The Impact of Long-Term Financing Policy on Firm's Value of Least Market Capitalization Non-Financial Companies Listed in Sri Lanka

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Abstract: - The idea of a firm's worth could be viewed as a fairly general phenomenon. Changes in the capital structure have been seen to inform investors, which has an impact on share prices. Through the value maximization does not mean profit maximization, a corporation could not attain its wealth maximization objectives without producing profit in the long run. Because the cost of debt is typically less than the cost of equity, the conventional view in finance is that by using loan capital, the profit-making process would be hastened. The tax-shielding effect of interest on loan financing is mostly to blame for this. The argument against high debt usage, on the other hand, is that because interest payments on debt must be made, a firm's risk would increase if it used more debt to finance its assets without restriction. Thus, increased debt use would result in decreased share prices, which would significantly affect the firm's worth. The study's goal was to determine how long-term financing policies affected the firm value of non-financial companies with the lowest market capitalization that were listed in Sri Lanka. In order to investigate the impact of long-term financing policy on firm value, the study included least twenty non-financial companies with market capitalizations. Debt to equity and debt to asset ratios were utilized as independent variables in the study to assess the long-term financing strategy. The price to earnings ratio, also known as market price to earnings, was used to calculate the firm's value. SPSS 20.0 was used to analyze the data collected for the study and produce the findings. Based on correlation and multiple regression analysis, long-term financing policy had partially insignificant effect on value of the firm in least twenty market capitalization non-financing companies (below 25 Billion) in Sri Lanka. It was concluded that long term financing policy had little bit significant (important) to determine the value of the firm in least twenty market capitalization non-financing companies in Sri Lanka.

Key Words: ***Debt to equity, Debt to asset ratio, Value of the firm, Price to earnings ratio, non-financial companies.***

I. INTRODUCTION

The function of financial management has changed dramatically during the past 50 years. There have been significant changes in the ownership structure, scope of business terms, security markets, financial systems, and instruments. As a result, the position of financial manager has taken on a far larger significance than that of simple fundraiser. The market value of the company, which represents the economic welfare of the owners, is what the finance manager is required to optimize.

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A variety of decisions must be made in order to accomplish this goal. The choices regarding investments, financing, and dividends are the most crucial. Without a doubt, every firm, from large corporations to small single proprietorships, requires a good capital structure and a competent policy for financing its long-term capital. The fundamental task for managers in charge of the company's finance departments and decision-makers is long-term financial planning. Before it can be used as a company's financial policies, it requires exceptional planning and appropriate research. Optimal capital structure is the core goal of long-term financial planning.

When a corporation can reduce the cost of capital, including the cost of debt (interest on bonds) and the cost of equity, it will achieve optimal capital (Dividend). As a result, the business might increase its income contributions to maximize shareholder wealth. Financial structure includes capital structure. Long-term debt, irredeemable preference shares, shareholder equity, and the total amount of retained earnings

make up the permanent financing. The capital structure of a firm at any particular time is a result of long-term financial decisions made by the company in the past, such as the amount of growth through new stock or debenture offerings, bank loans, or through retained earnings without giving dividends. But, when making these choices, management must consider how they will impact the firm's value. The option that maximizes the firm's worth should be selected from among these possibilities. The firm should also make an effort to balance the costs of bankruptcy and financial disgrace against the advantages of interest tax shielding resulting from debt financing.

Under these circumstances, it is important to observe this phenomenon practically. It is interesting to observe that the impact of method of long-term financing Policy on firm's value. This is done to determine whether increased loan capital utilization results in increased profitability, which affects the value of the company's stock. It's also intriguing to see if Sri Lankan market capitalization companies are affected by this link. Since decisions on long-term financing have an impact on investor returns, various scholars have been interested in this field of study.

II. Problem Statement

Prior academics tried to determine how long-term finance policy affected the worth of the company. The long-term financing strategy and the firm's value were shown to have an insignificantly positive association, and others discovered a strong negative relationship. Also, they chose a few selected businesses from one or more industries and then calculated the outcomes for all chosen businesses. None of the study's least market capitalization companies were examined. The current study was motivated to examine the effects of long-term financing policy on value of the business of the least market capitalization non-financing companies in Sri Lanka based on the conflicting results and small sample size of prior studies.

2.1 Research Objectives

The primary objective of the research was to investigate the impact of long-term financing policy on firm's value in least market capitalization non-financial companies in Sri Lanka.

This primary objective was breakdown into sub objectives as follows:

- To find out significant relationship between long-term financing policies and firm's value in least market capitalization non-financial companies in Sri Lanka.
- To find out significant impact in long-term financing policies on firm's value in least market capitalization non-financial companies in Sri Lanka.

