



FACTORS INFLUENCING ENTERPRISE PERFORMANCE OF SMALL AND MEDIUM SIZE ENTERPRISES (SMES) IN MALAYSIA

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Abstract:

In this research, SME business owners, top management, shareholders and financial managers are recommended and additionally implicit that they have direct involvement in the financial decision making of the respective enterprise, specifically in selecting debt or equity financing options. The design of the sampling technique is depicted trailed by the discussion of research instrument development. The sample size of a total of 210 respondents who met the predefined characteristics to contribute the insightful information related to corporate finance among SMEs in Malaysia. The findings revealed that a positive relationship exists between productivity and enterprise performance, as well as between enterprise size and enterprise performance. Likewise, there is a positive relationship between enterprise expansion and enterprise performance, as well as enterprise age and enterprise performance. Finally, a positive relationship has been identified between asset tangibility and enterprise performance. This study implies a new research framework consists of enterprise productivity, enterprise age and growth, working capital, enterprise size and asset tangibility as the determinant of capital structure decisions towards enterprise performance.

JEL: L10, L20, P12, D24

Keywords: capital structure decisions, enterprise performance, small and medium size enterprises (SMEs), Malaysia

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1. Introduction

SMEs denote one of the critical sources of world economic growth in both developed and developing countries. As such, SMEs are considered the backbone of the economy. Senderovitz (2009) pointed out the definitions of SME apply differently across the countries and regions despite different criteria for at least one or more than more criteria in terms of several employees, annual revenue, total assets or liabilities of the enterprise (Azam and Moha Asri, 2015; Tham et al., 2017; Udriyah et al., 2019; Al Shehhi and Azam, 2019a; Tao et al., 2019).

Capital is fundamental and recognizes as a pool of fund available for a enterprise. It is equally vital to every enterprise regardless of its enterprise size, sector and age. Capital represents a substantial financial value, assets and wealth, which include cash, fund, equipment, and investment portfolio and production plants. The capital structure of a enterprise can be partitioned into two major groups, particularly debt and equity financing. Equity financing arises when an enterprise offers some of its ownership rights to raise capital for further growth, expansion and investment activities. Debt financing is a legally binding contract, where an enterprise undertaking borrowing loan and the obligation to repay with interest rate within designated tenure (Haque et al., 2014; Rachmawati et al., 2019; Tarofder et al., 2019; Al Shehhi and Azam, 2019b).

An ideal capital structure is an essential choice of the financial decision in any enterprise. The choice of debt or equity is not just to increase shareholder wealth, but it has also affected the enterprise's capacity in financial management (Azam et al., 2014; Haur et al., 2017; Tarofder et al., 2017; Katukurunda et al., 2019; Chong et al., 2019). In the past 60 years, capital structure theory was associated with the enterprise's financial decision and argued the impact towards the enterprise performance significantly with several determinants. The financial crisis of the global economic downturn had severely affected all sectors across the board, and many SMEs are under intense financial pressure to sustain the business operations and make repayment to their creditors. Additionally, the weakening of Malaysia Ringgit currency and China economy slow down were causing a higher cost of imported goods risen by 150%, thinner profit margin and less profitable to all the business (Edward & Khawari, 2018). Therefore, many corporate customers demand longer credit terms or delay in making payments that place additional pressure on the survivability of SMEs due to the insufficient working capital.

2. Literature Review

The concerns of financial decision are only affecting the distribution of income, not a proportion of its capital structure. Thus, Modigliani and Miller concluded there is a perfect capital market with no optimal capital structure, as the value of the enterprise and the cost of capital are independent and irrelevant to financial decisions. However, Arnold (2008) pointed out that Modigliani and Miller ignore the factor of tax shield and financial distress in composing a perfect world. Unlike to the MM theory of the whole market, Kraus and Litzenberger (1973) proposed the trade-off theory with associated two

essential factors of tax shield and financial distress cost or bankruptcy cost of debt. It explained the balance between cost and tax benefits of debt constructs a balanced capital structure without overtrading or being entirely debt financed. Because of the trade-off theory, an ideal debt ratio is always expected by the enterprises (Jalilvand & Harris, 1984). Many research papers support trade-off theory and agree it is more accurate and work practices in today's imperfect, yet the dynamic capital market world (Jayasuriya and Azam, 2017; Dewi et al., 2019; Nguyen et al., 2019; Kanapathipillai and Azam, 2019; Gunasinghe et al., 2019).

