

**T.C.**  
**ISTANBUL AYDIN UNIVERSITY**  
**INSTITUTE OF SOCIAL SCIENCES**



**IMPACT OF DEBT FINANCING ON CORPORATE FINANCIAL PERFORMANCE**  
**(EVIDENCE FROM PAKISTAN'S TEXTILE FIRMS)**

**THESIS**  
**Muhammad IBRAR**

**Department of Business**  
**Business Management Program**

**Thesis Advisor: Assist. Prof. Dr. Öğr. Üyesi NURGÜN KOMŞUOĞLU**

**FEBURARY 2019**

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T.C.  
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YÜKSEK LİSANS TEZ ONAY FORMU

Enstitümüz İşletme İngilizce Anabilim Dalı İşletme Yönetimi İngilizce Tezli Yüksek Lisans Programı Y1612.130107 numaralı öğrencisi **Muhammad IBRAR**'ın "IMPACT OF DEBT FINANCING ON CORPORATE FINANCIAL PERFORMANCE: EVIDENCE FROM PAKISTAN TEXTILE SECTOR" adlı tez çalışması Enstitümüz Yönetim Kurulunun 28.01.2019 tarih ve 2019/02 sayılı kararıyla oluşturulan jüri tarafından oybirliği/oyçokluğu ile Tezli Yüksek Lisans tezi 12.02.2019 tarihinde kabul edilmiştir.

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## **FOREWORD**

This thesis is about the Impact of Debt Financing on Corporate Financial Performance (Evidence from Pakistan's Textile firms). Textile firm's data has been collected which are listed at Pakistan stock exchange for empirical investigation. Panel Least Square Regression and Correlation approach have been used to examine the affect. I personally hope that this compilation of research will be helpful to the subject. I am humbly grateful to my advisor Dr. Öğr. Üyesi Nurgün Komşuoğlu for guiding me, giving me support and courage to do this project. I would also like to thanks my friend İmran Ramzan for supporting and motivating me and at the end would like to thanks my mother who remembered me in her prayers.

**Feburary 2019**

**Muhammad IBRAR**

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## **ABBREVIATIONS**

<b>CA</b>	: Current Asset
<b>CG</b>	: Capital Gain
<b>CL</b>	: Current Liability
<b>COF</b>	: Cost of Funds
<b>DTA</b>	: Debt to Asset
<b>DTE</b>	: Debt to Equity
<b>EPS</b>	: Earning per share
<b>FCF</b>	: Free Cash Flow
<b>FG</b>	: Firm Growth
<b>FS</b>	: Financial Statement
<b>FSG</b>	: Firm Sales Growth
<b>GAAP</b>	: Generally Accepted Accounting Principle
<b>GATT</b>	: Generally Accepted Accounting Principle
<b>GCC</b>	: Gulf Cooperation council
<b>GDP</b>	: Gross domestic product
<b>LDTA</b>	: Long term Debt to Asset
<b>NI</b>	: Net Income
<b>NSE</b>	: Nairobi Stock Exchange
<b>PSE</b>	: Pakistan Stock Exchange
<b>ROA</b>	: Return on Asset
<b>ROE</b>	: Return on Equity
<b>SDTA</b>	: Short term Debt to Asset
<b>SME</b>	: Small and Medium Size Enterprise
<b>WTO</b>	: World Trade Organization
<b>WACC</b>	: Weighted Average Cost of Capital



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## **BORÇ FİNANSMANININ KURUMSAL FİNANS PERFORMANS ÜZERİNDEKİ ETKİSİ (PAKİSTAN TEKSTİL FİRMALARINDAN KANITLAR)**

### **ÖZET**

Borç finansmanı kararı, ekonomi alanında birçok açıdan işletme firmaları için çok önemlidir. Bazı işletme kuruluşunun borcun ve hakkaniyetin doğru bileşimini analiz etmesi çoğunlukla kolay değildir. Karar, firmanın çeşitli seçim bölgelerinde toparlanmayı en üst düzeye çıkarmanın gerekliliğinden dolayı hayati önem taşımaktadır. Bu, aynı zamanda savaş ortamı ile uğraşma konusunda örgütlerin kabiliyetine dair kararların çarpışmasıyla da hayati önem taşımaktadır. Bir organizasyon diğer birçok sermaye yapısı arasından seçim yapabilir. Geçmiş araştırmacılar tarafından kuruluşun kullandığı sermaye yapısı, finansal performans eğilimlerini etkileyen bir akıl yürütme ve samimi bir yoğunlaşma sağlanamamış bir tartışma olabilir. Son olarak, kuruluşun yönetimini yürütmek için özkaynak finansmanı daha fazla kaldıraç sağlar. Sermayenin yapısı, bir kuruluşun borç sermayesi veya öz sermayesi yoluyla gidebilecek görevlerini finanse ettiği veya bazen her ikisinin de bir birleşimi olabileceği bir tekniktir. Bir kuruluşun hisse senedi birleşimi borçlanması, bir kuruluşun değerine ve sermayenin maliyetine ilişkin gerekli göstergelere sahip olabilir. Hissedarların zenginliğinin artmasıyla, bir kuruluş sermayenin yapısında daha fazla borç sermayesi kullanmakta, bunun üzerine verilen faiz ve borcun azalması maliyet etkin olmaktadır. Regresyon analizi, DTE ve SDTA'nın ROA ve ROE'ye olumsuz etkide bulunduğunu göstermektedir. Firma büyümesi, ROA ve ROE üzerinde istatistiksel olarak anlamlı ve olumlu bir etkiye sahiptir. LDTA'nın pozitif ama önemsiz bir etkisi vardır. Bu nedenle, sonuçlar, tekstil firmalarının karlılığı için borçların uygun olmadığını ve sipariş teorisinin gagalanmasıyla desteklenmesini tavsiye etmektedir. Sonuçlar, (2007) ve Tian (2007) hakkında önceki çalışma ile tutarlıdır.

**Anahtar kelimeler :** *Tekstil Firması, Panel Veri Analizi, Pakistan*

## **IMPACT OF DEBT FINANCING ON CORPORATE FINANCIAL PERFORMANCE (EVIDENCE FROM PAKISTAN'S TEXTILE FIRMS)**

### **ABSTRACT**

The decision of the debt financing is very important for the business firms in many aspects in a field of economy. It is mostly not easy for a business organization to analyze the correct composition of the debt and equity. The decision is crucial due to the fact of the requirement of maximizing recovery to several constituencies of the firm. This one is also crucial due to the impingement of decision on organizations capability of dealing with its combative environment. An organization can select among many other capital structures. The structure of capital used by the organization can be a reasoning affecting their trends of financial performance, a controversy that has not been provided sincere concentration by past investigators. The aspect of debt is that the one has borrowed the money must give back the borrowed money as per agreement and also look into the charges of the services e.g the loan fee and interest. Many organizations utilize both types of financing in the process of making the life of their business. Loan borrowing, bond issuance, selling of shares are the main things for supporting an organization with finance and borrowing of the loan. Finally, the financing of equity provides more leverages in order to run the organization's management. Debt to equity combination of an organization may have necessary indications for the worth of an organization and capital's cost. In increasing wealth of shareholders, an organization utilizes more capital of debt in the structure of capital as the interest given on it is a tax provable and decreasing the debt is cost effective. The regression result shows that DTE and SDTA influence negatively to ROA and ROE. Firm growth has statistically significant and positive effect on ROA and ROE. LDTA has positive but insignificant effect. Therefore, results recommend that debts are not favourable for the profitability of the textile firms and supported by pecking order theory. The results are consistent with the previous study Abor (2007) and Tian (2007).

**Keywords :** *Textile Firm, Panel Data Analysis, Pakistan*



## **1. INTRODUCTION**

This chapter is going to discuss the background of the study, also showing an examination of the consequences of debt financing on the profitability of textile firms showing at Pakistan stock exchange. Moreover, it is going to discuss the statement of the problem, questions of the research, the main objective of the study, importance or significance of the study, the purview of the study and the circumspection of the study.

### **1.1. Background of Study**

The decision of the debt financing is very important for the business firms in many aspects in a field of economy. It is mostly not easy for a business organization to analyze the correct composition of the debt and equity. The decision is crucial due to the fact of the requirement of maximizing recovery to several constituencies of the firm. This one is also crucial due to the impingement of decision on organizations capability of dealing with its combative environment. An organization can select among many other capital structures. It can select whether to issue a big amount or a small amount of debt.

It has the ability to organize lease financing, give bonds that can be converted when needed, also have the possibility of signing forward contracts or trade bond types can be exchanged. Another way is to give many other apparent securities in endless mergers, withal its pursuit to take out the specific mixture that increases its comprehensive value of the market. The study of the capital structure main aim is to tell about the combination of securities and all the sources of the finance utilized by the firms to finance their investments (Myers,2001). The structure of the capital is the technique in which an organization finances its tasks which can go through debt capital or equity capital or sometimes it can be a merger of both (Brigham,2004). Many of the organizations mostly look for the amount of debt finance in their structure of the capital, in expectation of reconstruction of their work. The paramount of raising risk shows that by increasing debt the capability of diminishing in profit is greater than the capability for a rise in profit and some organization utilize higher debt in comparison to others and they are still performing better.

Wagacha (2001) in an examination of enterprise behavior came to know that organization seemed to raise their borrowing. For a higher listed organization, the debt to equity ratios looked as it has raised on the other hand for the little organizations they go down which shows that market advancement gives importance to large listed organizations. The financial improvement of an organization tells that how better an organization can utilize its resources or assets for gathering profit. Erasmus (2008) distinguished that the measures i.e profitability and liquidity of financial performance is used to check previous performance and the present situation of an organization. Brigham and Gapenski (1996) squabble that in one of the theory Miller and Modigliani model was authentic and still in routine, the cost of the bankruptcy exist and also that these expenses seemed to be directly proportional to levels of debts in a firm. The result obtained gave a direct connection between financial performance and structure of capital of an organization.

## **1.2. Global Perspective of Textile**

Globalization is the escalation of social relatives of the world joining far away regions in such a form that what is happening locally are mold by events taking place at long distance .Despite the fact that each every effort for categorizing the methods of globalization inevitably gave outcome in the form of reduction and oversimplification of intricacy(Giddens, 1991). A main explaining part of globalization in this manufactured components productions which as input for other parts are sold and come out in the shape of final product,all of them related and correlated globally(Dicken,1998).As a outcome in the developing countries and developed countries,companies aim is to sell little in such type of market that is perfectly competitive in nature, in the theory of economics and in value change of global which are monitored generally by global external firms (Kaplinsky,2005). The textile and clothing sector of global display these traits as network of marketing distribution and production of specific commodity or group of commodities (Gibbon, 2003:1811). The textile chain has been increasingly globalized.In the year 2007,golbal textile and clothing exports were found to be of the worth around US 628.4 billion dollars.Which is the most traded manufactured commodity of the world . Furtermore exports of textile increased at a yearly rate of 6 percent from year 1990 to 2007 (WTO,2008). In labour intensive the value chains of buyer driven are common and also in industries of consumer goods which are bounded in the chain (Roberts and tho burn,2002).

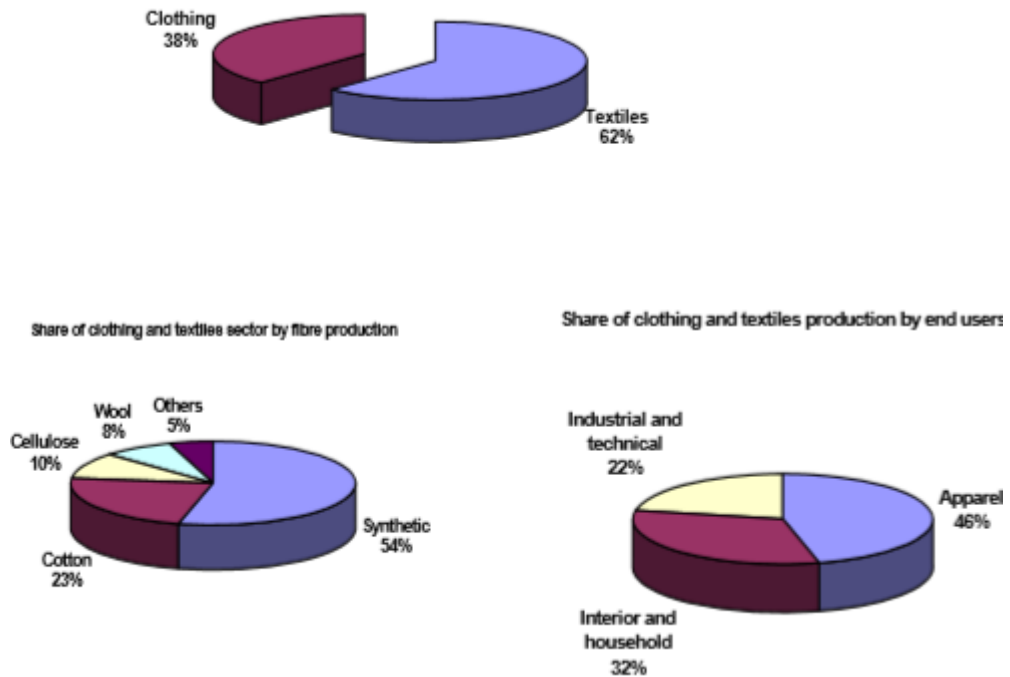
For example a value of chains, which are driven by buyers give a significant power to retailers on manufacturing with respect to raw material inputs, lead time, quality and price. The industry of textile is mostly higher capital demanding in comparison to the clothing industry and is automated on large scale, most preferably in developed countries. On first stage it is based on spinning then weaving and finishing and these three processes are mostly used in such plants that are integrated in nature. It is a fact that the flexibility of textile industry is less if we talk about the consumer taste adjustment in comparison to retail and clothing sectors. In supply chain the textile industry is considered as a bottle neck. Countries of industries such as United State of America, which has higher share of textile, produce lot of textile related product i.e household related and other products. Only about a third portion of textile in United State of America was used in 90s. It was not easy for poor countries to make backward links in the business environment to the local economy. The content related the clothing industry is high in developing countries.

Internationally the industries of clothing and textiles both extend and alter the line around 1990s. Now it has become a place for rising global market for the product's production. Many companies has moved these parts of production that added low value to them to keeping opposeness. This effort was started from Japan in year 1950s and 1960s which then after followed by the east asian countries such as Taiwan, Korea and Hongkong from the year 1970s to 1980s and then this movement went to China in 1990 and China came out as the biggest player in this region. Rest of the second level participants were India, Indonesia, Sirilanka and Philippines (Gereffi and Memedoric, 2003).

The textile and clothing industry of EU has turnover near around 289.1 billion dollar and it participate up to 4 percent to manufacturing and added value to it. The production in EU related to textile and clothing is based in five countries i.e Germany, France, Spain, Italy and Uk, which cover three percent of the total manufacturing. Uk and France have nearly around 60:40 of ratio between clothing and textile. In Spain, Greece and portugal the sector related to clothing industry account for nearly around 50 percent of textile and clothing workforce (Commision of European communities, 2003). America has gone through losses in textile and clothing production and employment as compare to european union.



From 1990 and 2006 the import of clothing by America increased up to 59.0 billion dollar and the impact related to textile sector rose to 7.3 billion dollar(Martin,2007).By the end of 2006 the America’s production was only 9 percent out of total clothing market of (American Apparel Footwear Association,2007).



**Figure 1.1 : Share of Clothing and Textile Production**

The above figure gives the estimation of 62 percent of textiles and clothing manufacturing is determined by the industry of textile with 38 percent association to cloth production and 46 percent of clothing and textile manufacturing is utilized by the industry related to clothing sector ,32 percent is utilized by household and internal industry and 22 percent out of its is used for technical and industrial purpose. The chain of textile from the seed of cotton to textile that is based on cotton and clothing manufacturing has got unique significance for those countries that are in developing stage.The large amount of cotton is produced and after that manufactured in countries which come in global south region such as Pakistan,China and India were the half of the world’s cotton producer in the year 2004.In developing countries nearly around one billion people are mostly linked with the production ,manufactring and marketing of cotton (Townsend, 2004).

There is no ambiguity that both India and China will achieve shares of market in the European union, the Canada and United State of America to a momentous range but the wanted upsurge in the market share can be low than expected as closeness to big markets expected rising economic importance and excise are hindrance trade due to the reason that commodities pass borders many times. Moreover rest of the developing countries are trying to come near the China in regarding to unit labour cost in clothing and textile sector and China has not bring forward its power of competition in the segment of the design and fashion of the market.

### 1.3. Pakistan Context

Textile industry of Pakistan is a biggest participator to the economy of Pakistan in regarding to exports and employment. Pakistan is the world's 4th biggest producer of the cotton as well as Pakistan is the 3rd biggest consumer in the world.

**Table 1.1:** Contribution of Pakistan Textile Sector

<b>Particular</b>	
Exports	60%
Manufacturing	46%
Employment	38%

**Source :** Economic Survey of Pakistan

Textile industries are known as the backbone of the economy and it is also going through hard competition in the market due to rise in prices of production which result in the form of less emulous than its neighbour countries i.e. China, Bangladesh and India. According to the journal of Pakistan's textile, Pakistan is in top ten exporters of the world. The export of textile sector in the world is around 400 billion dollar and out of this China is on the top of the list with its export of around 55 billion dollars after that Hong Kong i.e. 38 billion dollar at 3<sup>rd</sup> position; it is Korea with 35 billion dollar then so on to Taiwan 16 billion dollar.

The textile manufacturing industries of Pakistan participates nearly around 8.50 percent of the Pakistan's income. As cotton is known as the prime crop of Pakistan, helps to make Pakistan's textile industry as a most important industry of a country. More than 60 percent of earning from export is contributed to economy of Pakistan. The textile sector of Pakistan was developed in 1990s and now it is consisting of 46 percent of the total manufacturing. It gives 38 percent for labour force related to manufacturing. It contributes 9 percent in the ground domestic product i.e. (GDP) of a

country and got the capability to catch up the available challenges of global market competition which is very high. The country is not only facing the competition from its neighbouring countries but also going through the external competition from the countries such as American and European countries as these western countries has the support of advance mechanism and improved systematic operations.

Textile industry of Pakistan fulfils the 9 percent of the need for global textile and it is at number 10 in textile production. Textile industry of Pakistan depends on domestically grown cotton, yarn cotton production, cloths from cotton and apparel. Imported textile machinery and equipment market in Pakistan harmonious to the overall power of the domestic textile industry. For modernizing the textile industry, the government of Pakistan has made “Textile vision 2007”. In the eye of this vision the plan of Government of Pakistan was to invest 331 billion of rupees in this industry of textile to achieve fifth number in textile export of Asia and also to raise the export to USD 13.815 billion until 2007. Pakistan is at number eight position in Asia in the field of textile with respect to its export. The capability of a company to produce, design or market the products is known as the operational competitiveness with respect to price and non-price qualities (Dcurz, j and Rugman, A, 1992). Modern machinery and techniques are highly demanded by the local industry so that they can compete with the world with respect to basic problems. The textile industry also has to face political, economic crises, energy and security issues. Search done in to problems of industry competitiveness agree with importance of process in improving the effort of competition (Momaya, k.1998). The factors related to environment are almost same for all industries that are in competition. Research shows that 36 percent of the difference in income can be ascribe to the company’s actions and features (Kim J.S and Arnold, 1999). It is the requirement for the present time to look deeply into the ways and solutions to attain progress in the textile sector of Pakistan. Multi focus manufacturing strategies should be utilize by the companies in a comprehensive way basing on their business goal and plans. An aggressive preference relates to first stage of manufacturing strategies, which perform as the link between the objectives of manufacturing and strategies of the business (Murths, T.P, et al, 1998). The world competitiveness taken from Latin word competitor, meaning of which is the engrossment in a business competition for markets.

With respect to its competitors it has become common to describe economic power of system in the economy of global market in which the ideas, products, services and people move without any force across all the borders of the world. Results can be attained through competition and potential of dealing with the competition through the process of competitors(Kazmi,A, 2012).Complete restoration is needed in Pakistan's textile sector on the industrial revolution basis to bring positive and necessary changes on the contrary there is a fear that the hope of increasing exports remain in same short size. To endure in the present competitive global market and deal with severe inventive of the textile industry of Pakistan has to come over some of these challenges.

- Give quality products at feasible price.
- Identify customers need taste and desire at the right time.
- Make efforts to expand the market.
- Issues related to quality and productivity must be rectify.
- Should be in a touch to customers to know their decisions and taste.
- Make some movements to make a good image of Pakistan in a global market.
- Make a system of a market intelligence and purify the marketing and framework of publicity.
- Hard work is needed to make the HR skill levels better by maximum trainings and procurement of appropriate infrastructure.
- Developing strong R and D (Aziz shah,S.A(2006).

Convenience and framework to deal with the product novelty challenges and tenable enterprise has risen.A accesable shifting of units which are vertically integrated to the contractual type control, which got outsourcing elements that is needed to comeover concern related to quality and economy (Japan international cooperation agency, 2006).Enerprise related to textile manufacturing has organized a shifting of an important product of textile towards ready made clothing production ,which are good in quality and not only limited it to europeon countries and also towards American markets ,inspite of all such good efforts the hard allotment limitations ,no or less support from the government,economy issues security reasons ,political issues are some of the major problems that the textile industry has to faced in Pakistan (Government of Pakistan, 2006).

Pakistan has suffered most from Asian region crises e.g the one of the famous brand of Pakistan i.e Bonanza in 1996 which was doing well in textile industry had to go through negative growth up to -6 percent with respect to its exports in the year 1997 the yarn of the Pakistan was the biggest source of earning foreign exchange having tough competition with Indian varieties. Adding more Pakistan's export market usually has not taken as a preferred supplier by buyers of the product. Industry does not give importance to competition adapted charismatic of market as it does not have innovative ideas and supplies for a bounded range of product ,which is lesser than average quality one. These problems can be found at different levels in different developed industries around the world related to textile but most of the countries has come up with the solution and now producing a dividend due to lack of diversification and also due to low quality textile and clothing products have disintegrate country's contingent advantage even in that market where some quota has been set. In the year 1993 using of quota in some divisions for some biggest European union countries were less up to 20 percent but for United State of America the comparable number was 28 percent (Azhar, 1995).