2.2 Research Questions

Based on the above problem, the study was designed the following questions.

- Does long term financing policy have a significant relationship with firm's value in least market capitalization (below 25 billion) non-financing companies in Sri Lanka?
- Does long term financing policy have a significant impact on firm's value in least market capitalization (below 25 billion) non-financing companies in Sri Lanka?

III. Literature Review

The study, "Capital Structure and Its Effect on Profitability: A Study of Listed Manufacturing Firms in Sri Lanka," was done by Nimalathasan and Valeriu Brabete in 2010. Debt to equity ratio is positively and highly correlated with all profitability ratios, according to an analysis of publicly traded manufacturing companies.

Study on "Capital Structure and Financial Performance: Evidence from Selected Listed Business Companies in Colombo Stock Exchange Sri Lanka" by Puwanenthiren Pratheepkanth (2011). He discovered that there is a weak negative correlation between capital structure and financial performance in Sri Lankan business companies, at a level that is insignificant (-0.114).

In their 2010 paper, "Long Term Debt and the Worth of the Firm: Evidence from Transnational Listed Manufacturing Firms," Nicholas Apergis and John Sorros explored this topic. He discovered that long-term leverage has a statistically significant negative influence on the firm's worth.

Anandasayanan & Subramaniam (2013) investigated how the capital structure of listed sugar manufacturing companies in Sri Lanka affected their profitability. Their findings showed that organizations' financial performance improved in proportion to the amount of long-term debt they utilised in their capital structures.

Ahmad et al. (2012) looked into how Malaysian sugar businesses' capital structures affected their performance. Return on equity and return on assets were employed by the researchers to assess the impact of long-term debt on the firms' financial performance. The study found that long-term debt had a sizable

detrimental impact on asset return. Long-term debt was found to have a considerable negative impact on return on equity.Antwi, et al (2012), did a research on the effect of capital structure on company's value by taking all listed Sugar companies on Ghana stock exchange. Simple regression analysis was used to determine the effect of long-term debt on firm performance as long-term debt had been used as the independent variable. The results of the study indicated that long term debt had a positive effect on a firms' value.
The relationship between capital structure choices and firm performance was studied by Aliakbar et al. in 2013. The study compared large and small industries among businesses registered on the Tehran Stock Exchange. They discovered that in both large and small sectors, long-term debt has a favorable and considerable impact on firm performance as indicated by Tobin's Q.

Short-term debt obligations have maturities of one year or less and call for prompt repayment within 90 to 120 days. Short-term loans assist address current financial needs without requiring long-term commitments (Peavler, 2014). Short-term debt servicing costs are less onerous for the business. Low interest rates are typically offered by short-term loans, and most lenders do not start charging interest until the whole credit allowance period has passed. In his 2009 study, Ebaid intended to determine the connection between corporate debt levels and financial results of companies listed on the Egyptian stock exchange. The study discovered that short-term debt has a detrimental effect on asset return.

Cecchetti et al. (2011) studied the effects of debt on firms and concluded that moderate debt level improves welfare and enhances growth but high levels can lead to a decline in growth of the firm. Rainhart and Rogoff (2009) argued that when debt impacted positively to the growth of a firm only when it is within certain levels. When the ratio goes beyond certain levels financial crisis is very likely. The argument is also supported by Stern Stewart and Company which argues that a high level of debt increases the probability of a firm facing financial distress. Over borrowing can lead to bankruptcy and financial ruin (Ceccetti et al., 2011). High levels of debt will constrain the firm from undertaking project that are likely to be profitable because of the inability to attract more debt from financial institutions.

Ahmad, Abdullar and Roslan (2012) carried a study in Malaysia which sought to investigate the impact of capital structure on firm performance by analysing the relationship between return on assets (ROA), return on equity (ROE) and short-term debt and total debt. The study established that short-term debt and long-term debt had significant relationship with ROA. It was also established that ROE had significant relationship with shortterm debt, long-term debt and total debt.

Soumadi and Hayajneh (2012) studied the relationship between capital structure and corporate performance on Jordanian shareholdings firms. The study used multiple regression models by least squares (OLS) to establish the link between capital structure and corporate performance of firms over a period of 5 years. The results showed that capital structure was associated negatively and statistically with the performance of the firms in the sample. Another finding from the study was that there was there was no significant difference to the impact of financial leverage between high financial leverage firms and low financial leverage firms in their performance. The study also concluded that the relationship between capital structure and firm performance was negative for both high growth firms and low growth firms.

