THE IMPACT OF CAPITAL STRUCTURE ON PROFITABILITY: AN EMPIRICAL STUDY ON THE LISTED COMPANIES IN SRI LANKA

By

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List of Abbreviations

CSE - Colombo Stock Exchange
IDT - Type of industry
LDA - Long Term Debt to Total Assets
LNS - Logarithm of Sales
NIA - Net Income Approach
NOI - Net Operating Income Approach
Pip - performance improvement project
ROCE - Return on Capital Employed
ROE - Return on Equity
TDA - Total Debt to Total Assets
TDE - Total Debt to Equity

Abstract

This study aimed to investigate the impact of capital structure on profitability by comparatively analyzing the listed companies in two sectors that are Manufacturing and Beverage, Food & Tobacco industries of Colombo Stock Exchange (CSE) in Sri Lanka. The study period was from 2007 to 2012. A total of 38 companies were selected from these two industries where 14 companies from the Beverage, Food &Tobacco industry and 24 companies from the Manufacturing industry and the study consist of 228 financial data observations. Descriptive and multiple regression analysis used to analyze six models and Measured the profitability by proxy of Return on Equity (ROE) and Return on Capital Employed (ROCE) as dependents variables and the capital structure measured by the proxy of long term debt to total assets (LDA), total debt to total assets (TDA) and total debt to equity (TDE) and the size as control variable measured by log of net sales (LNS) and Type of industry (IDT).

There results revealed that LDA, TDA and TDE of all companies from two industries have significant negative relation with ROE meanwhile LDA and TDA have negative and insignificant relation with ROCE but TDE indicate a positive insignificant relation with ROCE. The LNS has a positive and significant relationship with ROE and ROCE in all six models and IDT indicated the type of industries influence on the firms' profitability.

When comparing both industries the Manufacturing industry used average LDA, TDA and TDE significantly greater compare to Beverage, Food & Tobacco($p=0.000$). Theoretically the attribution of the result seems to be supporting to packing order theory.

Further, the findings of this study revealed that the capital structure of a company makes impact on its profitability, average profitability of the Beverage, Food & Tobacco industry was greater than the Manufacturing industry and the Manufacturing industry is highly leveraged than Beverage, Food & Tobacco industry.

Keywords: Profitability, Capital Structure, Long-Term Debts, Total Debts, Debt to Equity and Industry Type