#### **1.4. Problem Statement**

The achievement of most of the financial institutions in Pakistan's vital business atmosphere relies on being capable to adequately measure the best and most suitable capital mix that is essential to make sure that the shareholders get good profit. Most of the financial institutions rely on their capability to recognize, evaluate, oversees and control risks in a peaceful and refined way. For assessing the right amount of capital which is important to consume surprising losses coming from their market, operational risk and credit disclosure. The persist best accomplishment of the sectors of the banks opposing backdrop of an economy, which is not achieving best results has lifted more questions. The sectors of banks had noted down an increase in gains for most of the past ten years when the growth of the economy has not been doing well. Emerging from the research of Berger(2006), the structure of capital hired by the organization can be a reasoning affecting their trends of financial performance, a controversy that has not been provided sincere concentration by past investigators. Therefore, the problem statement for the thesis is to test the impact of debt financing corporate financial performance by taking the evidence from Pakistan textile sector from the period of 2008 to 2017.

## **1.5. Study Objective**

### **1.5.1. General objective**

To interrogate the outcomes of debt financing on financial improvements of financial organizations mentioned at Pakistan stock exchange.

### **1.5.2. Specific objective**

- To ascertain the relationship between firm growth (FG) and returns on asset (ROA) listed at Pakistan stock exchange (PSE).
- To determine the relationship between DTE and ROA listed on PSE.
- To scrutinize the effect of SDTA and ROA listed at PSE.
- To determine the effect of LDTA and ROA listed at PSE.
- To ascertain the relationship between FG and ROE listed at Pakistan stock exchange.
- To determine the relationship between SDTA and ROE listed on PSE.
- To ascertain the relationship between LDTA and ROE listed on PSE.

## **1.6. Research Questions**

- What is the relationship between FG and ROA listed on PSE?
- What is the relationship between DTE and ROA listed on PSE?
- What is the relationship between SDTA and ROA listed at PSE?
- What is the relationship of LDTA and ROA listed at PSE?
- What is the relationship of FG and ROE listed at PSE?
- What is the relationship between SDTA and ROE listed on PSE?
- What is the relationship between LDTA and ROE listed on PSE?

## **1.7. Significance**

This study has a desire of creating the consequence of debt financing on the financial achievement of financial organizations listed at Pakistan stock exchange .Its result will be meaningful in the following ways.

- The managers of an organizations that are listed at the PSE has an exclusive responsibility of increasing shareholders revenue and may be capable of using the output of this study to conclude the possible results of the changes, which the organizations shoulder on debt financing.
- The findings of this research may able to help organizations, the management should be attentive of the hidden expense of carrying capital by their shareholders as a result of their decision over capital financing.
- This research can be beneficial for scholars those who may want to utilize this research as a base for additional research on a capital structure at PSE.
- There are 558 listed companies in PSE of different sectors i.e Agricultural, Chemical, Cement, Miscellaneous, Technology and Communication, Food and Personal care products, Commercial banks, Engineering, vanaspati and Allied industries, Textile Composites, Fertilizer etc.
- This study potent on the textile sector which has 101 listed and registered companies.

## **1.8. Variables Definition**

### **1.8.1. Debt to equity**

Darsono and Ashari (2005) explains that the debt to equity ratio (DER) is that ratio which tells about provision's percentage of funds by shareholders to their lenders. Greater the ratio, the lesser the firm is funding given by the shareholders. The debt to equity ratio tells about the percentage of total funds that are given by creditors against owners. It is a proportion of firm's financial influence that correlate the quantity of equity financing. It can be obtained by dividing total liabilities of the firm with shareholder equity. Lyn and Aileen (2008) clarify that the ratio of the debt is a consideration part of all such type of assets which are financed by debt. The long-term debt ratio to the ratio of total capitalization explains that the limit up to which the utilization of long-term debt is utilize by organization to fund the firm enduringly (both share holder equity and long-term debt).

### **1.8.2. Return on asset**

It is the capability of a company to make profit from its assets. It tells upto what extent the assets of a companies are beneficial in making profit .It can be obtained by dividing net income with its total assets. It gives alliance among assets and net profit. The increase in the ratio relates to an influence of the utilization of assets by the company (Robinson et al., 2015). Sofyan (2001) shows that return on assets (ROA) is a type of ratio that explains that the assets are calculated by the volume of its sales. As higher this ratio more good it will be for a firm which means that the amount of return is also going to be higher.

### **1.8.3. Return on equity**

It is the measure of the gain that shows how much a profit an organization makes with each investment of the shareholder's equity. It can be obtained by dividing net income to shareholder's equity. It also known as return on net worth. In the eye of Sofyan (2001), return on equity (ROE) is such a type of a ratio that tells that up to what percent a net income has been earned when calculated by the owner's capital. The greater the profits made by a firm, the greater the return will be made by a firm. A greater amount of return of corporate will raise its stock price which will win investors interest in buying more stock of a firm.

### **1.8.4. Firm growth**

It is the increase in the size of an organization .A company is growing if it is going up rapidly in compare to its rival in the market.

### **1.8.5. Short term debt to asset**

It tells about the liabilities that are not paid yet and to be paid within one year of time.

### **1.8.6. Long term debt to asset**

It tells the limit upto which an organization depends on external debt financing to arrange the requirements of its capital. It is a determination depicting the percentage of an organization assets financed debt with time period of more than one year. Increasing this ratio means raising a dependence on exterior financing and by this raise interests and reducing profitability (Gibson, 2009).



## **2. LITERATURE REVIEW**

This chapter pays the attention on the existing theories and their related materials. Theories which are covered in this chapter include trade-off theory, pecking order theory, market timing theory, agency theory, life cycle theory, free cash flow theory, Modigliani and Miller theory, signaling theory and life stage theory. Moreover, the empirical relationship between the debt financing and financial performance has been discussed.

### **2.1. Debt Financing**

In the eye of Tirole (2006), many forms have been taken by financing of debt. The aspect of debt is that the one who has borrowed the money must give back the borrowed money as per agreement and also look into the charges of the services e.g. the loan fee and interest. If the funds are not being paid back as it was agreed, the lender has the right to collect proceedings. This way can become distressful for the person who has started the business. The loan which is taken on long-term bases has to be paid back within five years. Whatever the deal has been made by negotiating between parties, these loans are protected by underlying assets and also by the guarantee provided by the entrepreneurs for securing such type of deals. The rules and regulations according to the rates and terms for the long-term type of loans mostly depend on those institutions which give policies and also on the fact that from how long the business is running and what is the financial condition of the company (Bichsel and Blum, 2005). Secondary (personal assets) are guaranteed by the owner of the company to compensate the loss to the money lender. If the debtor is unable to meet the terms and conditions of a guaranteed note, the person who has lent the money has the right to take possession of all such assets which has been kept as a guarantee and has the right to sell those guaranteed assets. The earnings of the sale are then recorded under the heading of amount due on the note. If still the lender is under loss after selling the assets, then the lender of the money is not going to free the borrower from his obligation to pay back the amount of debt. If the amount gathered by selling all underlying assets is not sufficient in regard to the amount lent, then in this case the lender can go for the guarantee which was kept by the owner of the firm.

Banking supervision committee of Basel was housed internationally at the bank for setting the international consequence of capital specification and obligation of each country. In 1988 a system for calculating the capital was introduced by the committee which is in accordance with the accord of Basel which later replaced by Basel II and it was a complex framework of the capital. After the year 2012, Basel III came and then it replaced Basel II. This competency has been the center of attraction of many researchers and it also acts as a regulator for such studies and it is known as the most important operator of profitability of any financial school (Bourke, 1989; 1995; Navapan and Tripe, 2003; White and Morrison, 2001). In contrary to this the rest of research squabble that in a good financial markets word, rules and regulations of capital and also the structure of the capital is inappropriate (Modigliani and Moller, 1958). Furthermore Morrison and white (2001) postulate that the regulator gives assurance that the banks have got abundant of their capital at risk. Blum and Bichsel (2005) backed up this proposal contending that these type of rules and regulations support in lowering the negative outcomes of externalities which in turn boost the sluggish growth of economy i.e Gross Domestic Product (GDP).

Many of the recent researches propose that we have to target the financing activities in place of debt ratios due to the fact that the debt ratios are inexplicable in regarding policies of corporate financing. Chen and Zhao (2007) explains how a debt ratio can degenerate to its mean, which obscures our judgment on the limit to which companies conform toward an objective debt ratio. Chang and Dasgupta (2009) explain that a partial arrange model cannot differentiate between them technical mean reversal of debt ratios and objective adaption behavior. Specifically, they create samples of companies where the selection regarding finance is made randomly, and it is that the selection related to finance is not linked to the supporting structure of the tradeoff theory. They demonstrate that companies that randomly form decisions related to financing illustrate the same pace of objective arrangement with those that pursue an objective debt ratio. Financing of debt takes place when a firm attains a loan and promise to pay back the loan in the given time period along with interest. The financing of debt can be arranged by taking a loan from a lender or by bonds selling to the community. Loans generally want the borrower to present assurance to guarantee repayment. Selling of commercial papers or bonds in the capital markets is one of the other sources of raising money by the mean of debt financing.

### **2.1.1. Advantages of debt financing**

Companies that have gone through high rates of tax will have relatively greater advantage ratios and therefore low tax rate will surpass the lower debt ratio. Mackie-Mason (1990) come to the conclusion that companies that have no debt tax protections are preferably going to take a loan that is less than those that have no protection of debt tax i.e. other protection like reduction or assemble losses. If taxes were to rise with respect to time it is anticipated that the debt ratio of a firm will rise with respect to time. Different Countries has got different rates of taxes that shows that it also has got debt ratio differences i.e. with huge rates of tax companies can have huge debt ratios. Congruent with this declaration Desai (1998) came to know that tax leverage is very important for high dividend paying companies that possibly have a huge tax rate of corporate and that is why the tax stimulus to utilize debt. Companies also provide foreign debt in relative tax stimulation reaction.

Jansen (1986) convey the justification that utilization of debt assists control in management. Managers seem to make such decisions that are not useful with respect to free cash flows when provided unrestricted powers on how to utilize these powers. Free cash flow is the cash of a company to which the management has unrestricted powers and can be utilized for making an investment in new resources and paying profit and financing for benefiting management. Many firms with high free cash flow and cash reservoir and less debt financing likely to attain big cash protection contrary to mistakes and there is no benefit of being efficient. The responsibility of Debt payment will mainly compel managers to make such investment decisions that are much competing in nature. Debt can also be worthy in checking the exercising of investment purpose, making sure that there is effectiveness. This is attained by making sure that the free cash flow accessible to management is intensely less or it is not significant, compelling managers of the organization to match the debt serving responsibility. Also, the institutions that provide a loan to the company they make check and balance on their own ,hence it can say that managers may not be going to borrow a lot. Debt financing is better for firms which attempt an assertive growth strategy, particularly at that time when they have an approach to fewer interest rates. Firms willing to utilize debt financing are suggested to look for a suitable legal recommendation from the lawyers and accountants of the firms so that they can have proper and better know how on the protection of asset.

### **2.1.2. Disadvantages of debt financing**

When the level of debt financing is high a company is possibly going to disclosed of default (Bankruptcy cost). The cost of Bankruptcy of debt is the high costs of financing along debt in place of equity that outcome from a greater chance of defaulting on repayments related to debt. According to (Dr. Fong Chun Cheong, Steve) The first main debt financing disadvantage is that firms not only have to return the principal amount for the loans, but also they have to return interest, which somehow can be a financial burden for a company. This financial responsibility must be to deal as an obligation on a firm's assertion of the financial point. A firm most likely going to borrow money so that it can pay for its business affairs, the firm may finish up by promising itself to business costs, that is why by compelling it to shift its holding rights to another company. The company may also be under pressure to repay its loans with cash that it badly needs for some other aspects of its business, and the company's business will suffer as a consequence. The second disadvantage of company financing concerns the process of securing a loan.

If companies borrow from banks or other financial companies, they will often be required to pledge company properties as collateral to secure the loan. This means that if a company does not repay its loans, then the lender can take the properties and sell them on the market in order to recover the value of the loan obligation. Thus, if a company pledges its business assets as collateral for the loans, and if the company is incapable to return money to its creditors, then the firm can lose the necessary resources of the corporate. In the same way, if a firm undertakes its intimate resources, such as properties or stock portfolio of a company, then it can be risky on losing them to return loans taken for the business purpose. Another credit financing or debt financing disadvantage is that taking loans for the purpose of business may become very difficult if a firm does not contain a good rating for their credit and also if the company has got a weak tracking record of loan repayment. Moreover, if a firm takes much debt, then that firm can go through "high risk" by capable investors; this is going to limit the capability of a company for gathering capital through equity financing also; this restriction can extremely limit the cash flow of future. Also, the debt financing can restrain growth chances of a firm due to the greater cost of giving back the loan, particularly in the matter of paying back of compound interest. The outcome of this may be in the form of rising in a firm's risk of bank defaulter.

## **2.2. Equity Financing**

It is the way of collecting capital by selling the shares of an organization. The one who buys these shares of a company is known as the shareholders of a company, as they have taken the right of ownership in the company. It is a way of collecting money to fulfill the liquidity obligations and it is done by giving a way to company's stock for cash. The total number of capital taken by shareholders is known as equity of shareholders. For operating any business financing an organization is the main matter and it is organized before making plans for a business. Debt financing and equity financing are the two main financing options which are mainly adopted by companies. The financing of equity is used for gathering funds through the mean of selling interests of shareholders in an organization.

Many organizations utilize both types of financing in the process of making the life of their business. Loan borrowing, bond issuance, selling of shares are the main things for supporting an organization with finance and borrowing of the loan. Financing directly from the capital type of markets may prevail the intermediated type of indirect financing by finance organizations and banks. These types of loans from the bank are required by a company to keep a balance for equity and debt which is also known as its advantage ratio and it is better for a company. Equity financing attribute to the promulgating of shares to investors for backing up business operations of a firm.

This type of financing is important at the beginning stage of a company. In this financing way, profit is made by investors when there is a rise in the price of the share, also by the allocation of allowances by an organization in which the investor has bought a share. The first leverage of financing the equity is that it provides another way of funding instead of gathering loans from financial organizations or banks. An organization can utilize sources of funds from investors of business when it starts its work and efforts of business to fulfill the costs occur in starting the business. An organization can then utilize the flow of cash from its actions to grow an organization or to put effort into other areas too. In regarding to this, it is the reality that investors want to have a long-term glance, and mostly do not figure out a quick return on the investment they had made. This makes an organization to have more cash with them to increase the size of business, in spite of paying a part of its gain on investment to pay back loans. That is why this way of financing is not much risky than the financing of debt because an organization does not have to give back something to its shareholders.

The second type of leverage on the financing of equity is that it helps to control the legitimacy, by making organizations capable of tapping into the network of investor and also to increase their credibility. The third related leverage of financing the equity is that if organizations have created advantages for investors of the corporate sector and tell them that their amount is at risk in an organization's new set up of business, then investors are going to understand the aspects of failing of business, that if the business gets fail they are not going to get their money back that they had invested in the business.

Finally, the financing of equity provides more leverages in order to run the organization's management. Some of the potential investors may be capable of offering worth able business help that an organization may be unable to produce this for itself. Investors give priceless help in the shape of management skills, business access and contact with other resources of capital. Many of a good number of Venture Capitals and investors observe the part of the role of advisors of business or they can come a valuable part of the team of management. This may be an important part, most preferably at the start of a new business. There a disadvantage and that is investors must be provided with some sort of ownership of an organization and some sort of percentage out of the profits should also be provided to them. If the organization's business gets off, then an organization should divide a part of its gain with the investors of equity. By the time, the transportation of earnings to shareholders may increase the total that an organization has to pay for credit.

Enterprise Capitals mostly inquire for a stake of an equity of about 35–50%, most preferably when organizations are at the starting stage and they do not have a strong background of finance. The capability for financing equity may be inadequate for this purpose, as directors of an organization are sometimes do not want to reduce their power of controlling by financing of equity. If we look into the past we can conclude that organizations mostly financed their business issues with two type of securities, equity, and debt. For an operation of the firm, stockholders got responsibility by the mean of the board of directors elections; the income they get by the capital's subscription is not assured and are given away at the caution of the directors of the board. Contradicting that holders of the debt are promised for a specific rate, which they will get a return, they do not have any authority of controlling, unless and until the payments by the companies are excluded.

As an outcome of the significance of equity and debt, the target of the probe into the company's selection of structure of capital has customarily been "What is the equity optimal debt ratio?" Miller and Modigliani (1958) and following authors demonstrate that if markets of capital are flawless and complete and there is no impact of taxes, a debt-equity ratio of an organization has no impact on its worth due to the fact that investor's chance to get sets are not afflicted by its structure of capital. If an income tax of a corporation is in contact, with provable of interest, Miller and Modigliani (1963) utilize the same concept to exhibit that the companies should use whole debt finance since this gives permission to taxes of corporate should be the refrain.

### **2.2.1. Advantages of equity financing**

The prior benefit of equity financing is that it provides one more root of funding in spite of taking loans from banks or other financial institutions. A firm can utilize money resources from investors of business when it starts its work for business tasks to fulfill the starting costs of a business. The firm may utilize the flow of cash from its business tasks to make the company better or to expand it into other places. Due to this fact, the investors want to have a long-term image, and usually, do not anticipate a quick payback on their investment. This gives permission to the firm to have more cash in hand for expanding the business, in spite of paying a part of its dividend to pay back loans. Due to this fact, this way of financing is not much risky than the financing of debt due to the fact that the firm does not have to return the amount to its shareholders. This point i.e financing through equity also makes it a good suggestion when a firm cannot bear to attain more debt. Another benefit to finance through equity is that equity financing support to deliberate justice, by permissive firms to faucet into the network of investor and to improve their integrity. The other benefit of equity financing is that if firms have established catalog for investors of corporate and interpreted them that their amount is at risk in the firms, then investors are going to realize that if the business does not succeed, then they are not going to get back their investment. Finally, equity financing provided extra benefits under the company's management. Some prospective investors may provide worthy support to a business that a firm may not be capable to arrange for itself. Invaluable support is provided by the investors in the shape of management competence, contacts that business made an approach to other capital resources.

### **2.2.2. Disadvantages of equity financing**

One of the disadvantages is that some control of the firm should be given to the investors of the firm and a certain share of the profits. If the business of the firms takes off, then the firm will have to divide some part of its gain profit with the investors of the equity. With time, the sharing of dividend to shareholders can increase the total that a firm would have had to give out for loans. Operating Capitals mostly ask for an equity investment of 35–51%, particularly at that time when firms are just start-up firms without a powerful financial backbone. The capability for the financing of equity can be restricted for this purpose, as sometimes the directors of an organization are not willing to diminish their holding power by the mean of equity financing. Your investors might be anticipating and thinking that they are entitled to a portion of your profits. Anyhow, it could be a beneficial trade-off if you are having an advantage from the worth they are bringing in the shape of financial background and their business experience.

Sharing proprietorship and when the company has to work with others could bring some tenseness and can lead to a fight if differences occur with respect to vision, style of the management and methods of conducting the business. So these issues should handle carefully. That is why the suggestion on the structure and consolidation of equity and debt which is used to finance the growth of a firm relies on many of different factors of business, more importantly on the funding sources available, the specific industry within which the firm is working, and the related banking demands. Lastly, firms have to keep good relationships with financial institutes and banks for the purpose of fundraising in the future, despite the fact either they desire to persist issuance of debt or equity

### **2.3. Firm Performance**

To earn on an investment is the main aim of all business people. Without gain in investment, no business can survive if it wants to go on long track. That is why it is important to know about present and Past earnings of business. If one wants to measure the performance of business it can be measured by income and expenses i.e by taking out expenses from income. Profit can be obtained from all of the of the business activities. That business which has profit margin got guts to appreciate it owners with a huge return on their money invested in the business(Waweru and Kalani,2009).



Necessary alterations in the operating type of environment more commonly credit risk is favorably the one which seems to affect the performance of the bank. It is found by empirical analysis that microeconomic factors and bank-specific are two important things to measure bank performance (Westerfield, 2008). Myers and Brealey (2003) claim that there are a lot of other necessary measures available for knowing the performance of an organization e.g return on equity, return on assets, net profit margin. To know how well a bank is doing in the market, David Cole in 1972 gives the procedure by which one can analyse the ratio (Macdonald and Koch, 2006). This procedure makes an analyst capable of assessing the significance and source of bank's profit respective to elected taken risks. Return on equity model was employed by David Cole to examine the performance of the bank and recognize specific calculations of risk related to credit, liquidity risk, capital risk, and interest rate risk (MacDonald and Koch, 2006).

Financial performance is an instinctive system of how good a company can utilize assets from its basic type of business and produce a profit. This concept is also utilized as a basic standard of a company's total financial strength over a given time period and can be utilized to examine in contrast to the same type of companies in regarding the same type of industries. There are a lot of various methods for measuring financial efficiency, but all methods of calculating the performance should be taken all together. Moreover, the examiner or the person who wants to invest may have a desire to look financial statements deeply and look for margin development rates or any reducing debt. Actually, the more adequate the company's activities are achieved the better the performance of an organization is and, on the other hand, the low effectiveness of company's activities and employees' operations means the performance of a company is not good. In accordance with this, employees' efficiency is an important portion of the company's efficiency because in the current environment of the business human resources consider as a necessary resource of an organization. That is why the performance of employees' has a great impact on the firm's performance.

Furthermore, it is necessary to think that the company's efficiency is a necessary indicator for stakeholders and investors. The performance of a company shows either the firm is good for making an investment or not. For example, investors want to make an investment in that company which has got positive image in the market on the other hand investors do not want to invest money in those firms.

#### **2.4. Debt Financing and Firm performance**

The part of the debt in the performance of the firm is the main motive of existing studies for more than a period of fifty years ( Miller and Modigliani 1958) still this task remains a part of a subject that needs to be answered and it was successful to attain the concentration of many researchers. Some of them are Weill(2008), Nunes et al (2009), Goddard et al. (2005), Berger and Bonaccors, (2006), Roa et al. (2007), Baum et al. (2007) and Kebewar (2012).Considerably researchers evaluate the debt ratio and attempt to conclude whether optimum debt ratio endures or not.Optimum debt ratio mainly known as the one of the ratio which decrease the expense of capital for the firm , while increasing the worth of the firm or one can say that the optimum debt ratio mainly known as one of the ratios which decrease the expense of capital for the firm, while increasing the worth of the firm or one can say that the optimum debt ratio is that which increase the profit of the firm.

