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ANALYZING THE FACTORS AFFECTING CAPITAL STRUCTURE OF PROPERTY COMPANIES IN MALAYSIA

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Abstract

Capital structure has long been a popular topic of research in a wide range of industries and countries around the world. The management of the company must choose a capital structure that optimises the company's value, which is a crucial decision and requires the management to make a wise decision. This paper aims to analyse the impact of asset structure, profitability, size of company and liquidity on capital structure of property companies under in Bursa Malaysia. Data was gathered through annual report from the year 2011 until 2021, been analysed using STATA and has employed random effect model. The findings show that asset structure and liquidity are negatively impacted on capital structure, company size is positively influencing the capital structure while profitability is insignificant. Asset structure is the most significant factor affected the companies' capital structure. Investors and corporate management should pay particular attention to fixed asset utilisation as this affects the leverage of property companies.

Keywords: Capital structure, leverage, asset structure, random effect, profitability, company size, liquidity

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1. Introduction

Capital structure refers to the method or approach by which businesses finance their assets with a combination or mixture of debt and equity (Titman & Wessels, 1988). The company is said to be well managed and systematic if they have sufficient and adequate capital structure. Poorly managed businesses not only threaten themselves but also can affects other businesses. They have the ability to depress the stock market due to less lucrative, lower values, high distress and are more likely to go bankrupt. This should gradually lead to a reduction in the frequency of the firm losses due to inadequate internal control systems, ineffective business operations and inefficient corporate structures.

Capital structure research has grown in prominence in the finance literature since Modigliani and Miller initially presented the concept in 1958. The management of the company must choose a capital structure that optimises the company's value, which is a crucial decision and requires the management to make a wise decision. Besides Modigliani and Miller's capital structure theories, the pecking order hypothesis asserts that if there is insufficient internal cash flow to support the business operation, the firm will borrow rather than issue shares. As a consequence, the amount of debt indicates the company's entire external cash requirement. According to the tradeoff hypothesis, businesses try to strike a balance between debt levels and the costs of potential financial problems and the tax benefits of increasing leverage. The tradeoff principle predicts that tax-paying businesses will only make modest loans.

The capital structure of a corporation is made up of a number of various securities. Institutions have a different capital configuration from which to choose. For addition, lease financing, convertible bonds issuance, usage of warrants and the signing of forward contracts, can all be arranged. Institutions might possibly issue hundreds of different securities in an infinite number of combinations to boost overall market value (Abor, 2005). Capital structure guidelines have one overall goal, which is to maximize a company's worth (Ross, 1977). Any incident that potentially result in unnecessary costs forces organizations to deviate from their stated goal. In the real world, however, determining a company's capital structure is incredibly challenging. Financial managers have a difficult time in determining a company's optimal capital structure.

The property sector played a crucial part in the development of the economic development in the late 1980s and early 1990s. Property is more static in nature than other asset classes; even among the same property categories, there are significant variances in risk and return features. These sectors benefit other parts of the economy by laying the groundwork for generating profit, revenue or others, all of which are critical components of economic growth. Investors should carefully analyse the performance criteria of each property in its portfolio as the property market transitions from a pleasant equilibrium to a worse future outlook for supply and demand balances.

Mujiatun et al. (2021) describe capital structure as long-term financing decision which includes debt and equity. They tested various set of variables on capital structure, namely asset structure and profitability, of companies in manufacturing sector in Indonesia for the period 2016 until 2019. Both independent variables resulted in positive impact on capital structure Cahyani and Handayani (2017) revealed a substantial negative relationship between asset and capital structure in their research. Organizations choose funding sources primarily based on a desired or acceptable capital structure, according to the balance theory. In their capital professions, the majority of firms have fixed assets that will generate revenue from long-term money acquired from equity or debt. As a response, the company will make a concerted effort to

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develop an ideal capital structure that will increase the firm's value. Firms that rely on fixed current assets for the majority of their activities will be capable of paying off debt.

