EFFECT OF CAPITAL STRUCTURE ON PROFITABILITY PERFORMANCE OF WOOD-BASED COMPANIES LISTED IN BURSA MALAYSIA

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EFFECT OF CAPITAL STRUCTURE ON PROFITABILITY PERFORMANCE OF WOOD-BASED COMPANIES LISTED IN BURSA MALAYSIA

By

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DEDICATION

I WOULD LIKE TO DEDICATE THIS THESIS TO MY BELOVED PARENTS

KHAMMUAN CHANMONTRI AND KOH AI HIAN

TO MY BELOVED SIBLINGS

RONNAKRIT CHANMONTRI AND KORAVIDH CHANMONTRI

TO MY SUPPORTIVE PARTNER

SOONG AI CHENG

AND LASTLY MY SUPERVISOR

DR. NORZANALIA BINTI SAADUN

THANK YOU FOR YOUR TIME, PATIENCE, AND SUPPORT

ABSTRACT

This study investigates the relationship between capital structure and profitability performance of wood-based companies listed in Bursa Malaysia from the year 2013 to 2017. This research employed current ratio (CR) and natural log of total debt (LNTD) as indicator of capital structure or independent variables. For profitability performance, the dependant variables earnings before interests and taxes (EBIT) and return on capital employed (ROCE) were used as indicators. Pearson correlation analysis was used to find whether there is an association between dependant and independent variables while multiple linear regression was used to test the strength of the association between dependant and independent variables. The results indicate a positive relationship between capital structure indicator of CR and LNTD to profitability performance indicators of EBIT. Other than that, a positive relationship also exists between capital structure indicators for both CR and LNTD with profitability performance indicator of ROCE. In short, the findings of this research suggest that debt financing in capital structure leads to a higher profit for wood-based companies listed in Bursa Malaysia. The results of this research could be useful to financial managers of wood-based companies listed in Bursa Malaysia.

ABSTRAK

Kajian ini menyiasat hubungan di antara struktur modal dan prestasi keuntungan syarikat-syarikat berasaskan kayu yang disenaraikan di Bursa Malaysia dari tahun 2013 sehingga 2017. Kajian ini menggunakan nisbah semasa (CR) dan logaritma asli jumlah hutang (LNTD) sebagai petunjuk struktur modal iaitu pemboleh ubah bebas. Untuk prestasi keuntungan iaitu pemboleh ubah tetap, pendapatan sebelum faedah dan cukai (EBIT) dan pulangan ke atas modal bekerja (ROCE) akan digunakan sebagai petunjuk. Analisis korelasi Pearson digunakan untuk mencari sama ada terdapat perkaitan antara pemboleh ubah tetap dan pemboleh ubah bebas manakala kaedah regresi linear digunakan untuk menguji kekuatan perkaitan antara pemboleh ubah bebas dan pemboleh ubah tetap. Keputusan menunjukkan hubungan yang positif antara petunjuk struktur modal CR dan LNTD kepada petunjuk prestasi keuntungan EBIT. Selain itu, hubungan positif juga wujud antara petunjuk struktur modal CR dan LNTD kepada petunjuk prestasi keuntungan ROCE. Pendek kata, penemuan-penemuan kajian ini mencadangkan bahawa pembiayaan hutang dalam struktur modal akan membawa kepada keuntungan yang lebih tinggi bagi syarikat-syarikat berasaskan kayu yang disenaraikan di Bursa Malaysia. Keputusan kajian ini berguna kepada pengurus kewangan syarikat-syarikat berasaskan kayu yang disenaraikan di Bursa Malaysia.

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APPROVAL SHEET

I certify that this research project entitled "Effect of Capital Structure on Profitability Performance of Wood-Based Companies Listed in Bursa Malaysia" by Siravidh Chanmontri has been examined and approved as a partial fulfilment of the requirement for the degree of Bachelor of Wood Science and Technology in the Faculty of Forestry, Universiti Putra Malaysia.

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ACE	Access, Certainty and Efficiency
CR	Current Ratio
EBIT	Earnings before interest and taxes
EPS	Earnings per share
IBM	International Business Machine
IMP	Industrial Master Plan
KLSEB	Kuala Lumpur Stock Exchange Berhad
LDTA	Long-term debt to total assets
LNTD	Natural log of total debt
MESDAQ	Malaysian Exchange of Securities Dealing and Quotation Berhad
MDF	Medium density fibreboard
NI	Net income
NIM	Net interest margin
NOI	Net operating income
PRF	Permanent reserved forests
ROA	Return on assets
ROE	Return on equity
ROCE	Return on capital employed
SDTA	Short-term debt to total assets
SME	Small and medium enterprise
SPSS	Statistical Package for Social Sciences
TD	Total debt
TDTA	Total-debt to total assets

LIST OF ABBREVIATIONS

TDTE	Total-debt to total equity
UAE	United Arab Emirates
UPM	Universiti Putra Malaysia

