

THE DETERMINANTS OF CAPITAL STRUCTURE:  
EVALUATION BETWEEN SHARIAH-COMPLIANT AND CONVENTIONAL  
COMPANIES



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## Contents

<b>1. Letter of Report Submission.....</b>	<b>iii</b>
<b>2. Letter of Offer (Research Grant).....</b>	<b>iv</b>
<b>3. Acknowledgements.....</b>	<b>v</b>
<b>4. Enhanced Research Title and Objectives.....</b>	<b>vii</b>
<b>5. Report.....</b>	<b>1</b>
5.1    Proposed Executive Summary.....	1
5.2    Enhanced Executive Summary.....	2
5.3    Introduction.....	3
5.4    Brief Literature Review.....	16
5.5    Methodology.....	25
5.6    Results and Discussion.....	35
5.7    Conclusion and Recommendation.....	47
5.8    References/Bibliography.....	53
<b>6. Research Outcomes.....</b>	<b>57</b>
<b>7. Appendix.....</b>	<b>58</b>

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## **5.2 Enhanced Executive Summary**

Islamic financial markets are still at infant stage in Malaysian economy, thus have created dual-economic financial systems which are Islamic and conventional financial system. The capital structure determinants between shariah-compliant and conventional companies might be different. The aim of this research was to disclose the factors that influence capital structure of shariah-compliant and conventional companies. By using multiple regressions, we examined 58 companies listed on the Main Market of Bursa Malaysia from year 2005 until 2010. We found that the shariah-compliant companies' debt ratio was significant with profitability, size and non-debt tax shield while profitability and tangibility play significant role in capital structure decision of conventional companies. This has suggested that being shariah-compliant companies has brought unique and privilege features in its capital structure.

## **5.3 Introduction**

Franco Modigliani and Merton Miller sired the theory of capital structure. Since the seminal work by Modigliani and Miller in 1958, numbers of researches has been undertaken in an attempt to identify the determinants of capital structure of companies. Many empirical efforts of researchers contributed to variety of theories that suggest many determinants that affect capital structure decision. However, the presence of inconsistent findings suggests further study in this area is necessary. Many researches regarding capital structure area have been explored across various countries and many types of industries. But the findings of these empirical studies do not lead to an agreement about the significant determinants of capital structure. This is due to variations in the use of long-term versus short-term debt or because of institutional differences that exist between developed and developing countries.

Among studies of capital structure determinants focus on industries that had been conducted such as property companies (Ooi, 1999), restaurant industry (Upneja and Dalbor, 2001), construction industry (Chiang, Chan and Hui, 2002), high technology versus traditional corporations (Hsiao, Pikas and Lee, (2003) and multinationals versus domestic corporations (Akhtar, 2005). These studies found different capital structure determinants because of difference in industry or sector. This called for the extension of research to compare capital structure of many sectors. But one of the sectors which need to be studied is comparison of capital structure determinants between shariah-compliant companies and conventional companies.

### **5.3.1 Conventional Companies Versus Shariah-Compliant Companies**

Islamic financial markets are still growing in Malaysian economy which encourages many firms in Malaysia to adopt business practices that comply with Islamic laws. Currently Bursa Malaysia provided indices for measuring the performance of shariah-firms such as FTSE Hijrah Shariah Index and the FTSE Bursa Malaysia EMAS Shariah Index. The shariah-compliant stocks in Bursa Malaysia are about 88% of the securities that are currently listed in Bursa Malaysia according to Bank Negara Malaysia 2010 Report. It also represented