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Tax Efficiency and Capital Structure Dynamics: Unveiling the Drivers of Financial Performance in Malaysia's Telecom Sector

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Abstract

This research investigates the influence of the Effective Tax Rate (ETR) and capital structure (CAPS) on the financial performance (FP) of telecommunications companies listed in Bursa Malaysia. The analysis utilizes a sample of 52 firms data form 2011-2023. The study employs both ordinary least squares (OLS) regression and fixed effect models to investigate the links between effective tax rate (ETR), debt ratio (DR), long-term debt (LTD), asset tangibility (AT), and firm size (FS) in relation to return on assets (ROA). The findings demonstrate that ETR exerts a substantial negative impact on ROA, but DR exhibits a considerable positive correlation. LTD demonstrates a favorable effect on ROA in the OLS model, however it shows a negative effect in the Fixed Effect Model. AT and FS exhibit inconsistent and negligible impacts among models. The results indicate that proficient tax administration and smart loan usage are essential for improving FP in the telecommunications industry. The research underscores the necessity for a sophisticated strategy for long-term financing and the significance of accounting for sector-specific variables. These insights can assist managers and policymakers in making educated decisions to enhance financial results.

Keywords: Effective Tax Rate, Telecom Sector, Debt Ratio, Long-Term Debt, Regression

Introduction

Although the term "telecommunication" originally referred to telephone services, it can also refer to communication across a distance via cable, phone, telegraph, broadcasting, and other means (Kolluru & Reddy, 2021; Ryzhov, 2020). Information transmission is another name for telecommunication (Gündüz et al., 2022). These days, the telecom services sector is expanding globally. Every nation in the globe understands how vital telecommunications services are to its citizens, and advancements in telecommunications follow the rise of mobile devices and communication technology (Enebeli, 2024; Meese & Wilken, 2024). With only adequate telecommunications, users can work with anyone in the world and remain linked on a global scale without having to travel (Akyildiz et al., 2020).

The telecommunications industry in Malaysia functions competitive and capital-intensive landscape (Krishna, 2013). It is essential for the economic development of any nation by promoting connectivity, innovation, and competitiveness. The telecom business in Malaysia has undergone substantial growth, propelled by technology innovations, governmental legislation, and rising consumer demand for digital services (Wong et al., 2016). This dynamic sector encounters issues with financial management and sustainability, especially in optimizing its CAPS and controlling tax liabilities. The effective tax rate (ETR) and a company's CAPS are essential financial elements that profoundly impact corporate FP. Similarly, attaining optimal FP necessitates a balance between debt and equity financing, efficient management of tax liabilities, and the assurance of sustainable profitability (Saleem et al., 2013; Guantai, 2023). Companies in this industry frequently have challenges in establishing an appropriate CAPS while navigating their tax obligations, perhaps resulting in financial instability or unsatisfactory performance.

The CAPS, comprising the mixture of debt and equity financing, directly influences a firm's profitability, risk profile, and long-term financial stability (Baker & Martin, 2011; Dao & Ta, 2020; Kruk, 2021). Simultaneously, the ETR signifies the tax obligation a corporation incurs and might influence its financial choices, investment approaches, and general economic vitality (Christensen et al., 2022). In the realm of Malaysia's telecommunications sector, comprehending the relationship of these elements and their influence on FP is vital for stakeholders, including investors, regulators, and policymakers.

Prior studies investigative the correlation amid CAPS and FP frequently neglect the influence of taxation. Although certain studies have investigated the influence of CAPS on profitability, they seldom address the impact of fluctuating tax rates on FP. Notwithstanding the significance of these issues, empirical evidence regarding the synergistic effect of ETR and CAPS on the FP of Malaysian telecom businesses is few. Most studies concentrate on CAPS or taxation independently, neglecting the interplay between these variables. Comprehending this relationship is essential for telecommunications firms aiming to enhance their financial plans and secure sustained growth. This study seeks to address this gap by inspecting the influence of both effective tax rate (ETR) and CAPS on the FP of Malaysian telecommunications firms, offering insights to inform financial decision-making within the industry.

