CHAPTER 5
CONCLUSION

5.1 Summary

Capital structure appears to play an important role in determining the value of the company. Hence a good understanding between capital structure and company performance is required by corporate policy makers in order to maximize the firm value and its shareholders' wealth. On the other hand, investors can use capital structure decisions as information to guide them in their stock selection decision.

This study seeks to investigate if there is any overall relationship between capital structure and company performance for the construction industry in Malaysia. Pearson correlation and linear regression analysis were used to test the correlation between the capital structure and company performance measured by ROE.

The results of this study shows that capital structure is negatively correlated to company performance. These relationship is significant, suggesting that capital structure is an important factor determining the company performance. Firm size was found to be not correlated to company performance. The relationship is insignificant, suggesting that firm size is not an important factor determining the company performance. Large firm size companies – both with low and high long term debt ratio shows a significant and negative relationship between company performance and capital structure decisions; wherelse, for small firm size companies, the relationship between company performance and long term debt ratio is found to be insignificant.

Corporate performance has emerged overwhelmingly as the top business priority in the minds of the management. Generally, they want to maximize the shareholders' wealth. At any point in time, the management wishes to develop or expand the business. The easiest and cheapest way to finance it is by using debt.

One often observes that firms with outstanding corporate performance use relatively little debt. One practical explanation is that very profitable firms such as Gamuda Bhd do not need to do much debt financing. Their high rates of return enable them to do most of their financing with retained earnings. In addition, it is a fact that in the recent economic crisis that hit Malaysia, firms that were negatively affected are the ones which have high debt.

This analysis suggests that capital structure is an important factor determining the company performance. This finding is consistent with expectations of the theory and also those of previous researches. Capital structure information should be used by both investors and corporate decision makers in making investment and borrowing decisions. The findings of this research indicate that there are also other determinants of company performance such as stock risk, local and world economy trends, management and policies of the company.

5.2 Limitations of the Study

The current research is not without weaknesses. One of the weaknesses is that the explanatory variable long term debt ratio may contain measurement error. Sources of this error could be the use of different accounting methods by firms to measure the same phenomenon and the estimation of variables from small sample. Moreover, the period for annual closing of accounts varies among companies. By using data of different period for comparison will not produce an accurate solution.

All the financial data obtained from annual reports has accrued basis; based on book value and might not be a good indicative of the actual market value. This might raise considerable criticism in the findings of the study.

Thirdly, the compilation of data by the sources concerned might contain error. Due to the measurement error, straightforward use of multiple regression analysis produces biased coefficient estimation.

The 5 year sample period from 1999 to 2003 may be insufficient and bias due to its short length and is not a good representative of a complete business cycle. Certain events such as the rise in oil prices and war or other political factors might affect this time period. Such events might affect the analysis resulting in inconsistency with expectations of the theory.

The use of simple linear regression analysis might not be adequate in establishing the relationship between long term debt ratio and company performance. A more advanced and complex statistical approach might be more accurate in ascertaining the relationship between this two factors.

The investigation is on the relationship between capital structure and firm size; and corporate performance of firms in the construction sector. The samples employed in the analysis are exclusively companies that are listed on the Bursa Malaysia Main Board. As a matter of fact, there are many companies and businesses, which are involved in the construction sector but not listed in the Bursa Malaysia, that are worth considered as sample. The exclusion of these companies might raise a question on the validity and reliability of the sample.

5.3 Suggestions for Future Research

It is suggested that a longer sample period is considered and monthly return are used for the analysis. The event-study methodology would give a clearer insight of the relationship between capital structure and company performance. Perhaps a more refined methodology such as correction for thinness in trading as well as multicollinearity problem could be incorporated to provide better and clearer results.

Other than capital structure, other factors such as dividend and residual variance, ownership structure, movement in KLCI Index and local and global political stability might be used as independent variables for future analysis to give a whole picture of the relationship. This will give an accurate measurement for company performance measured by this model instead of just measuring the capital structure.

As we now know, both the capital structure and company performance display a significant relationship; future research can be conducted to look into the cause and effect between capital structure and company performance.