The impact of liquidity on the capital structure: evidence from Malaysia

ABSTRACT

For many years, liquidity of a company's asset and its effect on the optimal debt level has been a controversial issue among scholars in finance studies. Prior studies have demonstrated that in some countries, asset liquidity increased debt level while in other countries liquid companies were less leveraged and more regularly financed by their own capital. This study investigates the effect of liquidity on the capital structure among the 300 listed companies in the Main market of Bursa Malaysia from 200 to 2013 fiscal years. Pooled OLS is applied to investigate the impact of liquidity ratios on different Debt ratios. Liquidity of a company, which is the independent variable of this study, is measured by two common ratios which are: quick ratio and current ratio. Additionally, the Debt/Equity and Debt/Asset ratios represent the capital structures based on the short-term, long-term and total debt. The results show that all the measures of liquidity have significant impacts on all the proxies of leverage. According to the results, Quick ratio has a positive effect on leverage; although, Current ratio is negatively related to leverage. Moreover, short-term debt is more influenced by liquidity compared to long-term debt.

Keyword: Bursa Malaysia; Capital structure; Current ratio; Liquidity; Quick ratio