Full Length Research Paper

The impact of the capital structure and financial performance: A study of the listed companies traded in Colombo stock exchange

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Abstract

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This research examines the relationship between capital structure and financial performance of the listed companies traded in Colombo stock exchange (CSE). The common approach in empirical studies has been to examine the relationship between capital structure and financial performance. Problem of this research is to study how the capital structure negatively or positively influences on signaling the firm's performance. The sample of this study composed of thirty companies listed on the Colombo Stock Exchange and period of 5 five years from 2007 to 2011. The required data and information for the study were gathered from published annual reports, fackbook, and website of listed companies in CSE from 2007 to 2011. The relationship between independent variable capital structure and dependent variable financial performance were tested by correlation analysis. It is focused on the overall point of view of the relationship between the capital structure and financial performance. There is a negative relationship between the capital structure and financial performance. This results that the researchers and interested parties of this research area are able to obtain information.

Keywords: Capital structure, Financial Performance, Total debt, Colombo Stock Exchange.

INTRODUCTION

This study focuses on capital structure and financial performance of the listed companies traded in Colombo stock exchange. The capital is an important resource in the firm's financial decision making process along with the other resources. The capital can be basically classified as ownership or non- ownership in corporate financial aspect. The usually represent equity capital and debt capital.

Capital structure (CS) refers to a mixture of a variety of long term sources of funds and equity shares including reserves and surpluses of an enterprise. The historical attempt to building theory of capital structure began with the presentation of a paper by Modigliani and Miller (1958). They revealed the situations under what conditions that the CS is relevant or irrelevant to the financial performance of the listed companies. Most of the decision making process related to the CS are deciding factors when determining the CS, a number of issues e.g. cost, various taxes and rate, interest rate have been proposed to explain the variation in Financial

Leverage across firms (Van Horne, 1993; Hampton, 1998; Titman and Wessels, 1998). These issues suggested that the depending on attributes that caused the cost of various sources of capital the firm's select CS and benefits related to debt and equity financing. Various costs of capital and their benefits directly affect the ultimate goal of the firm. An ultimate goal of a firm is the maximization of wealth or value of that firm (Modigliani and Miller, 1958, 1963; Miller, 1977). The relationship between CS and financial performance has been the subject of remarkable milestone over the past decade throughout the irrelevance theory. In the seminal article, presented by Modigliani and Miller's (1958) irrelevance theory, they argued that the CS is unrelated to firm's value. In the presence of corporate income tax and the cost of capital in Modigliani and Miller's (1963) they argued that the market value of the firm is positively related to the amount of long term debt used in its capital structure.

Strength of financial position of an organization is called financial performance. Financial analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing relationship between the items of the balance sheet and the profit and loss account. In financial analysis a ratio is used as a benchmark for evaluating the financial position and performance of a firm. Ratios help to summarize large quantities of financial data and to make qualitative judgment about the firm's financial performance. The relationship between capital structure and financial performance is one that received considerable attention in the finance literature. How important is the concentration of control for the company performance or the type of investors exerting that control are questions that authors have tried to answer for long time prior studies show that capital structure has relating with corporate governance, which is the key issues of state owned enterprise. To study the effects of capital structure or financial performance, will help us to know the potential problems in performance and capital structure.

The modern industrial firm must conduct its business in a highly complex and competitive business environment. Therefore, these types of research findings will be beneficial in selecting the capital structure to achieve the optimum level of firm's performance.

Research problem

When considering about the capital structure effects on the performance of listed companies, it has some impacts on the performance. Therefore, the capital structure of the companies has the influence on the performance of listed companies.

Further, in many countries, many investors or public don't have the perfect knowledge and understandings when dealing with the investment activities. Therefore, it should be made clear understanding on the impact of capital structure on the firm performance. The main problem of this research is to study how the capital structure negatively or positively influences on signaling the firm's performance in Sri Lanka.

Objectives

The objectives are grated towards the following:
- To identify the relationship between capital structure and financial performance of listed companies traded in Colombo Stock Exchange.
- To evaluate the interrelationship between capital structure and performance
- To find out the impact of capital structure on profitability.
- To determine the determinants of a capital structure

Review of literature

Capital structure is referred to as the way in which the firm finances itself through debts, equity and securities. It is the composition of debt and equity that is required for a firm to finance its assets. The capital structure of a firm is very important since it is related to the ability of the firm to meet the needs of its stakeholders. The Board of Directors or the financial manager of a company should always endeavor to develop a capital structure that would lie beneficial to the equity shareholders in particular and to the other groups such as employees, customers, creditors and society in general (Pandey, 2009).

