

# The Effect of Capital Structure on Firm Performance: Evidence from Listed Diversified Financials Sector Companies in Colombo Stock Exchange: Pre-Crisis vs. Economic Crisis

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## Abstract

**Introduction:** This study investigates the impact of capital structure on the financial performance of diversified financial sector companies listed on the Colombo Stock Exchange (CSE) during pre-crisis (2014–2020) and crisis (2021–2023) periods. The objectives of the study are to evaluate the strength of the causal relationship between capital structure and firm performance of the listed diversified financial sector companies between the periods of 2014-2023 and to check whether there is a statistically significant impact between the capital structure and firm performance of the listed Diversified Financial sector companies before and during the economic crisis periods (2014-2023). This study addresses this gap by examining the effect of debt on three key performance metrics: Return on Capital Employed (ROCE), Return on Assets (ROA), and Tobin's Q.

**Methodology:** The research follows a quantitative approach using secondary data from 27 listed diversified financial firms. Panel data regression will be used for the analysis to evaluate the relationship between capital structure and firm performance, with firm age, size, tangibility, and sales growth as control variables. The economic crisis is incorporated as a dummy variable to assess its effect on firm performance. Descriptive statistics and t-tests are used to identify differences in firm performance between pre-crisis and crisis periods.

**Findings:** The findings indicate a significant negative relationship between the debt-to-equity ratio and all three performance indicators (ROCE, ROA, and Tobin's Q) and ROA, ROCE are significantly impacted by the Economic Crisis and Tobin's Q is not impacted by the Economic Crisis.

**Conclusion:** Capital Structure and Firm Performance is a highly discussed topic among researchers. However, studies done on specific sectors are very rare in the Sri Lankan context. Furthermore, the study has incorporated the economic crisis as well. Therefore, this study will provide insights into future research on this topic.

**Keywords:** Capital Structure, Firm Performance, Economic Crisis, Diversified Financial Sector Companies, Colombo Stock Exchange