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Determinants of Capital Structure Evidence from Sri Lanka



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ABSTRACT

The study explores how the Sri Lankan companies make capital structure decisions. In this context the objectives of the study are two-fold. These two objectives are the examination of determinants of capital structure decisions and the examination of the relevance of capital structure theories in explaining the relationship between these determinants and capital structure decisions.

The study focuses on four key determinants of capital structure decisions of firms. These variables are identified based on the extant literature. The literature elicits four firm-specific key determinants, namely, size, profitability, tangibility and growth opportunities. The impact of these factors on capital structure decisions of Sri Lankan companies are considered in relation to three capital structure theories. These three theories are Static Trade-off Theory, Information Asymmetry Theory and Agency Cost Theory. The empirical examination is carried out based on the companies listed in the manufacturing sector of the Colombo Stock Exchange. This examination is mainly based on statistical techniques and the results of these techniques are analyzed and interpreted descriptively.

The study finds that firm size and tangibility of assets have a statistically significant positive impact on leverage, which denotes the capital structure decisions of firms. Both Static Trade-off Theory and Agency Cost Theory are relevant in explaining the impact of these two variables on the level of leverage used in firms in the Sri Lankan context. However, the Information Asymmetry Theory is applicable only in relation to tangibility of assets. Hence, these useful insights highlight factors influencing the capital structure decisions of Sri Lankan companies and the relevance of capital structure theories in explaining the practical aspects related to capital structure choices of companies.