Brander and Lewis (1986) and Maksimovic (1988) provided the theoretical framework that links capital structure and market structure. Contrary to the profit maximization objective postulated in industrial organization literature, these theories, like the corporate finance theory, assume that the firm's objective is to maximize the wealth of shareholders and show that market structure affects capital structure by influencing the competitive behavior and strategies of firms. According to Brander and Lewis (1986) firms in the oligopolistic market will follow the strategy of maximizing their output for improving profitability in favorable economic conditions. In unfavorable economic conditions, they would take a cut in production and reduce their profitability. Shareholders enjoy increased wealth in good periods, but they tend to ignore decline in profitability in bad times as unfavorable consequences are passed on to lenders because of shareholders' limited liability status. Thus the oligopoly firms, in contrast to the firms in the competitive markets, would employ higher levels of debt to produce more when opportunities to earn high profits arise. The implied prediction of the output maximization hypothesis is that capital structure and market structure have positive relationship.

Fischeretal (1989) developed a model of dynamic optimal gearing choice and demonstrate that debt ratios are characterized by wide swings. While Flannery and Rangan, (2006) find that US firms have target gearing ratios, they also find that the sample average debt ratio over the period 1966-2001 is very volatile.

Lalith, (1999) investigated the capital structure of Sri Lankan companies and found that the use of long-term debt is relatively low in Sri Lankan companies. The mean leverage in Sri Lanka is estimated as 13.5%, long term debt to equity ratio is 24% while the total debt to equity ratio is 104.1%. This evidence suggested that the use of debt financing in Sri Lanka is significantly low in comparison to G7 markets. Other factors both quantitative and qualitative, the potentially influence capital structure decisions in Sri Lanka.

Kathleen and Kuldeep, (2002) analyzed the relationship between the capital structure of a firm and the tax benefits realized from the exercise of stock options. Theory suggests that firms with tax benefits from the exercise of stock options should carry less debt since tax benefits are a non-debt tax shield. They find that both long- and short-term debt ratios are negatively related to the size of tax benefits from option exercise. Moreover, one year changes in long-term leverage are negatively related to changes in the number of options exercised. Such a relation does not exist for changes in short-term leverage. Finally, firms with option related tax benefits tend to issue equity, with the net amount of equity issued an increasing function of these tax benefits.

According to Champion (1999) and Leibestein (1966), companied can use more debt to enhance their financial performance because of debt's capability to cause managers to improve productivity to avoid bankruptcy. The point here is that, debt must be repaid while dividend payment is not obligatory and can even be postponed if the firm is financially hard up. David. Hutchison and Raymond, (2000) examined the causal relationship between the return on equity and financial leverage in the U. S. banking industry. For the periods 1983 – 1989 and 1996 – 2002 we find there is a negative connection between bank capital and equity profitability except for the best performing banks. Nimalathasan and Valeriu Brabete (2010) pointed out capital structure and its impact on profitability: a study of listed manufacturing companies in Sri Lanka. The analysis of listed manufacturing companies shows that Dept equity ratio is positively and strongly associated to all profitability ratios (Gross Profit, Operating Profit and Net Profit Ratios).

Prahalathan, and Ranjani, (2011) evaluated the Impact of capital Structure Choice on Firm Performance: Empirical Investigation of Listed companies in Colombo Stock Exchange, Sri Lanka. The results indicate that neither short term debt to total asset ratio, long term debt to total debt ratio nor total debt to total asset ratio has a significant impact on firm's performance measured by Return on Equity, and Return on Assets respectively.

These results contradict with findings of previous literature either in developed or transition economies which document a significant impact of capital structure on firm's performance either positively or negatively.

Conceptualization

Based on the research question, the following conceptual model has been constructed. Conceptualization model shows the impact of the capital structure and financial Performance of listed Companies Traded in Colombo Stock Exchange. (Figure 1)

Hypotheses of the study

The following hypotheses are developed for testing.
H_1:- There is positive relationship between capital structure and financial performance.
H_2:- The capital structure has significant impact on financial performance.