The ability of a corporation to make money is referred to as profitability. This implies that a company's profits are inextricably linked to its earnings (Yuliarti & Yanto, 2017). When a business generates a lot of money, it is more likely to use retained earnings rather than lending money (Abdulla, 2017). Arabahmadi and Arabahmadi (2013) investigated the connection between structure of capital and companies' performance measured by profitability, using financial data of 252 companies listed on Tehran Stock Exchange between the year 1999 and 2008. It established a direct relation between profitability, return on equity, and short-term leverage, which backs up previous findings. This reveals that rising in short-term leverage will boost earnings, whilst growing long-term obligations will cut profitability. Corporate assets can be used to calculate profitability. Earnings in a large organization with a lot of assets will be used to run the company. Mukaromah and Suwarti (2022) studied on property and real estate companies in Indonesia from 2018 to 2020. By using Moderating Regression Analysis, they found that liquidity has indirect impact on capital structure. However, profitability is insignificant in giving impact on the capital structure.

As per to Ullah et al. (2017), liquidity have significant positive and also negative impact on capital structure decisions, therefore the net impact is uncertain. Because of their increased ability to satisfy short-term obligations, high liquid companies might have a high leverage ratio. This argument indicates a link between a company's liquidity and its debt-to-equity ratio. Firms with more liquid assets, on the other hand, may utilize the assets as sources of funding to support potential investments in the future. Noraidi and Ramakrishnan (2018) conducted a research to identify the impact of total asset or size of company and other variables on capital structure. They revealed that company size, profitability, liquidity, tangibility, growth, non-tax debt shield and business risk are significant in affecting the capital structure. Fixed effect analysis is employed in this study.

The appropriate debt level and liquidity of a company's assets have long been contentious topics of discussion among finance academics. A study done by Ghasemi and Ab Razak (2016), two typical ratios, the quick ratio and the current ratio, are used to assess a company's liquidity on various debt ratios. This study examines how liquidity affects the capital structure of the 300 listed businesses on Bursa Malaysia's Main Market between the fiscal years of 2005 and 2013. The findings demonstrate that each and every measure of liquidity significantly affects each and every proxy for leverage. The findings show that quick ratio has a favorable influence on leverage whereas the current ratio has an indirect impact. Furthermore, compared to long-term debt, a short-term debt is found to have bigger influenced by liquidity.

2. Problem Statement

An online article written by Elliot Smith on November 9, 2021, an economist, George Magnus, warns China's property market as the market stagnant which affects the domestic and global economy. He argued that leverage in property sector could be the most problematic and threatening factor where it is in critical stage now. Because of the potential of catastrophic financial instability, Magnus believes the government no longer wants to rely on putting on the credit restraints. As property companies deal with high leverage, they are in high financial distress and might affects the performance. Hence, this research is

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conducted by focusing on Malaysian property market, investigating the potential factors of asset structure or tangibility, profitability, size of company and liquidity on leverage, as leverage was said to be the most problematic factor (Smith, 2021).

3. Research Objectives

The objectives of this study are to identify the significant impact of asset structure, profitability, company size and liquidity on capital structure of property companies in Malaysia and to determine the most significant factor which contribute to the effect of capital structure in property industry.

4. Research Methods

Yearly financial data were gathered from 20 selected companies' annual report which cover the period from year 2011 until 2021. Correlation analysis and regression analysis were tested using Stata10 software. Correlation test used to determine the connection between the variables while regression test employed to test the significant impact of the variables. Later researcher will decide either to employ random effect model or fixed effect model. Table 1 below shows the variables description in this study.

Table 1. Description of variables

Variables	Proxy
Capital structure	Debt equity ratio
Asset structure	Fixed asset to total asset ratio
Profitability	Return on asset ratio
Company size	Log total asset
Liquidity	Current ratio

5. Findings

5.1. Correlation analysis

Table 2 below shows the relationship among the variables. All of them have very weak relationship except liquidity, which shows negative low correlation with capital structure. Asset structure and profitability found to have negative relationship with capital structure, while company size shows a positive correlation. Only asset structure has a negative relationship with liquidity, the rest of the independent variables are positively correlated among each other.