Alongside the discrepancy among researchers can be examined in the eye of a theoretical string of literature. There are three important theories which intensify the consequence of debt on corporate performance, their names are pecking order theory, trade-off theory and market timing theory under the heading of trade of theory there is benefit to finance with debt and also there is expense of financing along with debt known as bankruptcy expense of debt .In the eye of agency cost theory ,the internal debt at the first stage when no longer beneficial then at second stage debt is released and when it is no more beneficial than at third stage equity is released.

The theory of market timing says that manager of the firms released securities basing on the cost which changes according to the time and conditions of relative debt and equity and therefore releasing opinions have a long-term consequence on structure of capital,the reason is the capital structure which is been observed at any specific date is the result of foremost effusion of bestowal companies which give importance on issuing the equity, only then when the cost is less and give importance to release debt when the price of equity is more. Adding more the facet of disagreement can be seen in the empirical stand and in the theoretical literature.Debt has a negative impact on gain of business was confirmed by Chibber and Majumdar (1999),Eriotis et al (2002),Capiez and Ngobo (2004),Goddard et al.(20005),Raa et al.(2007),Tian and Zeitum(2007 ) and Nunes et al, (2009) on the contrary Banum et al,(2006) and (2007) , Bonaccors and Berger (2006), Psillaki and Margartis (2007) has shown good effect.

Companies with greater rates of corporate tax and with more taxable income will prefer to purchase equity rather than decreasing debt due to the fact that if they decrease debt then there are chances that they may lose the benefit of tax which they are having from debt. Secondly, companies with the higher outcome of financial distress probably may decline their debt in spite of equity repurchasing. Size and growth advantages are more preferably be going to purchase equity again so that to avoid increasing tax advantage to debt can be avoided. The tax advantages of debt are anticipated to be huge when companies make a selection between purchasing of equity again and evacuation of debt due to the reason that they have an extra financing controlling out the chances of being tax-depleted. This gives a shoulder to the outcomes of MacKie-Mason(1990) that investment tax credits decline the outcome chances of a debt problem only at that time when companies are near debilitation of tax.

Adjacent to this Bonaccarsi and Berger (2006), Psillaki and Margaritis (2007) and Kabewar (2012) see the existence of a nonlinear effect. In the end, an effect of insignificant was approved by Baum et al,(2007) at industrial firms of America. Many of the factors show the reasons for the discrepancy of outcomes in empirical data studies. On prior, these empirical types of studies look into different kind of samples (sectors, countries, periods and companies). Adding more information the different type of measures has been adopted to measure profit as a dependent variable and many other ratios of debt under the heading of the dependent variable. In the end, different types of methodologies have been applied to these studies. The empirical literature with reference to the outcome of debt on the gain on profit takes us forward to make two interventions. At the first stage, it is seen that many of the empirical studies keep their eye on listed firms. The number two intervention is related to scarcity of researches on the firms as explained by, Goddard et al. (2005), Margaritis and Psilaki (2010), Weill (2008) and Kebewar (2012).

So both of these channels stimulate my study. Furthermore, the latest work is necessary because of the fact that debt is a risky selection whose outcomes on the firm performance can be considerable e.g the risk of defaulter and its outcomes for the shareholders. So it will be my effort to find empirically the outcome of debt on revenue for the textile firms in Pakistan. The debt financing effect on firm financial performance attracts the attention of researchers, who come up with different results.

## 2.5. Capital Structure Theories

The number two choice related to financing which an organization has to face, Structure of capital is still up till this time is a puzzle in the field of finance. Structure of capital or advantage of financial decision must be checked regarding how equity and debt combine in the capital structure of an organization which then control the value of its market. Debt to equity combination of an organization may have necessary indications for the worth of an organization and capital's cost. In increasing wealth of shareholders, an organization utilizes more capital of debt in the structure of capital as the interest given on it is a tax provable and decreasing the debt is cost effective. Adding more holders of the equity is not necessary for them to share their earnings with holders of the debt as their return is fixed. Withal, more the debt capital, riskier the company, so the cost of capital will also be high. That is why it is necessary to find out the important parts of the structure of capital, accurate measurement of these parts and the better capital structure for a specific company at a specific time. Practitioners and researchers told about the theories that have seem to found conflict on a structure of capital.

Durand (1952) explain by utilizing the approach of the Net Income (NI) that a company can reduce its cost for the capital and meanwhile can raise the worth of a company by the mean of financing the debt. In comparison to this, Miller and Modigliani (1958) argue in their one of the paper of seminal related to the structure of capital incongruity that company's worth is not dependent on its ratio for debt to equity which is called as an approach of Net Operating Income (NOI). They claim that the market which is a perfect capital market, without transaction cost and it taxes the worth of an organization remain same to the alteration that takes place in the structure of the capital. In the eye of Pandey (2007) the conventional access of Solaman,(1963) has come out with a compromise to the high point taken by the approach of net income. Traditional access does not accept the same cost of equity alterations in debt to equity ratio and frequently decreasing Weighted Average Cost of Capital (WACC). Furthermore this suggestion expect the idea of the structure of optimal capital and therefore apparently indicates that Weighted Average Cost of Capital( WACC) reduces only up to some level of financial advantage and touching the minimum point. Furthermore, the rise in financial advantage can increase the Weighted Average Cost of Capital( WACC).

Capital structure's one of the irrelevance theory presented by Modigliani and Miller (1958) is known as the beginning level of modern theory related to the capital structure. It relies on supposition connected to the attitude of capital market and investors, Modigliani and Miller demonstrate that the worth of a company is not affected by the company's capital structure. In the perfect capital market the securities are traded and all related data is present for both outsiders and insiders for taking the decision and there is no dissymmetry in the information, that is the cost of the transaction, cost of the bankruptcy and there is no tax. Lending and Borrowing of money is possible for companies and for investors at the equal rate of interest, which grant for homemade advantage, companies that are working on a same type of risk and have got same type of operating advantage, none of the taxes are save by interest that is payable on debt and companies go after 100% of profit payout. According to these suppositions, Miller and Modigliani's theory showed that there is no optimum ratio related to debt to equity and for a wealth of shareholders the structure of the capital is not relevant. This suggestion provided by Miller and Modigliani in (1958) in their seminal paper and discuss that the worth of the levered company is similar to the worth of the company that is not levered. That is why they gave an offer that managers should not deal with the structure of the capital and they can easily choose the combination of debt to equity. Important additions to the Modigliani and Miller access add Hirshleifer (1966) and Stiglitz (1969).

Furthermore, in their suggestion II, they demand that rise in advantage raise the company's risk and as an outcome of it the cost of equity rise. But the Weighted Average Cost of Capital (WACC) of an organization remains the same as debt cost accommodates with an increasing cost of equity. Irrelevance theory of capital structure was theoretically very good but it was depending on those set of assumptions that were unreal. That is why this theory goes through a lot of research on the structure of capital. Even after all of these facts, their theory was correct theoretically, In reality the world without taxes cannot run or valid. For making it more perfect Modigliani and Miller (1963) do not incorporate with the result of a tax on the cost of capital and company worth. In the existence of corporate taxes, the organization worth rise with the advantage due to the protection of the tax. The Interest on capital debt is a reasonable charge taken from the income made by the company and like this reduce the total tax payment of an organization.

Maybe there are chances that other theories may participate in the theory of capital structure developing basing on the Miller and Modigliani theorem and it is very hard to approve any of them. By knowing that there are some problems in MM theorem but even though it cannot be avoided completely. Arnold (2008) tells how the rise in the debt of capital in the structure of capital impact the worth of a company. As debt capital rise the Weighted Average Cost of Capital ( WACC ) of the company fall until that time the company approaches the level of optimal gearing and financial distress cost rise with the level of the debt. This was approved by Miller (1988) that the optimum ratio of debt to equity tells the topmost achievable tax protection that a firm can have the benefit of it. Furthermore regular with Miller and Modigliani (1963), Miller (1988) acknowledge the reality that companies raise the risk of default due to the presence of debt capital in their structure of capital. In the theory of trade-off the costs of debt are affiliated with indirect as well as the direct cost of insolvency. Bradley et. al., (1984) told that cost of insolvency to contain the cost of administrative and legal, another cost of indirect comes out by pardoning of customers and trustworthy among suppliers and staff due to the fact of ambiguous.

Delcoure (2007) came to know that companies in Eastern and Central European countries have advantages for short-term debt as it is hostile to debt related to long-term debt. The pecking order, trade-off theories, and agency somehow tell about the decisions of capital structure in these economies of transitional. Dissimilarities in settings of institutions help along the availability of the retailored pecking order theory. Sbeiti (2010) examined stock market's effect in growth on the decisions related to the capital structure of organizations running in thrice of countries of Gulf Cooperation Council (GCC) utilizing a sample of 142 companies from Saudi Arabia, Oman and Kuwait from the period of 1998 to 2005. In spite of all these aspects the countries of Gulf Cooperation Council ( GCC ) are found to be non-tax paying subsistence, the choices of capital structure are cognate among the developing and developed countries. The advantages in the countries of Gulf Cooperation Council (GCC) are comparatively lesser than those countries that are developed and the indicators of stock market are contrarily associated to the capital structure in both countries i.e Kuwait and Saudi Arabia shows that in their region the stock markets have shown improvement significantly and it looks to dominate the decisions of companies. Nagano (2003) displayed that the capital structure of an organization.

### **2.5.1. Trade-off theory**

It tells that there is a benefit if we finance with debt and also explain that there is an expense of financing with debt, which we can also name as cost of financing with debt i.e "the bankruptcy debt cost ".If debt keeps on increasing then the marginal advantage or benefit will decrease and another effect will be that its marginal cost will rise up. That is why, it is said that for the industry which is boosting, its all value should have an eye on this trade-off while selecting that up till which extent equity and debt to be used for financing. Empirically if you see, this theory can tell the differences in D/E ratios among industries, but it is not going to tell about the difference within the same firm.

The utilisation of this theory will tell the reason that the Corporation is usually financing on little extent with debt and little bit with equity. It also explain that there is benefit if someone is with debt and also there will be debt tax advantages and there is an expense of financial distress in which the cost of bankruptcy also involved. Again as said earlier if the amount of debt keeps on increasing then the marginal advantage will decrease with the result of an increase in the marginal cost. So far the firm that wants to increase its whole value needs to look carefully at this trade-off i.e while making a decision of how much equity and debt to be used for financing (Al-Sakran,2001). This theory has a concern with two things i.e financial distress cost secondly with the cost of the agency. The basic aim of trade theory is to tell that organizations are usually financed with debt and equity. Miller and Modigliani in 1963 brought in the tax advantage of debt.

After that trade of theory came which provide the structure for capital. The trade of theory of capital structure has got the ability to involve the the expense from agency theory as an expense of debt to tell people why organizations don't have 99.99% of debt as anticipated from Modigliani and Miller 94.99% of papers that are empirical in nature reveal in their studies about the dispute among shareholders and debt holders. Both of them has got equal importance to tell how the theory of agency is related to the trade-off theory of capital structure. The cost which is considered to be direct mention to the cost of defaults of an organization. Once the process of defaults begins there might be the need occurs for selling the assets of an organization at a depressing amount which is commonly lesser than the present worth of an asset.

After the deep discussion on the theorem of Modigliani-Miller, the trade-off theory has been given importance (Iqbal et al., 2012). An original form of trade-off theory was developed after the Modigliani-Miller theorem debate. When the unrelatedness theorem was joined with the income tax of the corporate, this privileged advantage for debt, i.e.; it gives the protection to the taxable earnings. Managers of the companies assess and examine many advantages and expenses of many substitutes of advantage-giving plans. Optimal capital structure is obtained by companies through the costs of debt and equity trading opposite to their benefits. The biggest advantage to utilize debt is the benefit of debt tax protection. On the other hand, the cost of potentiality financial distresses may be the deprivation of debt, specifically when a company needs more debt. Tax abatement of interest payment is the main advantage of the debt; this elevates the debt application. It rises with the presence of non-debt tax shelter (DeAngelo & Masulis, 1980) and personal taxes (Miller, 1977).

The research conducted a few years ago on static trade-off theory gave blended results. On one hand, research tells that target benefit is not necessary. A lot of researches, for example, Titman and Wessels (1988), Rajan & Zingales (1995) and Fama & French (2002) declares that companies with higher profitability want to borrow less, that is contradicting with the real trade-off forecasting that the companies with greater profitability should acquire more to lower liabilities of the tax. Graham (2000) guessing the cost and advantage of debt, came to know that the firms with higher profit have less financial distress assumption utilize the debt confidentially. Microsoft is a very good example of those research that it as a most profitable company has kept a debt policy of zero. Moreover, the inspection of corporate administrative demonstrates the softness of target leverage (Graham & Harvey, 2001). The adjustment speed towards the advantage of the target is not fast (Jalilvand and Harris (1984); French & Fama (2002)). Companies on their structure of capital do not counteract the effect of stock returns resolutely and precedent stock returns are the important determinant of the benefit of the market (Welch, 2004). On the other hand, most of the studies shoulder trade-off theory and affirm the act of objective leverage (See e.g. Marsh, 1982; Opler & Titman, Hovakimian 2001; Hovakimian, 2004; Hovakimian & Tehranian, 2004 Korajczyk & Levy, 2003). Frank & Goyal (2004) prefer the trade-off theory in advantage decisions by checking the relative significance of 39 factors.



### **2.5.2. Pecking order theory**

It tells that industries or firm schedule their financial resources in accordance to the law which is known as law of least effort which aim is to increase equity as a financing source. In this case firstly internal finance is going to be utilize, when this debt is utilized than on second stage debt is supply and when it is no longer be beneficial to supply or issue more debt then finally equity is issue. This theory explains that companies hierarchy of source financing and give importance to internal financing whenever it is available and if in case external financing is required then the importance is given to debt on equity. Debt is actually a fulfilling of a company need through external finance. The insinuation of this theory says that for raising a capital, equity is not given as much importance, the reason behind it is that the managers published new equity. This pecking theory of capital structure is one of the dominant theory of corporate dominance. In regarding Myers (1984), due to unpropitious chosen firms give importance to internal to external finance. When the need for external funds arises, firms give importance to debt to equity, the reason is that the cost of lower information is linked to debt issues. There are few chances that one issue equity. These thoughts were purified into a very important confirmable forecast or hunch by Shyam-sunder and Myers (1999).

The shortfall of finance should equate dollar for dollar with the help of adjustment in corporate debt with the outcome, if organization chase the order of pecking then taking out the regression for a net debt matter on the deficit of finance, one can see a slope coefficient of it, Harris and Raviv (1991). The basic aim behind this theory is to tell the world that how companies finance themselves. An effort to create empirical and theoretical research of how the companies finance themselves in the real world has become ambiguous. Theories that are explaining about the structure of the capital and about up and down of debt ratio from the structure of the capital to the firm range impertinence suggested by Modigliani and Miller to lineup the related theories. After their research other new theories, i.e trade of theory and pecking order theory established. One of the parts of pecking order theory says that when it comes to the companies that are making a profit, they are going to give importance to internal finance in spite of taking new debts or introducing new equity in the business. In spite of this debt is considered to be cheaper than equity but within definite proportions.

Pecking Order Theory has got significant importance in descriptive literature. Myers (1984) had made this major theory under the heading of corporate finance connected to the capital structure. It is assumed to be a substitute theory to the theory of trade-off where the company has an accurate order for financing decisions. Pecking order theory tells that the company makes an effort that at priority use its sources related to internal financing e.g retained earnings after that give out debt and then give out equity as last expediency. This theory tells about the financial resolution made about the companies. With the point of view of Myers and Shyam-Sunder (1999) pecking order theory assumes the effects of profits in a correct way. On the other hand, Fama and French (2002) and Frank and Goyal (2003), the theory has some other problems also. At a moment it is not much useful in managing the financial resources of the companies. Shyam-Sunder and Myers (1999) checked the alteration in debt by the model given below in it a single variable is explaining it.

The Pecking order theory model anticipates that the optimal capital structure will not be win by companies but companies would go after a certain principle and select external financing only then when capacity of the debt“ is attained. Pecking Order Theory furthermore tells that irregular information between company insiders and outsiders and the presumption that expenses and profits of outside financing in regarding trade-off theory are not much important when correlated to the costs connected to the (inside financing) giving away of new securities. The cost of transaction correlated to an external origin of financing also plays an important part in selecting financing sources. The transaction costs of debt are not higher than the cost of equity issues (Baskin, 1989). He also came to know that cost of raising debt in American markets is lesser than equity raising cost. Hamilton and Fox (1998) and Holmes and Kent (1991) came to know that managers do not like to give away their hold over companies. That is the fact that managers usually do not take new shareholders and their aim is to finance their company’s projects mostly with the availability of internal funds. Managers will finance the companies activities without hold limits if the company does not hold enough internal cash reserve. So, short-term financing is needed at first due to the fact that does not need a guarantee, pursue by long-term debt and after that by giving out equity. External equity as anticipating by pecking order theory is selected as the last option (Huang and Ritter, 2009; Bistрова, 2011).

Once the limit of the data is made the portion of the model, the hypothesis of the pecking order theory explains a fine adjustment to the data (Lemmon and Zender, 2008). Whereas Fama and French (2005) tell that the financial decision of the companies mostly repudiates with the hypothesis of the pecking order. Contrary to this, Leary and Roberts (2005) and Bharath et al. (2009) have seen empirical potency with the hypothesis of pecking order theory. Researches have also been done in developed countries to go through pecking order theory. According to Gaud et al. (2007) study which was performed in European countries to check decision made related to capital structure explains that both the hypotheses of static trade-off theories and pecking order theories are not able to describe the results properly. A study has also been done by Drobetz and Gruninger (2007) which checks the pecking order theory hypothesis in 42 countries and explains that the deficit of the finance can look after better than the giving away of net debt. Research made for European countries by Brounen et al. (2006) and Beattie et al. (2006) found backing up the hypothesis of pecking order theory. Although, Brounen et al. (2006) do not back up irregular information.

This discussion is back by Fama and French, (2000) who revealed that companies that are earning the good profit are less extract in comparison to those companies that are not making the profit. Murray Frank and Goyal(2003) revealed that bigger companies acquire debts so that they can keep up with the payments amounts of, on the other hand, small companies shows the opposite condition. Many of the researches have been done on developing countries found supporting packing order theory. One such research has been conducted on the Brazilian economy and found that the Brazilian economy is also supporting packing order theory. They conducted that the main logic behind it is difficulty in giving away equity. Abu Jalal (2007) has done his research on more than 16000 nonfinancial firms around 40 different countries and came to know that unfavorable preference from the available choices costs and irregular news or instructions were the important causes of issues related to debt. But meanwhile these two things did not perform their important task in those countries which are developed in comparison to the countries which are still in the list of developing countries .In 2011 Jong A.de verdbeck M and Verwijmeren P in their work checked the static trade-off theory adjacent to pecking order theory.We keep an eye on a most necessary difference in an indicator.

### **2.5.3. Market timing theory**

This theory explains that the manager provides securities which base on the time changing costs of connected debt and equity and that is why granting of decisions usually have got along term reaction on capital structure,the reason behind it is that the capital structure which went extensively through any specific date is the result of preceding issuance Accord,thus the organizations give importance on issuing equity at that time ,when they find that the relative cost is less and at this time they found it feasible to issue debt when the cost of equity is high (kwast and Rose 1982).The payments that are promised to be given to the bondholders are fixed, stockholders are capable of getting, what is remain as a balance after giving off the fixed payments. The prices of a stock are more reactive than the prices of the bond to any correct information about the future performance of an industry or organization.

If the manager has got the appropriate information that is unknown to the market till yet, the revealing of such news can make a higher rise in stock than the prices of the bond ,that is why the correct price of the stock will appear less valued to the firm managers than contemporaneous prices of the bond (Molyneux Thoruton 1992).Utilization of this theory can save the firm from diminishing the worth of claims of existing stockholders. The companies those are earning good profit through the capital, they also believe that the value of their share should not go down for this they definitely going to select the option which is to issue debt in the phase of equity. For those managers who think that their companies firms are having higher value, they may think of issuing the equity. Here is the need for management to understand that many firms those are giving new equity, those companies which are having high value should make them ready for certain change i.e drop in the prices of their stock while announcing offers.By the time market Timing theory had been published by Baker and Wargler (2002) Research line in capital structure has got a new way from that day. In his work he suggested that companies time the market of equity for the selection of capital structure and the good market to hire ratios with less advantage. Hovakimian (2006) revised the point of view of Baker and Wargler (2002), He tries to convince that adverse impacts of previous weighted average market to hire ratios on structure of capital was not purely due to the fact of market timing impacts ,actually this was due to the reason of book ratios of past market and it was an indicator of progress and it was poignant the decisions of finance.

Alti (2006) between others posit the initial public offering issuances as the sign of market timing, it was examined that the companies went public in the popular market, implicit the conduct of market timing, nonetheless the long run effects of market timing theory on the structure of capital failed to show its analysis. Larrian and I,(2003) figure the contention of market timing in security deliverance in addition to supervision the holdings of the shares. In the light of this research sale for those securities which are over price was the outcome of each others. (1) Those investors that were known as outsider investors were found to be optimist for the increase of company size. (2) On the other hand those investors which were seemed to be doubtful with the aim of controlling shareholders. (3) Investors were well aware of the aim of large shareholders but they were unable to do anything about them. These above mentioned three of the dimensions were reformed with the shareholder of the institute to find out the proof of market timing. The main and most important addition of the research was to include the possession structure and delivery attitude with company level characteristics e.g profitability, growth, leverage, size e.t.c.

