UNIVERSITI TEKNOLOGI MARA

THE INFLUENCE OF FINANCIAL LEVERAGES ON PROFITABILITY: CASE STUDY OF THE COMPANIES IN TECHNOLOGY SECTOR IN MALAYSIA

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ABSTRACT

This research is an attempt to initiate a theoretical relationship between financial leverage and profitability using four companies of the technology sector in Malaysia over the period 2011-2020. The research is performed using the Net Profit Margin (NPM) to examine the relationship between the financial leverages ratios. Previous research results shows that some of the independent variables have a significant relationship and some of the independent variables have insignificant relationship with the dependent variables which is profitability of the technology sector. This study uses secondary data from the four companies of the technology sector listed in Bursa Malaysia. This study uses panel data to examine the collected data. Result shows that only one insignificant result towards profitability and other 3 independent variables are significant. Other than that, the correlation analysis shows that ER and DCR have a positive relationship to the dependent variable which is profitability of technology sector. Meanwhile, DR and DER showing that it has a negative relationship to the profitability of technology sector. Based on the results for this study, it shows that financial leverage has an influence towards the profitability of technology sector in Malaysia. For the recommendation for this study, it should be adding more variables for this study. Other than that, replicating and expanding the study to the other sectors.

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CHAPTER ONE

INTRODUCTION

1.1 Introduction

All stakeholders, particularly common equity owners, need to understand the elements that affect a company's profitability. Many organizations use debt to leverage their capital in order to increase profit, and financial leverage is one of the most effective ways for a company to increase profit. Financial leverage is the use of debt instruments to improve the expected level return on a firm's equity, and the degree of financial leverage of a corporation is evaluated by calculating the total value of debt and equity, as well as the debt-to-equity ratio. The usage of high levels of debt in the capital structure affects the return on owners' capital, either increasing or decreasing it. The return on equity (ROE) is the monetary gain made by shareholders in exchange for the capital they would have invested in a company. If a company makes a lot of money, it's usually a good idea to take on debt since it means more money for the shareholders.

In the past, empirical studies of the relationship between profitability and firm size have yielded mixed results. The nature of the link between business size and profitability is a crucial question that could offer light on the elements that optimise earnings. According to the above-mentioned literature, the link between company size and profitability might be positive or negative depending on the firm size range. Furthermore, once a certain size is reached, further size growth may further divide ownership from control. These theories show that the relationship between business size and profit can deteriorate once a firm reaches a certain size barrier (Amato and Wilder, 1985). It demonstrates that Du Point chart analysis may be used to depict the relationship between profitability and debt use as expressed by a company's return on equity ratio, and that proper debt use can enhance the return on equity ratio. It simply means that the company's management can use debt to boost profits. Aside from that, the company's management can demonstrate its ability to maximise its asset operation in order to generate profit (Brigham and Ehrhardt, 2005).