Table 2. Pearson correlation coefficient test

	Capital structure	Asset structure	Profitability	Company size	Liquidity
Capital structure	1.0000				
Asset structure	-0.0972	1.0000			
Profitability	-0.1248	0.0841	1.0000		
Company size	0.1958	0.1779	0.1352	1.0000	
Liquidity	-0.3200	-0.1047	-0.0347	0.0819	1.0000

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5.2. Regression analysis

Table 3 below extracted from Pooled Ordinary Least Square (POLS), random effect and fixed effect regression analysis. Model 1 presented POLS result with 20.84% Rsquare and all independent variables have significant influence on capital structure. Breusch-Pagan Lagrangian Multiplier (BP-LM) test was run for researcher to choose between pool data and panel data. Since BP-LM test is significant, researcher rejects null hypothesis and this model can be extended to panel data, it is where Model 2 and Model 3 were run. Model 2 represents random effect regression analysis; 35.52% variation of independent variables are influence the capital structure in this model. Hausman Fixed test shows insignificant value; hence researcher can employ random effect model instead of fixed effect model. Variance Inflation Factor (VIF) adopted to test multicollinearity problem in the model and no multicollinearity existed since the VIF value is below 10 as per rule of thumb. This data is significantly heteroscedastic according to heteroscedasticity test.

The robust model is Model 2 which is random effect model. Asset structure, company size and liquidity are found to be significant. Any 1% increase in asset structure will decrease 32.91% in debt equity ratio. It shows that the larger a company's asset structure is, the higher its capital structure is. This is likely due to the fact that companies with large fixed asset positions will find it easier to increase leverage due to that tangible assets can be put as collateral. Companies frequently take advantage of this circumstance by prioritising debt when obtaining funding from outside sources, thereby expanding their capital structure, according to Ullah et al. (2017). For profitability, any 1% increase in profitability, will not give any impact on capital structure as it shown insignificant result. This finding is supported by Mukaromah and Suwarti (2022), where they claimed that even the company gains profit, they are not likely to use that money for funding or capital injection for business operation. There are companies whose have long-term planning to use that profit for research and development and dividends distribution to shareholders.

In addition, size of company is significantly affected the capital structure. Any 1% increase in company size, the capital structure will increase by 1.83%. This result is aligned with Mujiatun et al. (2021), where a company with high total asset with ultimately used that assets as collateral for their debt financing, hence will increase the capital structure of the company. A significant negative impact shown for liquidity. Any 1% increase in liquidity, it will decrease the capital structure by 2.18%. This is in line with the theory of pecking order, where the companies with a lot of liquidity chose to spend internal funds first, then borrow from outside sources. This study also shows that profitable enterprises with high liquidity levels will have lower debt levels. Ullah et al. (2017) also found that liquidity had a negative and significant impact on capital structure.

Table 3. Summary of analysis

	Model 1 POLS	Model 2 Random Effect	Model 3 Fixed Effect
Asset structure	-0.2830*	-0.3291*	-0.0343*
Profitability	-0.1385*	-0.0512	-0.0347
Company size	0.0229*	0.0183*	0.0150
Liquidity	-0.0372*	-0.0218*	-0.0173*
Constant	0.4173*	0.4596*	0.5032*

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R-square	0.2084	0.3252	
F-stat	0.000	0.0005	
BP-LM test	128.83*		
Hausman Fixed test		7.26	
Mean VIF	1.04	1.04	1.04
Heteroscedasticity test		8.93*	

6. Conclusions

This study analyses the influence of some factors on property company's capital structure in Malaysia, covers 20 companies for 11 years. A random effect analysis is a suitable and robust model for this study after went through some testes. All objectives for this study were met as researcher revealed that asset structure, size of company and liquidity have significant impact on capital structure. Besides that, asset structure found to be the most significant determinant for capital structure. Therefore, management of company have to look into their fixed asset, fully utilized and strategize to have more fixed asset, as this give greater impact on the capital structure. As this study concerned on the property companies, future researchers can expand the sample size to another sector in Malaysia, or even internationally. A different sample size will generate a different finding which much contribute to the value of this research. Before adopting on a capital structure, a company's manager should assess the influence of debt financing on the performance of company. They are helped to determine the optimal debt level and to avoid using an excessive amount of debt in their capital structure. The ideal capital structure level must be reached by business managers and maintain it as much as feasible in order to maximise company profitability and shareholder value. In addition, a benchmarking analysis with other countries is recommended as they have different perspectives and regulations.

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