Jensen and Meckling (1976) developed an agency theory and considered a conflict of interest between a manager or owner and shareholders due to rising agency costs of debt and equity, also cost of operating in the enterprises include financing and investment activities. It eventually will lead to a decline in corporate performance and imbalance capital structure. Pecking order theory was pioneered by Steward Myers (1984) in the study of optimal capital structure between debt and equity financing. Myers highlighted that most of the enterprises have similar financing preference in order with its internal source of finance with retained earnings as initially, then borrowings or bond issuance and lastly with equity securities issuance. Therefore, Tudose (2012) summarized that the majority of profitable enterprises are negatively associated between capital structure and enterprise performance because of select less debt and rely more on the internal source of finance.

The concept of the life cycle has a valuable history in economics, and the financial profession as The Ramsey Growth Model or The Ramsey Model was first initiated by a British mathematician and economist, Frank P. Ramsey in 1926, then completed by David Cass and Tjalling Koopmans in 1965. Later, Ramsey model is known as Ramsey-Cass-Koopmans model. The significant improvement of the life cycle concept expanded in a few decades and the adoption of this concept was shaping in more enormous than ever disregard to the line of discipline. For instance, the established theory of product life cycle was defined and popularized by an American economist and professor of Harvard Business School, Theodore Levitt in his article entitled "Exploit of Product Life Cycle" in 1965. A year later, another American economist, Vernon (1966), formulated a product life cycle model in a marketing context. Over the past decades, SMEs seek funding through their business life cycle, from seed financing throughout start-up, in the course of growing and maturity stage. SMEs cope with substantial difficulties in getting to financial access, consequently restricting their capacity to accelerate business growth. SMEs have specific financial needs at a different stage (Maghfuriyah et al., 2019; Pushpakumara et al., 2019; Al Shehhi and Azam, 2019c).

The failure rate of an enterprise start-up is regularly high, in particular, SME sector, for instance, inadequate visualization or unrealistic trade plan. Later, it probably is putting SME into rapid bankruptcy when unable to manage the cash flow to meet its financial commitments. Aside from individual assets and open finance sources, SMEs have to access to additional sources of fund to raise extra working capital such as microfinance, grants, angel investors and venture capital to sustain their business

survival (De Silva et al., 2017; Kuruwitaarachchi et al., 2019; Pambreni et al., 2019; Fernando et al., 2019).

A study by Shyam-Sunder and Myers (1999) claimed that the pecking order theory predicts the effects of proceeds accurately. Though Fama and French (2002) and Frank and Goyal (2003) pointed out that the theory has a couple of different impairments too. As of now, it is now that much in supporting the enterprise's financial resources. Pecking order theory additionally clarifies that the asymmetric information and the hypothesis that costs and advantages as far as tradeoffs are less critical when contrasted with the costs identified with new securities issuance. The transaction costs associated with external finance treat as a crucial element in selecting the source of funding, which usually higher than debt transaction costs (Baskin, 1989). On the other hand, Holmes and Kent (1991) and Hamilton and Fox (1998) reviewed that managers have always dictated the control over enterprises because they commonly do not acknowledge new shareholders and attempt to fund their investments with accessing internal finance. Alternatively, the enterprise will fund the business without limitation of management control if they have ample of funding internally.

According to Financial Sector Blueprint 2011-2020 by BNM (2013), the objective of financial ecosystem is to increase the nation's GDP to 41% and exports to 23% in 2010 with the successful implementation of government initiatives programs to continue to drive the areas of technology, access to financing, infrastructure, human capital, innovation, legal and regulatory condition. Ultimately, SMEs continue to contribute and endure the economic growth in Malaysia.

This research model of capital structure decision determinants is motivated by several researchers (Zabri, 2013; Kariuki & Kamau, 2014; Farhan *et al.*, 2018; Eddie *et al.*, 2018; Lisboa 2017; Siddik *et al.*, 2017) to further clarify the consequences between determinants of capital structure decisions and enterprise performance. Thus, research hypotheses were formed in correspondence of the research gap and constructed on the initiated theoretical model or conceptual framework (Saunders *et al.*, 2009). These hypotheses testing examine the relationship between the determinants of capital structure decisions influencing the enterprise performance of SMEs in Malaysia from a financial perspective. The hypotheses, in connection with the impact of capital structure decisions, were tested to accomplish the research objectives. There are five non-directional hypotheses have been created for this study.

H₁: There is a positive relationship between Productivity (PD) and Enterprise Performance (EP).

H₂: There is a positive relationship between Enterprise Size (ES) and Enterprise Performance (EP).

H₃: There is a positive relationship between Enterprise Expansion (EE) and Enterprise Performance (EP).