The subsequent half of the paper is dedicated to a literature review. The next parts outline the methodology and data analysis. The concluding portion encompasses the conclusion, implications, limitations, and future directions.

Literature Review

A lot of researchers have debated and examined the influence of CAPS on FP. Since the revolutionary work of Modigliani and Miller (1958), much literature has explored the consequences of CAPS decisions on a firm's value and performance. They showed that financial leverage is now positively correlated with business value. This suggests that companies can maximize shareholder value even when their CAPS has a higher amount of debt. Thus, while Modigliani and Miller's (1958) theory has a strong theoretical foundation and is still widely accepted, research throughout time has shown that the composition of a

firm's CAPS is crucial to its profitability and value. Finding the ideal debt to equity ratio, however, is a difficult undertaking that differs by industry.

Effective Tax Rate and Financial Performance

Otuya and Omoye (2021) examined the effective tax rate and PF of multinational corporations in Nigeria. The research acquired data from the financial statements of selected multinational corporations during the period from 2014 to 2018. Regression research indicated that the interest expense rate, ETR, and capital intensity exhibit a positive yet negligible correlation with the FP of multinational corporations (MNCs). Thanjunpong and Awirothananon (2019), investigate the correlation amid tax planning and FP. The sample size, excluding the banking industry, comprises 873 companies. The effective tax rate (ETR) assesses tax strategy, whereas the return on equity evaluates financial success. This study demonstrates a positive association between tax preparation, as indicated by ETR, and FP. Conversely, when employing Tax/Asset as the metric, the connection becomes negative. Saidu (2018), analyzed the impact of corporate income tax on the FP of publicly listed consumer goods firms. The research gathered data from corporate annual reports and using regression analysis as a method of data analysis. The analysis shows that the correlation between company tax and FP, as assessed by ROA, is insignificantly negative. Ioana (2018), illustrates the relationship between tax impact and FP with data from 27 real estate firms from 2009 to 2013. This study identifies an inverse association between the effective tax rate and performance, with a direct relationship between leverage, profit margin, and FP.

Kantudu et al (2018), evaluate the moderating effect of dividend distribution on the correlation between corporation tax and FP of publicly listed consumer products companies from 2007 to 2016. The research indicates that the dividend payout ratio has notably influenced the correlation between corporation tax and the financial success of publicly listed consumer goods companies. The study suggests that corporation tax and dividend policy are essential metrics for enhancing financial success. Katz and Jung (2023), scrutinize the influence of taxation on the performance of the telecommunications industry. The research formulates a model that accounts for the taxes and fees levied directly or indirectly along the telecoms value chain. We observe compelling data indicating that a rise in regulatory fees, profit taxes, and excise taxes adversely affects investment. Rasheed and Lateef (2023), studied the impact of corporation taxes on the FP of publicly listed firms. The results indicated that corporate taxation has a beneficial and considerable impact on the FP of firms. Mbevi (2023), conducted an extensive examination of the impact of taxation on the FP of telecommunications firms in Kenya. This study employed a descriptive research design and utilized a dataset covering seven years, from 2016 to 2022, comprising data from five prominent telecommunication companies in Kenya. The study's findings revealed substantial and noteworthy insights. It revealed strong positive relationships between FP and total corporate income tax, as well as total excise duty. Park et al. (2024) investigate the impact of taxation on CSR. The implementation of a tax reform in Korea, which introduced a new tax on cash retention, resulted in enhanced CSR performance among affected enterprises. Enhancements in environmental and social performance propel this outcome. The findings indicate that tax hikes result in heightened CSR investment, with the extent of the rise contingent upon firm-specific attributes.

