UNIVERSITI TEKNOLOGI MARA

THE EFFECT OF FINANCIAL LEVERAGES ON PROFITABILITY: CASE STUDY OF THE COMPANIES IN MANUFACTURING SECTOR IN MALAYSIA

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Abstract

Using three businesses in Malaysia's manufacturing sector from 2011 to 2020, this study attempts to establish a theoretical relationship between financial leverage and profitability. The relationship between debt ratio, equity ratio, debt to equity ratio, debt to EBITDA and debt to capital ratio for financial leverage is investigated using the Net Profit Margin. Previous study demonstrates that some independent factors have a strong link with the dependent variable, which is the profitability of the Malaysia manufacturing sector, while others have a negligible relationship. This research is based on secondary data from three businesses in the manufacturing sector that are publicly traded on the Malaysian stock exchange, Bursa Malaysia. The collected data is examined using panel data in this study. The study's findings concentrated on descriptive analysis, correlation analysis, regression analysis, and hypothesis testing. The results of this research for regression analysis demonstrate that only one of the independent variables are significant to the profitability of the manufacturing sector in Malaysia, while the other four exhibits insignificant results. Aside from that, the correlation analysis results suggest that the independent factors, such as debt ratio, equity ratio and debt to equity ratio, have a positive association with the dependent variable, manufacturing sector profitability. Meanwhile, debt to capital ratio and debt to EBITDA ratio reveal that the profitability of the manufacturing sector is negatively related. According to the findings of this study, financial leverage has an impact on the profitability of Malaysia manufacturing sector. More variables for this study should be added, such as acid test ratio and total asset amount, according to the recommendations for this study. Aside from that, repeating and expanding the study to other industries, such as healthcare or technology sector, so that we can determine whether financial leverage has a meaningful impact on profitability.

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CHAPTER ONE
INTRODUCTION

1.1 Introduction

This chapter will include the background of the study, problem statement, research questions, research objective, significant of the study, scope of the study, limitations of the study, and definition of key terms, as well as provide an overall summary.

1.2 Background of the study

Financial leverage is the important factor in determine the future of company and company growth. It includes capital structure management ideas. The notion of capital structure formulation is the result of a manager's decision to construct a debt- or equity-intensive firm to finance the company's assets. It has been noted that most of the time, firm executives employ a combination of debt and equity to fund their assets. As a result, the management of each firm must make careful decisions on how to combine debt and equity. Companies who do not want to borrow money to finance their assets must rely entirely on equity financing. As a result, they are free of any fixed fees to pay, implying that they have no financial leverage. Every company must devote special attention to the most essential issues of financial leverage, related cost of capital, and their influence on the firm's profitability.

Financial leverage is defined as the ratio of total debts owed by a corporation to total assets owned by that company. The financial leverage ratio indicates how much borrowed money a corporation has utilised to fund its capital structure. If a company borrows more money from creditors, it must pay a higher cost of debt to the creditors, which is known as interest rate, resulting in lower net income and hence poorer profitability. Higher financial leverage benefits the business during periods of economic expansion, but it has a negative influence on the firm's profitability during periods of economic contraction. It may generate cash flow issues for the company during an economic downturn, and the company may be unable to satisfy its interest obligations. This may occur because of lower sales volume during an economic downturn, leaving the company unable to satisfy interest payments to creditors. Several research on the market and book value measures of leverage have been done in the past (Jnag, 2005; Titman and Wessels, 1998; Rajan and Zingales, 1995).