CHAPTER 1

INTRODUCTION

1.1 General Background

In general, capital structure is an important decision to any financial managers as it is one of the key elements for a company to make profit. Capital structure can be explained as the way a company finances their assets using a mixture of debt and equity (Tan & Hamid, 2016). In other words, capital structure can also be referred as the debt to equity ratio making up the financial resources of a company (Gill, Biger, & Mathur, 2011). Thus, capital structure decisions which is basically the mixture of debt to equity ratio can have important implications to the value of a firm (Abeywardhana, 2017). Indicators of capital structure include total debt to total asset ratio, total debt to total equity ratio, and current ratio (Azhagaiah & Gavoury, 2011). Other than that, total debt was also used by Salim and Yadav (2012) to measure capital structure. According to Myers (2001) there is no universal theory of the debt to equity choice and no reason to expect one.

One index that can be affected by different capital structures is profitability performance which is the maximization of wealth or value of the firm (Modigliani & Miller, 1963). Indicators of profitability performance include return on equity and earnings before interests and taxes used by Gill, Biger, and Mathur (2011) other than return on assets and return on capital employed used by Azhagaiah and Gavoury (2011).

Up until now, relationship between capital structure and profitability performance is one that has obtained significant attention in the finance literature (Velnampy & Niresh, 2012). Many theories have been developed to explain the capital structure ratios used by firms. However, even with the theoretical appeal of capital structure, researchers in financial management have not been able to find an optimal capital structure ratio. The closest academicians have achieved are prescriptions that only satisfy short-term goals.

1.2 Problem Statement and Justification

Many prior studies have been carried out on the relationship between capital structure and profitability. For example, a study conducted by Salim and Yadav (2012) on 237 Malaysian listed firms from construction, consumer product, industrial product, plantation, property, and trading sector. The study found that there is a negative relationship between capital structure measured by short-term debt to total assets (SDTA), long-term debt to total assets (LDTA), and total-debt (TD) to profitability performance measured by return on assets (ROA), return on equity (ROE), and earnings per share (EPS). Another study was conducted by Velnampy and Niresh (2012) on 10 listed Sri-Lankan banks. The study found that there is a negative relationship between capital structure measured by total debt to total equity (TDTE) and total debt to total assets (TDTA) to profitability performance measured by net interest margin (NIM).

Next was a study conducted by Azhagaiah and Gavoury (2011) on 102 IT firms listed in India. However, this study discovered that there is a positive relationship between capital structure measured by current ratio (CR) to profitability performance measured by return on assets (ROA) and return on capital employed (ROCE). Another study which further supports this finding was conducted by Gill, Biger, and Mathur (2011) on 272 listed American firms. This study found that there is a positive relationship between capital structure indicated by short-term debt to total assets (SDTA), long-term debt to total assets (LDTA), and total-debt to total assets (TDTA) to profitability performance measured by earnings before interests and taxes (EBIT).

Many studies have been undertaken in the past to research on the topic of the effect of capital structure to profitability performance. However, most of those studies are done in countries outside Malaysia, specifically not on wood-based companies listed in Bursa Malaysia. It is clear from the ongoing discussions based on the available empirical literature, that results from investigations into the relationship between capital structure and profitability performance are inconclusive and requires more empirical work.

The importance of this study to the Malaysian economy cannot be ignored because, based on the Malaysian Investment Development Authority (2016), the Malaysian wood-based industry is one of the major revenue contributors to the Malaysian economy. In 2016 alone, the wood-based industry generated a revenue of RM22.11 billion accounting to 2.8% of Malaysian export for the year and created job opportunities for 240,000 people. Furniture produced in Malaysia are export-oriented, where 90% of its production is exported to more than 160 countries. The ability of Malaysian wood-based industry to produce a wide range of wooden products that can be exported combined with the emergence of new markets in UAE, Saudi Arabia, the Philippines, and Russia have made Malaysia the 8th largest exporter of furniture in the world. Thus, this study intends to determine the effect of capital structure measured by total debt (TD) and current ratio (CR) on wood-based companies' profitability performance measured by earnings before interests and taxes (EBIT) and return on capital employed (ROCE) to enable these firm to carry out wiser management practices in the future.

This study will benefit financial managers in wood-based companies who are attempting to manage their company's finance in today's highly competitive environment. When financial managers in wood-based companies are able to understand the capital structure better, they can plan better on how to manage firm total capital by adjusting capital structure. Stockholder will also benefit as they will preferably only need to use equity as last resort funding (Myers and Majluf, 1984); because when good capital structure is in place they can utilise funding from internally generated funds and debt (offers higher leverage) first.

1.3 Objectives

The objectives of this study are:

1. To determine the relationship between capital structure to profitability performance.
2. To determine the significance of the influence of capital structure (indicated by LNTD and CR) towards profitability performance (indicated by EBIT and ROCE).

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