

An Empirical Analysis on Determinants of Capital Structure in Sri Lankan Companies

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ABSTRACT

One of the central issues in both the theory and the practice of finance is the problem of determining the optimal capital structure of the firm. This study was undertaken to identify the most significant variables considered for the design of the capital structure and to determine whether or not such factors affect capital structure decision significantly and whether such vary among the sample companies. The study examined the relevance of the corporate capital structure determinants such as size, profitability, tangibility, growth, tax, non debt tax shields and volatility to leverage. The sample of five industries namely Beverage Food and Tobacco, Hotels and Travel, Land and Property, Manufacturing and Plantations during the period of 2003 to 200was selected from the companies registered and listed in Colombo Stock Exchange.

The preliminary analysis of the degree of the liner association between variables has been done with the help of Karl Pearsons correlation method. Stepwise multiple linear regression analysis has been used to identify the most significant variables out of various selected explanatory variables. The results show positive association between leverage and non debt tax shields, -size measured in terms of sales, size measured in terms of assets, tax, volatility, tangibility, and profitability (return on equity) while -negatively associate with profitability (return on capital), profitability (return on assets) and growth opportunities. The results have revealed that the size measured in terms of sales, size measured in terms of assets, profitability- (return on equity), profitability (return on capital), growth opportunities, tangibility, tax, non debt tax shields are the significant determinants in the capital structure.

Finally, it had been tested on the applicability of Static Trade-off, Pecking Order and Agency Cost theories in the Sri Lankan context. Hence, it is suggested to conduct further research on the determinants of capital structure by considering financial managers board of directors, and the financial consultants thinking patterns and attitudes, based on the available sources in the corporate sector.

Keywords- Capital Structure, determinants, profitability, tangibility, growth