company-specific on financial leverage of 88 industrial product companies listed in Bursa Malaysia. This study covers an observation period of 10 years (2005-2015) on panel data basis. Dynamic panel regression is applied as System General Method of Moment (S-GMM) suggesting that the research model is genuinely dynamic. The results of the study indicates that all variables Age ($SUSAge_{i,t}$), EPS Growth ($SUSEPSg_{i,t}$), Total Asset ($SIZETA_{i,t}$), Net Profit Margin ($PRONPM_{i,t}$), ROE ($PROROE_{i,t}$), Quick Ratio ($LIQR_{i,t}$), Cash ratio ($LICashR_{i,t}$) and Prior Leverage ($LagLEV_{i,t-1}$) are significantly affecting the financial leverage ($LEV_{i,t}$). However, variables Age ($SUSAge_{i,t}$), Total Asset ($SIZETA_{i,t}$), Net Profit Margin ($PRONPM_{i,t}$), and Quick Ratio ($LIQR_{i,t}$) have a negative association with the leverage. Results of $SUSEPSg$, $SIZETA$, $PRONPM$, $PROROE$ and $LIQR$ support the pecking order theory while variables $SUSAge$, $LICashR$ and $LagLEV_{i,t-1}$ support the trade-off theory. General outcome of this study reveals that company specific factors are affecting leverage.

Keywords: leverage, system-generalized method of moments (S-GMM), dynamic panel model, pecking order theory, trade off theory



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LIST OF ABBREVIATIONS/NOTATIONS/GLOSSARY OF TERMS

Terms	Definition
BNM	Bank Negara Malaysia
GDP	Gross Domestic Product
IMF	International Monetary Funds
LEV	Leverage
$LEV_{i,t-1}$	Measure last year leverage
LICash	Cash Ratio
LIQR	Quick Ratio
POT	Pecking Order Theory
PRONPM	Net profit Margin
PROROE	Return on equity
S-GMM	System-Generalized Method of Moments
SIZETA	Measure Total Asset
SUSAGE	Measure Company Age
SUSEPSg	Measure Earnings Per share growth
TOT	Trade Off Theory



CHAPTER ONE

INTRODUCTION

1.0 Introduction

This study investigates the effect of company-specific factors on leverage of Industrial Product sector listed companies in Bursa Malaysia. This research is based on 968 firm-year observation for 10 years (2005-2015) on balance panel data. Financing is able to cover short term funding while giving the company to finance the growth of its business. Without financing, opportunities for a company to develop would be forgone and be taken over by those who have access to credit. Based on previous literature, (Ahmad & Ismail, 2012; Barakat, 2014; Mat Kila & Wan Mahmood, 2008; Myers, 1984; Titman & Wessels, 1988) the researchers claim that company debt policy is one of the crucial factor for a company to determine its survival through economic and financial crisis.

During the adverse economic conditions, it is important for a company to determine best strategies to manage their operation and debt liabilities. Leverage allows a company to borrow a large financial sum to invest into an infrastructure. A company can utilize the financed funds to make long-term investments, such as building a factory in order to free up cash. At the same time, company's retained income can be used for current expenditures like employees salary and creditor debts. Industries that imply the production of durable goods for example raw materials and heavy equipment have a tendency to be cyclical. Companies that are in cyclical industries such as industrial product can benefit from the process by locking the lower interest rates before the down cycle. This can be done by revolving the line of credit. Previous

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APPENDIX

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44	KOBAY TECHNOLOGY	88	INDS.



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Gap Table

No	Authors/ Year	Variable Used	Method	Finding
1	Ting (2016)	DV: Leverage IV: Ownership concentration, ROA, Firm Size, Tangibility, Growth	Dynamic panel model	The result appears to support the concept of lagged firm leverage as determinants of firm leverage decision. Others IV result shows a significant with leverage at level 0.01
2	Onofrei <i>et al.</i> (2015)	DV: Debt Ratio IV: Profitability, tangibility, liquidity, size, and growth opportunity	Fixed effects regression model	Leverage is negatively related to tangibility, profitability and liquidity. The size of the firm and the growth opportunities can also have a negative impact on the leverage, but to a lower extent.
3	Miras <i>et al.</i> (2015)	IV: Total Debt Ratio DV: Profitability, size, growth opportunity, asset tangibility and liquidity	Pearson correlation coefficient and multiple linear regressions	The findings shows profitability, size and liquidity are negatively significant related to total debt ratio. Tangibility is founds positively related to total debt ratio and growth opportunity is found positively insignificant with total debt ratio
4	Haron (2014)	DV: Leverage IV: Non-debt tax shield (NDTS), asset structure, profitability, firm size, growth opportunity and liquidity	Dynamic panel model	The study finds that there exists target leverage for property firms in Malaysia and take into account factors like NDTS, asset structure, profitability, firm size, growth opportunity and liquidity in their capital structure and also appear to time their security issuance.
5	Prime and Qi (2013)	DV: Leverage IV: Profit, Sales, Size, Asset, Average Leverage, Age	Fixed effects regression model	The amount of leverage is negatively related to profits, liquidity, and age, and positively related to firm size and average leverage ratio.
6	Ahmad and Ismail (2012)	DV: Long Term Debt Ratio (LTDR) IV: Size, profitability, tangibility, non-debt tax shields (NDTS), growth	Multiple regression model	Findings indicate that SIZE, PROF, TANG, NDTS and GROWTH affect LTDR positively. LTDR has positive and statistically significant correlations with size and profitability, but a negative

		opportunities, liquidity, business risk (BR) and effective tax rate (ETR).		and statistically significant correlation with LIQ. BR and ETR have negative relationships with LTDR.
7	Alkhatib (2012)	DV: Leverage ratio IV: Firm liquidity, size, growth rate, profit, and tangibility	Multiple regression model	The results show that for both industrial and services sectors; there were no statistical significant relationship. When the two sectors were separated, the results for the industrial sector revealed that liquidity and tangibly have significant relationship with leverage, whereas the results for the services sector revealed that the growth rate, liquidity, and tangibility have significant relationship with leverage.
8	Mat Kila and Wan Mahmood (2008)	DV: Debt Ratio IV: Size, Liquidity, Interest Coverage Ratio, EPS Growth	Pooled OLS estimations model	The result shows that the size, liquidity and interest coverage ratio is significantly negatively related to total debt. However, the study finds insignificant negative relation between capital structure and growth of the firm, expressed by the annual changes of earnings.