H1: *There is a significant relationship between effective tax rate and financial performance in Malaysia's Telecom firms*

Capital Structure and Financial Performance

Ahmed et al (2023), investigate the moderating influence of agency cost on the association amid CAPS and FP. This study utilizes secondary data obtained from the annual reports of manufacturing companies from 2011 to 2019. The empirical findings demonstrate an inverse correlation between CAPS and FP. Boshnak (2023), examines the influence of CAPS on the performance of companies. The research utilizes a panel of 350 firm-year observations from 70 non-financial listed Saudi enterprises spanning the years 2016 to 2020. The findings demonstrate that short-term debt, long-term debt, total debt, and debt-to-equity ratios significantly adversely affect operational performance (return on assets), whereas long-term debt, total debt, and debt-to-equity ratios similarly impact FP. Panchal and Chand (2023) empirically examine the influence of CAPS on business performance within the Indian manufacturing sector from 2013 to 2022. The findings indicate that the debt-equity ratio adversely impacts the performance of Indian manufacturing enterprises. Utilizing ROA for performance measurement reveals a significant negative correlation compared to ROE. Of the control variables, only size exhibited a negative correlation with FP. Ahmed et al (2023), investigate the link between CAPS and firm profitability, including the moderating influence of firm size. The examination of financing options and corporate profitability in emerging nations is intriguing due to the disparities between the attributes of their enterprises and those of organizations in industrialized economies. This study employed secondary data derived from the yearly financial statements of 156 industrial firms from 2011 to 2019. The findings indicate that profitability is adversely impacted by CAPS choices. Nonetheless, firm size correlates positively with profitability. Mehzabin et al (2023), look into how the profitability of the banking sector in 28 Asian countries is impacted by CAPS as measured by the leverage ratio, long-term debt, operating efficiency, and non-interest income. They use panel data with a sample of 492 banks from 28 Asian nations over a 15-year period, from 2004 to 2018, using a fixed effect regression model. The findings support the agency cost theory's assertion that a higher overall debt ratio boosts a bank's profit margin, indicating that debt financing boosts a company's profitability.

Bui et al (2023), examine the relationship between CAPS and FP. The results show that ROA, ROE, and Tobin's Q are positively impacted by the debt ratio. Mansour et al. (2023) provide an extensive literature analysis to elucidate a theoretical framework that may clarify the interconnections among CAPS, corporate governance, and business performance. Nguyen et al (2023), examine the influence of CAPS on the profitability of Vietnamese companies. The study theoretically employed agency theory, which highlights the division between ownership and management, resulting in issues when managers prioritize their own interests over those of the owners. The results demonstrated that business profitability, as measured by ROE and ROA, was correlated with liquidity and debt levels. Ronoowah and Seetanah (2024), investigate the linear and non-linear relationships between CAPS and firm performance (FP), as well as the moderating and mediating effects of agency costs within the CSR and FP framework. This research utilized structural equation models to assess the mediating effect of agency costs in the corporate social responsibility-FP nexus of 38 publicly traded non-financial enterprises from 2009 to 2019. The results indicated that leverage exerts a substantial negative impact on FP, corroborating the pecking order argument. Agency costs exhibit a significant and positive correlation with FP. Sarpong-Danquah et al. (2023) analyze the impact of CAPS on the FP. The findings indicate that leverage adversely affects the FP of microfinance institutions (MFIs). Birhane et al. (2024) examine the effect of human capital as

a mediator in the relationship between CAPS and FP. The study's results imply that human capital serves as a partial mediator in the relationship between CAPS and organizational performance.

H2: *There is a significant relationship between capital structure and financial performance in Malaysia's Telecom firms*

