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Capital Structure and Firm Performance: Evidence From Food Processing Industry in Malaysia

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Abstract

Despite numerous debates on the relationship between the capital structure and the firm performance, there is still lack of study focusing on the food processing industry, which is considered a nation contributor towards the economic growth especially in developing countries. Therefore, this study attempt to obtain empirical findings on the relationship between the capital structure and the firm performance among the food-producing firms in Malaysia for the year 2007 to 2016. The panel data analysis in this study has found that all variables in this study have a significant relationship towards firm performance. This study could contributes in such a way to fill the gap in the literature with regard to the study on capital structure and performance by highlighting such issue to the processing firm in Malaysia.

Keywords: Capital structure; Leverage; Food processing industry; Firm performance; Agency cost theory.

1. Introduction

A good firm does not exist just in a vacuum but instead, the firm must have a well-functioning capital structure itself in order to maintain the wellbeing of its performance. According to Joshua (2005), a big argument on the issue of under a tight assumptions of perfect markets, capital structure is irrelevant in order to determine a firm value and future performance. However, these restrictive assumptions do not hold in the real world, which lead many researchers to introduce additional rationalization for this proposition and its underlying assumptions showing that capital structure affects firm's value and performance. For instance, the amount of leverage in a firm's capital structure affects the agency conflicts between managers and shareholders by constraining or encouraging managers to act more in the interest of shareholders and, thus, can alter manager's behaviors and operating decisions (Iavorskyi, 2013). According to Roshan (2009), we are far from reaching a consensus on the perfect combination between the relation of capital structure and firm performance but most of the previous study prove that, capital structure has more valuable issue than the basic Modigliami-Miller model.

Despite numerous prior study on capital structure and performance, there were still lack of the said relationship focusing on a specific industry of food processing industry, especially in Malaysia. The important role of the food processing industry to an economy has been widely reported. Morrison (1997) noted that the food processing industry was a major force affecting the economic performance of industries in the USA. As for Malaysia, the food processing industry considered a siginificant and potential sector with number of oppurtunity especially in investment. However, during the period of 2000 until 2006, the food processing industry in Malaysia experienced a negative total factor productivity growth of -1.3 percent, which was mainly caused by the lack of technological change (Mad *et al.*, 2011). The significance of growth issue in this industry within Malaysia and its role as a major driver towards economics performance has lead this study to focus on such industry. Hence, this study attempt to investigate the effect of capital structure on firm performance among the food processing industry in Malaysia.

2. Literature Review

Capital structure and performance has long been argued from number of prior literature. The generation of such relationship developed from different theories. This study would focus on agency cost theory to better understand the behavior of management. Later, the relationship between capital structure and performance are explained separately for each measurement of capital structure, namely leverage, age and size of the firm. Finally, this section includes the discussion on the importance to focus on food processing industry.

2.1. Agency Cost Theory

The agency theory concept was initially developed by Berle and Means (1932), who argued that due to a continuous dilution of equity ownership of large corporations, ownership and control become more and more

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