

THE PERFORMANCE OF CAPITAL STRUCTURE ON SHARIAH-COMPLIANT FIRMS IN MALAYSIA

Aflah Isa ¹ *

Nurulashikin Romli ²

Halimatun Saadiah Khaidzir ³

Sharazad Haris ⁴

Azila Jaini ⁵

¹ Faculty of Business and Management, Universiti Teknologi MARA, Cawangan Johor, Kampus Segamat Malaysia (E-mail: aflah171@uitm.edu.my);

*Corresponding author

² Faculty of Business and Management, Universiti Teknologi MARA Cawangan Johor, Kampus Segamat, Malaysia

(E-mail: ²nurulashikin@uitm.edu.my)

³ HS Prima Resources Seremban Negeri Sembilan

(E-mail: hsprimaresources@gmail.com)

⁴ Faculty of Business and Management, Universiti Teknologi MARA Cawangan Johor, Kampus Segamat, Malaysia

(E-mail: sharazad@uitm.edu.my)

⁵ Faculty of Business and Management, Universiti Teknologi MARA Cawangan Johor, Kampus Segamat, Malaysia

(E-mail: azilajaini@uitm.edu.my)

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Abstract: *This research aims to provide information on the capital structure performance of Malaysian shariah-compliant technology companies listed on Bursa Malaysia. From 2010 through 2020, these studies used Eviews software to analyze secondary data. According to the random effect results, profitability, expansion potential, firm size, tangibility, business risk, and GDP growth are the determinants that significantly impact leverage for trading firms in the Malaysian market. Furthermore, researchers expected that shariah-compliant enterprises' power positively correlates with profitability, business size, tangibility, and GDP growth. However, there is no correlation between growth prospects and company risk when it comes to the power of Sharia-compliant businesses.*

Keywords: *Business Risk, Firm Size, GDP Growth, Growth Opportunities, Leverage, Profitability, Tangibility*

Introduction

The capital structure is a combination of debts, equity, and hybrid securities used to expand and accomplish strategic goals through investing operations and assets. Therefore, financial managers must devise an optimal capital structure that incorporates the appropriate mix of debt, equity, and internal and external financial resources from various sources (Mazhar & Nasr, 2010). As a result, businesses can achieve their long-term economic growth goals while lowering their weighted average cost of capital with the correct capital structure.

A capital structure that maximizes market value while reducing capital costs. The optimal capital structure is for stock prices and deals to rise. This study examines the relationship between leverage, profitability, and risk, as well as a set of explanatory variables, to add to the body of knowledge concerning capital structure decision dynamics. For example, prior research assesses how profitability, growth potential, asset tangibility, and business size that affecting the business's leverage (Brendea, 2014). Thus, the present study would be centered on 10 companies from the technology industry that are Shariah-compliant. This research will look at the capital structure over the eleven years, from 2010 to 2020.

Furthermore, this study aimed to look at the capital structure determinants of shariah-compliant firms in the technology sector in Malaysia. According to Zeitun and Tian (2014), capital structure is relatively related to company performance. An organization's capital structure is how it finances itself by combining long-term debt, explicit immediate debt, and equity. Thus, an organization's capital structure should be advanced to meet the firm's long-term strategy and position the company to take advantage of speculative opportunities that might determine the impact of each determinant on the influence in the same way. Table 1 presents the firms under technology Shariah-compliant in Malaysia.

Table 1: Technology Shariah-compliant Firms

Company	Nature of Business
Censof Holdings Berhad	Financial management software and services are designed, developed, implemented, and marketed by the company.
Dataprep Holdings Bhd	A company that provides IT (Information Technology) services.
Dagang NeXchange Berhad	In Malaysia's trade facilitation and energy sectors, this company is a leader.
JCY International Berhad	Hard disc drive (HDD) mechanical components are manufactured by the firm.
D & O Green Technologies	Under original equipment manufacturer contract manufacturing and captive line agreements, the firm produces and assembles semiconductor components
Elsoft Research Berhad	Elsoft primarily serves the semiconductor, optoelectronic, and automation sectors with cost-effective ATE solutions.
Hong Seng Consolidated Berhad	It is engaged in the investment holding, search and advertising, information technology, and supply chain management businesses.
IRIS Corporation Berhad	It provided technological consultation as well as digital identity and business solution deployment.
K-One Technology Bhd	It operates in the healthcare, medical, IoT, automotive, consumer electronics, and electronic end-products and sub-systems industries.
Vsolar Group Bhd	The company's major activities include renewable energy production, media publication, software solutions, and related services.

