The Effect of Firm Characteristics on Capital Structure:
An Empirical Study

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ABSTRACT

The effect of firm characteristics on capital structure has been tested for this study. Sample is randomly drawn from 60 manufacturing firms listed in the Main Market of Bursa Malaysia for a period from year 2004 to 2008 which totalling 300 data. A regression model is formed amongst one dependent variable, five independent variables, and one dummy variable to study the relationship and effect between firm characteristics and capital structure. The results reveal that firm size has a positive relation to capital structure whereas interest coverage ratio, profitability, and growth opportunities have an inverse relation to capital structure. While tangibility alone is found to be statistically insignificant correlation with capital structure, it is making a statistically significant positive unique contribution to the prediction of capital structure when combining with other firm characteristics. There is a statistically significant difference in capital structure between firms that maintain more and less than fifty percent of debt ratio. T-test results indicate that there is a statistically significant difference in firm size, interest coverage ratio, profitability, and growth opportunities between firms that use heavy debt capital and those that use less debt capital.
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<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ICR</td>
<td>Interest coverage ratio variable</td>
</tr>
<tr>
<td>DR</td>
<td>Debt ratio variable</td>
</tr>
<tr>
<td>DUM_50</td>
<td>Dummy variable for firms with more and less than 50% of debt ratio</td>
</tr>
<tr>
<td>EBIT</td>
<td>Earning before interest and taxes</td>
</tr>
<tr>
<td>EBITDA</td>
<td>Earning before Interest, taxes, depreciation, and amortization</td>
</tr>
<tr>
<td>GRO</td>
<td>Growth opportunities variable</td>
</tr>
<tr>
<td>MM</td>
<td>Modigliani-Miller</td>
</tr>
<tr>
<td>NPV</td>
<td>Net present value</td>
</tr>
<tr>
<td>PRO</td>
<td>Profitability variable</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and development</td>
</tr>
<tr>
<td>ROA</td>
<td>Return on assets</td>
</tr>
<tr>
<td>SIZ</td>
<td>Firm size variable</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small and medium enterprises</td>
</tr>
<tr>
<td>TAN</td>
<td>Tangibility variable</td>
</tr>
<tr>
<td>VIF</td>
<td>Variance inflation factor</td>
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