

THE IMPACT OF FINANCIAL LEVERAGE ON COMPANY  
GROWTH OF THE LISTED COMPANIES IN COLOMBO

**THE IMPACT OF FINANCIAL LEVERAGE ON COMPANY  
GROWTH OF THE LISTED COMPANIES IN COLOMBO  
STOCK EXCHANGE**

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## Abstract

This study investigates the impact of financial leverage (FL) on company growth of the listed companies traded in Colombo Stocks Exchange (CSE). Many scholars (Gupta, 1968; Jensen and Meckling, 1976; Ross, 1977; Scott, 1977; Warner, 1977; Bredly, Jarrell and et al 1984; Senbent and Traggart 1984; Myers and Majluf, 1984; Titman, 1984; Titman, and Wessels, 1988; Rajan and Zingales, 1995) have argued that the FL is one of the most influencing factors in determining the growth of a company. The common approach in empirical capital structure studies has been to examine the relationship between observed FL and the set of explanatory variables. This approach has a number of shortcomings. The problem of this study is to investigate whether the FL influences negatively or positively on signaling the firms' growth. This problem furnishes useful information to two groups of users of accounting information; accounting policy makers and financial managers. The objectives of this problem are mainly divided into a primary objective and secondary objectives. The primary objective is to identify the relationship between FL position and the growth rate of the listed companies traded on the Colombo Stock Exchange (CSE). The observation of the level of FL and the growth rate, industrial differences and the degree of relationship of FL and the growth rate and the relationship between financial strength (FS), growth and FL are secondary objectives of this study. Sample size of this study is 30% of thirteen sectors which represent sixty-three quoted companies randomly selected from the CSE, and a period of ten years from 1990 to 2000. The required data and information for the study were gathered from published annual reports, Handbook of listed companies in CSE from 1994, 1997 and 2001 and Central Bank annual report of 2000 AD. The financial ratios are used to evaluate the companies' financial performance and conditions. The growth of the companies is represented by total assets, profit, and sales, which were calculated using the growth index. Altman (1968) multiple discriminant function was constructed to ascertain financial strength of the sample companies. Under the descriptive analysis, average, median and Standard deviation (SD) of the sample companies and sectors were calculated. The relationship between independent variable FL of the sample companies and sectors and dependent variables growth and FS of the sample companies and sectors were tested by regression analysis. F- Statistics was performed to test the significance of the  $\beta$  parameter in the regression model at 5% level of significance. In addition to the above, correlation coefficient (R) and goodness to fit the model (Coefficient of Determination-  $R^2$ ) were

calculated. The results of the study are presented with the use of table and line chart. The overall results of the study indicate that the FL had a strong positive relationship between growth and FS. Conversely, this situation supports this view that there is a positive rather than a negative relationship between FL and other growth variables as implied by the negative signals about the future growth of the company.

## Chapter 1: Introduction

1.0	Background of the Study	1
1.1	Problem of the Study	2
1.2	Objectives of the Study	2
1.3	Significance of the Study	4
1.4	Limitations of the Study	7
1.5	Structure of the Report	8
1.6	Summary	8

## Chapter 2: Literature Review

2.0	Introduction	9
2.1	Concept of Capital Structure	9
2.2	Determinants of Capital Structure	9
2.2.0	Asset Structure	9
2.2.1	Non Debt Tax Shield	10
2.2.2	Growth	10
2.2.3	Uniqueness	11
2.2.4	Industry Classification	11
2.2.5	Size	11
2.2.6	Earning Volatility	12
2.2.7	Profitability	12
2.3	Capital Structure Theories	12
2.3.0	Review of the Empirical Works	14
2.4	Defining Financial Leverage	20
2.4.0	Measures and Arguments for Financial Leverage	20
2.4.1	Financial Leverage and Pecking Order Theory	22
2.5	Meaning and Measures of Firm's Growth	23
2.5.0	Internal and External Growth	25
2.5.1	Need for Seeking Growth	27
2.6	Financial Strength	27
2.6.0	Short Term Financial Strength	28
2.6.0.0	Factors Affecting Need for Short Term Financial Strength	29
2.6.0.1	Short Term Financial Strength and Growth of the Firm	30
2.6.1	Long Term Financial Strength	31
2.7	Debt Financing and Financial Distress	31
2.8	Factors Affecting the firm's Financing	32
2.9	Summary	38

