

Determinants of Capital Structure: An Empirical Study of Selected Companies in Sri Lanka

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Abstract

The capital structure of a company consists of a particular combination of debt and equity issue to relieve potential pressure of its long term financing .To examine such issues, many theories have been focused upon what determinants are likely to influence the leverage decisions of the firms. This research tries to discuss the determinants of the capital structure of listed companies in Sri Lanka. This study was limited to a sample of seventy six listed companies from thirteen sectors in the Colombo Stock Exchange.

The literature review of the study examines the existing research on capital structure and introduces briefly the different theories of the capital structure. Based on the literature on the capital structure, five hypotheses were developed.

The companies were selected through stratified sampling method and period concern was from 2006 to 2010. The working sample was limited to companies due to various constraints. The study used debt equity ratio to measure financial leverage and five variables namely profitability, tangibility, size, business risk and non-debt tax shield which are used as independent variables. For analysis purpose descriptive statistics, correlation and regression analysis are used with the help of EVIEWS 05 software through the computer.

The results reveal that size of the firms and tangibility of assets have a positive and statistically significant impact on the firm's leverage ratio, while profitability, business risk, and non debt tax shield seem to have negative and significant impact on firms leverage ratio.

The results of this study establish the clear relationship between leverage and independent variables. The findings of this study contributed toward a better understanding of financial behavior in Sri Lankan firms. This results suggested that both the trade off and the pecking order theories are pertinent theories to Sri Lankan firms.

Keywords: The Capital structure. Leverage. Pecking order. Profitability. Trade off.