A capital design that incorporates money uses a company's resources to create a mix of obligation, value, and cross-breed safeguards. It also depicts the capitalization of a corporation. According to Yildirim et al. (2017), the shariah compliance category is still relatively new where academic studies are restricted. As a result, no maturity level has been established for establishing an Islamic capital structure theory to explain the financing behavior of these enterprises. Considering this situation, more research is required to determine what factors influence the capital structure of Malaysian shariah firms.

Therefore, this study focuses on the dependent variable, which is leverage that influenced by the independent variables (profitability, growth opportunities, firm size, tangibility, business risk, and GDP growth). The empirical study is based on a sample set of 10 publicly listed Shariah-based companies. Data was gathered from each firm's annual reports as well as other similar sources such as DataStream. The following sections discuss past literatures on all variables, methodology, results and analysis, conclusion and recommendation.

Literature Review

Capital Structure

Capital structure determinants have been at the heart of finance theory for decades. According to Fraser et al. (2006), a company's capital structure is its long-term permanent finance, consisting of long-term debt, preferred stock, common stock, and retained earnings. The two forms of funding sources for a business are liabilities and equity; according to the capital above structure theory, sales stability, asset structure, operational leverage, growth rate, profitability, and taxation influence a company's capital structure decisions (Parrino et al., 2011). Both capital structure theories use business-specific and macroeconomic factors to explain firm financing behavior. The notion behind the trade-off theory is that firms can pick their capital structure by weighing the benefits of borrowing, such as tax savings, against the downsides of borrowing, such as bankruptcy costs (Abdeljawad et al., 2013). Nonetheless, as (Dobusch & Kapeller, 2017) points out, developments in innovation and digital technology substantially impact strategic options for firms. Therefore, variables impacting corporate finance decisions must be reconsidered, particularly in high-tech industries. In addition, the industry has a significant impact on access to finance, partly because companies from other industries would be looking for funding for various reasons.

Leverage

According to (Kayhan & Titman, 2007), when the financial deficit, defined as the difference between financing demands and internal financing sources, is bigger, the leverage is higher. In other words, when the firms are successful, the leverage is lower, and when the firms have more investment opportunities, the leverage is larger (Fama & French, 2002). The capacity of managers to properly control their level of debt ratio is critical to the performance of the firm, hence leverage or debt management policy is an important part of capital structure management (Affandi et al., 2012).

Profitability

In academic research, profitability is one of the most researched leverage generators. However, different capital structure theories view the relationship between leverage and profitability differently. For example, according to the Trade-Off Theory, more profitable enterprises should employ more debt because of the tax benefit. This is due to their ability to conceal additional profits to benefit from the tax advantages of debt tax shields.

Profitable businesses have a lower anticipated cost of financial difficulty, implying that debt financing is less expensive, indicating a positive relationship. Similar conclusions were reached by (Harvey & Graham, 2002), (Deesomsak et al., 2004). On the other hand, studies by (Fama & French, 2002), (Frank et al., 2003), and others consistently show a negative relationship between leverage and profitability.

Growth Opportunities

Growth is anticipated to increase demand for domestically generated funds, forcing the company to borrow (OECD 2015). Debt ratios will be higher for companies that have had substantial expansion. High-growth enterprises are expected to demand more external investment and demonstrate higher leverage in the case of small firms with highly concentrated ownership. Organizations must change their finance sources as they develop through various stages such as micro, small, medium, and large

Firm Size

Firm size is one of those properties that produce reliable effects on utilization. According to (Pandey, 2001). A company's size is defined as the total value of its assets. Whatever capital structure theory is investigated, the impact of scale on influence is different. Larger companies with more transactions or work have more clout. An element such as the size of a corporation has a big influence on the potential to issue debt. Size may be a replacement for the efficiency of a corporation because in business, generally, huge organizations are effective. According to (Baker & Martin, 2011), larger organizations have a more diverse business portfolio, which means less cash flow volatility, fewer financial distress costs, and a reduced risk of bankruptcy than smaller businesses.