METHODOLOGY

a) Data Collection

The present study used secondary data for the analysis. Secondary data is data that have been previously collected for some other project rather than the one at hand but found useful by the researcher. The financial statements which are made up of income statements and balance sheet of the sample companies were the main sources of data for this study. These were obtained from the Hand book of Listed Companies 2007 and the annual reports of respective companies. Further, scholarly articles from academic journals, relevant text books on the subject and the internet search engines were also used. Specifically, the financial statements of the companies in the sample were collected for the period 2007-2011 and a balanced panel of thirty companies emerged for the study.

b) Sampling design

According to Jankowicz, (1994) generalization about the population from data collected using any sample is based on probability. In order to be able to generalize about the research finding to the population, it is necessary to select samples of sufficient size. A large sample size will in general improve the quality of the research. A large sample size is always better than a small one. Saunders, Lewis and Thornhill (1996) also point out that the larger the sample size, the lower the likely error in generalizing the population. The Colombo Stock Exchange (CSE) has
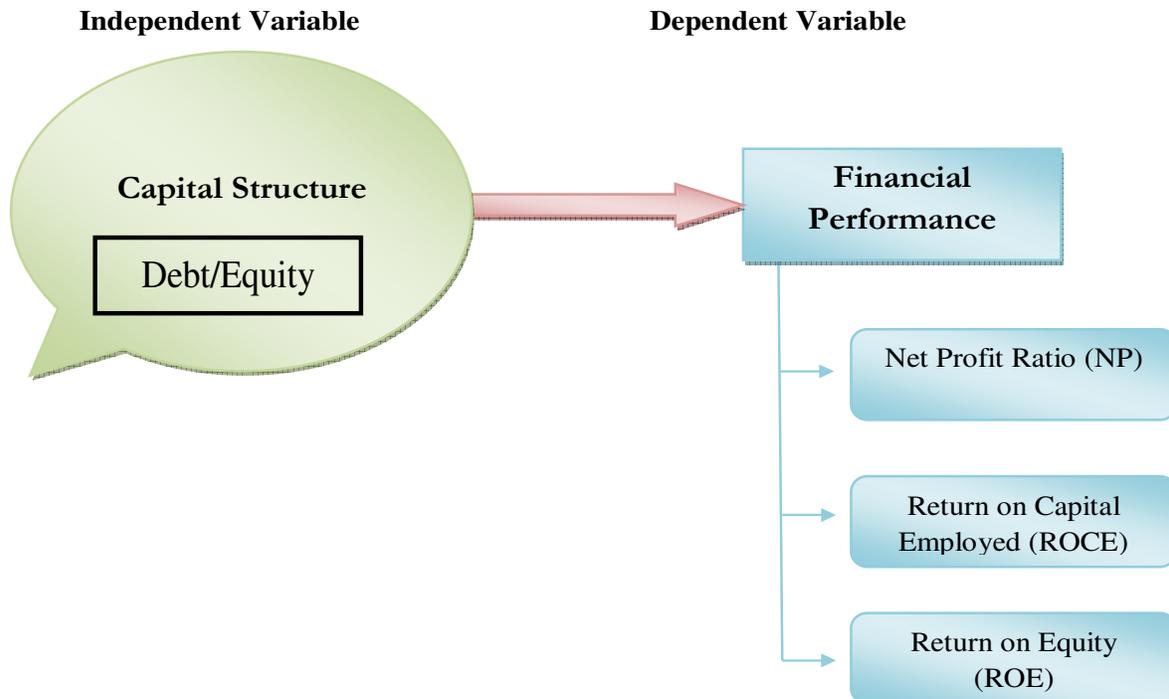
Independent Variable   **Dependent Variable**

Figure 1. Conceptualization Model

Table 1. Sampling Design

Sector	Number of samples
Bank finance and Insurance	3
Beverage Food and Tobacco	3
Chemicals and Pharmaceuticals	2
Construction and Engineering	3
Diversified Holdings	2
Footwear and Textiles	1
Health care	1
Hotels and Travel	2
Information Technology	1
Investment Trust	1
Land and Property	1
Manufacturing	3
Motors	1
Oil Palms	1
Plantations	1
Power and Energy	1
Services	1
Stores and Supplies	1
Telecommunication	1
Total No. of. Samples	30

Source: CSE weekly report as at 23.01.2012

241 companies representing 20 business sectors as at 31st December 2011. The sample of this study composed of thirty companies listed in the Colombo Stock Exchange and period of 5 years from 2007 to 2011. The following table shows the sample companies based on the sectors. (Table 1)

c) Mode of analysis

The quantitative research approach is employed to find out the findings of the research study. Since numerical and secondary data is used, quantitative approach is considered to be a suitable approach for the study. According to Leavy (2004, p.37), "statistical analyses are used to describe an account for the observed variability in the data". This involves the process of analyzing the data that has been collected. Thus the purpose of statistics is to summarize and answer questions that were obtained in the research. The upper level of statistical significance for hypotheses testing was set at 5%. All statistical test results were computed at the 2-tailed level of significance. Statistical analysis involves both descriptive and inferential statistics.