A budget of the capital inferred that if the shift in the demand curve found to be positive for a firm in coming time, there is a possibility that it might gather funds by giving away equity (Dellavigna and Pollet, 2013). Meanwhile theory of market timing deductive that if in demand they found positive shifts for 5 to 10 years there might be possible that companies had lower the equity, the reason is that in this case the equity might be valued at less price and in accordance with the market timing examination companies made an effort to purchase the equity again whose price is less valued. So due to this reason research conducted found connection with the issuance of the stock and also with the long-term shift of the demand. The regression of OLS measures tells that the shifts in demand to different demographics make the industries to help both of the indications given by budget of the capital and by a theory of market timing from 1974 to 2004. Market timing has got great significance in checking the performance of a company while making the proper structure of the finance Baker and Wurgler (2002). By taking it in a different style, the financial priorities of the companies state the outcomes of previous modifications of their stock prices and also the desire to time the market. Managers abduct the advantage of the circumstances to provide shares to lessen the pressure of debt restrictions and in this way intensify the favorable prospects of its entrenchment; throughout the period of market growth and prosperity.

When the surrounding of the financial market is not such promising that matches a rigid hold put into action by the portion of shareholders, officers are restricted towards demands as well as limitations strained by means of the market; in search of giving away the less risky debt. Baker and Wurgler (2002) publication of analysis correlating with preceding market-to-book ratios to capital structure, static trade-off theories and pecking order theories have been vindicated by the market timing theory. Wurgler and Baker verify that securities given away over a year have extended impacts on capital structure has vindicated by many of most papers. The executives of business are looking forward to making their financing decisions quickly with respect to market timing. Two-third executives of business have the same point of view that “the proportion by which our stock is overvalued or undervalued was a very important issue to concern” in the decisions of issuing the equity in a survey by Graham and Harvey (2001).

The hunch of pecking order theory that markets are semi-strong skilled, that is why the notification of a result of security issues is the main surrogate for the limitation of asymmetrical information. The theory of market timing does not rely on the assumption of the semi-strong form of marketplace efficiency. Only if the respective cost of equity shows a disparity over time for either logical or illogical base, so the door of favorable circumstances exists. Alti and Sulaeman (2012) show in their research that such timing behavior is shown by companies in reply to greater returns that takes place with the demand of higher investment by institutions. Rajan & Zingales (1995) and Baker & Wurgler (2002) have utilized the following hypothesis correlated to market timing in their research where the market-to-book ratio (MB) has been known for measuring the chances of growth. Hovakimian (2004) provide MB time to calculate past MTB ratios” weighted average of time series. Thus, market timing theory help to explain the fluctuation of stock prices with respect to the information as available to manager which is unknown to public thereby rise the stock's price In one of the study conducted by Jenter (2005) explained that market timing in decision-making of managers was due to opponent opinions of managers about the market worth of companies. The research intended to look at the decisions of the managers to time the markets of the equity when their personal interest was involved. It was said that managers had constrict point of view about their stock's market value.

#### **2.5.4. Agency theory**

The agency theory is a presumption that tells about the connection among principles and agents of business. This theory deals with giving solution for the problems that can be found in relationships of agencies due to irregular motives or other reluctances levels to risk. Finance is one of the common relationships of an agency finds among shareholders principles and executives of company agents. Agency theory gives directions of the problem that occurs because of the fact of difference among the desires and goals among the agent and principal. This condition can be due to the fact that the principle is not conscious of the acts of the agent. An agency is basically a relationship among two parties in which one can act as a principle and the other will act as an agent whose job is to present the principle in a transaction with the third number party. The relationship of agency develops when the principle appoint an agent to do service on behalf of the principle. According to an article of 1976 which says that the theory of firm managerial behavior ownership and cost structure of an agency by Meckling and Jensen founded a theoretical framework of the literature of capital gain and state of shareholders as an important stakeholder Lan et al 2010, daily et al 2003. Taking in the logic of agency rise in the 1980s because at that time firms begin to start shifting the logic corporate of hitherto capitalism of managerial system along the notion of managers acting as an agent for the shareholders (Zajac et al 2004). The consequent flow of literature may break along the heritage of huge dealing of a company as a dark box and the presumption that a company always look for increasing the worth (Jenson, 1994). Agency theory discussed about the grown-up by giving the way of principal by which they can control the agents to hamper managerial advantage and their own benefit (Perrow, 1986). It was found that market reacted in a positive way to the change that occurs logically, As the time passed the approach of agency start practicing in the institutions i.e within business, media and research (Zajac et al, 2004; Shapiro 2005; Lan et al, 2010).

The modern corporation model which is used in agency theory is taken from the development done in the 20th century. In this century the organization get bigger in size in demand for external capital and in complication. This linked with the grown stock market a restriction on management funds and a demand for adequate risk distribution (Fama, 1980; Fama et al, 1983; Demsetz et al, 1997) convey a growth in the dispersed ownership of organizations between shareholders.

This modern organization come down to a contracts of nexus among agents and dissolution of proprietorship and hold is made (Jensen et al 1976).The moral hazards problems take it forward towards the expenses of the companies which are related with contract administration, cost of information, moral hazards and transactions cost (GomezMejia et al, 2005; Jensen et al, 1985). The degree of the expenses rely on the capability of the principle to trace a correct solution for bringing down asymmetries of information by calculating performance of manager measuring useful benefits bring such rules and regulation that can reduce the behavior or moral hazards which is not required by the company (Brickley et al,1994; Gomez Meija et al, 2005). Although in acquiring cost of zero agency is unachievable to obtain practically because of the higher managerial cost which indirectly going to reduce the benefit (Jensen et al, 1976) by keeping an eye on them and benefit aim is to reduce them (Eisenhardt 1989; Jensen et al, 1985; Shapiro 2005).

It is natural to have an expectation from human beings of making maximum wealth. According to Bhundia (2012), many people are unable to handle their assets in the perfect way, it is wise to contract with other people that are more expert to do this job. According to agency theory, the first group belongs to proprietors and the second group is made up of agents or managers. Actually, the agents are the spokesperson of the owners of the firms (the principals), busy in maximizing the profit of the proprietor. For Jensen & Meckling (1976), if two portions of this relationship want to increase their own profit, it is better to believe that the agent is not always going to perform in the best concern of the principal. These writers explain the agency connection as a contract through which one or more properties activate a manager to do a service that includes representatives of authority for making decisions. Perhaps, managers do not have a list from which he can select to start.

The proprietors of the companies naturally going to limit the disparity of interests by creating proper benefits for the managers of the company and also going to create a structure to look into the managers' conduct and if he/she does something bad then the manager can be punished on his/her misbehavior. This supervision by the proprietors definitely comes at an expense. Jensen & Meckling (1976) said that the capacity of the agency expense relies on the manager's personality, to grow they have to work at their own interests in rival to increase the wealth of their owners, the supervision expense and the linking activities among the company's parties.



This devaluation of assets makes it more probable that managers will provoke the supervision of the market of the capital due to the fact that companies want to acquire a new capital. This type of supervision is avoided by internally financing the projects and there are the chances that the funds are going to be available or unavailable only at greater unambiguous prices. One of the other factors that were lifted by Jensen (1986) is that managers have gotten stimulus to make the company rise apart from its ideal size. Such rise in the size of the company gives rise to the manager's control over the company, since it increases the assets under their supervision, with a resultant rise in their commission, due to the positive relation between increase of sales and remuneration of the executive.

#### **2.5.5. Life cycle theory**

It is a way of incidents that accompany a new creation into reality and chase its development into a sophisticated commodity and prospective critical mass and downturn. Following are some of the steps that take place in a life cycle theory. In the product development phase includes analysis of the market testing and inception phase of market. In this at a primary stage a product is discharged and is pointed with a high level of advertisement. In the growth phase the growth of sales start to dominate. As the level of production increase the margin of gross starts coming down which in return decline the product profit on a unit basis. Also, the rise in completion is apparent. After that, there comes a maturity stage the product goes to a higher level of its cycle of demand and further making expenses for advertisement which in return will show little or no effect on demand. In decline phase product has reacted to its highest point of demand. From this point, the demand can remain stable or slowly start decreasing because of a new product which makes it no longer in use.

It is necessary for a person who is going to invest in a business to understand the life cycle of the product. Those companies that are in the phase of development may distinguish by smaller sales and are riskier than companies in the process of growing. A time when company reaches the stage of maturity, it is not good to say that the product has fielded in making profit for a company still can look in to further improvements and can innovate itself furthermore a mature company with improved products may in the position to give away dividends than companies in another cycle.

Fama and French (2001) mutually agreed on the hypothesis given by Mueller (1972) when they checked the downfall in profit payers from the time period of 1972-1999. They came to know that companies that are paying dividend have gotten greater profitability than those who are not paying dividend, the companies that are not paying dividend have got better chances of investment, and those who are giving out dividend are greater in size than those who are not paying out dividend (Fama and French, 2001). DeAngelo et al. (2006) further explain these findings while providing the information about the determinant of the life cycle gained/contributed capital mix, which is calculated by earnings of the retained one to total equity. They checked this determinant since they thought that it is a better proxy of the life cycle, as it calculates that up to what limit a company depends on a capital which is produced internally and also on that which is generated externally. They find support for their hypothesis that companies which have greater retained profit as a part of whole equity have gotten more chances to give away dividends, which is expected for successful companies. This indicated that companies those depend more on externally subsidized capital should not pay any dividends, which is more expected for new companies. On contrary to this, they wish that companies having greater cash should pay more profit, but their outcomes intimate the opposite. Their projected clarification related to this fact is that holdings of cash is not much trustworthy life cycle-proxy, since a company's holding of cash can be explained by proceedings from e.g. a current offering of equities, which is more preferably for a new company, i.e. a company giving away fewer dividends (DeAngelo et al., 2006).

Companies experience an uncertain environment of the business which is continually forced by uncertain effects of advancement of technology, competitor and globalization in a period of knowledge economy framework (Thoumrungroje and Tansuhaj, 2007). This type of knowledge for workers has become a requirement at workplaces (Sloman and Webster, 2005) and also do they have the capability to provide a source of ambitious benefit for a business (Eddy, Dabate, Tannenbaum, Givens-Skeaton and Robison, 2006). When companies learn something new meanwhile their workers learn too, enhancing the productivity of employee and growth of the firm in the long run (Senge, 1993) and (Campbell hunt, 2003). Through a series of different stages companies grows and their process is known life cycle of an organization.

This theory can be followed from 1950 in the economic fields because in the economic field the concept of a company improvement can be seen in the biological form as we do for living creatures (Haire, 1959; Rostow, 1960) Chandler (1962) and Lippitt and Schmidt (1967) explain this in deep detail from prospect in strategic change, structural movement, arrangement and elaborating concern of managers in raising companies. Downs (1967) also talked about the impact of the company motivation on growth of a company. These writers theoretically told about the life cycle of a company as growing up stages that a company attains by progressing doing well over time Steinmetz (1969) is known as the main character in discussing the life cycle of an organization. Hanks and Chandler (1999) empirical work is known as a close inclusion to the model given by Kazanjian, (1988) and Drazin (1989, 1990) although the names of the stages change on a small scale. Utilizing small and medium enterprise (SME) in those companies which are equipped with technology. Hanks and Chandler (1994) agreed with the problems that were progressive in the nature that organizations had to go through across the four different type of stages.

On first priority, they see that specialization of a job also goes after the organization life cycle in that way which shows that the state of the new firm is found to be less specialized jobs than companies that are old in nature in the workplace. Mitra and Pingali's (1999) research was known as the first empirical research which went out of range to the context of the west to investigate small and medium enterprise (SME) growth. The writer took Lewis and Churchill's (1983) growth model and endorsed it by utilizing little organizations in the additional sector of an automobile in India. The cycle growth stage is related to the fast growth of sales diversification of the product and unique ability (Miller and Friesen, 1984). A structure that is based on functions was settled, those managers that are middle level in nature play a necessary part in the daily day to day work and procedures are established to make sure the efficiency of administration (Adizes, 2004). Adding more, when we see that business is growing quickly then the business depends strongly on external financial markets for raising the shortage of capital so that it can be used later for investment and existing activities purpose and for them the need for capital is higher than their capability to raise cash internally (Lemon and Zender, 2010). Marketing performed well part with voluminous commodities ranges and bounded putrefaction of power making companies increasingly little delicate to market changes (Frielinghaus et al, 2005).

A company life cycle is particularly relevant to its decisions related to financing and features of the company in many life cycle stages are necessary for making decisions related to finance (Adizes, 2004). Different decisions of financing in different stages of life cycle gives information about the extent of financing needed (Fama and French, 2005). Trade-off theory (Myers, 1984) advise that the decisions of the capital structure depend on balancing the cost of financing the debt and advantages (Deloof, 2008) and the expenses and advantages changes on different stages of life cycle. At the stage of birth and growth of a company the bankruptcy cost is higher in comparison to those companies which are in mature stage, the reason behind it is that at this stage companies may go through higher level of liquidity risk and also due to improper information. It also implies by the trade of theory that in the time of boom and decline period companies has to go through a fall down in their profit, the outcome of which can take to decrease in the tax paid by the companies. The outcome of it can be in the form of reducing debt by effective companies. That is why the companies at birth and growth stages and companies at restoration and downturn stages may bring down debt ratios among companies to companies in the mature stage.

#### **2.5.6. Free cash flow theory**

It gives the information about the cash a firm can make after required investment to retain or increase its asset base. By this one can come to know that how well a company is performing. Free cash flow has got two types (1) Free cash flow for the company and equity. It is such cash flow which is accessible to all investors in a firm containing common stockholders. Free cash flow gives a helpful valuation method mostly utilize to take out company's worth or worth of a company's common equity. Mostly the stockholders will measure a company's worth by utilizing free cash flow model methods and minus total debt to find the firms equity worth in a structure of a capital. One can calculate free cash flow by using these formulas.

- $FCF = \text{Cash flow from operating activities} - \text{capital expenditure}$
- $FCF = \text{Net profit after tax} - \text{Net investment in operating capital}$

The cash flow, which is in a large amount is free cash flow which is needed to finance all of the projects of a company that net present values are positive when it is discounted at capital relevant cost. This type of free cash flow must be given to shareholders if the company is effective and to increase the worth for shareholders.

Payment in cash made to the shareholders decrease the reserves under the control of the manager that is why by decreasing the power or authority of manager and likely administrating them to observe by the markets of the capital that appear when a company must get new capital. Putting money into projects internally save this from supervising and the feasibility that amount will be available or unavailable only at high cost. Myers and Majluf (1984) claim that flexibility of finance is needed when managers of a company have got a good report about the company than outside investors. Their claims provided have indicated that such easiness has cost; easiness of finance in the shape of the free flow of cash, which gives the manager the biggest foresight on assets that are mostly not utilized in the interest of shareholders. That is why antagonistic of Majluf and Myers argument have indicated that ultimately the cost of an agency of free cash flow create the worth of the company to come down with rising in the elasticity of finance. The theory which created here tells.

- How inefficiencies of organization which is foster by free cash flow decrease by changes happen in exchange of debt for stock.
- How we can put debt in place of dividends.
- Why hetrogeneity in the same line of business program are favourably linked with losses than development program.
- Why fusion with an organization and takeover of motivated liquidation going to generate higher profit in comparison to the fusion of cross-industry.
- Why it is like that the factors provocating takeovers in this distinct type of business as the announcing system of cables, tobacco, and oil are basically the same.
- Why it is like this that the good performance has to be shown targets and bidders earlier to take over.

For those organizations that have positive type of free cash flow, the theory gives the prediction about the prices of the stock and said the prices are going to increase with astonishing rise in payments made to the shareholders and go down with astonishing decrease in the payments made. It also gives the information about the surprise rise in demand for cash reserves from shareholders through new issuance is going to decrease the stock price.

Free cash flow agency cost is the same with a big dimension of that data which is already not been explained and there is no consistent explanation for this data. The answer which is positive in nature to the creation of debt in the oil sector and the rest of other taken over (Burner 1985, Asquith, Burner and Mullins 1987) is regular with the cost of the agency with the free cash flow and also with the restraint hypothesis of debt. Cash flow of an organization is an important factor that improves its operations. In the eye of Efobi (2008) with the reason of cash flow relevance found with organizations performance and operations. The companies related to the corporate sector have to generate a cash flow which must be suitable for them and if they want to increase the value of the shareholders they have to apply this mix cash flow. Uremadu (2004) found that the cash flows of firms as that huge amount of funds that an organization can execute to its assets that are fixed, marketable securities, account receivable and inventories that are taken forward to corporate earning, gain or profit. The capability of an organization to select correct source of finance that can give hand to its operations which can give difference among cash, which is managed poorly and strongly for a flow of cash (Efobi, 2008). If an organization wants well structure of its cash flow and also wants it to be used effectively then a company must devise many ways for choosing the better component for the flow of its cash which can be utilized in an organization task for increasing its productivity and also for getting performance. The process of it should depend on the process which must be made well by the manager of the finance after creating a cautious plan for the finance and hold for an organization (Uremade, 2004).

Cash flow is a money index that is obtained by or given out by a company for some specific time (Albretch, 2003). This indication is not comprehensive of accounts changes of those that are non-cash in nature e.g depreciation cash gives the information about the system of the firm, if the cash waste away, then it is very difficult for the business to run effectively. The reason behind is that if a company is earning a good money it does not mean that it is also stable. The cash is not a profit. The financial performance, flexibility, and the solvency of an organization are based on the capability of an organization to make good cash flow from the activities of the finance, investment and operating (Turcas, 2011). All input and output activities are represented by cash flows and also represent cash equivalent, demand deposit and cash on hand are represented as liquidity.

The information of cash flow helps its users of the financial statement for taking the information which is in accordance to the utilization of resources of essentially the whole resources of the finance in a provided time period (Ross, et al 2007). The significance cannot be overstated only due to the reason that the consumer of accounting information is specifically taking interest in the published cash of the company in its statements of finance (Narkabtee,2000).In the eye of Bodie et al (2004) inwardly it is important for the manager to know about the firm's financial performance .In accordance to Markomits and Fabozzi(2006),the transistors are taking interest in the liquidity of the firm due to their short-term rights and in this condition liquidity indicator reflect at its best their capability to pay.In the eye of Bragg(2002), financier in restrained those who usually give a loan to a company on long-term or medium for compensation, They are taking interest in the firm's capability to make cash flow for long-term and medium coverage of debt service.

Jensen (1986) announced the free cash flow theory and explained it as the cash flow from functioning enterprise in abundance of that needed for investment in the business with a positive net present value (NPV) when discounted at the suitable capital's cost. According to Lehn & Poulsen (1989), free cash flow is the functional profit that comes before depreciation and comes after making payments related to tax and dividend. According to Dechow & Ge (2006), the free cash flow is that cash flow which comes from practical activities and also the cash flow from monetary investments.

#### **2.5.7. Modigliani and miller theory**

Modigliani and Miller utilized the proposition theorem which is the irrelevance as a point of beginning in their theory of trade-off that tells that company has to select that up to what extent debt and equity finance is going to be used by equalizing the growth and the cost. Miller and Modigliani in the 1950s researched capital structure theory deeply. They create a proposition which is an irrelevance to capital structure. They explain that in a perfect type of markets to finance a corporation what type of capital should be used, it does not matter. They have a theory that an organization market worth can be known by the fact that how much are they earning and also by the fact that up to what extent its assets are under risk and also that its worth is not dependent of the type it selected to finance its investment.

Key assumptions are as follow;

- No cost of bankruptcy.
- There are not any taxes.
- No cost for a transaction.
- Bank investors and companies borrowing costs are equal.
- Investors and organizations have the same information.
- Before taxes and interest, there is no impact on the earnings of a company.

The Modigliani and Miller structure of capital inconsistent suggestion consider none of any cost related to bankruptcy. According to this capital weighted average cost(WACC) must be same with a change in capital structure of a company e.g there is no concern that how a company takes a loan from interest there will be no tax advantages so no changes to WACC. As there are no advantages from a rise in the debt, a company stock price is not going to disturb by a structure of a capital and the structure of the capital is not relevant to a stock price of a company. The theory of trade-off thinks that there are advantages to leverage but within the structure of a capital up to that extent the capital structure reach the optimal stage. Tax benefit from payments of interest is recognized by this theory and said that the interest that is paid by someone on debt is tax deductible, company tax liability can be reduced by issuing the bonds but on equity, if someone pays dividends is not going to help in this way. Because of a tax savings nominal rate of interest is less than the actual amount of interest that firms pay on bonds. Research suggests that many of the firms have less benefit than a suggestion of this theory is optimal. Miller and Modigliani without taxes of corporate explain that company's respective fraction debt is much feasible due to a shield of interest.

The proposition of Modigliani and Miller is that the worth of an organization base on the fact that how much profit it is earning and it does not depends on capital structure(Modigliani and Miller 1958) is assertedly a field of finance application which says that money is unbiased .In an effort to recognize the feasibility of an optimum structure of capital out of emptied left by Modigliani and Miller believe that bankruptcy cost is linked to shareholders rise with preparation of major role. The cost of bankruptcy and their achievable ramifications were particularly accepted in the real Modigliani and Miller paper.



Modigliani and Miller view of gearing and the WACC with no tax: It says that if the shareholders use debt it will give more risk to shareholders and the result will be in the form of expensive equity, but the debt is not going to decrease the cost of finance and does not decrease the weighted average cost of the capital (WACC). The market of the capital is perfect which means no cost for the transaction and the rate of borrowing is the same. The risk is calculated by the volatility of the cash flow. The weighted average cost of capital throughout remains the same. The holder of equity is going to bear more risk as a firm takes on extra debt. Extra debt reduces the WACC but for equity holders, the extra risk rises the equity cost and so by this, the weighted average cost of capital comes back again to its original position.

According to Modigliani and Miller's point of view of gearing and WACC with tax says that if debt is capable of saving tax for a corporation then it can decrease the cost of finance too, which is going to give an advantage to the shareholders by decreasing the weighted average cost of capital. This advice that a firm can utilize debt according to their need. If debt attains a support for tax and equity does not get any support then the graph with the straight line is not correct. The debt will be less expensive due to tax in comparison to equity so extra debt is beneficial at all levels. When people do not worry about the risk of bankruptcy then we can assume that market as a perfect market. That is why at-large debt weighted average cost of a capital increase in the real type of imperfect market.

