Impact of Capital Structure on Profitability of Manufacturing Companies Listed on the Colombo Stock Exchange in Sri Lanka

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Abstract

A business concern can go for different levels of the mixtures of equity, debt and or other financial facilities with equity having the emphasis on maximizing the firm's value. The primary objectives of this study are to investigate the significant impact of capital structure on profitability and analysis the relationship between financial leverage and capital structure determinations of manufacturing listed companies in Sri Lanka. In this regard, researcher has selected a sample of 15 manufacturing companies for a period of five financial years from 2006 – 2010. The data are collected from the financial statements of these 15 manufacturing firms and hand book of listed companies 2010. Researcher has used Pearson's correlation, and regression analysis. Multiple Linear Regression (MLR) models are used in the estimation of a function relating to the Return on Equity (ROE) with the independent variables including short-term debt, long-term debt, total debt, sales growth and size of the firm measured in terms of natural logarithm of sales. The empirical findings suggest that firm structure emerges as an important factor affecting profitability. The results indicate that the capital structure of the manufacturing companies listed on Colombo Stock Exchange has a significantly positive relationship between the ratio of short-term debt to total assets and ROE. However, an insignificant relationship between the ratio of long-term debt to total assets and ROE was found. With regard to the relationship between total debt and return rates, the results show a significantly positive association between the ratio of total debt to total assets and return on equity.

Key words: Capital Structure, profitability.

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