Maritala (2012) examined the optimal level of capital structure which enabled a firm to increase its financial performance. The study found that there was a negative relationship between the firm's debt ratio and financial performance measured by return on assets and return on equity.

Fosu (2013) did research in South Africa which investigated the relationship between capital structure and corporate performance paying particular attention to the degree of competition. The paper examined the extent to which the relationship between capital structure and corporate performance depended on the level of product market competition. The findings from the research showed that there was positive relationship between capital structure and corporate performance. The study also found out that product market competition enhanced the performance effect of leverage.

Very recent research (Ogebe, Patric and Alewi, 2013) investigated the impact of capital structure on corporate performance in Nigeria from 2000 to 2010.The study paid particular attention to macroeconomic variables (Gross Domestic Product and inflation) on firm performance. The study concluded that there was a strong relationship between leverage and corporate performance. The study concluded that

there was a significant negative relationship between capital structure and corporate performance. The negative relationship was also confirmed by Mumtaz et al (2013) in their study in Pakistan. They wanted to establish the relationship between leverage and firm performance. The findings from the study showed that financial performance of firms was significantly negatively affected by their capital structure. Further research (Saeed, Gull and Rusheed ,2013) examined the impact of capital structure and corporate performance using multiple regression models to estimate the relationship between capital structure and corporate performance of the banking performance. The findings from the study showed that there was a negative relationship between capital structure and performance of the banking industry.

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IV. METHODOLOGY

4.1 Sample and Data Collection

The study was covered least twenty-market capitalization non-financial companies listed on CSE. This study was carried out based on the secondary data. It was collected from annual reports of selected companies for the period from 2012/2013 to 2017/2018.

4.2 Data Analysis

The study was used SPSS 20.0 to investigate the objectives by descriptive statistics, correlation analysis and multiple regression analysis. Descriptive statistics was used to understand the basic characteristics of study variables. Correlation analysis and multiple regression analysis were used to test the hypothesis.

4.3 Research Model

The study was used debt to equity ratio (DE) and debt to asset ratio (DA) as independent variables to measure the long-term financing policy. Price to earnings ratio (PE) was used to measure the value of firm. The study was developed following regression model to investigate the objectives.

$PE_{it} = B_0 + B_1 (DE_{it}) + B_2 (DA_{it}) + E$

Where,

PE = Price to earnings ratio of company "i" for the period "t"

DE = Debt to equity ratio of company "i" for the period "t"

DA = Debt to asset ratio of company "i" for the period "t"

B = Coefficients

E = Error

4.4 Definitions of Key Terms

4.4.1 Debt to Equity Ratio

The debt-to-equity (D/E) ratio is calculated by dividing a company's total liabilities by its shareholder equity. These numbers are available on the balance sheet of a company's financial statements.

$$\text{Debt to Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Shareholders Equity}}$$

4.4.2 Debt to assets Ratio

The debt to asset ratio is a leverage ratio that measures the amount of total assets that are financed by creditors instead of investors. In other words, it shows what percentage of assets is funded by borrowing compared with the percentage of resources that are funded by the investors.

$$\text{Debt to asset Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

4.4.3 Price to Earnings Ratio

The price-to-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings (EPS). The price-to-earnings ratio is also sometimes known as the price multiple or the earnings multiple.

$$\text{Price to earnings ratio} = \frac{\text{Market Value per share}}{\text{Earnings per share}}$$

4.5 Theoretical Framework

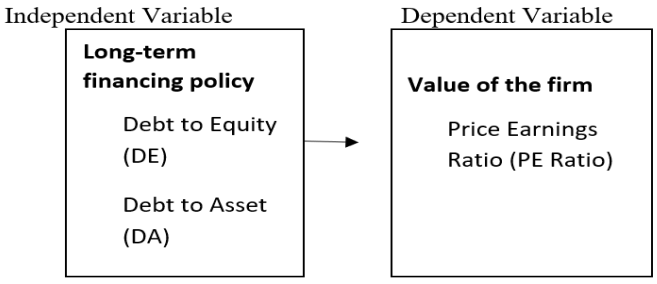

Fig.1. Conceptual framework

Hypotheses:

For studying the relationship between method of long-term financing and the value of the firm. The researcher developed the following hypothesis;

H_1: There is a significant relationship between long-term financing policy and firm's value in least twenty market capitalization non-financial companies in Sri Lanka.

H_2: There is a significant impact of long-term financing policy on firm's value in least twenty market capitalization non-financial companies in Sri Lanka.

