UNIVERSITI TEKNOLOGI MARA

THE RELATIONSHIP BETWEEN CAPITAL STRUCTURE AND BANK'S PROFITABILITY IN MALAYSIA

NUR ERMIEDZA BT RADZALI

Thesis submitted in fulfilment
Of the requirements for the degree of
Bachelor of Business Administration
(Hons) (Islamic Banking)

Faculty of Business and Management

JULY 2017

ABSTRACT

Capital structure of a firm or a company refers to financing mix which are debt and equity. There a few previous studies in Malaysia on the determinants of capital structure of different sectors such as Construction Company and small to medium enterprises. However, no research was emphasized on the capital structure and profitability of banks. In the context of other countries such as, there are a lot of previous studies regarding the relationship between capital structure and bank's profitability in other countries such as Ghana, Ethiopia and Tanzania. However, most of the research did not focus on the core business activities of banks. The objective of this study is to determine the relationship between capital structure and banking profitability in Malaysia. Panel data analysis was used to meet the objective. The data were obtained from the data stream for six banks in Malaysia for the period of eleven years (2005-2015). The fixed effects model was employed. The findings shows that there is insignificant relationship between capital structure and bank's profitability (net interest margin) in Malaysia and it is supported by Anarfo (2015). Total debt to asset ratio and deposit to asset ratio have a positive significant relationship with the bank's profitability while the other three independent variables which are growth, spread and spread have an insignificant relationship with bank's profitability. The results has been discussed in chapter four to provide a meaningful information. As for the recommendation it is vital for the banks to focus on the significant variables in aiming to obtain a maximum profit of the core business activities and also in determining the optimal capital structure. It is also recommended for future researcher to consider financial institutions that are performing almost the same functions as banks as samples of the study add more observations to obtain a better result.

ACKNOWLEDGEMENT

First of all I would like to thank Allah S.W.T for his countless blessings on me which I had an opportunity to embark on this research and had completed it successfully. I would like to thank many individuals for the supports and helps that they have given to me along this long and challenging journey.

One of the individuals is my advisor, Puan Zuraidah Binti Ahamad. I would like to express my gratitude for her guidance and supervision on my thesis progress. She had continuously provided me with so many helpful information related to my research topic and also guide me on the errors which have come out throughout the progress. As without her, completing this research successfully would be impossible.

Furthermore, I would like to thank my family members especially my parents from the deepest of my heart for continuously giving me love and supports as without them, I would never get the determination to complete this research with all of my efforts. Not to forget, to the other lecturers and friends for giving me some tips and also encouragement. I would like to thank them for their cooperation that really helped my research progress.

TABLE OF CONTENT

LETTER OF SUBMISSION i
AUTHOR'S DECLARATION ii
ABSTRACT iii
ACKNOWLEDGEMENT iv
TABLE CONTENT v
LIST OF TABLES viii
LIST OF FIGURES ix
CHAPTER ONE: INTRODUCTION 1
1.1 Introduction 1
1.2 Background of study 2
1.3 Problem Statement 4
1.4 Research Questions 7
1.5 Research Objcetives 8
1.5.1 Main objective 8
1.5.2 Specific objectives 8
1.6 Significance of the Study 9
1.7 Scope of Study 9
1.8 Limitations of the Study 10
1.9 Definition of Term 10
1.9.1 Net Interest Margin 10
1.9.2 Total Debt to Asset 11
1.9.3 Deposit to Asset 11
1.9.4 Loan to Deposit 11
1.9.5 Spread 12
1.9.6 Growth 12
1.9.7 Asset size 12
1.10 Summary 12
CHAPTER TWO: LITERATURE REVIEW 13
2.1 Introduction 13
2.2 Overview of Malaysian Banking System 13
2.3 Overview of Capital Structure 14

CHAPTER ONE
INTRODUCTION

1.1 INTRODUCTION

Two basic goals for every companies are to minimize the cost and maximize the profit. In order to achieve the goals, the management should determine the optimal capital structure. Capital structure of a firm or a company refers to financing mix which are debt and equity. It is basically the decision that has to be made by a company or a firm on how to finance their assets which are whether to choose equity, debt or hybrid securities. According to Taani (2013), the capital structure is generally described as the combination of debt & equity that make the total capital of firms. According to Abor (2005), the capital structure decision is vital for every business organization. It is because such decision will directly affect the profitability of a company or a firm. Hence, every companies need to pay attention on its capital structure decision. Profit functions as a measurement to evaluate the efficiency of a company and also as an indicator to dividend payments. According to Asgari et al. (2015), an appropriate debt and equity structure for shareholders is more sensitive in service providing organizations like banks, transportation industry, medical services, insurance and hotel management. A bank plays an important role of intermediation between savers and investors. Therefore, it is also crucial for banks to focus on their capital structure decision because of that special feature. According to Niresh & Velnampy (2012), there is a considerable attention on the relationship between capital structure and profitability. Hence, the study is important to foresee the potential problems in the capital structure and performance.