Descriptive statistics are used to describe and summarize the behavior of the variables in a study. They refer to the ways in which a large number of observations are reduced to interpretable numbers such as averages and percentages. Inferential statistics are used to draw conclusions about the reliability and generalisability of the findings (Leary, 2004, p.38). In order to test the research hypotheses; the inferential tests used include the Pearson Product-Moment Correlation Coefficient and Regression Analysis.

RESULTS AND ANALYSIS

a) Correlation analysis

Correlation is concerned describing the strength of relationship between two variables. In this study the correlation co-efficient analysis is under taken to find out the relationship between capital structure and financial performance. It show the amount of relationship exist between capital structure and financial performance. With the help of the computer the following output is obtained.

Capital structure correlated with

	R value	R2 value
Net Profit	0.050	0.003
ROCE	0.411	0.169
ROE	0.083	0.007
Performance	0.137	0.019

According to the above calculation, It can be refers positive relationship between capital structure and financial performance variables.

Capital Structure vs Net profit

The Table 2 illustrates the relationship between net profit and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.050. Significant level is 0.01. The co-efficient of determination is 0.003. That is only 0.3% of variance in the capital structure is accounted by the net profit. So, there is a weak negative relationship between capital structure and net profit.

Capital Structure Vs Return on Capital Employed (ROCE)

The Table 3 indicates the relationship between ROCE and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.411. Significant level is 0.01. The co-efficient of determination is 0.169. That is only 16.9% of variance in the capital structure is accounted by the ROCE. Therefore, there is a weak negative relationship between capital structure and ROCE.

Capital Structure Vs Return on Equity (ROE)

The Table 4 illustrates the relationship between ROE and capital structure variables. There is a weak negative relationship between two variables. The correlation is -0.083 significant level is 0.05. The co-efficient of determination is 0.007. That is only 0.7% of variance in the capital structure is accounted by the ROE. So, there is a weak negative relationship between capital structure and ROE.

Capital Structure Vs Financial Performance (Overall Analysis)

The Table 5 illustrates the relationship between performance and capital structure variables. There is a weak negative relationship between two variables. The correlation is 0.014. Significant level is 0.01. The co-efficient of determination is 0.019. That is only 1.9% of variance in the capital structure is accounted by the performance. Therefore, there is a weak negative relationship between capital structure and performance.

b) Regression analysis

Regression analysis is used to test the impact of financial performance on capital structure of the listed companies traded in Colombo stock exchange. Here financial performance is the dependent variable and capital structure of the independent variable. From these independent and dependent variables, the following relationships are formulated.

Table 2. Correlation of Capital Structure Vs Net Profit

Variables		Capital Structure	Net Profit
Capital Structure	Pearson Correlation	1	-.050
	Sig. (2-tailed)		.792
	N	30	30
Net Profit	Pearson Correlation	-.050	1
	Sig. (2-tailed)	.792	
	N	30	30

Table 3. Correlation of Capital Structure Vs ROCE

Variables		Capital Structure	ROCE
Capital Structure	Pearson Correlation	1	-.411*
	Sig. (2-tailed)		.024
	N	30	30
ROCE	Pearson Correlation	-.411*	1
	Sig. (2-tailed)	.024	
	N	30	30

Table 4. Correlation of Capital Structure Vs ROE

Variables		Capital Structure	ROE
Capital Structure	Pearson Correlation	1	-.083
	Sig. (2-tailed)		.664
	N	30	30
ROE	Pearson Correlation	-.083	1
	Sig. (2-tailed)	.664	
	N	30	30

*Correlation is significant at the 0.05 level (2-tailed).

