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DETERMINANTS OF CAPITAL STRUCTURE: APPLICATION TO SHARIAH-COMPLIANT FIRMS IN MALAYSIA

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AUTHOR'S DECLARATION

I declare that the work in this thesis was carried out in accordance with the regulations of Universiti Teknologi MARA. It is original and is the results of my own work, unless otherwise indicated or acknowledged as referenced work. This thesis has not been submitted to any other academic institution or non-academic institution for any degree or qualification.

I, hereby, acknowledge that I have been supplied with the Academic Rules and Regulations for Post Graduate, Universiti Teknologi MARA, regulating the conduct of my study and research.

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ABSTRACT

This study highlights the sensitivity of capital structure determinants in each sector within the Shariah-compliant firms listed in Bursa Malaysia. Although the proportion of debt financing is similar, each sector adopted different financing patterns. Remarkably, this pattern occurred after the implementation of the Malaysian Capital Market Plan in early 2001. Evolution of the capital market development, particularly the Islamic bonds, or Sukuk, further highlights the vibrancy of the capital market as the main provider of financial resources to the corporate sector. The inconsistencies of results on capital structure in previous literature have been inconclusive but remained the core debatable issue in the finance world. This study is primarily motivated by the issue of the scrutinised determinants still being inconclusive in the area of capital structure. It includes three new variables that are efficiency and bankruptcy risk for firm specific factor and industry concentration for sector specific factor. This is a new contribution to the literature as no work has been done regarding these issues in Shariah-compliant firms in Malaysia. Additionally, it employs two-stage analysis namely the parametric Stochastic Frontier Analysis (SFA) method and the panel data analysis. Employing SFA is to acquire the technical efficiency score of every Shariah-compliant firm. This study quoted revenue efficiency instead of cost efficiency because the firms in the sector are competing to increase the revenue. Additionally, it includes the efficiency as the independent variable to the leverage model. By employing panel data analysis, this study could examine the determinants influencing firm leverage and to analyse relationship of the new variables namely efficiency, bankruptcy risk as well as industry concentration with the firm leverage. Focussing on construction, property, plantation, industrial as well as trade and services sectors for the period of 2002-2011, this study made use of the static models namely Pooled Ordinary Least Square, Fixed Effect and Random Effect Model. Empirical analysis on the determinants reveals that country specific factor (lending rate) and sector specific factor (industry concentration) are significant in influencing the corporate financing decisions, along with firm specific factor (profitability, tangibility and liquidity). Nevertheless, the applicability of capital structure theories such as the trade-off theory, agency theory and pecking order theory diverge across sectors in Malaysia. The pecking order theory and agency theory are found to be the dominant theories governing the corporate financing decision. It indicates strong evidence of hierarchy practised in firms' financing decision. The finding on agency theory being dominant justifies the function of short term debt as a controlling mechanism to mitigate the agency problem, arising within firm across sectors. The firm specific factors (bankruptcy risk, profitability, tangibility, liquidity and firm size) significantly influence the firm leverage in Malaysia. However, the sector specific factor and country specific factor (industry concentration and lending rates) are persistently maintained as the most significant factor to leverage across sectors. Being important, these variables influence the financing decision of the Shariah-compliant firms in Malaysia. As a vital contribution, this study employed the Shariah-compliant firms as samples which have yet to be conducted on determinants of their capital structure and efficiency.

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CHAPTER ONE
INTRODUCTION

1.1 INTRODUCTION

Capital structure is still a puzzling issue as mentioned by Myers (1984). In today's dynamic and highly competitive business atmosphere, capital structure plays a crucial role in ensuring a competitive and sustainable growth of a firm. Presently, in Malaysia, for example, managing capital structure and restructuring activities have become a major concern due to the global financial crisis and the bubble economy which have led to financial distress, liquidation and bankruptcy among major businesses. It is vital for every stakeholder of a firm to know any information about the firm in order to bring about the capital structure decisions of their firm.

Determination to choose capital structure is the decision that the firms have to make in order to identify the best level mixture of both debt and equity to avoid bankruptcy risk and less cost to pay (Brealey & Myers, 1984; Damodaran, 1997; and Nikbakht & Paikani, 2009). Choosing which level of debt and equity to be employed in the firm is not an easy task. It requires a very careful and proper decision as it is a very important financial choice in a business organisation besides the investment decisions because it will give a long term impact on the firm which is very costly. Therefore, a strategic and proper planning is required as the decision will give a very big impact to the firm's value and thus will affect the efficiency and performance of the firm to completely compete in a global market. For several decades ago, the role of capital structure has become an important issue in the world of corporate finance.

An appropriate mix of capital structure is not only imperious to maximise the interest of the stakeholders, but it is also essential for that organisation to compete competently and efficiently in its operating environment (Simerly & Li, 1999) whether the firm is either a Shariah-compliant or Shariah non-compliant firm. Erroneous on deciding the mix of capital structure will lead to financial distress, will cause indebtedness to the organisation (Eriotis, Vasiliou, & Neokosmidi, 2007) and will affect the firm performance in a long run and will give negative effect to the economy.