UNIVERSITI TEKNOLOGI MARA

THE RELATIONSHIP BETWEEN DEBT FINANCING AND FIRMS' PERFORMANCE IN MALAYSIA

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ABSTRACT

Debt financing is one of the most used methods to raise funds for expansionary or increase the market coverage by going global. In contrast with equity financing, debt financing is easily obtained from bank credit or other financial institutions offering credit plans. However, it is crucial for firms to assess the implications of the rise in debt level in relation to its profitability in order to ensure sustainability and growth of these firms. Present study sampled a total of 11 companies within the plantation sector in Malaysia to investigate the relationship between debt financing and firms' performance. Profitability is measured by the gross profit margin (GPM) while the independent variables used were total debt ratio (TDR), debt equity ratio (DER), interest coverage ratio (ICR), interest rate (INT) and inflation rate (INF). Results showed that TDR has an inverse impact on profitability whereas ICR has no role in explaining GPM. However, DER, INT and INF have a positive relationship with GPM. These findings will serve as a guide for firms that are deciding on opting for debt financing as it helps them in constructing the financial plan.

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TABLE OF CONTENTS

Page

AUTHOR'S DECLARATION i
LETTER OF SUBMISSION ii
ABSTRACT iii
ACKNOWLEDGEMENTS iv
TABLE OF CONTENTS v
LIST OF TABLES viii
LIST OF FIGURES ix
LIST OF SYMBOLS x
LIST OF ABBREVIATIONS xi

CHAPTER 1: INTRODUCTION 1
1.1 Introduction 1
1.2 Background of The Study 2
1.3 Problem Statement 3
1.4 Research Objectives 4
1.4.1 Main Research Objective 4
1.4.2 Specific Research Objectives 4
1.5 Research Questions 5
1.5.1 Main Research Question 5
1.5.2 Specific Research Questions 5
1.6 Significance of The Study 6
1.7 Scope of Study 7
1.8 Limitation of Study 7
1.9 Definition of Terms 8
1.10 Summary 9

CHAPTER ONE
INTRODUCTION

1.1 INTRODUCTION

Debt financing is a technique implemented by the issuance of debt instrument known generally as corporate bonds. Capital through debt financing is gained by entering into an agreement with another party to borrow a certain sum of money to be paid back in a specified and agreed time. A long-term debt takes longer than a year for the repayment period while short-term debt (Kajirwa, 2015). Debt financing could also be obtained by various loans offered by banks and other corporations.

Nonetheless, majority of the firms prefer equity financing to avoid any involvements with debts. Debts are always linked with failures and danger. This is proven from a study by Zaher (2010) who investigated the performance of debt free firms and in his findings stated that investment return on firms with zero liabilities is more significant than firms practicing debt financing. Öhman & Peter (2015) concluded in their study that Small Medium Enterprises (SMEs) opted for equity financing to reduce the risk of bankruptcy.

However, it is unfair to arrive at a general conclusion without a solid study on the subject matter. Therefore, this study will approach on the long-standing questions regarding debt structure towards firm's profitability performance. Findings on this study will positively aid firms in deciding on their capital restructuring, either through debt issuance or equity financing. This study will use several firm-specific variables along with two (2) important macroeconomic variables in order to achieve a better understanding on the subject matter.

In the first chapter, researcher outlines the in-depth overview of the study, explaining on the debt structure of a firm and a statement of the problem that arise causing a need for this study to be conducted. Besides, research objectives and research questions were listed in order to guide researcher on the direction of this study and a comprehensive explanation on the scope of the study.