Impact of Capital Structure on Firm Performance: Evidence from Manufacturing Sector SMEs in UK

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The purpose of this study is to investigate empirically the impact of capital structure on firm performance. This study examined the impact of capital structure on firm performance of manufacturing sector SMEs in UK for the period of 1998-2008. The authors hypothesize that there is a negative relationship between capital structure and firm performance. To examine the association, the authors run a Pearson correlation and multiple regression analysis. Results of this study reveals that there is a significant negative relationship between leverage and firm performance (ROA, ROCE), strong negative relationship between liquidity and firm performance and highly significant positive relationship between size and the firm performance. This study concluded that firms which perform well do not rely on debt capital and they finance their operations from retained earnings and specially SMEs have less access to external finance and face difficulties in borrowing funds. It is recommended that firm should establish the point at which the weighted average cost of capital is minimized and to maintain the optimal capital structure and thereby maximize the shareholders wealth.

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