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The Effect of Leverage and Liquidity on the Companies' Performance

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Abstract
Purpose: To analyse the relationship between leverage and liquidity and the companies' performance in Malaysia
Design/methodology/approach: All data analyzed by using Spss and methods of analysis are correlation analysis and regression analysis.
Findings: The empirical results show that the liquidity and leverage are significant with the performance of the company.
Research limitations/implications: not applicable
Practical implications: not applicable
Originality/value: This study thus implies that liquidity and leverage are significant with the performance of the company.

Keywords: liquidity, leverage, ROA

Introduction

The companies usually have difficult decisions to make between profitability and risks. Firms are exposed to risks and challenges that could reduce profitability performance. Profitability performance is the ability of company management to distribute and manage resources efficiently. (Zulkipli, 2019). The company used fixed income securities like preference capital and debt as financial leverage and liquidity is the ability to resolve current debt with current assets. Dilpreet (2018). Meanwhile, Sumani (2020) studied the capital structure and liquidity on corporate performance for 182 manufacturing companies listed on the Indonesia Stock Exchange in 2010-2019. They indicated that capital structure has a significant negative effect on corporate performance, but liquidity policy has no significant effect on corporate performance.

Many researchers and academicians have studied selected firm characteristics such as leverage, and liquidity on firm performance measured by profitability (ROA). (Mahfoudh 2013). Almajali (2012) indicated that the importance and challenges for companies' performance are liquidity and leverage risk. Zulkipli (2019) discovered that significant relationships exist between financial leverage and liquidity on firm profitability. Chesang (2017) found that debt to equity ratio and the current ratio has a significant effect on agricultural firms in Nigeria. Hence, the main objective is to analyze the significant relationship between liquidity and leverage on company profitability.

1. To examine the relationship between leverage and liquidity on company performance.
2. To examine the impact of leverage and liquidity on company performance.

Literature Review

Kyule (2015) found that liquidity could influence the profitability of firms in Kenya. Karani (2014) indicated that there is a positive relationship between profitability and liquidity management of commercial banks in Kenya. Rudin (2016) proved that leverage and liquidity have a significant effect on company performance (ROA). According to research by Jahan

(2017) used regression model, found that leverage and liquidity has a statistically significant impact on the firm's profitability. Reddy (2018) analyzed the relationship with the impact of financial leverage and liquidity on the financial performance of select pharmaceutical companies in India. The study revealed that no significant impact of leverage and liquidity on profitability.
Then, Ansari (2020) investigated the leverage and efficiency of a firm are positively and significantly related to ROE, while on the contrary, liquidity has significant negative relationship with ROE. Overall, profitability, leverage, efficiency and liquidity play a significant role and contribute to variation in ROE of a firm in Indian IT companies listed on National Stock Exchange. Dakua (2019) stated that leverage and liquidity carry positive relationship with profitability.
Research done by Akinlo (2012) showed that leverage has a negative effect on profitability. Duca (2012), Mahfoudh (2013), and Mulyana (2018) proved that leverage positively affects the return on assets used the regression analysis. The result revealed a positive relationship and a significant impact of liquidity and leverage on the financial performance of commercial state corporations in Kenya. (Suhaila, 2014). Tangut (2017) examined the effect of financial leverage with stock return in Nigeria. Empirical results indicated a negative relationship between leverage and ROA in Nigeria during the research period. Almajali (2012) with their studies on the financial performance of Jordanian insurance companies. The study indicates the positive relationship between liquidity and profitability.

Method
Data was collected from the 21 manufacturing and construction companies at the Bursa Malaysia between 2014 and 2018.

INDEPENDENT VARIABLE → DEPENDENT VARIABLE

Liquidity
Leverage

→

Company Performance
(ROA)

This study is tested the relationship between liquidity and leverage with company performance.
The formula of multiple regression equations:
P =a +B1 X1 +B2 X2 +e

Whereby;
P = company performance
a = constant
B = independent
e = error

Hypothesis 1

H1: there is a significantly relationship between liquidity and leverage with the profitability.

Hypothesis 2
H2: there is a significantly impact of liquidity and leverage with the profitability.

Findings
Regression

Table 1: Coefficients

Model	Unstandard. Coeff. B	Unstandard. Coeff. Std. Error	Standard Coeff.. B.	t	Significance.
(Constant)	3.067	1.113		2.755	0.007
CurrentRatio	0.041	0.019	0.102	2.096	0.039**
DebtRatio	-5.618	2.516	-0.108	-2.233	0.028**
r-square	0.788				
Adj. r-square	0.754				
F-Statistic	107.455				
Probability	0.000				

Notes: ** denotes significant at 0.05

Table 1 indicated that all variables significantly explain at 75.4 percent of the variation. The result showed the current ratio p value = 0.039 < 0.05 and Debt Ratio p value = 0.028 < 0.05 have significantly affect with company performance. Supported by Dakua (2019) and Karani (2014). Therefore, H2 are accept for liquidity and leverage with the profitability.

Correlation Analysis

Table 2: Correlation analysis

	ROA	**Current Ratio**	**Debt Ratio**
ROA	1	0.342** 0.003	- 0.234** 0.003
Current Ratio	-0.342** 0.003	1	0.056 0.356
DebtRatio	-0.234** 0.003	0.056 0.356	1

Notes: ** denotes significant at 0.01

Table 2 shows current ratio, ROE and debt ratio have relationship with company performance supported by Ansari (2020) and Mulyana (2018). Therefore, H1 are accept for liquidity and leverage with the profitability.

Discussion and Conclusion

This study indicated a significant relationship between liquidity and leverage with profitability. The liquidity has a positive relationship with profitability and leverage has a negative relationship with profitability. This empirical result supported by Dakua (2019) and Tangut (2017). The correlation test shows that liquidity and leverage have a significant relationship with profitability. This result supported by Reddy (2018). Apart from that, there is a substantial impact between liquidity and leverage with profitability supported by Ansari (2020) and Mulyana (2018). This study recommended that the company should keep a maximum capital structure to ensure any rise in debt and equity will raise performance company.

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