H₄: There is a positive relationship between Enterprise Age (EA) and Enterprise Performance (EP).

H₅: There is a positive relationship between Asset Tangibility (AT) and Enterprise Performance (EP).

2. Research Methodology

There are two kinds of variables available in this study, which are independent variables and dependent variable to create a robust conceptual framework and hypotheses testing. The primary interest of the research is the dependent variable, and its objective is to clarify or predict the fluctuation (Norwood, 2010; Burns *et al.*, 2015). The primary dependent variable of this study would be the enterprise performance. Despite this, independent variables radically impacted the dependent variables in two ways, either positive or negative contrarily, which accounted for the degree of variability independent variables of the research (Polit & Beck, 2010). There are five independent variables focuses in this study, which serves as determinants of capital structure decisions such as productivity, enterprise size, enterprise expansion, enterprise age and asset tangibility to be examined the significant impact on the dependent variable, enterprise performance of SMEs. This study concentrates on the importance of understanding the financial gaps and determinants of capital structure decisions in influencing the enterprise performance of SMEs in Malaysia.

The quantitative research approach focuses on utilizing the standard questions as an instrument and options of prescribed answers in the structured questionnaire that is being directed to a group of participants to respond in the survey. In this study, the research instrument requires respondents who have specific knowledge, a good understanding of the financial position, treasury, budgeting, policies and capital structure by having direct access to the financial information about the enterprise. It is imperative in selecting the right respondents who fulfil the criteria to ensure the responses provided are substantially accurate and useful (Sekaran & Bougie, 2018). Therefore, SME business owners, top management, shareholders and financial managers are recommended and additionally implicit that they have direct involvement in the financial decision making of the respective enterprise, specifically in selecting debt or equity financing options.

The design of the sampling technique is depicted trailed by the discussion of research instrument development. In this research, SME business owners, top management, shareholders and finance managers are the individuals who can furnish the desired information and contextual insights. Additionally, Bernard (2002) and Lewis and Sheppard (2006) highlighted that purposive samples are explicitly predefined based on their expertise, size of the enterprise, the management level of involving corporate finance, business sector and financial knowledge within the population of SMEs in Malaysia. Therefore, the preliminary identification and selection of subjects are well informed of the sample characteristics and the phenomena of this study.

3. Results and Discussion

This study examines the existence of a relationship between variables of capital structure decisions under study and enterprise performance from a financial perspective. The five research hypotheses based on a conceptual framework are tested and aimed to develop

some critical dimensions of achieving optimal capital structure among SMEs in Malaysia. This study utilized the statistical techniques, specifically descriptive statistics on frequency summary and analyzed to profile of both respondents individually and company profile. The demographic profile of the total of 210 respondents who met the predefined characteristics to contribute insightful information related to corporate finance among SMEs in Malaysia. They are mainly SME business owners, top management, shareholders and finance managers who can furnish the desired information and contextual insights with the phenomena of this study.

Together these variables of company information provide a useful analysis of descriptive statistics in this study. It itemizes the data collected by the number of frequency and percentage based on the definition of SME in Malaysia. The highest score of the mean is 4.94, and the item involves the easiness to access bank loan when the enterprise has more collateral. This item was developed under the independent variable of asset tangibility in capital structure decision, and it also has the lowest standard deviation value at 0.252.

In contrast, the item of the dependent variable to assess the enterprise return on equity (ROE) showed the lowest mean at 4.49 and the highest standard deviation at 0.572. From the data, there is no item having the same mean score in the descriptive analysis. The result indicates that most of the respondents were well aware of the importance of asset tangibly for capital structure decisions in corporate finance management.

Table 1: KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy		.823
	Approx. Chi-Square	6834.825
Bartlett's Test of Sphericity	Df	703
	Sig.	.000

In Table 1, the KMO result shown at 0.823, which 82.3% and close to 1 and is excellent. The KMO analysis remained much satisfactory with return a very favourable value exceeds of 0.8, which is the high adequacy of the sample. In terms of Bartlett's test of sphericity, Table 1 shows the result of the significance level at .000, which is durable and favourable in this study. The result presented that there is a significant and robust relationship among the items, and the data are sufficient for factor analysis. The analysis of reliability is to demonstrate the degree of consistency between several items, measures or assessment with one another.