Tangibility

Tangibility, according to the Trade-Off Theory, boosts a company's leverage. Fixed assets can be converted into cash more efficiently than intangibles, providing more security as collateral for potential investors. Debtholder risk and debt costs are reduced; as a result, allowing businesses to operate with higher leverage ratios without incurring higher financial distress costs. Tangibility and firm leverage are connected, according to (Frank & Goyal, 2009).

Business Risk

Business risk refers to a company's or organization's exposure to factors that could reduce profitability or cause it to fail. According to (Ndegwa, 2001), business risk is defined as the difference between a company's operating income and expected dividends due to its operating conditions. Business risk is anything that puts a company's ability to accomplish its financial goals in jeopardy the risk of a corporation defaulting on a debt payment rises as earnings rise.

Creditors who want to provide new loans to hazardous enterprises may face steeper fines. As a result, the public's faith in creditors would be harmed. According to the Trade-Off Theory, businesses should minimize their debt volume to reduce their chances of bankruptcy.

GDP Growth

GDP is an essential indicator of a country's performance. Booth et al. (2001) recommended that economic growth be considered a leverage element. The results of previous research on GDP and leverage have been mixed. Rising businesses adopt the least debt in their capital structure to GDP. According to Booth et al. (2001), and Deesomsak et al. (2004), GDP and leverage have a positive relationship. On the other hand, noticed an opposed relationship (Arif & Mai, 2020).

Based on previous justifications, Figure 1 presented the conceptual framework derives in the study. There are six independent variables that consist of growth opportunities, profitability, firm size, tangibility, business risk and GDP growth that may influence the dependent variable which is firm's leverage.

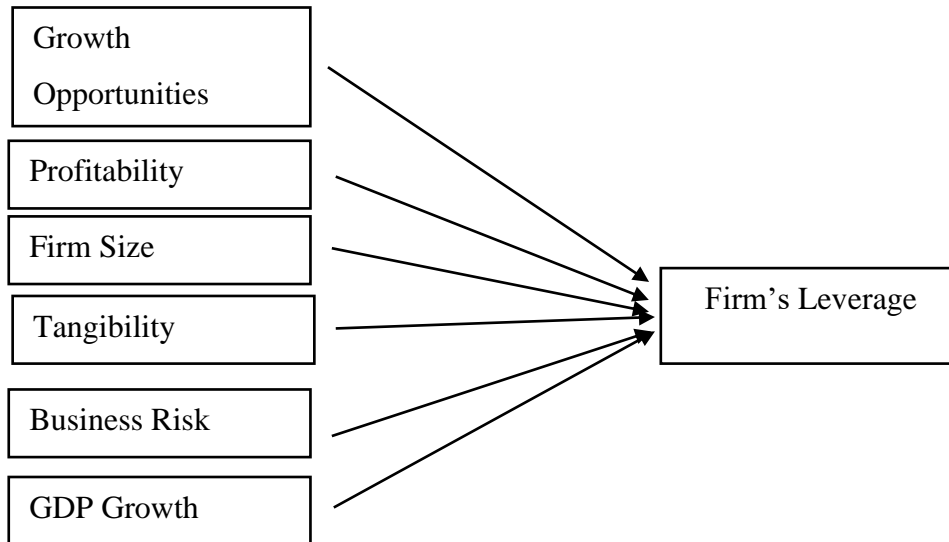


Figure 1: Conceptual Framework

Methodology

This research aims to investigate the link between the dependent variable and other variables that may affect leverage. In general, to assess the success of Malaysian Shariah-compliant technology businesses' financial structure

In this study, 10 out of 86 firms in Malaysia's technology industry are evaluated. Data was gathered from DataStream, MalaysiaStockBiz, Bursa Malaysia, and the company's annual report. The additional data sources that connect to the sample are from the World Bank's open data. The businesses were chosen based on the availability of comprehensive information over the previous 11 years. EViews 12 software was utilized in this study because it examined the data and different tests that were used to meet the study's goal and answer the research question

Data Analysis

Correlation Analysis

Correlation analysis aims to show how two or more continuous variables are related linearly. The correlation coefficient would effectively oscillate between -1 and +1. On the other hand, a zero correlation indicates that the two variables have no linear relationship. There is a positive correlation between leverage (LEV) and growth opportunities (GRWTH), firm size (SIZE), business risk (RISK), and GDP growth (GDP). However, there is a negative correlation between leverage and profitability (PROF) and tangibility (TANG).

