

The Determinants of Capital Structure: Evidence from Listed Manufacturing Companies in Sri Lanka

Kuruvita, K.A.S.P.¹ and Ariyaratna Jayamaha ²
sithumkuruvita@gmail.com¹, jayamaha@kln.ac.lk²

The aim of this study is to investigate, the factors that affect to the capital structure decision of manufacturing companies in Sri Lanka. Capital structure decision is most debatable topic in the current business environment. There are several factors which determine the leverage level of the firm. Therefore, it is more essential to identify the key firm specific factors, which determined the leverage of the firm. Different capital structure theories are reviewed (Modigliani – Miller Theory, Pecking order theory, Static trade-off theory and Agency cost theory) in order to formulate hypotheses regarding the determinants of capital structure of the listed manufacturing companies. For this study, a sample of 28 listed manufacturing companies was considered for the period 2011 to 2015. Five firm specific explanatory variables (Tangibility, Profitability, Growth, Age of the company and Tax-shield) were selected to discover what determines capital structure. This study employs Descriptive analysis, correlation analysis and multiple regression analysis to measure relationship between variables, individual and overall impact on optimal capital structure and to test the operational hypotheses. The major result of the study indicated that Age, Profitability and tax-shield variables are the significant firm specific determinants of capital structure in Sri Lankan manufacturing companies. In addition to this, the two variables (Tangibility of Assets and Profitability) showed negative relationship between leverage (Debt equity ratio). That negative result consistent with implication of pecking order theory. Remaining selected three variables (Growth rate, Age, Tax-shield) are positively correlated with capital structure, which is help to prove trade-off theory, and agency cost theory. The researcher believes that research findings should help managers to make optimal capital structure decisions.

Keywords: Capital structure, Determinants of capital structure, Leverage, pecking order theory, Trade-off theory, Agency cost theory