Table 2: Reliability Analysis (n=210)

Constructs	Cronbach's Alpha	N of Items
Productivity (PD)	0.767	6
Enterprise Size (ES)	0.891	6
Enterprise Expansion (EE)	0.809	6
Enterprise Age (EA)	0.771	6
Asset Tangibility (AT)	0.871	6
Enterprise Performance (EP)	0.885	8
Overall	0.953	38

As shown in Table 2, the reliability analysis of Cronbach's alpha of each construct was conducted and fell between the range of 0.767 to 0.891, particularly productivity (PD) at 0.767, enterprise size (ES) at 0.891, enterprise expansion (EE) at 0.809, enterprise age (EA) at 0.771, asset tangibility (AT) at 0.871 and enterprise performance (EP) at 0.885 respectively. The overall Cronbach's alpha is 0.953 for 38 items in 6 constructs, which is above 0.7 and indicates that all scales had a high degree of internal consistency reliability of the instrument. All the items are tested and well correlated with other items in the construct. The results of the Kolmogorov-Smirnov test and Shapiro-Wilk test were more significant with a p-value less than 0.001, which shows that the scores of variables were mostly unique and not being distributed normally. This critical outcome can be clarified by the large samples used in this research.

Besides, a Mann-Whitney U test was performed to test the hypothesis between determinants of capital structure decisions and enterprise performance. The results of the test were in the predicted direction and significant. The range of average rank is falling between 87.42 and 95.94. In terms of mean ranks, obviously asset tangibility rank much higher compared to the other variables.

On the other hand, the p-value of the Kruskal Wallis test is 0.000, which is less than 0.05. Therefore, there is no significant impact between the determinants of capital structure decisions and enterprise performance.

A correlation analysis is conducted to test the existence of a multicollinearity issue within independent variables. This statistical assessment uses the correlation coefficient among the explanatory variables exhibited in a correlation matrix table. The issue of multicollinearity arises when there are more than two variables exceedingly correlated with each other.

Table 3: Correlation Coefficient Matrix of Determinants of Capital Structure Decisions

Variable	Enterprise Size	Enterprise expansion	Enterprise Age	Asset Tangibility	Enterprise Performance
Productivity	0.595	0.744	0.682	0.749	0.619
Enterprise Size		0.561	0.491	0.651	0.652
Enterprise Expansion			0.804	0.753	0.570
Enterprise Age				0.708	0.613
Asset Tangibility					0.490

As per Pallant (2011), the indication of multicollinearity occurs if the correlation coefficient, *r* value is above 0.9 and close to 1 among two continuous independent variables. Table 3: shows the correlation coefficient, *r* value falls in between 0.490 to 0.804, which means the issue of multicollinearity is not critical, and it is acceptable.

Besides that, some measures of data collinearity with variance inflation factors (VIF) and tolerance statistics. The output of regression presents the VIF values fall in between 1.830 and 3.853, which are all great below 10. Meanwhile, the lowest tolerance value is 0.260, which is more than 0.2. Hence, the low level of multicollinearity does not lead to the issue of multicollinearity within the data in this study.

The results of the correlation coefficient present that productivity has a significantly positive impact on enterprise performance. Company income yield and company enterprise expansion affect enterprise performance positively. Based on the correlation coefficient of enterprise size and enterprise performance, the older of the enterprise age has a significant impact on enterprise performance. The result also confirms that the association between enterprise age and enterprise performance are positively related. As illustrated, the coefficient between asset tangibility and enterprise performance is positive and much significant, which indicates an increase in collaterals caused an expansion of capital structure decisions and financial performance. The multiple regression analysis is a method for anticipating a result variable from one or few indicator variables.

In this study, multiple regression is the primary analysis performed to create a model in predicting the enterprise performance of SMEs from a set of selected capital structure decisions determinants. As presented, the results of the regression model revealed that all the determinants of capital structure decisions are fundamentally impact on the enterprise performance of SMEs in Malaysia. The significance value is less than 0.05. In perspective of these outcomes, the conclusion of regression analysis is to confirm the testing of five hypotheses in this study. Moreover, this study employed correlation analysis and regression analysis, particularly the Pearson correlation technique and multiple regression.

Table 4: Results of Hypothesis Testing

H _x	Hypothesis	Result
H ₁	There is a positive relationship between Productivity (PD) and Enterprise Performance (EP).	Accepted
H ₂	There is a positive relationship between Enterprise Size (ES) and the Enterprise Performance (EP).	Accepted
H ₃	There is a positive relationship between Enterprise Expansion (GR) moreover, Enterprise Performance (EP).	Accepted
H ₄	There is a positive relationship between Enterprise Age (EA) and Enterprise Performance (FP).	Accepted
H ₅	There is a positive relationship between Asset Tangibility (AT) and Enterprise Performance (EP).	Accepted

The results of the hypothesis testing of five hypotheses are accepted in this study. Remarkably, the result reports the hypothesis that one has a significant correlation. It indicates the impact of enterprise size in capital structure decisions determinants is substantially influenced the enterprise performance among SMEs in Malaysia.