Table 5. Correlation of Capital Structure Vs Financial Performance

Variables		Capital Structure	Financial Performance
Capital Structure	Pearson Correlation	1	-.137
	Sig. (2-tailed)		.472
	N	30	30
Financial Performance	Pearson Correlation	-.137	1
	Sig. (2-tailed)	.472	
	N	30	30

Capital Structure Vs Net Profit

The above Table 6 shows the weak positive correlation between the capital structure and net profit.

The above Table 7 indicates the coefficient of correlation between the capital structure and net profit. Multiple R^2 is 0.003. Only 0.3% of variance of net profit is accurate by the capital structure. But, remaining 99.7 % of variance with net profit is attributed to other factors.

In the figure 2, X axis indicates the capital structure and Y axis indicates the net profit. From the above figure it is observable that there is a weak linear negative relationship between the two variables. The plot are scattered loosely around the linear line which mean that net profit have some impact over the capital structure. According to the above figure linear equation is formulated as follows Y=27.053 +-0.031X. and R Square Linear is 0.003.

The regression equation Y=27.053+-0.031X exhibits that the relationship between capital structure and net

Table 6. Regression of Capital Structure Vs Net Profit

Model Summary -1

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.050(a)	.003	-.033	79.11415

a Predictors: (Constant), Capital Structure

Table 7. Coefficients of Capital Structure Vs Net Profit

Coefficients

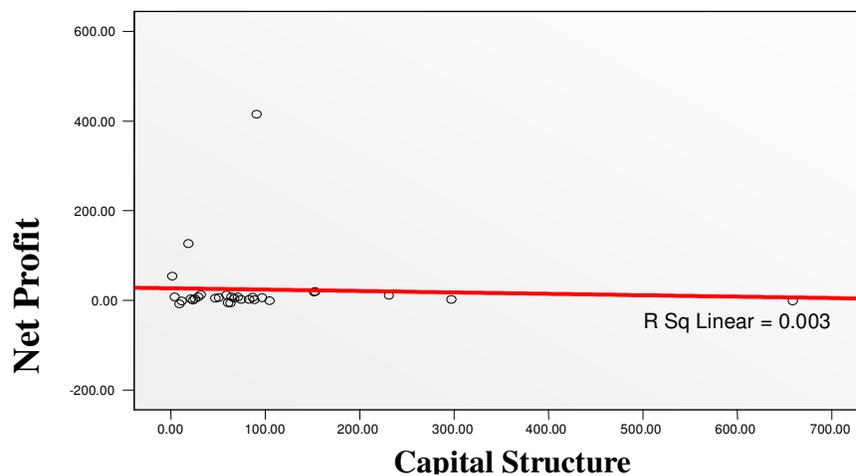| Model	Un standardized Coefficients		Standardized Coefficients	t	Sig
	B	Std.Error	Beta		
1 (constant)	27.053	18.054		1.498	0.145
Capital structure	-0.031	0.117	-0.050	-0.267	0.792

a Dependent Variable: Net Profit

Figure 2. Capital Structure Vs Net Profit

profit. If capital structure is X=0, net profit is to be 27.053. Further capital structure is increased by one; the net profit will be decreased by 0.031. Therefore, it can be said that there is a negative relationship between variables (Capital structure and Net Profit).

Capital Structure Vs ROCE

Table 8 below shows the weak positive correlation between the capital structure and ROCE.

Table 9 below indicates the coefficient of correlation between the capital structure and ROCE. Multiple R2 is 0.169. Only 16.9% of variance of ROCE is accurate by the capital structure. But, remaining 83.1% of variance with ROCE is attributed to other factors.

In the figure 3, X axis indicates the capital structure and Y axis indicates the ROCE. From the figure below it is observable that there is a weak linear negative relationship between the two variables. The plot are scattered loosely around the linear line which mean that ROCE have some impact over the capital structure. According to the figure below linear equation is formulated as follows Y=14.520+-0.044X and R Square Linear is 0.169.

The regression equation Y=14.520+-0.044X exhibits that the relationship between capital structure and ROCE. If capital structure is X=0, ROCE is to be 14.520. Further capital structure is increased by one; the ROCE will be decreased by 0.044. Therefore, it can be said that there is a negative relationship between variables (Capital structure and ROCE).