Research Framework

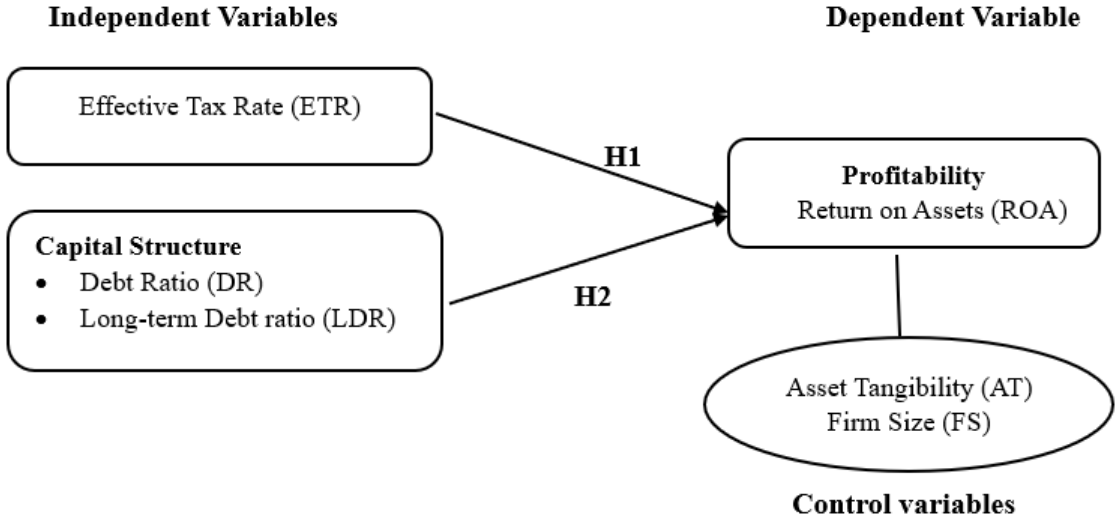

Figure 1: Research Framework

Methodology

Research Design

This study utilizes a quantitative research methodology to analyze the influence of the effective tax rate (ETR), CAPS variables including debt ratio (DR), and long-term debt (LTD). The research included two control variables: asset tangibility (AT) and firm size (FS) in relation to the FP of telecommunications businesses in Malaysia. The return on assets (ROA) serves as the dependent variable indicative of FP. The research employs panel data encompassing a sample of Malaysian telecommunications firms throughout a defined timeframe. Data were collected from the annual reports of four telecommunications firms listed in Bursa Malaysia from 2011 to 2023. The study employed OLS regression and the fixed effects technique, along by mandatory preliminary tests. Equation 1 illustrates the study variables.

$$FP_{it} = \alpha_0 + \beta_1 ETR_{it} + \beta_2 DR_{it} + \beta_3 LTD_{it} + \beta_4 AT_{it} + \beta_5 FS_{it} + \in_{it} \quad (1)$$

Data Analysis and Findings

Descriptive Statistics

The table presents data for 52 observations across four companies, indicating an average return on assets (ROA) of 10.2%, with a range from -1.1% to 47.2%. The effective tax rate (ETR) averages 28.1%, with significant variation ranging from 0.2% to 67.1%. The debt ratio (DR) averages -38.2%, signifying greater liabilities than assets, although long-term debt (LTD) constitutes an average of 56.7% of capital. Asset tangibility (AT) averages 43.2%, whereas firm size (FS) exhibits considerable variation, with an average of 14.354. This data underscores the financial diversity and differing capital arrangements among the firms.

Table 1
Descriptive Statistics

Variables	Obs	Mean	Std. Dev	Min	Max
ROA	52.000	0.102	0.112	-0.011	0.472
ETR	52.000	0.281	0.100	0.002	0.671
DR	52.000	-0.382	0.185	-0.803	-0.067
LTD	52.000	0.567	0.141	0.349	0.893
AT	52.000	0.432	0.164	0.168	0.893
FS	52.000	14.354	3.412	9.893	18.218

Correlation Analysis

This table displays the correlation coefficients among several financial factors. The Effective Tax Rate (ETR) exhibits a negative correlation with Return on Assets (ROA) of -0.3594, indicating that elevated tax rates correspond to diminished returns. The Return on Assets (ROA) exhibits a moderate positive correlation with the debt ratio (DR) of 0.5436, suggesting that companies with elevated debt ratios generally achieve better returns on assets. Long-term debt (LTD) exhibits a robust correlation with the long-term debt ratio (LTD) of 0193, indicating that enterprises with elevated debt ratios tend to own greater long-term debt. Asset tangibility (AT) exhibits weak correlations with ROA (0.0657), however firm size (FS) demonstrates a weak positive association with ROA (0.1692) respectively.

