

Empirical Study on Determinants of Capital structure: Panel Data Analysis for Listed Manufacturing Companies in Sri Lanka

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The optimum capital structure remains ambiguous despite extensive empirical research attempts and theoretical literature. Traditionally debt is often thought of as purely bad given the negative consequences of higher leverage levels. The study reveals that Sri Lankan manufacturing companies prefer short-term debt to long-term debt thus maintaining a considerable level of leverage at an aggregate level. Proper capital structure leads a firm to take advantage of cheap cost of debt and tax shield on interest payments thereby increasing the company performance, firm value, shareholders wealth and investor confidence. This investigation is conducted, with a particular regard to Manufacturing Companies listed in the Colombo Stock Exchange for the period from 2011 to 2018, in an attempt to establish a relationship between capital structure and its determinants. Panel data analysis, undertaken for 203 observations collected from 29 listed manufacturing companies, generated results that are simply not detectable in pure cross-sections or pure time-series studies. The leverage level of the companies, measured by long-term debt ratio, short-term debt ratio and total debt ratio, is termed as the dependent variable. The tangibility, profitability, firm size, firm growth and investor confidence are termed as independent variables. The Fixed Effects regression model revealed the influence of aforementioned variables and the results further validated some empirical and theoretical evidence such as pecking order theory and trade-off theory but it also held evidence to the contrary. Further, this study prompts the manufacturing companies to employ short-term debt such as revolving credit facilities and financial institutions to introduce new short-term debt products given the nature of manufacturing companies. The Fixed Assets are appeared to have used to collateralize against short-term debt as they become outmoded due to frequent replacement cycles and technological advancements.

Keywords: Capital Structure, Panel Data, Determinants, Leverage level