Table 8. Regression of Capital Structure Vs ROCE

Model summary 2

| Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.411 (a)	.169	.139	12.38281

a Predictors: (Constant), Capital Structure

Table 9. Coefficients of Capital Structure Vs ROCE

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig
	B	Std.Error	Beta		
1 (constant)	14.520	2.826		5.138	.000
Capital structure	-.044	.018	-.411	-2.383	.024

a. Dependent Variable: ROCE
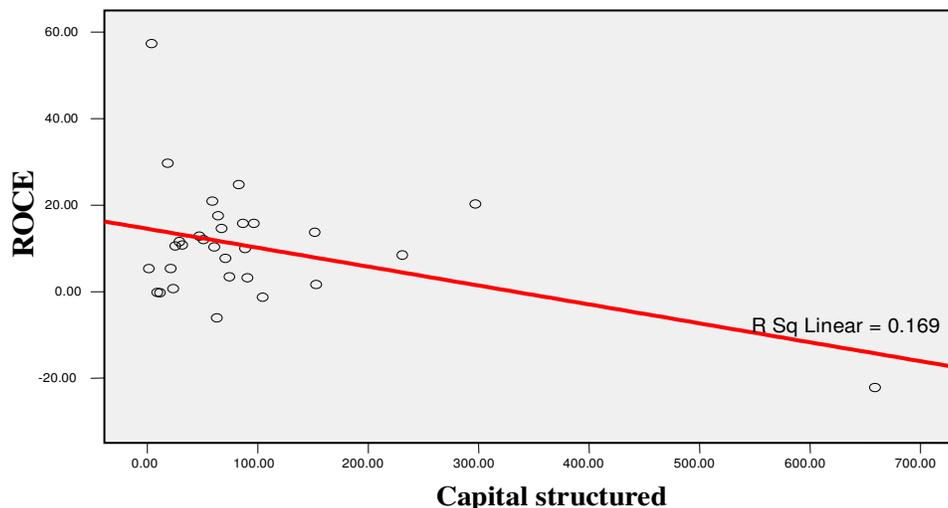
Figure 3. Capital Structure Vs ROCE

Capital Structure Vs ROE

The above Table 10 shows the weak positive correlation between the capital structure and ROE.

The above Table 11 indicates the coefficient of correlation between the capital structure and ROE. Multiple R^2 is 0.007.Only 0.7% of variance of ROE is accurate by the capital structure. But, remaining 99.3% of variance with ROE is attributed to other factors.

In the figure 4, X axis indicates the capital structure and Y axis indicates the ROE. From the above figure it is observable that there is a weak linear negative relationship between the two variables. The plot are scattered loosely around the linear line which mean that ROE have some impact over the capital structure. According to the above figure linear equation is formulated as follows Y=77.277+-0.079X. and R Square Linear is -0.029.

The regression equation Y=77.277+-0.079X exhibits that the relationship between capital structure and ROE. If capital structure is X=0, ROE is to be 77.277. Further capital structure is decreased by one; the ROE will be decreased by 0.079. Therefore, it can be said that there is a negative relationship between variables (Capital structure and ROE).

Capital Structure Vs Financial Performance (overall analysis)

The Table 12 below shows the weak positive correlation between the capital structure and performance.

Table 10. Regression of Capital Structure Vs ROE

Model summary 3

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.083	.007	-.029	121.89881

a Predictors: (Constant), Capital Structure

Table 11. Coefficients of Capital Structure Vs ROE

Coefficients

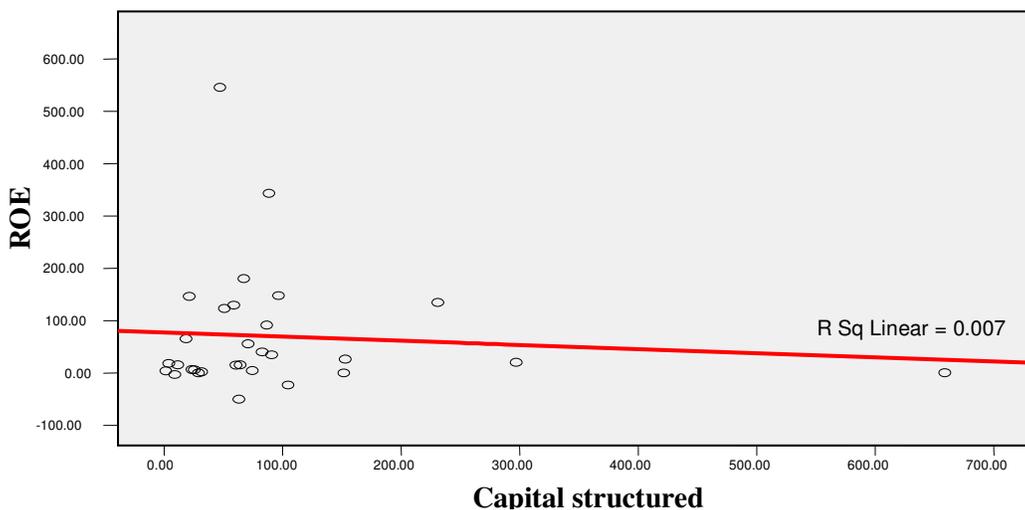| Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig
	B	Std. Error	Beta		
1 (constant)	77.277	27.818		2.778	.010
Capital structure	-.079	.181	-.083	-.439	.664

