# DETERMINANTS OF CAPITAL STRUCTURE IN LICENSED FINANCE COMPANIES IN SRI LANKA.

**D.M.A.R. Karunanayaka[1, *], W.P. Wijewardana[2] and C.T. Gamage[3]**

[1,2,3] *Department of Accountancy and Finance, Faculty of Management Studies, Rajarata University of Sri Lanka*

*Corresponding author (Email: ac2019160@mgt.rjt.ac.lk)

## ABSTRACT

This study examines the determinants of licensed financial firms' capital structure in Sri Lanka. This study addresses a critical gap in the understanding of how firm-specific factors influence financing decisions within the sector. Based on the existing literature, a conceptual framework was developed with capital structure as the dependent variable and firm size, profitability, tangibility, and non-debt tax coverage as the independent variables. The research uses secondary data from 165 annual reports of 33 licensed financial companies from to 2018-2022 analysed using STATA 15.0. The regression analysis revealed significant relationships between the variables. Notably, firm size exhibits an unexpected negative correlation with capital structure, challenging conventional theories associated with larger firms with higher debt levels. Profitability showed a positive relationship with capital structure, consistent with pecking order theory, while tangibility showed a strong negative correlation. However, non-debt tax shields are found to have a statistically insignificant effect. These findings have practical implications for the decision-making processes of licensed financial companies in Sri Lanka, particularly for risk management and capital allocation strategies. The study acknowledges limitations, including its focus on licensed financial companies, excluding other financial institutions, such as banks and non-bank financial institutions. Moreover, the analysis considered only a narrow set of criteria, excluding external factors, such as regulatory changes, economic policies, and global market influences. The relatively short study period may only partially capture the long-term capital structure dynamics. Despite these limitations, this study contributes to a better understanding of capital structure decisions in the context of economic volatility and the COVID-19 pandemic, prompting a reexamination of established ideas about firm size and the role of non-debt tax shields.

***Keywords*:** Capital structure, firm size, profitability, tangibility, nondebt tax shield