THE IMPACT OF CAPITAL STRUCTURE ON PROFITABILITY: FOCUSING ON AUTOMOTIVE PARTS INDUSTRY ON MALAYSIAN FIRMS

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ABSTRACT

The purpose of this paper is to investigate the impact of capital structure on firm profitability. Multiple regression analysis is used in the study in estimating the relationship between the capital structure and firm's performance. Based on a sample of eleven manufacturing firms in automotive parts industry that listed in Bursa Malaysia from 2006 to 2015, the results indicate that interest coverage and asset tangibility are significantly and positively effect to firm performance measured by ROA, while report a negative relation between total debt, short term debt, long term debt and total capital with firm performance, ROA.

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CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Understanding capital structure and its practical implications in business is imperative to the professional manager. Shubita, Jordan, & Jordan, (2012) explains the capital structure decisions centre on the allocation between debt and equity in financing company. An efficient mixture of capital structure reduces the cost of capital. Lowering the cost of capital will result in growth firm value.

Keeping in mind the basic objective of financial management, which is to maximize the shareholder's wealth and therefore, all financing decisions must be taken in the light of this objective. The theory of capital structure has derived its importance from the relationship between the financial leverage and the earnings available to the equity shareholders. Considering the case of favorable financial leverage, the increase in sales or more particularly the increase in earnings before interest and tax (EBIT) will have a magnifying effect on the earning per share (EPS), Kumari, (2015). Hence, the firm should, therefore, select such a capital structure or financial leverage that will maximize the expected EPS. The decisions regarding the capital structure or the financial leverage or the financing mix should also be constructed to fulfill the basic objective of financial management, or in achieving the maximization of shareholder's wealth and also the profitability of firm.