

Capital Structure of Sri Lankan Firms: A Dynamic Panel Data Analysis

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Abstract

The study investigates capital structure of a sample of 69 firms listed in the Colombo Stock Exchange. Generalized Method of Moments (GMM) estimator is employed for an unbalanced panel data for years, from 2006 to 2010. The dynamic analysis is conducted using a combination of the GMM approach and instrumental variables to check for endogeneity in variables. Consistent with prior literature, the study finds a significant negative influence of profitability, size, growth and operating risk on the debt ratio of firms. The firms do not rely on optimal capital structures and the financial policies to follow a financial hierarchy in Sri Lanka. The asset structure has a significant negative impact on financial leverage; growth affects negatively to leverage suggesting that the large firms have easy access to equity markets and become low levered. Small firms rely on the credit market of Sri Lanka. The firms use retained earnings largely, hence the increased revenue results in low debt ratio. The results indicate that the firms do not follow a target debt ratio, and are consistent with the pecking order theory for finance.

Keywords: Capital Structure, Dynamic Panel Data, Sri Lanka

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