Table 2: Correlation Analysis

Correlation t-Statistic Probability	LEV	PROF	GRWTH	SIZE	TANG	RISK	GDP
LEV	1.0000						
						
						
PROF	-0.0653	1.0000					
	-0.6205	....				
	0.5365	....				
GRWTH	0.0578	-0.1004	1.0000				
	0.5495	-0.9578	....			
	0.5840	0.3408	....			
SIZE	0.1861	0.5252	-0.2361	1.0000			
	1.7967	5.8551	-2.3054	....		
	0.0757	0.0000	0.0234	....		
TANG	-0.7014	-0.1349	-0.3044	-0.3441	1.0000		
	-9.3362	-1.2918	-3.0322	-3.4762	....	
	0.0000	0.1997	0.0032	0.0008	....	
RISK	0.1566	0.0030	-0.0224	-0.0495	-0.0027	1.0000	
	1.5040	0.0286	-0.2126	-0.4701	-0.0257	....
	0.1361	0.9772	0.8321	0.6394	0.9796	....
GDP	0.1714	0.1809	-0.0499	0.0212	-0.0146	0.0598	1.0000
	1.6507	1.7451	-0.4740	0.2016	-0.1382	0.5682	....
	0.1023	0.0844	0.6366	0.8407	0.8904	0.5713	....

The analysis shows a negative correlation between leverage and profitability with -0.0653. It may show the company's high profitability and the increased usage of power. The companies used debt to cover the cost of operating. Besides that, the probability value of PROF is 0.5365, which has no significant relationship with leverage. It is also more than the significance level of 5%. Next, there is a positive correlation of 0.0578 between leverage and growth opportunities. When businesses' expansion possibilities dwindle, they turn to debt finance for help.

Leverage and firm size have a positive association of 0.1861, as shown in the graph above. Aside from that, SIZE has a probability value of 0.0757, which is less than a 5% significance level. There is a strong link between leverage and the size of a company. These figures could indicate that the larger the business, the higher the profit return. It also plays a part in the fact that earnings must be increased for a large organization to fund its internal costs. There is also a -0.7014 negative association between leverage and tangibility. Firms with minimal tangible assets will accumulate more debt and leverage over time.

Besides that, the figure shows the positive correlation between leverage and business risk with a value of 0.1566. Increased risk equates to a higher power, with the argument being that earnings volatility will cause investors to demand a higher rate of return. The probability value of 0.1361 was more than a 5% significance level. The figure above shows a positive correlation between leverage and GDP growth, 0.171419. The greater the economic growth rate, the readier

businesses are to take on debt to fund new initiatives. Then, the probability of 0.1023 results in an insignificant relationship between the variables as more than the 5% significance level.

However, there is a distinction between profitability with growth opportunities and tangibility; the latter has a negative correlation and is insignificant when the dependent variable is leverage. The correlation between profitability with firm size, business risk, and GDP growth is 0.5252, 0.0030, and 0.1809, respectively. For a company's stability, ensuring an acceptable profit rate is critical. The figure above shows a negative correlation between growth opportunities with the other independent variables, firm size, tangibility, business risk, and GDP growth. These might show that GRWTH is unaffected by the other variables. On the other hand, there is a significant relationship between growth opportunities with firm size and tangibility, 0.0234 and 0.0032.

The negative correlation revealed by examining the relationship between firm size and tangibility is -0.3441, indicating the likelihood of a business collateral assets insufficient profits due to the size. The probability value of 0.0008 is lower than the 5% significance level. Furthermore, the negative association of -0.0495 between firm size and business risk demonstrates this shariah-compliant company's achievement in properly arranging and planning the company's stability. In contrast, there is a positive correlation of 0.0212 between firm size and GDP growth.