4. Conclusions and Managerial Implications

The result of study outlines the evidence on the relationship between determinants of capital structure by identifying the determinants of capital structure decisions towards enterprise performance among SMEs in Malaysia. The primary objective of this study is achieved and significant influences between capital structure decisions and financial

performance, as well as filling up the research gap of SME capital structure decisions appropriately.

The finding proves that productivity is positively associated with enterprise performance (Shyu, 2011; Ting & Lean, 2011; Muzir, 2011; Ghazouani, 2013; Alani & Alamri, 2015; Farhan *et al.*, 2018; Mota & Moreira, 2017; Lisboa, 2017). It indicated that productivity is one of the critical determinants of capital structure decisions. In general, majority of SMEs are more favourable with an internal source of finance, and external sources of finance like debt and equity are aims to accelerate their performance and business expansion, which in line with pecking order theory.

The statistical analysis showed enterprise size is constructively related to the enterprise performance (Ting & Lean, 2011; Muzir, 2011; Wellalage & Locke, 2015; Farhan *et al.*, 2018; Eddie *et al.*, 2018; Ying *et al.*, 2018; Shambor, 2017; Lisboa, 2017; Siddik *et al.*, 2017). It is incredibly vital for SMEs to understand the difference and drawbacks of each source of fund in the capital structure in accordance to their size and phase of the business life cycle before securing the most cost-effective source to finance their business plan and expansion.

The study found the relationship between enterprise expansion and enterprise performance is positively related to the enterprise performance, which aligned with previous studies (Qayyum, 2013; Kariuki & Kamau, 2014; Acaravci, 2015; Alipour *et al.*, 2015; Ying *et al.*, 2018; Shambor, 2017; Lisboa, 2017; Siddik *et al.*, 2017). It explains most of the SMEs whom with better growth opportunities will have greater access to finance and more sources in selecting financing options compared to low growth enterprises in Malaysia.

According to the findings of this study, enterprise age of the capital structure determinant is positively associated with the enterprise performance of SMEs in Malaysia (Saarani & Shahadan, 2013; Zabri, 2013; Wellalage & Locke, 2015; Mota & Moreira, 2017; Shambor, 2017; Lisboa, 2017). It justifies that the older of the enterprise age, the higher creditworthiness and better historical records that provide a more significant reputation and trust to financial institutions.

This study proves a positive relationship between the asset tangibility and enterprise performance (Ibrahim & Masron, 2011; Ghazouani, 2013; Siti & NurAinna, 2014; Alani & Alamri, 2015; Alipour *et al.*, 2015; Berkman *et al.*, 2018; Mota & Moreira, 2017; Shambor, 2017). Asset tangibility serves as an essential determinant of capital structure decision because it influences the enterprise's opportunity in obtaining funding of capital. It also uses as collateral to secure debt and lenders are more willing to supply finance.

This study implies a new research framework consists of enterprise productivity, enterprise age and growth, working capital, enterprise size and asset tangibility as the determinant of capital structure decisions towards enterprise performance. Furthermore, it provides several implications to academia, SMEs and policymakers in Malaysia, also empower SMEs to have a better understanding of the impact on between financial preference and financial access in the market. The implications give some supportive

recommendation to other SMEs in dealing with capital structure concerning the enterprise performance productively.

The limitation of this study is the issue with some SME enterprises in the sample set which embrace several accounting policies. For instance, the period of yearly closing account is not the same among the SMEs. The different accounting policies and different period of the year closing account may affect the precision of the results. Thus, the time-series data collection method is suggested to obtain a more precise and accurate result in assessing enterprise financial performance.

Another limitation of this study was that the respondents were only covered six states, namely Kuala Lumpur, Selangor, Perak, Penang, Melaka and Johor, instead of every state. Future research can consider generalizing the results by expanding to the entire Malaysia. In the SME context, inaccessibility of financial information is one of the critical limitations in the study of capital structure, especially in emerging countries. Thus, considerably more work will need to be done by conducting a comparative study of capital structure with two different legal status of the company, for instance, private limited companies and ACE listed companies to the extent of liability, corporate governance and financial preference. The future study of capital structure, corporate governance and economic factors will expand the literature with a better understanding of the influences of economics in making financing decisions. Another possible area of future research would be to investigate the liability and personal risks of SME business owners given owner equity and level of management control.

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