So by looking deeply into the real study of authors Modigliani and Miller (1958), it can be seen that this theory is an abstract of outcomes by which it was pursued to illustrate the incongruity of decisions related to finance, in best suitable circumstances of the capital market. In no time after its announcement, the Modigliani and Miller theory was converted into the utmost theory of the capital structure (Pan, 2012). The real proportion and the foundations of Modigliani and Miller's Theorem (1958), explains that there is a fully competitive market, which is without taxes, bankruptcy, and transactions type expenses, it also implies that there is a lot of information at the clearance of all groups. The impacts of taxes on their model were comprised by Modigliani and Miller in 1963, due to the fact that their theory can come closer to the truth. According to the publications of the Modigliani and Miller's (1958, 1961 and 1963), there are three main propositions, which developed the ground of their theorem, can be formed (Breuer and Gürtler, 2008).

### **2.5.8. Signaling theory**

Ross(1977) and other researchers make a signaling theory of a capital, which is based on asymmetric information type problems among investors and managers. These type of models depends on an idea that higher management of a company that got inside information has an aim and the aim is to deliver this information to the outside investors, which outcome should be in the form of increased stock price. Managers want to face the condition with suspicious that why do not announce the news simply. One answer to the problem is to provide a signal to investors which contain related information. By taking a policy of finance for the firm of low worth .this strategy is forbidden from the cost point of view. Dittmar and Bhattacharya (2004) talk about signals that are costly and about those that are costless. Managers are not going to tell about the good information that they got due to the fact that all firms without being valid could do it .Inplace of this the leverage of an organization rise by the administration. For an organization, this structure of capital is an obligation. Their leverage is increase by an organization that sends forward an information that their prospects are good and profitable those organizations which are overstated are not ready to take debt burden due to the fact of bankruptcy risk.

The idea of signaling was first researched in the context of product and job markets by Akerlof and Arrow and was made into equilibrium of signal theory by 7 Spence (1973), it says a good company can come to know about itself from a bad company by forwarding a credible information about its quality to capital markets. The signal will be credible only if the bad company is unable to imitate the good company by forwarding the same information. If the cost of the signal is greater for the bad type than that of the good type of company, the bad type of company may not find it value while simulation and the signal can be conceivable. Ross (1977) explain how debt could be utilized as a signal of a cost to isolate the good from the bad companies. Under the unbalance information between investors and management, signals from companies are hard to attain financial reserves. Ross observes that managers (the insiders) know about the real allocation of company returns, but shareholders do not. Signaling of greater debt by managers advice that a better future and high-quality companies would use more debt while companies with less quality have lesser debt levels. In this way, a better company can apart itself by drawing the attention of investigation while the bad performing company will not imitate.

At first, the expensive signaling equilibrium explained by Spence (1973), Leland and Pyle (1977), Ross (1977) and Talmor (1981) etc., the second one is the inexpensive signaling equilibrium as recommended by Bhattacharya and Heinkel (1982), Rennan and Kraus (1984). A signal is expensive if the creating of the signal utilize resource or if the signal is linked with a loss in prosperity produce by divergence from allotment or sharing of the allegation in perfect markets. For financial instruments the signaling criterion is multivariate. Poitevin (1989) explains that debt could be utilized as a signal to explain the difference of the capability of competition for the companies that are new in the business. Harris and Raviv (1985) said that attracting companies as convertibles can be a type of signal and Bhattacharya and Dittmar (1991) demonstrate stock rebuying is another type of signal to show a value of a company. Also, the accuracy of the signal is momentous too (Veronesi, 2000). Many changes used to be made in capital structure by a manager for sending forward an information about the company risk and profitability to the outsiders. Internal users know more than external users, this is the point at which the theory of signaling was founded. The market value of an organization is an independent variable on which the privileges and the wages that managers earn are dependent.

Higher possibilities for bankruptcy are shown up by the rising leverage. It gives signs for good evolutions. An application for the loan means that the management has trust that the good movement of a company will make it capable of paying back the debt. The related news will be believable only in the case if the expense of the wrong leaked information is big enough to face a company to come out with the right information. The rise of advantage is a good signal. Stable cash flow make sure to be adopted by a company is forced by a loan contract during the period of the loan and if a company unable to meet these requirements then the companies may have to face bankruptcy. On the other hand, if we talk about inequality we found that in this case, the things are more flexible. Stockholders hold on for payments of the cash but in this way, the management has the ability to lessen or to take them out during the time of financial deflation. Due to this problem, to take a new loan is a conceivable sign for the flow of cash for the future time. Akerlof was the first economist who looks into asymmetric information with problems named by him as lemons problems, which involved the market of the car. Akerlof's idea was carried forward by Michael Spence in his article of (1973).

The selection of the structure of capital of an organization is an indication for the outsider users. In the eye of Neo a quality of a company that issue stock is not better than a company that raises loan. In the announcement of stock issuance, the price of the stock predicts the negative reaction by Neo's model. It was believed by the Ross that the structure of the capital act as a mechanism for signaling within market. An undertaking of the debt is the best-known signal. Ross considers that the structure of capital performs as a mechanism for signaling in the market. Undertaking the debt is known as one of the best signals. This act raises the feasibility and expense of financial strain for a company. Rest of other signals for finance are as follow:

- Poison pill announcement.
- Spin off announcement.
- Tender off announcement.
- Acquisitor or mereger announcement.
- Repurcahse of stock.
- Advantage or Leverage.

For the worth of a company, the conception can be modified by making the changes in capital structure. The price of the stock is negatively affected by the issuance of the stock, argue by the above-mentioned writers. If we add up, we can see that Narayanan (1985), Noe (1988) and Ross (1977) with respect to the rise in debt anticipate a positive stock price reaction. Majluf and Mayers (1984) anticipate that the price of the stock is not going to be disturbed by endeavor risk-free loan. McDonald and Lucas (1990) come to know that the price of the stock came down after equity rise declaration but after a little span of time it increases. In the eye of Krasker (1986), the price of the stock is negatively related with the issue of size.

Many of the researches have been conducted on signaling theory Johnson's (1988) study shows that the signaling theory was very active in the united state of America, during the time period of 1970-1988. The higher gains from the common stock were not connected positively with the declining of loans pay-off and the easiness of the distribution of the dividends. The prices of the common stock can be changed due to the fact if the offer from exchange gone through properly. The Jahera and Pugh (1990) research finished along theory of signaling in the united state of America, perhaps it looks carefully into the theory from the stock repurchase point of view.

### **2.5.9. Life stage theory**

The main assertion of organizational life stage theory is that company – in the same style to living organisms – improve by a position of life stages that begins at birth and finishes by the death to Utami & Inanga (2012), Companies in various stages of the life cycle have got various features, most importantly in regard to the asymmetry type of information. Mature companies have got little asymmetry type of information whereas growth companies have got a lot of information. This is due to the fact that mature and older companies are more closely seen, studied and followed by researchers and also known to be very well by investors and hence, should bare less from asymmetry type information problems. This theory explains a relation among the structure of the capital and the life stage of a company. In accordance with this theory, the stages of formulation and growth are typical with greater utilization of debt inspite of equity. The firms that are mature bring down the debt level, which increases again during the tenure of decline. To have the glance on a relationship among capital structure and company worth (Chowdhury, A. & Chowdhury, S. 2010) undertake price of a share as the proxy for worth or value and some different ratios for the decision of capital structure in Bangladesh.

The interesting results tell that increasing the wealth of shareholders needs the best consolidation of equity and debt, on the other hand, capital's cost found to has a negative correlation in this accord and it must be as less as it can be. This is also found that by altering the composition of capital structure during the company's life stages can raise its worth in the market. Nonetheless, this had been important policy incrimination for finance managers, because they can use debt to make an optimal capital structure to increase the shareholder's wealth. Pringle (1971) feel that the banks that are under capitalization will see themselves exposed to high levels of borrowing of short-term at high cost during the tenure of tough Money. Flaming et al (2009) suggest that the return from banks are simulated with variables of macroeconomic advising that policies of macroeconomic that gives the rise to low-level inflation and secure output development to increase credit growth. According to Christian et al (2008), the fairness of capital determinant gives the remarkable information about the return of the firms, on the other hand, some of the independent variables are representing the quality of asset and gains are explanatory. Growth size and loan do not have any significant explanation power of inspecting returns

## **2.6. Measurement of Variables**

### **2.6.1. Debt financing**

Cost of funds ratio is the way for measuring the debt financing, which calculates the average cost of the funds that are borrowed from the bank. This is very important input cost for all financial institutions, the reason is that the less cost can bring the best return at that time when the funds are employed in the shape of long term and short terms loans to one who is asking for loans. The expands between the fund's cost and the rate of interest taken from their borrowers, shows one of the important sources of profit for many institutions that are financing. When differentiating the banks, the fund's cost ration tells that, have they got to approach low-cost funding sources or not, as one of them is saving.

Those banks that are capable of muster the savings, more likely have a chances of low funds cost but this benefit up to some extent counteracted by a high level of administrative cost of muster savings. The formula for calculating the cost of funds is  $COF = \text{interest and fees paid on loans on excluding payments on savings} / \text{Avg outstanding loan from creditors}$ . Still there has not any study found yet by which using funds cost one can found or calculate financial performance. If we seek the guide from technology we came to learn that "the indicators for microfinance institutions "(2003) for measuring the performance of financial management bank cost of funds are used, which also known as indicator for the measuring of their performance (Microrate and Inter American Development Bank, 2003).

What capitalization ratio do? It simply analogizes the total debt to its total capitalization (structure of capital). The ratio of capitalization indicates that up to which point a company is working on its equity. The ratio of capitalization is also known to be a ratio of financial leverage .It gives the information to investors about that point up to which the firm can utilize its equity to securities tasks and development. This type of ratio support and help in the analysis of risk. Those companies having a high capitalization ratio are known to be risky, the reason behind it is that they are at risk of ruination if they are unable to pay back their loan on time. The ratio of capitalization can be found by dividing the debt of long-term with shareholder equity and long-term debt.

$$\text{Capitalization ratio} = \text{Long term debt} / \text{long-term debt} + \text{Short term equity}$$

This ratio is very important and useful debt ratio due to the fact that it provides an important understanding of the use of financial resources by a company. Its emphasis is on the relationship of long-term debt as the part of the firm's total base of capital. The total capital is the capital which is evaluated through the holders of the share and by the Lenders. The company's capitalization tells about the make-up of the long-term firm's capital. The capitalization can also be known as the structure of the capital. The long-term capital of the company composed of long-term borrowings and the equity of the shareholders. There is no merit for setting the perfect debt amount. The ascendency will rely on the kind of firm business line and also help to know that at what stage of development a company is?

It is well known that high quality and low debt levels of the capitalization ratio tells about the nice quality investment. In the finance the multiplier of equity is known as the financial leverage measure. In regarding to debt management ratios, if to see a company is capable of using its debt for financing its assets can be measured by the method of equity multiplier. The equity multiplier also direct to leverage ratio of finance. As it was told by Silva (2008), that the multiplier of equity tells about the total asset of a company as per the equity of stakeholders shilling. If the multiplier of the equity is more, the more will be the leverage of finance. Which shows that firm depends more on debt so that it can finance its assets. The way of calculating the equity multiplier is by dividing the total number of assets with the equity of common stakeholders.

$$\text{Equity multiplier} = \frac{\text{Total Assets}}{\text{Stockholders equity}}$$

$$\text{Alternative formula} = 1/\text{equity ratio}$$

As discussed before the assets of the firm are the sum of debt and equity. That is why the ratio of the equity calculates the part of the assets of a firm. The debt to equity ratio is used to check a leverage of a firm (Berk and De Marz 2007).

$$\text{The formula for debt to equity ratio} = \frac{\text{Total debt}}{\text{total equity}}$$

W.r.t debt to equity ratio the short-term debt to equity, long-term debt to equity ratio, short-term debt to equity and long-term debt to equity ratio also used in this study. Equity and long-term debt i.e capital give the information about the fund's source to the bank along with borrowings and deposits.

### **2.6.2. Financial performance measure**

The profitability is calculated by return on equity (ROE). The return on equity is explained as the firm's yearly net profit division of tax by shareholders equity. The net income is the earning amount obtain after giving away tax and expense. Equity gives the information about the capital which is invested in the firm in addition to retained earnings. The ROE also tells about the earned amount produce or obtained from equity and it is chosen as a measure of profitability due to the fact that return on equity contains features of performance, such as leverage of finance and profit (Foong, 2008). The performance of bank calculation has been flourish with respect to time. In the start, many of the banks utilize a purified driven accounting approach and keep an eye on the calculation of national income e.g the measurement of return on asset. In spite of this, this approach does not deem that is related to risk which is referred to the assets e.g the risk of transactions and also with the off-balance sheet activities growth. The underlying asset risk becomes important and the banks also observe that equity has become the scarce resource. Therefore the banks start giving importance by keeping an eye on the return on equity so that they can calculate the net income, with which banks can find out the business, which is much profitable so that investment can be made (Joetta, 2007).

The return on equity mainly used to calculate the bank's profits. Up to what extent the banks are efficient can be checked by utilization of return on equity formula, since it tells that the profit of banks was invested again so that they can earn a profit for future. The success in the growth of return on equity can also depend on the banks' capitalization and margin of operating profit. The extension of return on equity will be postponed if a bank largely capitalized by the weighted capital adequacy ratio or by the ratio of tier 1 capital adequacy ratio (Foong, 2008). The return on equity is a necessary indicator for measuring how much or up to what extent the banks are earning the profit and it has been the part of many studies held before. Foong (2008) showed that the performance of banks can be calculated with the help of return on equity, which tells that up to what limit banks are using income that is reinvested for producing future profits. In the eye of risk, bank's financial report (2002), the calculation of related profit to share holder's equity is basically used to tell about the profit condition in the banks. The return on equity also depends on the activities of the capital management.



Due to the fact that greater leverage of finance multiplier tells that on a small base banks can leverage the funds of stockholders, and have the potential to produce assets with high interest taking it to one step forward towards the progress of earnings. On the other hand, an increase in ROE has the ability to reflect the rise in risks due to the fact that the great level of risk can generate more profit. So we can say that return on equity not only increase by raising the returns on profit but it can also develop by having more debt which brings more risk. So positivity of return on equity not only tells about the strength of finance.

## **2.7. Empirical Evidence**

A lot of empirical analyses have been gone through with the structure of the capital, governance of corporate and with the value of the firm, but many out of them have focused just on one equity. That is why one facet of the relation has been considered and the availability of alternative reasons and interdependently among capital structure and other guiding tools have not been taken in to consideration in finding out the value of the firm (Jensen and Warner (1998); Heinrich (2000); Bhogat and Jefferis,(2002).

Bougheas et al,(2006) utilizing data from 136 manufacturing firms of UK from 1989 to 1999 utilize the measure of finance from an external source where the firm's short-term debt ratio to total external debt to it's all liabilities, which nearly looks after overall approach to external finance. The writer came to know that many of the companies features e.g size, risk, age, collateral, and profitability were necessary determiners of approach to long-term and short-term credit. Furthermore, they observe the condition of the monetary policy had a much influence on risky, smaller and younger companies. Lewis, Rogalski, and Seward (2001)carry out research on long-run achievements of firms for giving out equity finance, for this they took a sample in the United state of 106 equity financing market from the year 1979 to 1999. Lewis et al squabble that issuers may use the market of equity financing due to the fact that they were "rationed out" of the market of equity. They came to know that worsen working performance of the issues of those bonds that can be converted by chasing the finance of equity while comparing the matched sample of non-issuing companies. Lewis et al explained this research as proof which somehow denies the squabble over Green (1984) and Mayers (1998). Lewis et al claim that in Green's and Mayer's models it can be seen that one of the results of a financing the equity can be that company invest just for favorable net present value projects.

Chang, Chen, and Lia (2004) notice Mayers sequence of the hypothesis of finance which depends on a sample of about 109 problems of Taiwanese firms. They produce and check two suggestions belongs to the problem of over-investment. If modifiable is a fruitful way to diminish this problem, then they are extremely useful in cases, where their present investment and upcoming future investments choices are positively related to each other. In the eye of Chang et al, this characteristic is normally can be seen in companies with attentive activities and more highly strong type of firms will give more advantage utilization of convertibles. Berle and Means (1967) in their research on large organization profitability took a sample of about 18 firms in England they proclaim that big organizations are most successful because of its great rise in their proportion of income and wealth. They come to know that companies increased their income by reinvestment of their gains by increasing new capital by selling securities in the market known as public market and by attaining the power of other organizations by purchasing or by give and take of securities. In that era, they also came to know that company by company has raised its wealth, which they called as "corporate way". Contrary to this they found that many of the organizations have increased by the means of financing their new capital by giving securities in the market of the public. They testified that the extent of diffusion will be greater when the length of the organization is higher. Factor that participated in the rise in the numbers of stakeholders in that duration of time was the possessorship offered to employers and customers. Such type of diffusion has been known as a consecutive process.

Darush Yazdanfar and Peter Öhman (2014) investigated the empirical study on debt financing and its effect on Swedish firm performance by using three stage of least square and fixed effect method. The study aim to find out the relationship of debt level with the performance of Swedish firms. Data is taken for the Swedish firms from 2009 to 2012. Profitability is measured through return on assets and debt level is measured through short term debt to assets, long term debt to assets, account payable to assets with respect to the assets percentage. There is one dependent variable and three independent variables. However, the study also includes some control variables such as size, age and industry effect. The three stage least square and fixed effect methodology has been followed in order to find the relationship between debt level and profitability. The results indicated that there is negative influence of debt level on the profitability of the Swedish firm.

Further, short term debt to assets and long term debt to assets also negatively influence on the profitability of the Swedish firm. Furthermore, by increasing the debt level, managers of the Swedish firms lose their control which will also increase the cost of agency. Therefore, it was recommended there to finance the business operations through internal sources such as equity and using the fair level of debt, so that managers of small and medium enterprises don't lose the control. So, it can be concluded from the results that debts influence on the firm negatively which means by increasing the debt level, profitability of the firm will get decrease. Therefore, they recommend to use the optimal level of debt.

The research by Abai (2003) inspected on the catalyst structure of the debt maturity of corporate for firms cited on the Nairobi security exchange. He pursues to confirm the deviate information on the aim for financing equity and determinants of stock price reflection to equity financing. He evaluates the result of issuer features on the size of income linked with the news of offers of equity finance. He repeatedly combine the issues in regarding to the precedently declared data calculation into more equity and more debt type problems chasing a exertion of the literature on timing of the market e.g (Chaplinsky and Bayless 1996) he observe the influence of the market issue and issuer features on unusual recovery for subsamples of different weather market span of security offerings .

The research by Ngugi (2008) examined the capital structure determinants for about 22 firms samples on the stock exchange of sample of Nairobi from 1991-1999. Turn down from the equation taken out from the model of static trade and the pecking order type hypothesis was calculated and examined by the mean of panel data technique. The outcomes Show that a pecking order model with the process of arrangement cannot be refused. Mainly it is seen that the important determinants of behavior of capital contain facts of non-debt tax shields, the infrastructure of a local capital market and asymmetries. The research made by Tomo in (2008) on the role of NSE in increasing equity capital between almost 49 mentioned companies on the exchange from 1998-2004. The results show that the firms shown up on the NSE have noted down a huge rise in the time span of under review, a lot of this was financed through capital that was borrowed and from profit. The research possessed with the conclusion that the NSE has not been succeeded in its main purpose of helping investors to increase capital.

Furthermore, there is some proof that advises that the NSE has participated in the development of the economic condition in the country of Kenya. This research affirms the research that was conducted before by Kimara and Amoro(1999), who comes with the result that there was not any remarkable relation among the growth of the economy and the NSE growth. A research conducted by Zong-Jun (2006), by utilization a sample of 96 financially upset firms and 96 good going firms came with the solution that ownership of the state, shareholders and some part of the independent directors are linked with the probability of agony negatively.

Also, the expenses of agencies of managerial are worse and harmful for firm's financial states. So how the extent of equal ownership of manager size of the board and the duality of the CEO can not remarkably disturb the probability of failure in fulfilling the obligation. Additionally, they gone through the impact of a right of controlling the state by sub-grouping the sample into the companies that are controlled by the state and those which are not controlled by the state. The outcomes show that the article of governance of corporate does not act same on the financial agony among the two subsamples. Du ana Dai (2005) in their survey which they made in 1979 of East Asian firms (1994-96) concentrate on possession and structure of capital and come to result that controlling possessor with little shareholding select greater debt and that weak CG and intimate capitalism contribution to a structure of a capital which is risky.

Kumar (2005) when survey about 2000 companies of India (1994-2000) concentrate on CG and company financing and came to know that companies with gloomy shareholding have greater grip and that companies with greater FS and lesser institutional shareholding have lesser debt. Adding more no connection between debt and directors of shareholders were seen. Using the data of firms from 1989 to 2009 for England, Wilson and Atansova (2004) inspected 78 financially contrived companies, where the Word financing over here was explained as an approach to internally originated funds, banks grants, and payable accounts, utilizing a model of disequilibrium of granting. Their analysis empirical study recommended that companies total asset as a substitute for available security is an important measure of availability of bank loan. In addition to fiscal policy factors, they came out with findings that rigid fiscal states help in increasing demand for financing of a bank by cutting down the supply.

### **3. RESEARCH METHODOLOGY AND DESIGN**

#### **3.1. Introduction**

This chapter explains the method of research which is going to be used in this study. The chapter encompasses the plan of the research, which population is going to be a target and the instrument of the research. This chapter also shows the validity and the reliability of the instrument.

#### **3.2. Research Design**

The study will be performed by utilizing a longitudinal research design and by utilizing secondary quantitative data. Schindler and Cooper explain about the study which is longitudinal in nature and it is such type of study which is performed again and again over a different time period. This study will depend totally on annual audited statements of textile firm listed on Pakistani stock exchange for the time span of 2008-2017. The needed data on the debt to equity ratio, debt to asset ratio will be obtained from the yearly reports of textile firms.

#### **3.3. Target Population**

The research population contains textile firms listed on Pakistan stock exchange for the time span of 2008 to 2017 i.e a time period of 10 years. This time span is known as an adequate time span over which the research will be performed (Abor, 2005) in his consequence of capital structure on profitability, an empirical investigation of listed companies in Pakistan. The companies to be investigated are Nishat chunia ltd, Nishat Mills Ltd, Sapphire textile, Sapphire fiber, Suraj cotton, Crescent fibres, Ellcot spinning, Hira textile, Kohinoor textile, Kohat textile.

