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THE EFFECT DEBT, EQUITY ON COST OF CAPITAL AMONG CONSUMER SECTOR, TRADING SECTOR, AND FINANCE SECTOR DURING ECONOMIC CRISIS AND AFTER ECONOMIC CRISIS

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<u>"IN THE NAME OF ALLAH, THE MERCIFUL, THE BENEFICENT"</u>

Alhamdulillah, Glory to Allah, the most gracious, and the most merciful is upon his messenger Holy Prophet Muhammad S.A.W. All the worship belongs to only Allah. I also praised to Allah S.W.T for giving us courage, time and knowledge in completing this project paper.

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ABSTRACT

The optimal capital structure is important to the board of director. It is because the best selections of capital structure were giving the good effect to the company. The capital structure is the funds that company uses to finance their activities. However the choosing of capital structure will depends on the cost of capital and others factors. This study especially tries to examine the effect capital structure on cost of capital based on the three main sectors that listed in Kuala Lumpur Stock Exchange (KLSE). The time period for the analysis is the 1996 to 2004. The primary objectives of this study are to known the effect or relationship capital structure on cost of capital. This study identified the capital structure as dependent variable and cost of capital as independent variables. Regression model and Spearman correlation were used to test the research hypotheses. The major finding shows that trading sector and consumer sectors were have the relationship with the debt and cost of capital during economic crisis. However, after economic crisis only consumer sectors were have the relevant result to the debt and cost of capital. So, the overall result shows that only consumer sector have the best result. Instead, the finance sectors insignificant with this hypotheses.

CHAPTER 1. INTRODUCTION

1.1 BACKGROUND OF STUDY

Capital structure is the mixture of sources of funds a firm uses (debt, preferred stock, common stock but excluding all short –term credit). The amount of debt that a firm uses to finance its assets is called *leverage*. A firm with a lot of debt in its capital structure is to be highly levered. A firm with no debt is said to be unlevered. Capital structure theory is one of the most puzzling issues in the corporate finance literature. Numerous empirical studies have shown that announcements of seasoned equity offerings (SEOs) cause negative price reactions, whereas the news of an additional debt issue is followed by an increase in stock prices.

The financial manager should seek that capital structure which maximizes the value of the firm (optimal capital structure). The capital structure decision and the firm's leverage position are co-determined. To determine the firm's optimal capital structure it should look at the tax deductibility of interest. The tax deductibility feature of interest expenses tends to increase the use of debt in the firm's capital structure. The second factors are financial risk. The increased financial risk that comes with increased use of debt tends to moderate the use of debt in the firm's capital structure.