Table 2
Correlation

	ROA	ETR	DR	LTD	AT	FS
ROA	1					
ETR	-0.3594	1				
DR	0.5436	0.0196	1			
LTD	0.193	0.0609	0.7752	1		
AT	0.0657	-0.0174	0.1148	-0.0836	1	
FS	0.1692	0.0974	-0.2139	-0.199	-0.3484	1

VIF Test

This table displays the Variance Inflation Factor (VIF) and its reciprocal (1/VIF) for several variables, utilized to identify multicollinearity in regression analysis. A VIF number beyond 10 often signifies substantial multicollinearity; nevertheless, in this case, all values remain much below that threshold. The Effective Tax Rate (ETR) and Debt Ratio (LDR) have the highest Variance Inflation Factors (VIFs) at 2.800 and 2.730, respectively, indicating substantial multicollinearity. Long-term Debt (LTD), Asset Tangibility (AT), and Firm Size (FS) exhibit reduced Variance Inflation Factors (VIFs), signifying negligible multicollinearity. The 1/VIF values corroborate these findings, with elevated values signifying less multicollinearity. The variables exhibit appropriate levels of multicollinearity for regression analysis.

Table 3
Variance Inflation Factor/Tolerance Test

Variable	VIF	1/VIF
ETR	2.800	0.3566
DR	2.730	0.3658
LTD	1.260	0.7906
AT	1.230	0.8149
FS	1.020	0.9809

Hausman Test

The Hausman Test assesses the suitability of fixed effects vs random effects models in panel data analysis. The table indicates a test statistic (chi-squared value) of 64.91 and a p-value (Prob>chi2) of 0.00. The p-value, being less than 0.05, suggests a preference for the fixed effects model over the random effects model. This indicates that substantial disparities among entities (e.g., companies or temporal phases) must be considered in the investigation.

Table 4
Hausman Test

Test Summary		
Dependent Variable	Chi-Sq. Statistics	Prob>chi2
ROA	64.91	0.00

OLS Regression Analysis

The table presents a comparison of the outcomes from an Ordinary Least Squares (OLS) regression and a Fixed Effect Model concerning various financial variables. Both models demonstrate that the Effective Tax Rate (ETR) significantly negatively affects Return on Assets (ROA), with the OLS model revealing a more pronounced effect. The Debt Ratio (DR) has a positive impact on ROA in both models, with a more significant effect observed in the OLS model. Long Term Debt (LTD) exhibits a positive correlation with ROA in the OLS model, whereas a negative correlation is observed in the Fixed Effect Model. Asset Tangibility (AT) shows no significance in either model, whereas Firm Size (FS) is significant solely in the OLS model. The OLS model accounts for a greater proportion of variance in ROA (R-squared = 0.643) than the Fixed Effect Model (R-squared = 0.547). This indicates that, although both models are statistically significant, the OLS model offers a superior fit for the data.

This study's findings are consistent with numerous prior studies in FP. The positive relationship between the Debt Ratio (DR) and Return on Assets (ROA) aligns with findings from multiple studies indicating that increased leverage may result in higher returns, attributable to the tax shield advantages of debt (Capon et al., 1990). The inverse relationship between the Effective Tax Rate (ETR) and Return on Assets (ROA) corresponds with research suggesting that increased taxation diminishes net income and, consequently, profitability (Xu, 2021). The varied outcomes for Long Term Debt (LTD) illustrate the intricate relationship between debt and performance, consistent with other studies indicating that long-term debt may have either beneficial or detrimental effects on firm performance, contingent upon the specific context.