#### **3.4. Data Sources and Instruments**

The research will manipulate secondary data. All of the work done will be gather by evaluation of yearly reports, documents, financial statements of the firm listed at Pakistan stock exchange.

### **3.5. Measurement of Variables**

The capital structure is going to calculate by using the debt ratios i.e debt to equity ratio, long-term debt to equity ratio, short-term debt to equity ratio and firm growth.

#### **3.5.1. Debt to equity ratio**

It can be calculated by dividing a firm's all liabilities by its equity of stockholders, one can say it is a debt ratio which is used to calculate a firm's financial advantage.

The debt to equity ratio shows that how much debt a firm is utilizing to finance its assets comparative to the financial worth of shareholders equity.

Formula:

$$\text{Debt to equity ratio} = \text{Total liabilities} / \text{Shareholders equity}$$

The outcome can be shown in a form of a percentage or in the form of the number. The D/E ratio is also specified either as a percentage or as a number. The debt to equity ratio is also mentioned as a gearing ratio or a risk. One of the question which is fundamental in nature arise in corporate finance i.e: How companies make those decisions that are related to finance? To provide answer to this question researches have been conducted to found out a number of factors of the companies that tells about real debt ratios e.g Zingales and Rajan (1995), Goyal and Frank (2009). Even though we know that how company-particular aspects are linked with ratios of the debt that we do not uptill now properly master that how some of the company-particular features are linked to the theoretical outcomes of the structure of the capital. Chen and Zhao (2007) and Chang and Dasgupta (2009), with some of the others authors, ask that the ratios of debt can not be informative in order to find out policies related to corporate financing and give an advice to look deeply on choices of corporate debt-equity.

There is blended proof on the corporation among company's debt-equity selection and objective role. The research conducted by Marsh (1982) was the first research that formed a logic of model to check the selective determinants among equity and debt given out for the companies of England. He gave proof that a company's selection among equity and debt supply based on the conditions of the market and also on the historical prices of security. He also checked that either the companies fix into a long-run aimed debt ratio or not.

In peculiar, he examines the decision of giving away of debt by analyzing not only all other calculations of protection of non-debt tax but collaborating them with the company's future outcome that is not going to have taxable income and therefore it will be depleted of tax. He concludes that those companies having greater tax-losses seem to be using debt in very less amount. He also finds that tax credit investment type does not decrease the issues related to debt. Hovakimian et al. (2001) utilize a logic model to determine the decisions related to issuance and repurchase. They conclude that the impact of the disparity among real and the aimed debt ratios are powerful when companies make a selection among retirement of a debt and repurchasement of an equity, the coefficient of the advantage shortage is slightly important when companies make their selection among debt and equity problems. Hovakimian (2004) finds out the act of aimed advantage in issues related to security and repurchases. He finds that only by taking down the debt offset the diversion from the aimed ratio of debt. The releasing of debt and the releasing of equity rises in spite of decreasing it and it deviates from the aimed ratio of the debt. Finally, repurchasement of the equity is not successful in offsetting any of the important part of the aggregate alteration from the aimed debt ratio. Hovakimian et al. (2004) examine the act of aimed advantage looking deeply on issues related to equity and dual debt. They came to know that companies which give out both equity and debt negate the divergence from the aimed debt ratio. Leary and Roberts (2005) look deeply to find out to see in which way the cost of adjustment influence the decisions of corporate financing.

They explained that companies mostly do not provide equity as frequently as they provide debt as the cost for providing equity are greater than cost of providing the debt. For every type event of refinancing they also calculate hazard models. They explain that the cost of transaction play a significant part in decisions related to financing of companies. The risk management can be most significant so that it can make sure feasible profits in banks (Sam and Magda, 2009). One of the papers "Why return on equity is the better criteria for choosing equity" by Kee (2008) has explained that return on equity gives very beneficial way for producing profit effectively. It is very useful to tell that up to what extent a company can attain a gain on the equity capital. The rise in the rate of return can give information that the profit is increasing without bringing new capital into the firm. A slowly moving return on equity also explains that the shareholders provide more for their investment.

### 3.5.2. Short-term debt to asset ratio

This ratio describes the part of a firm's assets which are financed w.r.t those debts which are payable within a year.

$$\text{STDA} = \text{Short-term debt} / \text{Total assets}$$

Short-term debt gives information about liabilities that are payable or due, means to be paid within one year of time. Utilizing an accounting metric which is known as debt ration, it is to measure either a firm will be capable of meeting its short-term debt responsibilities. Short-term debt to asset ration signifies this by contrasting with a firm's current assets.

In Accordance to the alike standard of finance, the financing of short-term assets should be done with respect to liabilities of short-term and financing of long-term assets should be performed with respect to liabilities of long-term (Guin, 2011). Liabilities and Short-term assets are mostly defined to be those things that will be utilized, liquidated, get ready or given away in the time span of one year (Guin, 2011). A company's current assets (including cash, inventories, cash, accounts that have to be received, etc.) are mostly known as short-term assets on the other hand equipment and plant are mostly known as long-term assets. However, current assets can become long-term if they are not entirely utilizing or abolish within the year. As an example, think about a company's inventory of raw materials is utilize and stock systematically so that the inventory's level changes from \$600 and \$900 within the year. The least level inventory of raw materials i.e (\$600) is an inventory of such investment, which is base on long-term as the level of inventory never comes down from this amount. The distinction among higher and lower values (\$300) is an interim inventory investment that will at some time within the year is going to liquidate. Contrary to this in the balance sheet, current liabilities i.e short-term debt accounts payable etc mostly utilize short-term liabilities while long-term debt (debt with a maturity of more than one year) and equity capital is taken as long-term liabilities. Though, the current liabilities can be a root for long-term financing if within the year they are not fully paid off. As an example, think about a company systematically gets and giveaway short-term type of loans in such a manner that the company's short-term loan balance change from \$300 to \$500 within the year.



If it is observed like that a company's current liabilities (CL) and current assets (CA) are short-term assets and short-term financing with respect to their nature the matching standard indicates that a company's current assets should level its current liabilities. The spontaneous current liabilities are those type of liabilities whose worth alter within a year in spite of any unambiguous act by the company's managers. As an example, when a company rise than from its supplier it buys more services and goods resulting in an instinctive rise in the payment of accounts. Enacting the current liabilities, other than short-term debt, are comparably extemporaneous ways of financing then the company's short-term financing selection variable is short-term debt.

Richard H. Fosberg(2013) in his study of Short-Term Debt Financing During the Financial Crisis state that in the period of financial crisis of the late 2000s had a great impact on the capital market and lending market of America and other countries too. The data shown in this research explain that the crisis related to the financial situation made companies to raise the price of short-term debt they occupied from 1.3% of resources in 2006 to 2.2% in 2008. This rise in short-term debt financing was thoroughly turned around by the end of the year 2009 advising that the rise in the financing of short-term debt was unpleasant and was turned back quickly with the diminished financial crisis. The imminent precipitation of the quick response in short-term debt financing contains a devaluation in such accounts that are payable in nature in regarding financing from suppliers and a devaluation in financing equity and long-term debt. An important devaluation in sales of an asset also arises the requirement for additional short-term debt financing.

The capability of borrowing short-term debt also relies on the perfection and deepness of the market. In America, the short-term instruments markets are well matured. As a consequence, bigger companies may approach these reserves immediately and accurately. In the rest of the countries, the deficiency of an accurate short-term capital market can restraint their selections of debt. When analyzing the capital structure of companies in other countries, not only it has gone through the impact of institutional, cultural and social factors but also on the standard of the capital market's progress. In accordance with this, the alike standard indicates that a company should modify its short-term debt financing until that time at which the company's current liabilities price becomes equals to the price of its current assets.

### 3.5.3. Long-term debt to asset ratio

It relates to the long-term debt with respect to assets. Increasing this ratio means raising belief on external financing and thus rise in interests and decreasing profitability (Gibson, 2009).

$$\text{LTDA} = \text{Long-term debt} / \text{Total assets}$$

This ratio gives a measure of a long-term financial state of a firm containing its capability need for outstanding loans. For instance, if an organization has 200,000 dollars as a total asset with 80,000 dollars as a long-term debt so if we calculate its long-term debt to asset ratio is  $80,000/200,000 = 0.4$  i.e 40%. This ratio tells that the firm has 40 cents of a loan that is long-term debt in nature for each and single dollar it has got under its asset. For comparing the whole of the benefit stage of the firm, the investors have an eye on the comparable organization or companies and the real cost in this ratio.

Many types of research had been conducted in the past that makes sure about the availability or unavailability of moral connections among ratios of solvency, financial structure, and profitability along the different level of each. The aim of this research by Hasan et al. (2014) is to find out the effect of the ratios of financial structure on the performance of finance on firms. The research has been done on a sample of thirty six companies of Dhaka Bursa in Bangladesh, in the year(2007-2012). As a dependent variable, It utilizes four types of ratios for (financial efficiency, return on equity [ROE], earning per share, return on asset (ROA), and Tobin's Q). As an independent variable, It utilizes three type of ratios for the financial structure ( long-term debt, short-term and total debt). The outcomes reflect that profit per share has got a positive effect of short-term debt and has got a negative effect of long-term debt. There was a negative connection between ROAs and financial structure. On the other hand, return on equity and the ratios of the financial structure have not got a positive effect on the financial work out of the firm. One more thing to concern related to a capital structure is the selection between long-term debt and short-term debt. Short-term debt is slighter costly than long-term debt but contrary to this fact there is another fact and that is, it is riskier because they require to be refreshed systematically. A company can see itself in a problem if they are not capable of refreshing their debt. Mostly due to some of the adverse news.

Long-term debt provides more firmness but is much costly than short-term debt. Wanzenried (2002) came to know that there is a significant distinction between the structure of the capital of continental European countries and the UK. In utilizing financial data from 167 companies in the time period of 1989 to 1998, Wanzenried came to know that English and continental firms on average finance around 16% of their available resources with external long-term capital and both have got the greater benefit as the size of the company get bigger. European companies, therefore, gather most of their amount through banks. which may also carry a huge interest in the firm.

In a study of time-series, Bevan & Danbolt (2000) realized the capital structure's determinants of 1,054 firms of England from 1991 to 1997. Firms with huge levels of expansion chances are seemed to use more short-term and long-term debt, however, with respect to time, there is a movement towards equity finance. Antoniou, et. al. (2002) studied the capital structure of companies in England, Germany, and France in the years 1969, 1983, 1987 and 2000. The study showed that the interest rate of the market plays its part in measuring the long-term debt's levels. They come to the conclusion that firms gave importance to not borrowing long-term at that time when the interest rates were high. Germany and France had a greater benefit than England. which affirm the accustomed opinion that firms of Europe take more debt, while companies of England give preference on utilizing more equity. The good presentation of a firm is known as the shareholder's investment return. The profit to shareholders is known as the net profit ratio which is obtained after taxes. The net gain after the deduction of the tax will be obtained after taking out all necessary cost of the business, in which the cost of interest and tax will also be included. The funds of shareholders have got retained profits, share capital and other reservoirs. This ratio signifies the recovery over shareholder funding.

The long term debt to asset ratio indicates the proportion of debt financing used by the firm to finance its assets. The assets are finance from long term debt financing which are obtained from the different financial institution at different mark up rate. Thus, It is important for the firm to see whether such financing is suitable for the firms or not. In other others words, it is important to see the effect of such financing on financial performance for the textile firm. If such financing produces the negative affect on profitability of the firm thereby reducing such facility is recommended.

### 3.5.4. Return on equity

It is said to be the amount which someone gets back as a percentage for the equity he or she have put into the shares. More investment in shares will bring you more return and vice-versa. Someone can also regard it as the return on total worth if someone wants to know the probability of return it can be known by ROE, which tells how much revenue a firm generate with each investment of shareholders equity. By this, it can be a measure that how profitable a firm is in making a profit. The firm performance is going to measure ROE using the variables such as FG, SDTA, LDTA.

$$\text{ROE} = \text{Profit after tax} / \text{Shareholders funds}$$

Example:

Mr. Ali has to make a decision in which organization he must make his investment i.e Nishat textile or Sapphire textile. Both of the firms has generated about 10,0000 dollars this year i.e the revenue of both the firms is equal. Each of the firms has got (equity, the amount of cash taken from its real investors on behalf of exchanging shares). Nishat textile has an equity of 1000 dollar and sapphire textile got an equity of 2500 dollar. To measure the ROE divide the firm's revenue to equity.

$$\text{ROE} = \text{Profit} / \text{Equity}$$

It can be seen that Nishat textile has ROE of 50 % and Sapphire textile has higher equity to work on but it generates the same revenue as generated by Nishat textile. Both of the firms in spite of the impact of different equities has the same profit. This brings us to the result that Nishat textile is more efficient in producing the revenue from its equity. A good gain on equity attract the investors towards itself. Mr. Ali will go to brokers of the stock and will purchase the share of Nishat textile firm. Out of many matrixes, ROE is one of the matrices that investors utilize to calculate the stock.

Return on equity (ROE), with respect to return on assets (ROA), is known as the most favourite and also the one which mostly used overall calculations of financial performance of all corporate sectors (Rappaport 1986:31). This was recognized by Monteiro (2006:3) who said that return on equity (ROE) is a most significant ratio that an investor has to think about.

The reality that return on equity (ROE) depicts the last outcome of analysis of structured financial ratio, that is also known by the name Du Pont analysis (Robinson, Stowe, Correia, Pinto & McLeavy, 2002:85; Firer, Flynn, Uliana & Wormald, 2003:5-19; Ross, Westerfield & Jordan, 2004:67) participates towards its fame in between the shareholders, analysts and financial managers. Return on equity is measured by getting the profit after giving out the tax and give importance to profits of a provided year and after that dividing it by equity's book value at the start of the year. The use of Average equity can also be brought into the practice. Equity depends on issuing capital's ordinary share, also the reserves and premium of the share. The measurement of return on equity (ROE) can be split up into three of different ratios, such as:  $ROE = \text{Sales} \times \text{Assets} \times \text{Equity}$ . The three parts or you can say ratios, can be explained as turnover of assets, financial benefit and profitability.

The return on equity (ROE) can be made proper by working on better profitability, by utilizing assets more precisely and by raising financial benefit. With respect to time it has become understandable that by making better the return on equity (ROE) may be not necessarily going to make the worth of shareholder much better. However the return on equity (ROE) has some request because its relation with the income statement profit to the equity of the balance sheet, it has got little important flaws as a performance calculation. The number one and most important flaw is that the gains can be handled legally with Generally Accepted Accounting Practice (GAAP) framework via alterations in policy of accounting. The number two flaw is that return on equity (ROE) is measured after inquiring the cost of debt, but before accepting the cost of own capital. The return on equity (ROE) rises with more financial adjustments, as lengthy as the returns won on the funds that are borrowed surpass the borrowing cost. The terrified condition is that if the financial gearing rises surpassing a certain level then the rise in financial risk may cause the worth of a firm and make the price of the share down. In 1989 when Reimann (1989:3) advertised his findings, return on equity (ROE) was utilized highly for calculating whether the worth was being made up for shareholders. The fact after taking in of return on equity (ROE) was that it provides more trustworthy outcomes than earnings per share (EPS) (Reimann, 1989:18). As it is necessary to understand that how investors worth the shares of a firm Reimann (1989:7) looked in to a number of strategies conferring companies and came to know that they keep eye on their calculations on the expansion of cost of equity.

Reimann (1989:8) also recognize alterations to conventions of accounting customs as being a difficulty when using return on equity as a measure for the efficiency. It was also consider that measures for the financial such as return on equity is the measure of it may be of short-term nature and that along it long-term measures, must be choosen as well. Reimann (1989:18) came to know that equity's return still sisty six percent of the ups and downs in the prices of share are not explained yet, showing a high extent of untrustworthiness. The other difficulty with the utilization of return on equity found by Finegan (1991:33) is that it does not take in to consideration about the cash flow timing . For this fact the model of free cash is mostly seek as a good way to measure to check whether the worth of shareholder has been created or not. Finegan (1991:45) also explained that investors go far away from earnings in checking and measuring performance. That is the reason the firm's managers cannot depend on gaining figures alone for calculating the progress,untill and unless they want to wait for reactions of the investors to check how are they doing. Koller and Murrin,Koller and Copeland (1996:105)makes an arguement that return on equity is a measure of a short-term performance and that extreme deep examination on it can take a firm to overlook at the growth of long-term opportunities that can raise worth for shareholder . A firm may also be capable of making return on equity better , at the same moment gaining a return that is not much than its weighted average cost of capital (WACC), and thereby diminished worth.

### **3.5.5. Return on assets**

ROA is a sign which shows how a firm can be profitable with respect to its total assets.ROA provides a hint to investors, managers or to researchers that if a firm is utilizing its assets then how efficient it is or it can be for producing a profit. Return on asset give a view of a percentage and it is found out by using the formula.

$$\text{ROA}=\text{Net income}/\text{Total Assets}$$

În the eye of Prastowo (2002:86), Return on Assets (ROA) is utilized to calculate how well a firm performing company by utilizing its assets. The obtained ratio may provide a hint about bad or good management by enforcing a control over a cost or by managing its property. Return on Assets (ROA) is mostly utilized as a medium to calculate return rate on total assets after giving away all type of expanses such as taxes and interest (Brigham, 2001:109).

The higher Return on Assets (ROA) indicated that the performance of a firm is very good in the market and investor is going to collect higher rate of return on investment. (Riyanto, 2001:267). In accordance to Harahap (2002: 304), the profitability of a firm's capability to produce income for a specific time. The impact of Return on Assets (ROA) on rise in profit in a firm of Automotive in Indonesia Stock Exchange. The model equations for a return of variable on assets has a significance level and that is 0,029 lesser than the significance level of  $\alpha$  value which is (0.05). If a level of significant level is found to be  $<\alpha = 0.05$ , then the hypothesis give information that return on assets has a good i.e positive impact on growth earnings in the firm of automotive in stock exchange of Indonesia . The positive impact on assets return with the rise in income give a suggestion that any rise in the worth of return on assets specifically will lead towards rise in gain of firms.

Return on Assets (ROA) is utilized to calculate the relationship of earned profit to the money invested in assets needed to make that profit. The ROA is a criterion that can be utilized to calculate the participation of the profit needed from new investments. Like this, it calculates the rate of return required that can keep on current achievement that can be utilized to create difficult rates all current investments must accommodate for authorization. D.K. Lindo(2008) An inclusive examination of the return on assets also developed by George W. Gallinger. He made a model that situated of, indicators like return on sales, the financial advantage, variables, the costs of interest and ROE. This gives permission to check management of assets of a company and a chance to set up the assets in the future. G.W. Gallinger(2000) The company's return has been dominated by many of the factors. Understanding these factors is necessary at the first stage for the management of the firm, to select suitable growth's evaluation and to conduct short or long-term estimation. Also, by understanding the link of reliance between the revenue and the influence factors are necessary for creditors, investors, and for a different type of stakeholders. M. T. Bosch-Badia conducted research that measured "a functional link between operating asset return and the important indicators of the production at a level of the firm and that is known as labor productivity and total factor productivity. Both of the indicators of productivity along with the change of price of outputs and inputs are the factors that measure the worth of return on operating asset, as the beneficial connection.

### **3.5.6. Firm growth**

What are the goals that are related to growth and up to what extent a business can grow? It is mostly seen that companies want to grow, and they have only one aim of higher profit or revenue and a greater number of employees (Achtenhagen, Naldi and Melin, 2010). The literature of business growth is keeping eye deeply on growth as rising in outcomes that can be measured too (Achtenhagen, Naldi and Melin, 2010; Leitch, Hill and Neergaard, 2010). The development of the business contains criteria of becoming better that attain those challenges that must overcome. The meaning of qualitative is that the aim is not only growth in regarding rising sale, employment, output or assets, despite these facts the aim is also to make the company better by bringing improvement in it (Achtenhagen et al,2010). The success of the company is mostly known by the growth of a company i.e. rise in the financial results, production and by the number of employees too (Brandstatter, 2011). One of the most common ways of the success of entrepreneurial explains with respect to the growth of sales (Florin et al, 2003; Zhou et al, 2007; Steffens et al, 2009; Achtenhagen et al, 2010). Dobrovolsky (1951) has seen a productive, distinct influence of total earning on savings. Lintner (1956) by his research on Corporations of American came to the final point that profit shows the primary and effective conclusive variable.

Savings are regulated with respect to balance. Florence (1959) by his examination of England companies exhibit that companies chase a fixed dividend order which is manipulated by both of the nature and size of a company. Herbert E Sim (1960) demonstrate companies have depends mostly upon internal ways of cash reserves to support their gains of tangible assets. In his point of view, past profit payments and present profit are the two determinants that are extremely effective in measuring the point of retained profit. Smith (1963) in his research openly shows that part of corporate income saved in a given time based on both past levels of profit and on supply and demand states for funds related to corporate. He came out with his findings that there is a higher marginal capacity of saving from income get from the corporate sector in the short-run despite getting it out of long-run and corporation aims to redeem and invest should not be deal as absolute as its mostly performed in the conversation act of savings from corporate sector as a moderator. Hart (1963) has tried to discover the difference between firm savings with respect to its size in chosen England companies related to the corporate sector.



He found that in between the firms the savings are not necessarily different, giving the preference to the conflicts of Bates and Dobrovolsky that the amount of withholding is not dependent on the size of a company. Puckett and Friend (1964) exhibit that there is found a preference of good investor for profit in that firms which have not been grown yet, contrary to that in growth firms there is some importance for profit that is known as retained earnings. For their working matters, Purnanandam and Rao (1966) have utilized Lintner's classifications. They verify that firms of India go after a policy of fix dividend and fast adaptation of profits; variation has been shown in the long run in their policies related to finance within the same company; their reply to variations in profit is quick.

