

CAPITAL STRUCTURE AND FIRMS PERFORMANCE: EVIDENCE FROM KUWAIT

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DECLARATION

I declare that the substance of this project paper has never been submitted for any degree or postgraduate program and qualifications.

I certify that all the support and assistance received in preparing this project paper and the entire source abstracted have been acknowledged in this stated project paper.

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ABSTRACT

The purpose of this study is to examine the impact of capital structure on the performance of 192 firms listed on the stock exchange of Kuwait, covering from year 2009 to 2013. There are very little empirical studies in the existing literature that investigate the influence of capital structure on performance of Kuwaiti firms. Following previous studies, this study hypothesizes that capital structure will positively influence the performance of Kuwaiti firms. In this respect, capital structures are measured by the total debt to equity ratio (TDE) and total debt to assets ratio (TDA). Meanwhile, the performance variables are measured by the return on assets (ROA) and return on equity (ROE). This study also includes firm specific variables as control variables such as capital expenditure to sales, sales growth, and firm size. By using pooled OLS estimation, the results indicate that there is a positive and significant relationship between TDE and ROE, while TDA is negatively but significantly related with the ROE. Then, the findings show a positive but insignificant impact between TDE and ROA, whereas TDA is negatively and insignificantly related with ROA. The findings also reveal that firm specific variables such as capital expenditure to sales, firm size, and sales growth demonstrate a significant and positive relationship with the ROA and ROE.

Keywords: Firm performance, capital structure, return on equity, return on asset, Kuwait Stock Exchange.

ABSTRAK

Tujuan kajian ini adalah untuk mengkaji kesan struktur modal ke atas prestasi 192 syarikat tersenarai di bursa saham di Kuwait, meliputi dari tahun 2009 hingga 2013. Terdapat sangat sedikit kajian empirikal dalam karya yang sedia ada yang mengkaji pengaruh modal struktur ke atas prestasi firma di Kuwait. Berdasarkan kajian sebelum ini, kajian ini menghipotesiskan bahawa struktur modal akan mempengaruhi prestasi firma di Kuwait secara positif. Dalam hal ini, struktur modal diukur oleh jumlah hutang kepada nisbah ekuiti (TDE) dan jumlah hutang kepada nisbah aset (TDA). Sementara itu, pembolehubah prestasi diukur dengan pulangan atas aset (ROA) dan pulangan ke atas ekuiti (ROE). Kajian ini juga memasukkan pembolehubah spesifik firma sebagai pembolehubah kawalan seperti nisbah perbelanjaan modal atas jualan, pertumbuhan jualan, dan saiz firma. Dengan menggunakan anggaran '*pooled OLS*', keputusan menunjukkan bahawa terdapat hubungan yang positif dan signifikan di antara TDE dan ROE, manakala TDA mempunyai hubungan yang negatif dan signifikan dengan ROE. Kemudian, hasil kajian menunjukkan kesan yang positif tetapi tidak signifikan antara TDE dan ROA, manakala TDA adalah negatif dan tidak signifikan dengan ROA. Dapatan kajian juga menunjukkan pembolehubah spesifik firma seperti nisbah perbelanjaan modal atas jualan, saiz firma, dan pertumbuhan jualan menunjukkan hubungan yang positif dan signifikan dengan ROA dan ROE.

Kata kunci: Prestasi korporat, struktur modal, pulangan ke atas ekuiti, pulangan ke atas aset, Bursa Saham Kuwait.

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CHAPTER ONE

INTRODUCTION

1.0 BACKGROUND OF STUDY

Capital structure refers to the composition of a firm's liabilities and owners' equity. Capital structure decisions are one of the three financing decisions namely investment, financing, and dividend decisions that finance managers have to make (Karadeniz, Kandir, Balcilar, & Onal, 2009). The capital structure of a firm is actually a mix of different securities. In general, a firm can choose among many alternative capital structures. It can issue a large amount of debt or very little debt. It can arrange lease financing, use warrants, issue convertible bonds, sign forward contracts or trade bond swaps. It can issue dozens of distinct securities in countless combinations; however, it attempts to find the particular combination that maximizes its overall market value (Liang, Li, & Song, 2014).

In reality, establishing an optimal capital structure is a difficult task (Shoaib, 2011). He contends that a firm may require issuing a number of securities in a mixture of debt and equity to meet an exact combination that can maximize its value and having succeeded in doing so, the firm has achieved its optimal capital structure. Jensen and Meckling (1976) demonstrates the amount of leverage in a firm's capital structure affects the agency conflicts between managers and shareholders and thus, can alter manager's behaviors and operating decisions. This position is agreed by Harris and Raviv (1991); Graham and Harvey (2001); Ebaid (2009). It is obvious that, the decisions on finance that led to a certain suboptimal financing and capital structure decisions can result in firm failure (Mwangi, Makau, & Kosimbei, 2014). The existence and achievement of an optimal capital structure is of great concern for investors and management of firms. Therefore, since the goals of all financing decisions is to maximize

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