There is a negative correlation between tangibility with business risk and GDP growth, -0.0027 and -0.0146, respectively. The probability value of business risk is 0.9796, it more than a 5% significance level. Moreover, the GDP growth's probability value is 0.8904, more significant than the significance level of 5%. Finally, there is a positive correlation between business risk and GDP growth with a value of 0.0598. In addition, the probability value of 0.5713 is more than a 5% significance level.

Regression Analysis

Table 2: Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	40.4872	9.8508	4.1100	0.0001
PROF	-13.0968	4.9418	-2.6502	0.0096
GRWTH	-1.5560	0.6106	-2.5484	0.0126
SIZE	-0.2593	1.4115	-0.1837	0.8547
TANG	-43.3729	4.3781	-9.9067	0.0000
RISK	0.2191	0.1074	2.0399	0.0445
GDP	0.5545	0.2126	2.6079	0.0108
R-squared	0.6090	Mean dependent var	12.4317	
Adjusted R-squared	0.5814	S.D. dependent var	10.2912	
S.E. of regression	6.6584	Akaike info criterion	6.7027	
Sum squared resid	3768.4200	Schwarz criterion	6.8945	
Log likelihood	-301.3230	Hannan-Quinn criter.	6.7801	
F-statistic	22.0644	Durbin-Watson stat	0.8925	
Prob(F-statistic)	0.0000			

This regression is used to examine the relationship between two or more variables and determine if independent variables explain the influence of the dependent variable. Figure 8 shows the results of a shariah-compliant regression analysis using an 11-year observation period from 2010 to 2020. The results can be described by looking at the econometrics formula. The 50-coefficient value is employed in the econometric equation; hence the econometric procedure is as follows:

$$LEV = 40.4872 + (-13.0968) PROF + (-1.5560) GRWTH + (-0.2593) SIZE + (-43.3729) TANG + 0.2191 RISK + 0.5545 GDP + e$$

Profitability, growth potential, firm size, and tangibility had a negative relationship with leverage, whereas business risk and GDP growth had a positive relationship. As shown in the graph above, the F-statistic value is 22.06442, and the F-statistic P-value is 0.0000. The null hypothesis must be rejected because the deal has a significant level of less than 5%.

As a result, the R-squared value of 0.6090 implies that variation in the independent variables of profitability, growth opportunities, firm size, tangibility, business risk, and GDP growth account for 60.90 percent of the variance in corporate leverage. The estimated R-squared value is 0.5814, or 58.14 percent. The variability of independent variables may explain 58.14 percent of the financial firm's leverage variance, which has R-squared significance. Using each variable, a great deal of information can be clarified.

The first independent variable is profitability. The value of the PROF coefficient is - 13.09683. By assuming constant values for other factors, each one percent rise in profitability can result in a 13.10 percent loss in return for Shariah firms. The probability value is 0.0096, which is less than 5% significant. It implies that the null hypothesis must be rejected, resulting in changes in profitability that could substantially influence leverage. The findings of (Kaouther Toumi, & Jean Laurent Viviani, 2012) bolster the conclusion by demonstrating a significant relationship between profitability and capital structure as measured by the equity ratio. According to (Lartey et al., 2013), when it comes to profitability, liquid assets have a limited ability to create returns.

Second, the growth opportunities variable (GRWTH) is -1.5560. It shows that Sharia-compliant enterprises' leverage reduces for every percentage increase in growth potential. The probability figure for these variables is 0.0126, less than the 5% significance level. The null hypothesis can thus be rejected, resulting in changes in growth prospects that could have a considerable impact on leverage. According to the Pecking Order Theory, growth opportunities and power have a positive relationship. These investment prospects entail capital expenditures, which increases the company's liquidity gap and necessitates external funding, preferably short-term debt financing (Gaud et al., 2005).

Finally, the firm's size is an independent variable. According to the statistics, the SIZE coefficient for a Shariah firm is -0.259270, or -25.93 percent. For every one percent increase in business size, it assumes a 25.93 percent drop in return for the financial firm's leverage, providing all other parameters remain equal. The probability value is 0.8547, indicating a degree of significance greater than 5%. Because changes in the average firm size could significantly impact leverage, the null hypothesis should not be ruled out.