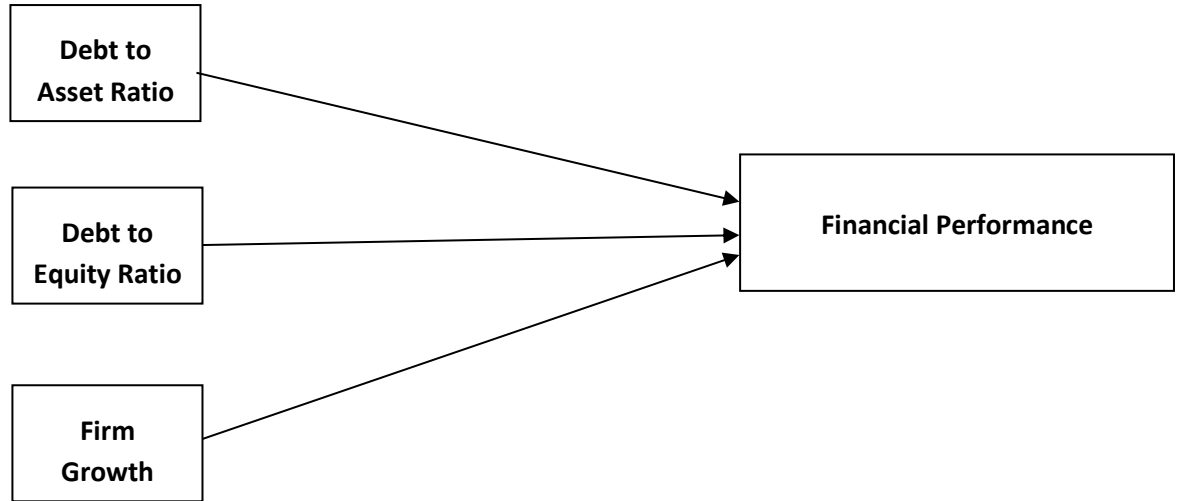
Dhrymes and Kurz (1967) put forward a statement that companies with greater debt-equity ratio show a little ratio of payout showing that companies working with greater debt capital will possibly try to decrease their need for investment and debt and will be supported financially on a large scale by profits that are invested again. Little companies keep a greater composition of their dividends than bigger companies due to the reason that little companies were unable to manage higher cost for going into markets of capital to gather their finance. Turnovosky (1967) assist that retained profits are known as the balance of earnings, after profits are given away; it is an alteration in dividends than current level which measures that up to what extent should keep by a company.

### **3.6. Data Processing and Analysis**

The study employs different approaches to see the effect of debt financing on textile firm financial performance. Firstly, Descriptive statistics are going to be utilized to describe the population characteristics. The variance and the means of the data will be calculated by using E-views. Then graphical analysis has been presented with respect to the firm financing and its correlation with independent variables. This research will utilize a regression known as multiple linear regression in which the ROE will be regressed contrary to firm growth, short-term debt to equity ratio, long-term debt to equity ratio and ROA will be regressed on FG, DTE, SDTA, LDTA.

### 3.7. Conceptual Framework

On the basis of theoretical and empirical studies which are discussed and presented above, the study draw the conceptual framework model for this research:



**Figure 3.1 : Conceptual Framework**

### 3.8. Model Specification

$$ROA_{i,t} = \beta_0 + \beta_1 (SDTA_{i,t}) + \beta_2 (LDTA_{i,t}) + \beta_3 (DTE_{i,t}) + \beta_4 (FG_{i,t}) + \varepsilon_{i,t} \quad (1)$$

$$ROE_{i,t} = \beta_0 + \beta_1 (SDTA_{i,t}) + \beta_2 (LDTA_{i,t}) + \beta_3 (FG_{i,t}) + \varepsilon_{i,t} \quad (2)$$

Where ‘i’ denotes the studied firm, ‘t’ represents the time period and ‘ $\varepsilon_{i,t}$ ’ represents the error term and assumed to be independent

ROA = Return on Assets

ROE = Return on Equity

SDTA = Short term Debt to Assets Ratio  
Assets Ratio

LDAT = Long Term Debt to

DTE = Debt to equity ratio

FG = Firm Growth

#### 4. ANALYSIS AND RESULTS

This chapter inspects the analyzation of data and also the interpretation of the obtained results. The descriptive analysis of the explanatory and dependent variables are fully shown. The correlation type of matrix for the variables has been stated in order to check the correlation that exists among variables. The results of the regression of the panel data for each measure of performance for the year 2008 to 2017 are presented and fully explain. The analyses are used for testing the earlier formulated hypotheses the analyses have been used in order to create a connection which may present among the expressed variables.

##### 4.1. Descriptive Analysis

Descriptive statistics give simple information about the observations and about the sample that has been interpreted after the collection of data. It works for displaying the data or numerical facts in any of the form i.e table or graph and with the procedure of examining and determining the data. It gathers and compiles the wide range of data and knowledge in a significant and organized way. It is a simple method that can easily be converted into outcomes in an allocation of frequency, overall averages, and percents. For establishing standard deviation a help of descriptive statistics can be taken and can make the groundwork for more complicated statistical evaluations.

**Table 4.1:** Descriptive Results

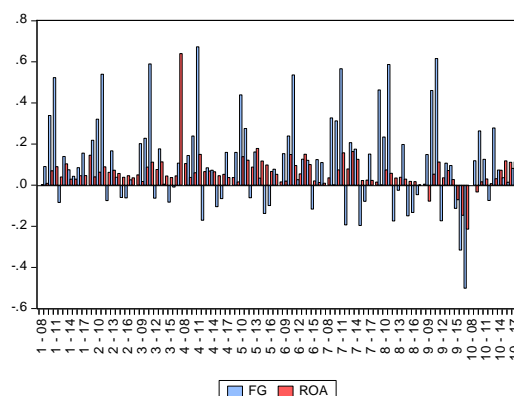
<b>Particulars</b>	<b>DTE</b>	<b>FG</b>	<b>LDTA</b>	<b>ROA</b>	<b>ROE</b>	<b>SDTA</b>
Mean	1.13	0.1	0.11	0.06	0.11	0.24
Median	0.97	0.08	0.08	0.05	0.09	0.22
Maximum	3.17	0.67	0.36	0.64	1.6	1.75
Minimum	0.3	-0.5	0	-0.21	-0.69	0.01
Std. Dev.	0.6	0.21	0.08	0.08	0.2	0.19
Observations	100	100	100	100	100	100

The maximum value of debt to equity ratio is 3.17 and the minimum value is 0.30. The mean and median values of DTE are 1.13 and 0.97 respectively. The average deviation of the DTE ratio value from the mean is 0.60 and total number of observations are 100. The maximum value of FG is 0.67 and the minimum value is -0.50. The mean and median values of FG are 0.10 and 0.08 respectively. The average deviation of the FG ratio value from the mean is 0.21 and total number of observations are 100. The maximum value of LDTA is 0.36 and the minimum value is 0.00. The mean and median values of LDTA are 0.11 and 0.08 respectively. The average deviation of the LDTA ratio value from the mean is 0.08 and total number of observations are 100. The maximum value of ROA is 0.64 and the minimum value is -0.21. The mean and median values of ROA are 0.06 and 0.05 respectively. The average deviation of the ROA value from the mean is 0.08 and total number of observations are 100. The maximum value of ROE is 1.60 and the minimum value is -0.69. The mean and median values of ROE are 0.11 and 0.09 respectively. The average deviation of the ROE value from the mean is 0.20 and total number of observations are 100. The maximum value of SDTA is 1.75 and the minimum value is 0.01. The mean and median values of SDTA are 0.24 and 0.22 respectively.

## 4.2. Graphical Analysis

### 4.2.1. Relationship between ROA and FG

The graph of ROA and FG indicates that there is a positive relationship between ROA and FG which state that when there is an increase in FG then there will be an increase in ROA and similarly when there is a decrease in ROA then there will be a decrease in ROA. So a direct relationship has been found among them..



**Figure 4.1 : Relationship between FG and ROA**

#### 4.2.2. Relationship between ROA and DTE

The graph of DTE and ROA indicates that there is a negative relationship between DTE and ROA which states that when there is a decrease in ROA then there will be an increase in DTE and when there is an increase in DTE then there will be a decrease in ROA. Which means that there is an inverse relationship between them. Therefore, when the textile firms will use the more debt as compare to equity, its profit will decrease as it has negative relationship. Thus, it is recommend to reduce the debt level and consider the optimal debt to equity ratio.

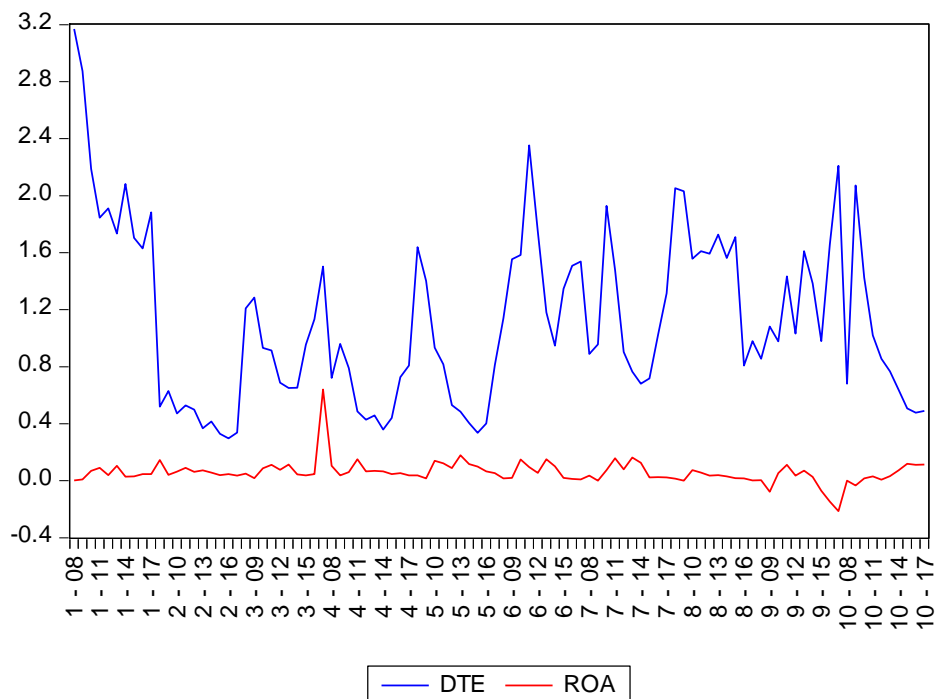
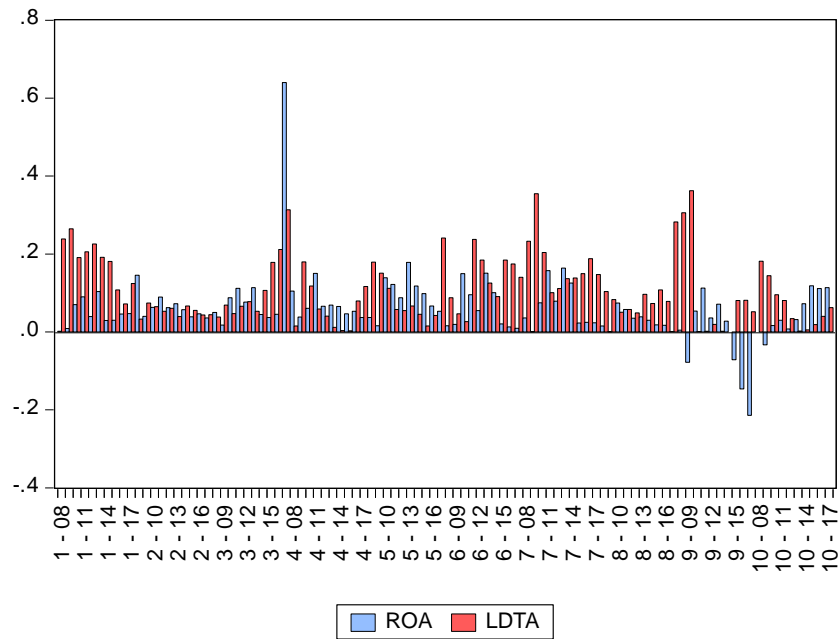


Figure 4.2 : Relationship between ROA and DTE

#### 4.2.3. Relationship between ROA and LDTA

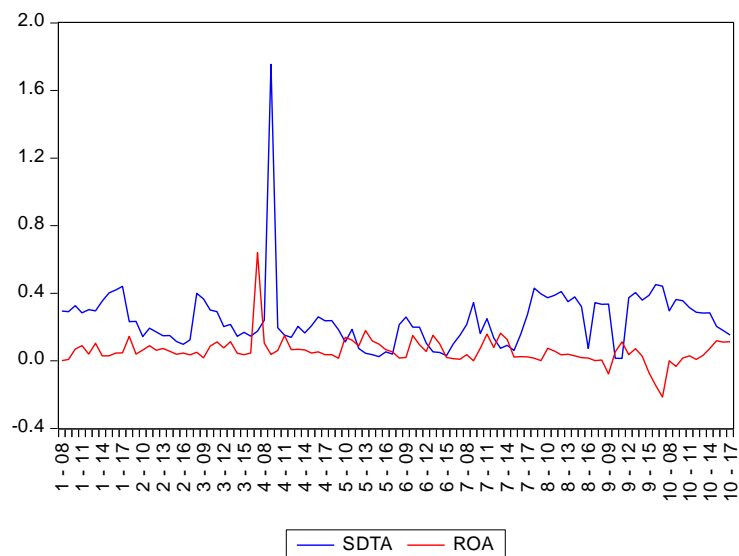
The graph of ROA and LDTA indicates that there is a negative relationship between ROA and LDTA which state that when there is decrease in ROA then there will be an increase in LDTA and when there is increase in LTDA then there will be decrease in ROA. Pointing towards inverse relation. Therefore, when the textile firms are going to use more long term debt to asset it will going to have an adverse effect on return on asset.



**Figure 4.3 : Relationship between ROA and LDTA**

#### 4.2.4. Relationship between ROA and SDTA

The graph of ROA and SDTA indicates that there is a negative relationship between ROA and SDTA which state that when there is a decrease in SDTA then there will be an increase in ROA and similarly when there is a decrease in ROA then there will be an increase in SDTA, indicating an inverse relation. This is giving information that when the textile firms will use the more short term debt it will effect return on asset negatively. Thus, it is recommend to reduce the debt level and consider the optimal sort term debt .



**Figure 4.4 : Relationship between ROA and SDTA**

#### 4.2.5. Relationship between DTE and ROE

The graph of DTE and ROE indicates that there is a negative relationship between DTE and ROE which state that when there is a decrease in DTE then there will be an increase in ROE and similarly when there is an increase in ROE then there will be decrease in DTE. Means there is an indirect relation between them. Therefore, when the textile firms will use the more debt as compare to equity, its return on equity will decrease as it has negative relationship. Thus, it is recommend to reduce the debt level and consider the optimal debt to equity ratio.

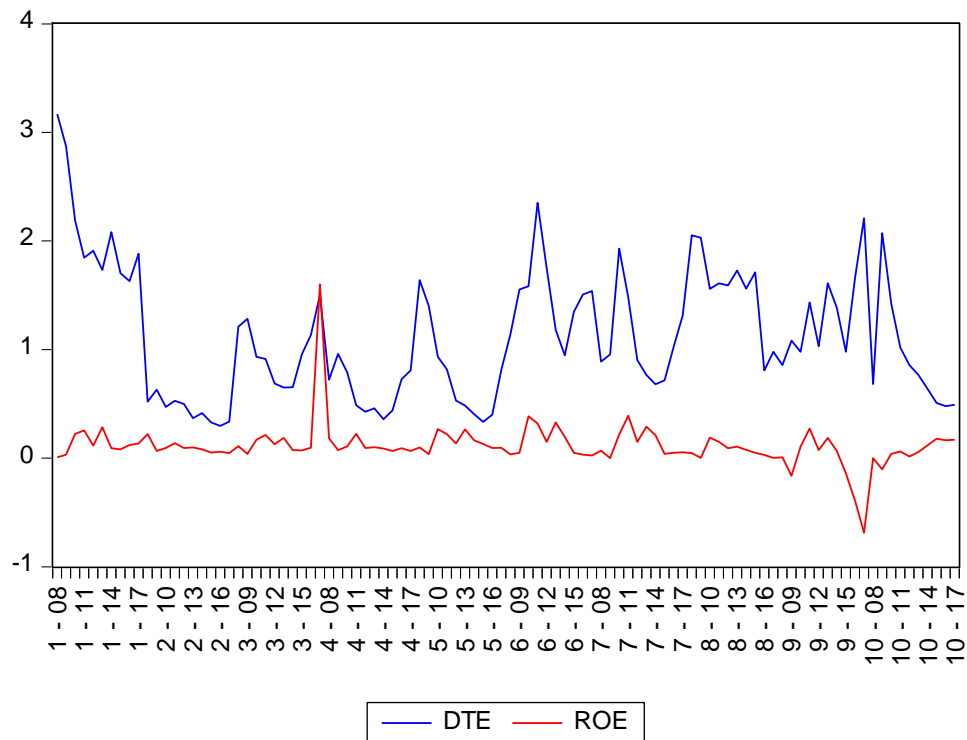
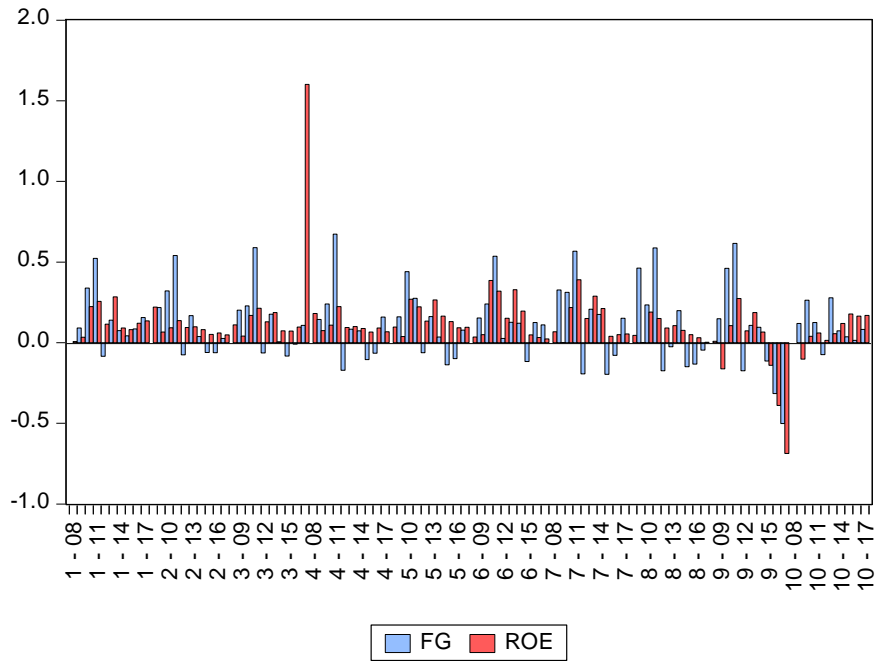


Figure 4.5 : Relationship between DTE and ROE

#### 4.2.6. Firm growth and return on equity

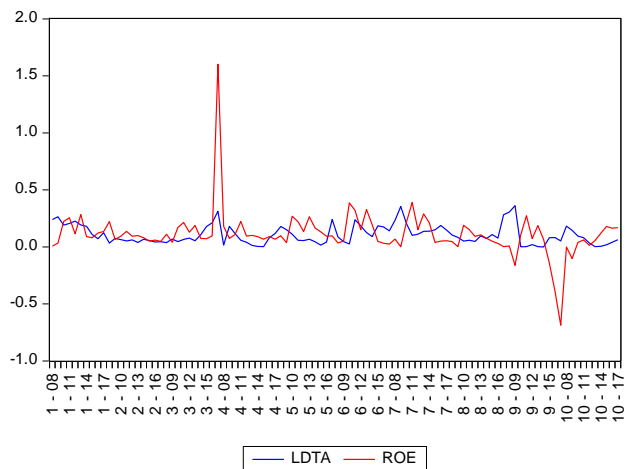
The graph of FG and ROE indicates that there is a positive relationship between FG and ROE which state that when there is an increase in FG then there will be an increase in ROE and similarly when there is a decrease in ROE then there will be a decrease in FG which indicates a direct relationship among them. This is telling that when the growth of the textile firms will increase then the return on equity will also increase and they are going to have a positive effect on each other which in return is also good for firms.



**Figure 4.6 : Firm Growth and Return on Equity**

#### 4.2.7. Relationship between LDTA and ROE

The graph of LDTA and ROE indicates that there is a positive relationship between LDTA and ROE which states that when there is an increase in ROE then there will be increase in LDTA and similarly when there is decrease in LDTA then there will be decrease in ROE ,means there is a direct relation between them.So, when the textile firms will use the more long term debt to asset , it directly will increase the return on equity.

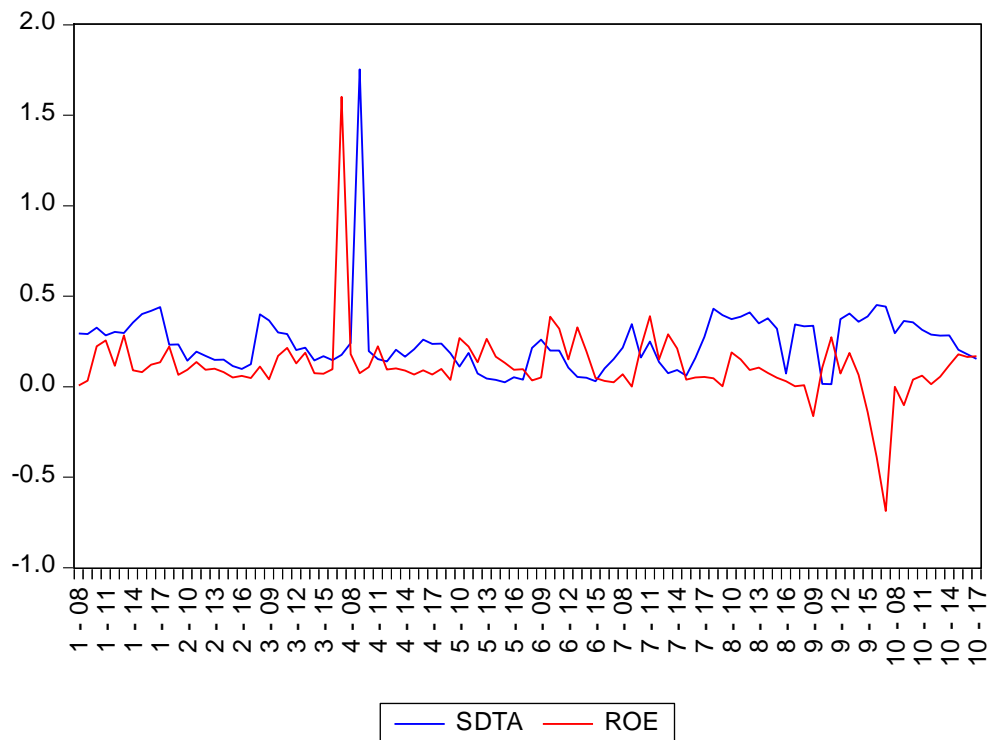


**Figure 4.7 : Relationship between LDTA and ROE**



#### 4.2.8. Relationship between SDTA and ROE

The graph of SDTA and ROE indicates that there is a negative relationship between SDTA and ROE which state that when there is a decrease in SDTA then there will be an increase in ROE and similarly when there is decrease in ROE then there will be increase in DTE which indicates that there is an inverse relationship between them. That is why, when the textile firms will use the more short term debt to asset, it will going to effect return on equity negatively so it is advised to use optimal debt.

