Capital Structure and Firm Performance: With Special Reference to the Commercial Banks and Manufacturing Firms in Sri Lanka

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Introduction

In addition to the other financial services, commercial banks are institutions that play a pivotal role in financial intermediation. They play an imperative role in an economy especially financing economic activities. Improvement in the performance of commercial banks would in turn increase their role in an economy (Terraza, 2015; Sufian, 2011; Pasioura & Kosmidou, 2007). In addition to that the manufacturing sector of a country plays a vital role in boosting the economy through value addition and it is the second largest sector in the Colombo Stock Exchange (CSE). Further, number of manufacturing firms in Sri Lankan context is growing rapidly, as indicated by number of companies listed on the CSE drawing our attention back to the sector today.

For both the sectors, capital structure decision is an important decision since the profitability of an enterprise is directly affected by such decision. Capital structure is described as the combination of debt and equity. One crucial issue challenging to the managers today is how to determine the combination of debt and equity to achieve optimum capital structure that would minimize the firm's cost of capital and improves return to owners of the business (Vitor & Badu, 2012).

The study identified the firm size as a variable of scholarly interest, due to the fact of, it's traditionally having much explanatory power, and an understanding of its importance, which has identified as vital for managers who operate in today's competitive environments (Kioko, 2013). In today's world, being on the phenomenon of economies of scale, the size of a firm is taking as a crucial factor for a firm's success. However, modern corporate firms also, seem to be looking to increase their size so as to get a competitive edge over their competitors through multiple ways (Luqman, Ilo, Lawal, & Fatai , 2017).

The study will make multiple contributions to the literature on capital structure, firm size and financial performance through the investigation of the precise composition of capital structure and firm size that maximizes the shareholders return and impacts positively on a bank's financial performance. And additionally, the study will come in handy to support the government, and regulators in their quest to streamline operations in the banking sector putting in mind that the economy as a whole inch on how the banking sector performs as inappropriate resource allocation can hinder the growth in the economy while paying attention on the manufacturing sector of the country parallel.

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