

## Capital Structure and Its Impact on Profitability: With Special Reference to Listed Manufacturing and Service Companies in Sri Lanka

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### Abstract

This study investigates the relationship between capital structure and profitability of listed manufacturing and service sector companies in Sri Lanka. The study covers six years period from 2009 to 2014 and the sample size is five companies from service sector and twenty companies from manufacturing sector. The study uses return on assets (ROA) and return on equity (ROE) as performance variables. In addition debt equity ratio (DER) and debt assets ratio (DAR) are used as capital structure variables. The relationship between the performance and capital structure variables are analyzed using correlation coefficient and regression techniques. According to the results of this comparative study the relationship between capital structure and return on assets is not significant across all the observations carried out for both manufacturing and service sector except one observation in manufacturing sector. It also shows an insignificant relationship between profitability between debt assets ratio. However, there is a significant relationship in all observations between return on equity and debt to equity in both manufacturing and service sector. Moreover the study reveals that the nature of the industry also determines the effect of capital structure on their profitability. In manufacturing firms, there is a negative significant relationship between return on equity and debt equity ratio while service sector reveals a positive significant relationship between return on equity and debt equity ratio.

**Key words:** *Capital Structure, Profitability, Listed Manufacturing firms, Listed Service Firms, Debt Equity Ratio, Debt Assets Ratio, Return on Equity, Return on Assets*