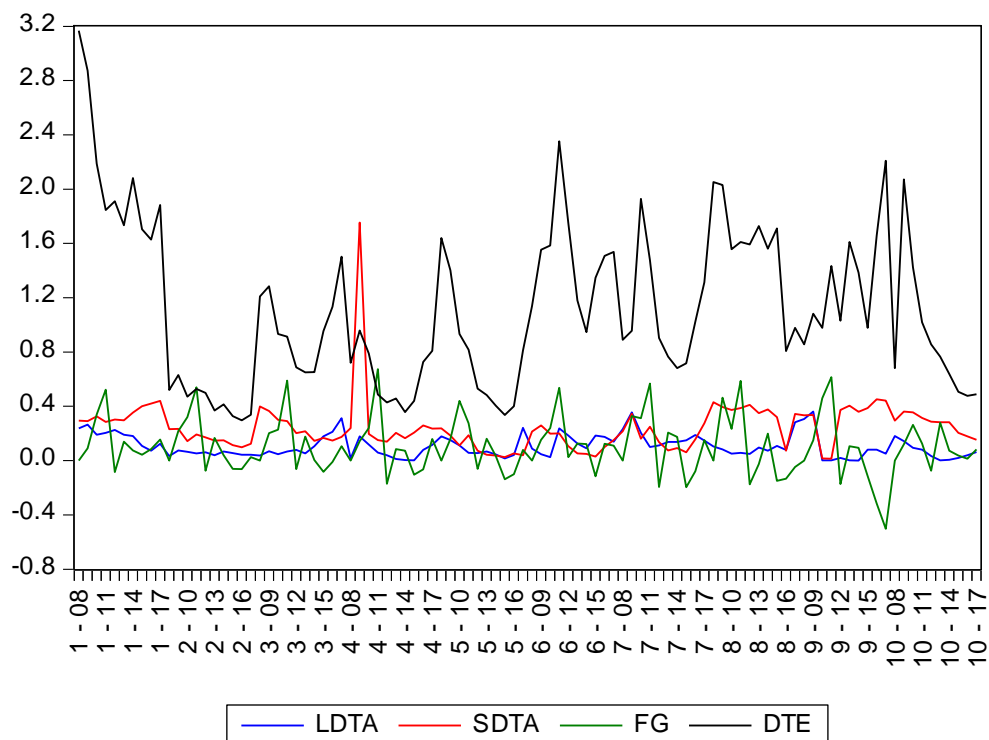


**Figure 4.8 :** Relationship between SDTA and ROE

#### 4.2.9. Relationship among explanatory variables

In this graph the relation of LDTA and SDTA indicates that there is a positive relationship between LDTA and SDTA which state that when there is an increase in LDTA then there will be an increase in STDA and similarly when there is decrease in SDTA then there will be decrease in LDTA, it means that there is a direct relationship between them. By looking into a relationship between LDTA and FG from the graph we came to know that there is a positive relationship between them which means that with the increase in LDTA there will be an increase in FG and with the decrease in FG there will be a decrease in LDTA which means that there is a direct relationship among them.

Therefore, when the textile firms will use the more long term debt to assets then it will have a positive effect on growth of the firm i.e firm growth will rise. Moreover, the relationship between LDTA and DTE from the graph gives information that there is a positive relationship among them which means with the increase in LDTA the DTE will also increase and when DTE is going to decrease then with that LDTA will also be going to decrease ,it means there is a direct relation between them. So it can be seen that, when the textile firms will use more long term debt to asset the ratio of debt to equity will rise.



**Figure 4.9 :** Relationship among Explanatory Variables

Also, the relation of SDTA and FG can be seen in this graph which gives the information that the relation between them is negative which shows that with the decrease in SDTA the FG will increase and when FG is going to increase then SDTA will decrease, it means there is an inverse relation among them. It explains that, when the textile firms will use the more short term debt to asset then the outcome will effect firm growth negatively i.e the growth of the firm will go down. Furthermore, from this graph we came to know that the relation between SDTA and DTE is positive it means there is direct relation among them which states that with the increase in SDTA the DTE ratio will also increase and by the decrease of DTE the SDTA will also decrease.

Therefore, when the textile firms will use more short term debt to asset it will rise debt to equity which is good for a firm. However, the relation between FG and DTE is found to be positive w.r.t this graph which indicated a direct relationship among them which means when FG is going to increase then with it DTE will also going to increase and with the decrease in DTE the FG will also decrease. So it can be examine that , when the textile firms will use the more debt to equity it will increase the firm growth.

### 4.3. Correlation Analysis

It is a bivariate type of analysis that calculates the strong relation among two variables. In statistics, the correlation coefficient value lies between +1 and -1. If the value of the correlation coefficient is +1 or -1, then it is known as a perfect amount of connection among the two variables. As the value of the correlation coefficient approaches 0, then the connection among the two variables will not be stronger. Mostly, in statistics, the researcher's calculates correlations of three types: Kendall rank, Pearson and Spearman correlation. Pearson correlation is usually a test of parametric type which is utilize in statistics to calculate the extent of the connection among linear related variables.

**Table 4.2 : Rule of Thumb for Interpreting the Size of a Correlation Coefficient**

<b>Size of Correlation</b>	<b>Interpretation</b>
.90 to 1.00 (-.90 to -1.00)	Very high positive (negative) correlation
.70 to .90 (-.70 to -.90)	High positive (negative) correlation
.50 to .70 (-.50 to -.70)	Moderate positive (negative) correlation
.30 to .50 (-.30 to -.50)	Low positive (negative) correlation
.00 to .30 (.00 to -.30)	Little if any correlation

Both variables has to be normally distributed for the Pearson r type correlation. Other assumptions attain a homoscedasticity and linearity. Linearity go with a straight line connection among each of the variables in the analysis and homoscedasticity which tells that the data has been distributed in regarding the regression line. Contrary to this, Kendall rank correlation is not a parametric test that calculates the extremity of reliance among two variables. The Spearman rank correlation is also consider as a non-parametric test that is utilize to calculate the extent of relation among two variables. It developer was Spearman, that is why it is called the Spearman rank correlation.

The correlation between DTE and FG is 0.108 which indicates that there is a little positive relationship between them. The correlation between DTE and LDTA is 0.4038 which indicates that there is a low positive relationship between them. The correlation between DTE and ROA is -0.2012 which indicates that there is a little negative relationship between them. The correlation between DTE and ROE is -0.0476 which indicates that there is a low negative relationship between them.

**Table 4.3 : Correlation Result**

<b>Particular</b>	<b>DTE</b>	<b>FG</b>	<b>LDTA</b>	<b>ROA</b>	<b>ROE</b>	<b>SDTA</b>
DTE	1.00	-	-	-	-	-
FG	0.11	1.00	-	-	-	-
LDTA	0.40	0.02	1.00	-	-	-
ROA	-0.20	0.33	0.00	1.00	-	-
ROE	-0.05	0.36	0.11	0.97	1.00	-
SDTA	0.30	-0.01	0.11	-0.25	-0.19	1.00

The correlation between DTE and SDTA is 0.2979 which indicates that there is a little positive relationship between them. The correlation between FG and LDTA is 0.0220 which indicates that there is a little positive relationship between them. The correlation between FG and ROA is 0.3310 which indicates that there is a low positive relationship between them. The correlation between FG and ROE is 0.3642 which indicates that there is a low positive relationship between them. The correlation between FG and SDTA is -0.0116 which indicates that there is a little negative relationship between them.

The correlation between LDTA and ROA is -0.0030 which indicates that there is a little negative relationship between them. The correlation between LDTA and ROE is 0.1114 which indicates that there is a little positive relationship between them. The correlation between LDTA and SDTA is 0.1133 which indicates that there is a little positive relationship between them. The correlation between ROA and ROE is 0.9715 which indicates that there is very high positive relationship between them. The correlation between ROA and SDTA is -0.2541 which indicates that there is a little negative relationship between them. The correlation between ROE and SDTA is -0.1901 which indicates that there is a little negative relationship between them.

#### 4.4. Regression Analysis

Regression is a statistic calculation utilizing in finance, investing and in other aspects where there is a need of determining that how strong is the relationship between dependent and independent variables.

##### 4.4.1. ROE and explanatory variables

The below table represents that the return on equity (ROE) has got a positive relationship with firm growth (FG) and this is shown by significant relation between ROE and FG known by P-value i.e (0.0002) which is less than 5 percent. On the other hand, the relationship between return on equity (ROE) and short-term debt to asset ratio (SDTA) contribute negatively towards each other even though there is a significant relationship among each other which is shown by p-value i.e (0.0335) which is less than 5%. Furthermore, with respect to Long-term debt to asset ratio(LDTA), the ROE contribute positively perhaps relationship among them is non-significant as the P value i.e( 0.1776) is greater than 5%. The overall model of ROE is valid which has been shown by Prob(F-static) value which is (0.000216) and is less than 5%, means the model is significant. Regression is a statistical measure used in finance, investing and other disciplines that attempt to determine the strength of the relationship between one dependent variable (usually denoted by Y) and a series of other changing variables (known as independent variables).

**Table 4.4 : ROE and Explanatory Variables**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.10	0.04	2.58	0.01
FG	0.34	0.09	3.89	0.00
SDTA	-0.21	0.10	-2.16	0.03
LDTA	0.30	0.22	1.36	0.18
R-squared	0.18	Adjusted R-squared	0.16	
F-statistic	7.16	Prob(F-statistic)	0.00	

Regression is a statistic calculation utilizing in finance, investing and in other aspects where there is a need of determining that how strong is the relationship between dependent and independent variables. Whereas R-squared is a statistical calculation used for calculating how near the data are adjustable to the line of regression.  $R^2$  with a value of 1 tells that the outcomes of regression are fit for data.

In the above case, the total effect of all the independent variables i.e firm growth, short-term debt to asset and long-term debt to an asset on dependent variable return on equity is 0.182937 means up to this extent the change has been occurred in ROE by these three independent variables.

#### 4.4.2. Return on asset and explanatory variables

The below table represents that the return on asset (ROA) has got a positive relationship with firm growth(FG) and this is shown by significant relation between ROA and FG known by P-value i.e (0.0002 )which is less than 5 percent. On the other hand, the relationship between return on asset (ROA) and debt to equity ratio(DTE) contribute negatively towards each other even though there is a significant relationship among each other which is shown by p-value i.e( 0.0364 )which is less than 5 %. Furthermore, with respect to short-term debt to asset ratio(SDTA), the ROA contribute negatively perhaps relationship among them is significant as the P value i.e( 0.0438) is less than 5%. Furthermore, by looking the relation with respect to long-term debt to asset ratio, it is found that the relation among( ROA) and (LDTA) is positive but it is not a significant relationship as P value is higher than 5 %. The overall model of ROA is valid which has been shown by Prob(F-static) value which is (0.000151) and is less than 5%, which makes the model significantly true.

**Table 4.5 :** Return on asset and Explanatory Variables

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.09	0.02	4.99	0.00
FG	0.14	0.04	3.82	0.00
DTE	-0.03	0.01	-2.12	0.04
SDTA	-0.08	0.04	-2.04	0.04
LDTA	0.10	0.10	1.01	0.31
R-squared	0.21	Adjusted R-squared		0.18
F-statistic	6.31	Prob(F-statistic)		0.00

In the above case, the total effect of all the independent variables i.e firm growth, debt to equity, short-term debt to asset and long-term debt to an asset on dependent variable return on asset is 0.209969 means up to this extent the change has been occurred in ROA by these four above mentioned independent variables.

## **5. DISCUSSION AND CONCLUSION**

### **5.1. Introduction of Chapter**

In this chapter, results of the correlation, descriptive analysis and regression analysis are discussed thereby its implication. The chapter also concludes the result as per previous literature which are consistent with respect to the previous studies. The chapter also presents study limitations along with some recommendations that how the textile firms can increase their profitability.

### **5.2. Discussion of Results**

The study aims to investigate the impact of debt financing on financial performance by taking the evidence from textile sectors. It is found that short term debt to asset ratio has negative effect on return on assets and return on equity. Moreover, long term debt to asset ratio also negatively related with return on assets and return on equity. Therefore, it is not in the interest of the textile firms to use more debt to finance their operation. Furthermore, it is found that debt to equity ratio also negatively effect the return on assets. However, firm growth is found as positive with return on assets. It means that whenever, there is an increase in the growth of the firms then return on asset for the textile sector will also increase.

RQ-1: What is the relationship between DTE and ROA listed on PSE?

Lislevand (2012) reported that return on asset is widely used as a measure for the firm financial performance. The correlation result indicates that there is negative relationship between DTE and ROA which means that whenever there is an increase in the proportion of DTE, ROA will get decrease thereby not recommend to increase the DTE as per correlation result. The regression result also shows that DTE influences negatively to ROA which is statistically significant. The regression shows DTE effects on ROA by -0.0304 which is significant (p value <5%). Therefore, as per correlation and regression results, it is recommend to avoid an increase in debt to equity proportion since it has negative influence on return on assets.

RQ-2: What is the relationship between SDTA and ROA listed at PSE?

The descriptive result states that mean value for using the SDTA proportion to total debt is 0.24. The correlation result indicates that there is negative relationship between SDTA and ROA which means that whenever there is an increase in the proportion of SDTA, ROA will get decrease thereby not recommend to increase the SDTA as per correlation result. The regression result also shows that SDTA influences negatively to ROA which is statistically significant. The regression shows SDTA effects on ROA by -0.083 which is significant (p value  $0.04 < 5\%$ ). Therefore, as per correlation and regression results, it is recommend to decrease the proportion of SDTA since it has negative influence on return on assets.

RQ-3: What is the relationship of LDTA and ROA listed at PSE?

The descriptive result states that mean value for using the LDTA proportion to total debt is 0.11. The correlation result indicates that there is negative relationship between LDTA and ROA which means that whenever there is an increase in the proportion of LDTA, ROA will get decrease thereby not recommend to increase the LDTA as per correlation result. The regression result shows that LDTA influences positively to ROA but statistically insignificant. The regression shows LDTA effects on ROA by 0.100 which is insignificant (p value  $0.31 > 5\%$ ). Therefore, as per correlation and regression results, LDTA statistically has got insignificant influence on return on assets.

RQ-4: What is the relationship between FG and ROA listed on PSE?

The descriptive result states that mean value for the FG is 0.10. The correlation result indicates that there is positive relationship between FG and ROA which means that whenever there is an increase in the proportion of FG, ROA will get increase thereby recommend to increase the FG as per correlation result. The regression result also shows that FG influences positively to ROA which is statistically significant. The regression shows FG effects on ROA by 0.136 which is significant (p value  $0.00 < 5\%$ ). Therefore, as per correlation and regression results, it is recommend to increase FG since it has positive influence on the return on assets for textile firm. Bottazzi et al. (2008) and Asimakopoulous et al. (2009) also reported the positive relationship thus, supporting to present result.



RQ-5: What is the relationship between SDTA and ROE listed on PSE?

The descriptive result states that mean value for the SDTA ratio is 0.24. The correlation result indicates that there is negative relationship between SDTA and ROE which means that whenever there is an increase in the proportion of SDTA, ROE will get decrease thereby not recommend to increase the SDTA as per correlation result. The regression result also shows that SDTA influences negatively to ROE which is statistically significant. The regression shows SDTA effects on ROE by -0.209 which is significant (p value  $0.03 < 5\%$ ). Therefore, as per correlation and regression results, it is recommend to decrease the proportion of SDTA since it has negative influence on return on equity for the textile firm.

RQ-6: What is the relationship between LDTA and ROE listed on PSE?

The descriptive result states that mean value for the LDTA is 0.11. The correlation result indicates that there is positive relationship between LDTA and ROE which means that whenever there is an increase in the proportion of LDTA, ROE will get increase. The regression result shows that LDTA influences positively to ROE but statistically insignificant. The regression shows LDTA effects on ROE by 0.300 which is insignificant (p value  $0.17 > 5\%$ ). Therefore, as per correlation and regression results, LDTA statistically insignificant influence on return on equity.

RQ-7: What is the relationship of FG and ROE listed at PSE?

The descriptive result states that mean value for the FG is 0.10. The correlation result indicates that there is positive relationship between FG and ROE which means that whenever there is an increase in the proportion of FG, ROE will get increase thereby recommend to increase the FG as per correlation result. The regression result also shows that FG influences positively to ROE which is statistically significant. The regression shows FG effects on ROE by 0.34 which is significant (p value  $0.00 < 5\%$ ). Therefore, as per correlation and regression results, it is recommend to increase FG since it has positive influence on the return on equity for textile firm.

### **5.3. Implication of Study**

The research thesis provides the implications for both theoretical and practical. These are explained as below;

#### **5.3.1. Theoretical implications**

- This research can be beneficial for scholars those who may want to utilize this research as a base for additional research on a capital structure at PSE.
- The study attempts to investigate whether debt financing is fruitful for the textile firm or not and result found that debt are unfavorable for Pakistani textile firm thereby supporting the pecking order theory.

#### **5.3.2. Practical implications**

- The managers of an organizations that are listed at the PSE has an exclusive responsibility of increasing shareholders revenue and may be capable of using the output of this study to conclude the possible results of the changes, which the organizations shoulder on debt financing.
- The findings of this research may able to help organizations, the management should be attentive of the hidden expense of carrying capital by their shareholders as a result of their decision over capital financing.
- This study potent on the textile sector which has 101 listed and registered companies.

### **5.4. Limitations and Future Directions**

The study uses the data from 2008 to 2017, therefore any change in the time period might change the result. The sample excluded all of those textile firms which have negative equity, because negative equity influences on the analysis. The literature explained that there are many other factors that also effect on the firm financial performance, therefore included those variables could also help to explore new results.

### **5.5. Conclusion**

The decision of the debt financing is very important for the business firms in many aspects in a field of economy. It is mostly not easy for a business organization to analyze the correct composition of the debt and equity. The decision is crucial due to the fact of the requirement of maximizing recovery to several constituencies of the firm. The structure of capital used by the organization can be a reasoning affecting

their trends of financial performance, a controversy that has not been provided sincere concentration by past investigators. The aspect of debt is that the one has borrowed the money must give back the borrowed money as per agreement and also look into the charges of the services e.g the loan fee and interest. Many organizations utilize both types of financing in the process of making the life of their business. Loan borrowing, bond issuance, selling of shares are the main things for supporting an organization with finance and borrowing of the loan. The regression result shows that DTE and SDTA influence negatively to ROA and ROE. Firm growth has statistically significant and positive effect on ROA and ROE. LDTA has positive but insignificant effect. Therefore, results recommend that debts are not favourable for the profitability of the textile firms and supported by pecking order theory. The results are consistent with the previous stud Abor (2007) and Tian (2007).

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## RESUME



### MUHAMMAD IBRAR

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### Objective

Seeking a challenging and talent enhancing role in the field of Accounting, Finance and Management Sciences where my skills and expertise can be utilized to their full potential and can grow professionally by accomplishing the organization goals and objectives efficiently.

### Qualification

- **MBA** Specialization in Finance with CGPA 3.50 from Istanbul Aydin University, Istanbul - Turkey (2017-2019)
- **Post Graduate Diploma (PGD)** From Edexcel, London, United Kingdom (2011-2013)
- **B.Com (IT)** From Government Commerce College, Lahore - Pakistan (2005-2007)

### Corporate Experience

- **Lahore Laser Health Care Center, Pakistan**  
As Marketing Manager from 01-01-2014 to 01-01-2015

#### Job Responsibilities

- Managing all marketing for the company and activities within the marketing department.
- Developing the marketing strategy for the company in line with company objectives.
- Co-ordinating marketing campaigns with sales activities.
- Overseeing the company's marketing budget.
- Creation and publication of all marketing material in line with marketing plans.
- Planning and implementing promotional campaigns.
- Manage and improve lead generation campaigns, measuring results.
- Overall responsibility for brand management and corporate identity
- Preparing online and print marketing campaigns.
- Monitor and report on effectiveness of marketing communications.

### Academic Instructor

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- **Ozel Bogazhisar Egitim**  
As English Teacher from 01-01-2016 to Present

#### **Job Responsibilities**

I am working as volunteer research consultant where i am advising and guiding the students about their research problems, literature writing, proof reading and grammar rectification. I also served to help the students to prepare the entry test exams, IELTS and TOFEL exams preparation with respect to admission requirements.

#### **Organisational / Managerial Skills**

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- Good Coordination and monitoring and deadlines
- Good communication skills
- Team player
- Ability to meet schedules
- Cost/ Benefit Consciousness
- Problem solving ability

#### **Communication Skills**

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- Honest and trustworthy, Respectful Posses, cultural awareness and sensitivity, Demonstrate sound work ethics. Language skills include;
  - English (Reading - Fluent; Writing - Fluent; Speaking - Fluent; Listening - Fluent)
  - Urdu (Reading - Fluent; Writing - Fluent; Speaking - Fluent; Listening - Fluent)
  - Turkish (Reading - Beginner; Writing - Beginner; Speaking - Beginner; Listening - Beginner)

#### **Computer Proficiency**

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- Accounting Software; Peachtree & Quick Book
- Microsoft Office: Excel, PowerPoints Presentation, Word