Dependent Variable: ROE

Figure 4. Capital Structure Vs ROE

Table 12. Regression of Capital structure Vs Financial Performance

Model Summary 4

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.137a	.019	-.016	47.57642

Table 13 below indicates the coefficient of correlation between the capital structure and performance. Multiple R^2 is 0.019. Only 1.9% of variance of performance is accurate by the capital structure. But, remaining 98.1% of variance with performance is attributed to other factors.

In the figure 5 X-axis indicates the capital structure and Y axis indicates the financial performance. From the above figure it is observable that there is a linear negative relationship between the two variables. The plot are scattered loosely around the linear line which mean that performance have some impact over the capital structure. According to the above figure linear equation is formulated as follows Y=39.617+ -0.051X. and R Square is Linear 0.019.

The regression equation Y=39.617+-0.051X exhibits that the relationship between capital structure and performance. If capital structure is X=0, performance is to be 39.617. Further capital structure is increased by one;

Table 13. Coefficients of Capital Structure Vs Financial Performance

Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig
	B	Std. Error	Beta		
1 (constant)	39.617	10.857		3.649	.001
Capital structure	-.051	.070	-.137	-.729	.472

a. Dependent Variable: Financial Performance
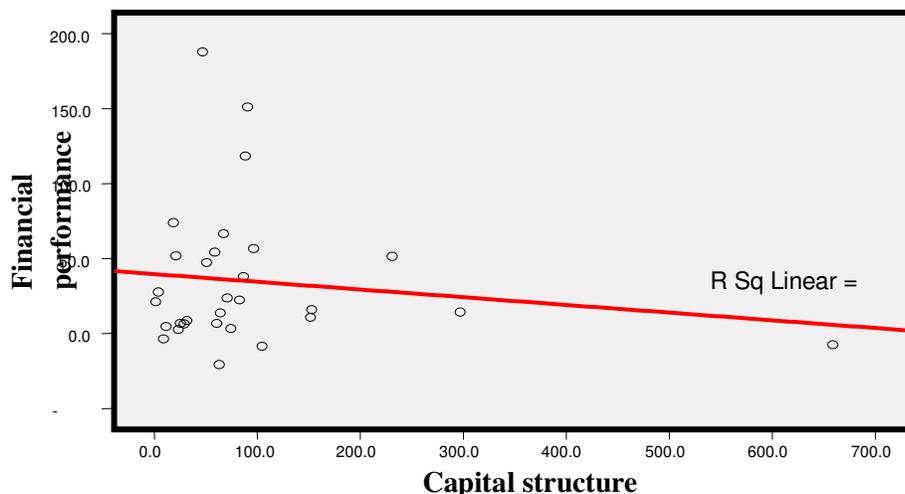
Figure 5. Capital Structure Vs Financial Performance

Table 14. Descriptive Statistics

Descriptive Statistics

	N	Range	Minimum	Maximum	Mean		Std. Deviation	Variance	Skewness		Kurtosis	
	Statistic	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic	Statistic	Statistic	Std. Error	Statistic	Std. Error
Netprofit	30	422.94	-7.60	415.34	24.1647	14.21099	77.83680	6058.567	4.755	.427	23.857	.833
ROCE	30	79.50	-22.14	57.36	10.4803	2.43633	13.34432	178.071	1.087	.427	5.101	.833
ROE	30	596.01	-50.18	545.83	69.9520	21.94359	120.18998	14445.63	2.657	.427	8.380	.833
Financialperformance	30	208.57	-20.73	187.84	34.8657	8.61585	47.19094	2226.985	1.844	.427	3.569	.833
Capitalstructured	30	657.36	1.39	658.75	92.3963	22.87950	125.31617	15704.142	3.540	.427	14.790	.833
Valid N (listwise)	30											

the performance will be decreased by 0.051. Therefore, it can be said that there is a negative relationship between variables (Capital structure and Financial Performance).