Table 5
Regression Analysis

Variable	OLS Regression		Fixed Effect Model	
	Coef	P-value	Coef	P-value
ETR	-0.423	0.000	-0.279	0.002
LDR	0.603	0.000	0.402	0.000
LTD	0.391	0.002	-0.388	0.000
AT	0.012	0.863	0.071	0.484
FS	0.011	0.002	0.005	0.352
Con	0.514	0.000	0.458	0.000
R-Square	0.643		0.547	
No. of Obs		52.000		
Prob>F		0.000		

Conclusion, Implications, Limitations, and Future Directions

This research examines the influence of the Effective Tax Rate (ETR) and CAPS on the FP of telecommunications firms in Malaysia. The findings indicate that ETR negatively impacts Return on Assets (ROA), suggesting that increased tax rates diminish profitability. This is consistent with prior studies indicating that higher tax burdens reduce net income and overall FP. The Debt Ratio (DR) exhibits a significant positive correlation with ROA, indicating that the use of debt may improve returns through tax shield advantages, aligning with established research findings. The relationship between Long Term Debt (LTD) and ROA is complex; the OLS model shows a positive impact, whereas the Fixed Effect Model indicates a negative effect. This discrepancy underscores the intricate relationship between debt and FP, which may differ based on the context and particular attributes of the firms examined. Asset Tangibility (AT) and Firm Size (FS) exhibited inconsistent significant effects across models, indicating that these variables may not be principal determinants of FP in this sector. The study highlights the significance of tax management and strategic debt utilization in improving the FP of telecom companies in Malaysia. These insights can assist managers and policymakers in making informed decisions to enhance financial outcomes in the telecom sector.

This study's findings hold significant implications for managers, policymakers, and stakeholders within Malaysia's telecom sector. The substantial adverse effect of the Effective Tax Rate (ETR) on FP indicates that telecom companies ought to emphasize effective tax planning and management strategies to improve profitability. The correlation between the Debt Ratio (LDR) and Return on Assets (ROA) suggests that utilizing debt may yield advantages, enabling firms to capitalize on tax shield benefits. The mixed results for Long Term Debt (LTD) underscore the necessity for a nuanced approach to long-term financing, balancing the advantages of additional capital with the firm's capacity to generate returns. While Asset Tangibility (AT) and Firm Size (FS) did not demonstrate consistent significant effects, they are nonetheless important considerations in financial planning. Policymakers must evaluate the effects of tax policies on the financial outcomes of telecom companies, aiming to establish a conducive tax environment that promotes investment and growth. Telecom companies in Malaysia can enhance FP and attain sustained success through the comprehension and application of these implications.

This study presents several limitations that must be acknowledged in the interpretation of the results. The limited sample size of 52 observations may restrict the applicability of the findings to the wider telecom sector in Malaysia or other areas. The analysis is limited to a defined time frame, potentially overlooking long-term trends and the effects of economic cycles on FP. The study primarily examines the telecom sector; however, it may overlook various unique industry-specific factors, including regulatory changes, technological advancements, and market competition. While OLS and Fixed Effect Models are robust, they may not adequately encapsulate the complexity of variable relationships; thus, employing advanced econometric models could yield additional insights. The findings pertain specifically to telecom companies in Malaysia and may not be directly applicable to telecom sectors in other countries due to differing economic, regulatory, and market conditions. Additionally, although control variables such as Asset Tangibility (AT) and Firm Size (FS) are incorporated, other pertinent factors may be overlooked in the analysis. Finally, measurement errors in the financial data utilized may impact the accuracy of the results. The identified limitations underscore the necessity for careful interpretation and indicate potential avenues for future research.

Future research may enhance this study by enlarging the sample size and prolonging the analysis period to identify long-term trends and the influence of economic cycles on the FP of telecommunications firms. Moreover, the integration of advanced econometric models may yield enhanced understanding of the intricate relationships among variables. Investigating sector-specific factors, including regulatory changes, technological advancements, and market competition, would improve the comprehension of their impact on FP. Comparative studies across various countries or regions may yield significant insights into the influence of differing economic, regulatory, and market conditions on the telecommunications sector. Incorporating supplementary control variables and addressing possible measurement errors in financial data would enhance the robustness of the findings. These future directions would enhance the understanding of the factors affecting FP in the telecom sector.

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