

Capital Structure and Financial Performance: A Comparative Study of Listed Banking and Insurance Companies of the Colombo Stock Exchange (CSE) in Sri Lanka

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ABSTRACT

Capital Structure is a most important discipline in the area of corporate finance since the financial performance of the firm is directly affected by its decisions. The optimal selection and use of equity and debt capital is one of the key elements of corporate financial strategies of a firm. Due to this reason, financial managers should give utmost care and attention in the process of determining capital structure decisions. The aim of this comparative study is to identify the relationship between capital structure and financial performance of Sri Lankan listed banks and insurance companies by using the descriptive statistics, correlation analysis and multiple regression analysis through the Statistical Package for Social Sciences (SPSS). This research measures the capital structure in terms of Debt to Equity ratio and Debt to Assets ratio, where as the financial performance is measured in terms of Gross Profit Ratio, Net Profit ratio, Return on Assets and Return on Equity. Each independent variable along with dependent variables is measured separately for a sample of twelve Sri Lankan listed banks and seven Sri Lankan listed insurance firms during the period of ten years from 2003 to 2012. Findings of the research show that there is positive relationship between capital structure and financial performance in banking and insurance companies and significant differences in capital structure and financial performance of banks and insurance companies were compared using an independent sample t-test. The results show that there are significant differences in capital structure and financial performance between the bank and insurance companies as $t=1.4$, $P=.000$; $t=-2.017$, $P=.003$ respectively. It is concluded that the capital structure and financial performance of Sri Lankan listed banking companies is significantly differed with compared to the Sri Lankan listed insurance companies. Therefore, it can be proved that the research gap in this research is already fulfilled with concentrating other results.

Keywords: Debt to Equity Ratio, Debt to Assets Ratio, Net Profit Ratio, Return on Equity