Tangibility (TANG) is the other independent variable, with a coefficient of -43.3729. It is assumed that for every one percent rise in tangibility, the return on the firm's leverage will fall

by 43.37 percent. The probability value is 0.0000, which has a significant level of less than 5%. This suggests that the null hypothesis can be rejected since changes in tangibility can impact leverage. As a result, the costs of shareholder and debtholder agencies should be lowered, and firms should use more debt in proportion to their tangible assets. According to (Frank & Goyal, 2009), Tangibility and firm leverage have a positive relationship.

Next, the business risk indicator for Shariah enterprises shows that the RISK coefficient value is 0.219059, or 21.90 percent. It reveals that there would be a 21.90 percent increase in 52 Shariah firm leverage for every percentage rise in business risk if all other factors remained constant. Business risk can also result in the tiniest shifts in power. For these variables, the probability figure is 0.0445, which is less than the 5% significance level. The null hypothesis would be rejected, and changes in business risk would result in a significant effect against leverage on Shariah enterprises. The larger the company, the more leveraged it is since banks and financial markets are more likely to lend to it (Booth et al., 2001).

GDP growth variable has a coefficient of 0.5545, which equals 55.45%. It indicates that for every one percent rise in GDP growth, the return on financial firm leverage increases by 55.45%, assuming all other parameters remain constant. The probability value is then 0.0108, which is less than the 5% significance level. Because the adjustments would considerably influence leverage, this result to the null hypothesis must be rejected. According to (de Jong et al., 2007), the faster the economy grows, the more willing businesses are to take on debt to fund new initiatives

Conclusion

Several business factors influence capital structure decisions regularly. Profitability, expansion opportunities, firm size, tangibility, business risk, and GDP growth are among the evaluation factors. First, it was shown how they interacted with the company's leverage. Following that, the predictions of critical capital structure theories, such as trade-off theories, were explored. The fundamental purpose of this study is to investigate and find the factors that influence capital structure in Shariah-compliant firms. The goal of this study is to examine the effects of six determinants. To get the best findings, we used Eviews software to run a variety of regression and test comparisons on panel data.

The shariah value for R-squared is 0.6090, suggesting that the variation in independent factors such as profitability, growth opportunities, company size, tangibility, business risk, and GDP growth accounts for 60.90 percent of the variance in corporate leverage, according to the 54 test results. As a result, the remaining 39.10 percent cannot be explained by the variables in this study. Other variables would surely help to present more information about the subject. The F statistic has a value of 0.0000. According to the study, profitability, expansion potential, tangibility, business risk, and GDP growth are essential factors in leveraging Shariah compliance variables, but firm size has the reverse effect. This is due to the inadequate and insufficient data used, which results in the variable's insignificance. According to the findings of a previous study (Yildirim et al., 2017), however, the findings are slightly different, with significant results for complaints on business size. Because it is the log of total assets, the business size is predicted to have a substantial relationship with leverage. This could be owing to the availability of company data from specific years.

The conclusions of this study may be deduced from the relationship between the dependent and independent variables. On the other hand, the study's conclusion is unexpected. This is because,

according to data, the firm size is relatively small. Shariah-compliant listed firms do not engage in debt interest to achieve tax savings on interest payments, according to (Shahzinda et al., 2015), since Shariah-compliant companies would focus more on profit and risk sharing through Islamic financing.

This study has undoubtedly shed light on the characteristics and funding structure of Shariah-compliant businesses (Rehan & Abdul Hadi, 2019). The study's objectives were to examine the performance of capital structure on Malaysian Shariah-compliant enterprises. Technology companies in the early stages of development are the sector's focus. The dependent variable is leverage, and profitability, growth potential, firm size, tangibility, business risk, and GDP growth are all independent variables

Recommendation

The study recommends for future research to delve at other factors to enrich the findings of the study. This is because there are more studies can be relatable to the capital structure. Finding more variables can assist in restructuring better shariah-compliant in the future. Hence, further study is highly recommended with additional or more variables. Additionally, it is advisable for future research to apply more observations to understand further the issue of Shariah-compliant in business environment. This is because adding more observations can give a study better result (Roslan et al., 2022). In this research, we include 11 firms of observations so it is suggested to go up for 30 or more observations. Based on Yildirim et al., (2017), they have provided over 5562 for shariah compliant and 4021 for non-shariah compliant. With more observations, the results will be more significant and enrich the existing literature in various research contexts.

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