Descriptive statistics

The Descriptive procedure displays unvaried summary statistics for several variables in a single table and calculates standardized values (Z scores). Variables can be ordered by the size of their means (in ascending or descending order), alphabetically, or by the order in which you select the variables. Here, the sample consists

of 30 listed companies traded in Colombo stock exchange.

It refers the following items, Sample size, mean, minimum, maximum, standard deviation, variance, range, sum, standard error of the mean, and kurtosis and skewness with their standard errors.

The Table 14 shows the values of range, minimum, maximum, mean, variance of independent, dependent variables, skewness and kurtosis. ROE has high mean value of 69.9520% than other variables. It has high maximum value of 545.83 and high variance of 445.631. At the same time according to the above table ROCE has low maximum value and low mean value too than other

variables. The maximum and minimum values for each performance measures indicate that the performance varies substantially among companies. Capital structure has high mean value compare to the financial performance.

Testing of hypotheses

H_1: "There is a positive relationship between the capital structure and firm's financial performance".
At the first step of testing the hypothesis (H_1), hypothesis (H_1) was considered and tested for its validity. It has the following result

Statistical Techniques	Results
Correlation	-0.137
Co –efficient of determination	-0.019

Based on the empirical results of this study, this hypothesis come false .Because in this study the empirical results shows that there is a insignificant negative relationship Between the capital structure and firm's financial performance measured by performance measures such as ROCE, ROE, Net profit margin and etc. Based on the above evidence gathered, the H1 was rejected. Because, research result is negative relationship between the capital structure and firm's financial performance.
H_0: "There is a negative relationship between the capital structure and firm's financial performance".
After the rejection of H_1, the Null hypothesis (H_0) was tested for its validity. H_0 was accepted based on the above evidence gathered. It has been provided that there is a negative relationship between the capital structure and firm's financial performance (-0.137).

CONCLUSION AND RECOMMENDATION

The objective of this study find out the relationship between the capital structure and financial performance of listed companies traded in Colombo stock exchange. The study has examined empirically the relationship between the capital structure and firm's financial performance using 30 samples of listed companies in Sri Lanka over 2007-2011 periods. According to the empirical results of this study, the researcher can drive the conclusions regarding the impact of capital structure on company's financial performance. Based on this, this study documents a negative relationship. R value is 0.137. This can be explained more detailed as follows, when we take into consideration, each variable individually. Correlation analysis explains there is a weak negative relationship between net profit and capital

structure (-0.050).
It reflects the high financial cost among the firms. ROE and ROCE also has negative relationship with capital structure at-0.083,-0.411 respectively. It is focused on the overall point of view of the relationship between the capital structure and financial performance. There is a negative association at -0.137. Co-efficient of determination is 0.019. F and t values are 0.532, -0.729 respectively. It is reflect the insignificant level of the listed companies of the Sri Lanka. Sri Lankan listed companies mostly depend on the dept capital. Therefore, they have to pay interest expenses much. The absence of a well-developed bond market was viewed as the primary reasons for the observed relationship. The firms don't have efficient investment structure. Therefore, there is investment not enough to increase the profitability and financial benefits. Due to this reason ROCE has negative relationship with capital structure. Further, there are many reasons for negative relationship such as, political fluctuation, internal war, and financial crisis of the world market, inflation and exchange rate fluctuations.
According to the literature review, the researcher was able to observe the negative relationship between capital structure and firm's financial performance in many developing countries like Sri Lanka. In the concluding remarks section, it is summarized that Sri Lankan listed firms with dispersed capital structure are associated with higher risk, implying higher market valuation, but worse performance when it comes to Net profit margin, and ROE. On the contrary, firms with a high efficient capital structure in general have lower firm-specific risk. This implies lower valuation, but better performance when it comes to ROE and ROCE.

SUGGESTIONS AND RECOMMENDATIONS

The following suggestions are recommended to increase the firm's financial performance based on capital structure.
- Performance standards should be established and communicated to the investors. This will help investors to achieve the standard and take better investment decisions.
- Identifying weaknesses of investment may be best one to improve the firm's financial performance, because it indicates the area which decision should be taken.
- Motivating the investors to help to achieve the high level of firm's financial performance.

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