## Table of Contents

Acknowledgement		I
Abstract		II
Table of Contents		IV
List of Tables		VII
List of Figures		VIII
<b>Chapter 1: Introduction</b>		
1.0	Background of the Study	1
1.1	Problem of the Study	3
1.2	Objectives of the Study	5
1.3	Significance of the Study	6
1.4	Limitations of the Study	7
1.5	Structure of the Report	8
1.6	Summary	8
<b>Chapter 2: Literature Review</b>		
2.0	Introduction	9
2.1	Concept of Capital Structure	9
2.2	Determinants of Capital Structure	9
2.2.0	Assets Structure	9
2.2.1	Non Debt Tax Shield	10
2.2.2	Growth	10
2.2.3	Uniqueness	11
2.2.4	Industry Classification	11
2.2.5	Size	11
2.2.6	Earning Volatility	12
2.2.7	Profitability	12
2.3	Capital Structure Theories	12
2.3.0	Review of the Empirical Works	14
2.4	Defining Financial Leverage	20
2.4.0	Measurers and Arguments for Financial Leverage	20
2.4.1	Financial Leverage and Pecking Order Theory	22
2.5	Meaning and Measures of Firm's Growth	23
2.5.0	Internal and External Growth	25
2.5.1	Need for Seeking Growth	27
2.6	Financial Strength	27
2.6.0	Short Term Financial Strength	28
2.6.0.0	Factors Affecting Need for Short Term Financial Strength	29
2.6.0.1	Short Term Financial Strength and Growth of the Firm	30
2.6.1	Long Term Financial Strength	31
2.7	Debt Financing and Financial Distress	31
2.8	Factors Affecting the firms Financing	32
2.9	Summary	34

### **Chapter 3: Methodology of the Study**

3.0	Introduction	35
3.1	Description of the Sample	35
3.2	Study Period	38
3.3	Description of the Data	38
3.4	Analytical Tools of the Study	38
3.5	Data Presentation	41
3.6	Summary	41

### **Chapter 4: Analysis of Growth, Financial Strength and Financial Leverage of the Sample Companies and Sample Sectors**

4.0	Introduction	42
4.1	Analysis of Growth and Financial Strength Variables of the Sample Companies	42
4.1.0	Total Assets Growth of the Sample Companies	43
4.1.1	Profit Growth of the Sample Companies	44
4.1.2	Sales Growth of the Sample Companies	46
4.1.3	Financial Strengths of the Sample Companies	48
4.2	Analysis of Financial Leverage Variables of the Sample Companies	50
4.2.0	Long Term Debt to Total Assets of the Sample Companies	50
4.2.1	Long Term Debt to Fixed Assets of the Sample Companies	52
4.2.2	Total Debt to Equity Capital of the Sample Companies	54
4.2.3	Total Debt to Total Assets of the Sample Companies	56
4.3	Growth and Financial Strength Analysis of the Sample Sectors	58
4.3.0	Total Assets Growth of the Sample Sectors	58
4.3.1	Profit Growth of the Sample Sectors	60
4.3.2	Sales Growth of the Sample Sectors	62
4.3.3	Financial Strength of the Sectors of the Sample Sectors	64
4.4	Analysis of Financial Leverage Variables of the Sample Sectors	66
4.4.0	Long Term Debt to Total Assets of the Sample Sectors	66
4.4.1	Long Term Debt to Fixed Assets of the Sample Sectors	68
4.4.2	Total Debt to Equity Capital of the Sample Sectors	70
4.4.3	Total Debt to Total Assets of the Sample Sectors	72
4.5	Summary	74

### **Chapter 5: Analysis of the Multiple Regression Results of the Sample Companies and Sample Sectors**

5.0	Introduction	76
5.1	Analysis of Multiple Regression Results of the Sample Companies	76
5.1.0	Regression Results of Total Assets Growth Leverage Variables of the Sample Companies	76

5.1.1	Regression Results of Profit Growth and Financial Leverage Variables of the Sample Companies	78
5.1.2	Regression Results of Sales Growth and Financial Leverage Variables of the Sample Companies	80
5.1.3	Regression Results of Financial Strength and Financial Leverage Variables of the Sample Companies	82
5.2	Analysis of Multiple Regression Results of the Sample Sectors	84
5.2.0	Regression Results of Total Assets Growth and Financial Leverage Variables of the Sample Sectors	84
5.2.1	Regression Results of Profit Growth and Financial Leverage Variables of the Sample Sectors	86
5.2.2	Regression Results of Sales Growth and Financial Leverage Variables of the Sample Sectors	88
5.2.3	Regression Results of Financial Strength and Financial Leverage Variables of the Sample Sectors	90
5.3	Overall Regression Results of Total Assets Growth, Profit Growth, Sales Growth Financial Strength and Financial Leverage	92
5.4	Summary	94

## **Chapter 6: Conclusion and Areas for Further Research**

6.0	Introduction	95
6.1	Suggestions for Further Research	96
References		IX
Bibliography		XII
Appendix		XIV