Capital structure and investment growth: A case study of listed manufacturing companies in Sri Lanka

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Abstract

The study aims to investigate the impact of firm capital structure on the investment growth of listed manufacturing firms in Sri Lanka. The data was gathered by using secondary sources and the sample is confined to the manufacturing sector consists of 27 firms listed in the Colombo Stock Exchange using a random sampling method, whereas Pearson's correlation and multiple regression analysis were employed to analyse the data for the period of 2012 to 2018. The independent variable, capital structure, is measured by short-term debt, long-term debt and total debt, whereas the dependent variable is investment growth. The results reveal that firm capital structure has a strong and significant influence on listed manufacturing firms' investment growth in Sri Lanka. Further, it shows that short-term debt and long-term debt were found to have a significant and positive impact on investment growth while control variables of profitability and firm size have no significant impact on the investment growth of listed manufacturing firms in Sri Lanka. The study recommends that the management of listed manufacturing firms increase the level at which the organization uses long-term debt or short-term debt to finance its business activities. This may increase the investment opportunity potentials of the organizations. Few studies have addressed this area in the Sri Lankan economy.

Keywords: investment growth, long term debt, short term debt and total debt

Introduction

Capital structure is the mixture of debt and equity that a firm uses to fund its operations and expansions (Abor, 2005). It has a significant part in the firm's financial operations. Every business can combine debt and equity in various ways to maximize ordinary shareholder capital. There are many forms of debt and equity, including common shares, preferential securities, derivatives, preferred shares. Therefore, in various configurations, the companies collect the debt and equity financing as they need to consider the right mix to reduce the weighted average cost of capital and meet the management goal to increase the business value. Then businesses will seek to establish the optimum capital structure that allows the company's profitability to be maximized. However, no strict theory to decide the exact optimal capital structure has yet been established (Safeena & Hassan, 2015). So, it is about managers recognizing those variables affecting capital structure decisions