V. Results And Discussions

5.1 Descriptive statistics

Table 1 provides the summary of descriptive statistics for the variables of all the least twenty market capitalization non-financial companies. It presents the sample size, minimum, maximum, mean and standard deviation of the variables for least twenty market capitalization non-financial companies in Sri Lanka for the sample data from 2012 to 2017.

Table.1. Results of the Descriptive Statistics of least twenty market capitalization non-financial companies

	N	Minimum	Maximum	Mean	Std. Deviation
DE	120	-18.14	24.21	1.231	4.217
DA	120	0.00	4.94	0.570	0.683
PE	120	-1285.71	2214.29	1.613	356.719

Table 1 displayed the findings of a descriptive analysis of least twenty Sri Lankan non-financial enterprises with market capitalizations. The DE ratio's mean value was 1.231. It meant that, on average, the twenty largest non-financial corporations by market capitalization had one rupee to pay down the debt of 1.231 rupees. The deviation from the mean was 4.217. It means that the long-term finance technique might differ by 4.217 from the mean on both sides. A company's DE ratio peaked in 2015 at 24.21, while it reached its lowest point in 2012 at -18.14 for another company.

The DA ratio was 0.570 on average. It meant that, on average, the twenty non-financial enterprises with the lowest market capitalization had 1 rupee in assets to pay off 0.570 in loans. 0.683 was the standard deviation. It means that the long-term finance technique may deviate by 0.683 from the mean on either side. The largest DA ratio for a company was 4.94 in 2015, while the lowest number for another company was 0.00 in 2012.

The PE ratio was 1.613 on average. In order to determine the PE ratio, MPS and EPS were divided. 356.719 was the standard deviation. A company's PE ratio reached its highest point in 2013 at 2214.29, while it reached its lowest point in 2012 at -1285.71 for another company.

The DE ratio and DA ratio of the companies were generally good, according to descriptive statistics of least twenty non-financial companies in Sri Lanka with a market capitalization. As a result, the capital structures of least twenty non-financial enterprises with the largest market capitalization were generally sound.

5.2 Correlation Analysis

Correlation coefficient was used to identify the relationship between method of long-term financing and value of the firm in overall in least twenty market capitalization non-financial companies in Sri Lanka. The table 2 represents the correlation Analysis of the least twenty market capitalization companies in the Sri Lanka.

Table.2. Correlation Analysis of least twenty market capitalization non-financial companies

		DE	DA	PE
DE	Pearson Correlation	1	-.037	.040
	Sig. (2-tailed)		.688	.663
	N	120	120	120
DA	Pearson Correlation	-.037	1	-.267**
	Sig. (2-tailed)	.688		.003
	N	120	120	120
PE	Pearson Correlation	.040	-.267**	1
	Sig. (2-tailed)	.663	.003	
	N	120	120	120

Table 2 displayed the correlation between the dependent and independent variables for least twenty Sri Lankan non-financial enterprises with market capitalization. As the p-value was higher than 0.05, there was a positive, insignificant link between the dependent variable PE and the independent variable DE. The dependent variable PE and the independent variable DA had negative significant connection since p-value was less than 0.05. Least twenty market capitalization non-financial enterprises in Sri Lanka were found to have a marginally significant link between long-term financing (capital structure) and firm value. At the 5% significance level, the coefficient value between the independent variables DE and DA was -0.037, which was significant. The coefficient value, however, was below 0.8. It was established that this study's multicollinearity was unproblematic. As a result, the study

could employ both capital structure indicators to evaluate the relationship between firm value and least twenty Sri Lankan non-financial enterprises with market capitalization.

5.3 Multiple Regression Analysis

Regression Analysis is made out for finding the impact of independent variables on dependent variable. The study was used multiple regressions Analysis since, it had more than one independent variables (DE and DA) Therefore, the multiple regression analysis was made for finding how the independent variables (DE and DA) impact on the dependent variable (PE Ratio).

5.4 Overall Summary

Table.3. Overall summaries of least twenty market capitalization non-financial companies in the impact of long-term financing on value of firm

R value	0.269
R-squared value	0.072
Adjusted R-squared value	0.057
f-Value	4.567
F-sig	0.012
Durbin-Watson	1.876

Table 3 shows that the R value of least twenty non-financial enterprises with market capitalization in Sri Lanka was 0.269. Least twenty market capitalization non-financing corporations in Sri Lanka were said to have a weak positive association between long-term financing and firm value, with an R-value between 0 and 0.5. The R square value (R2) was 0.072, which demonstrated that only 7.2% of variations in firm value could be attributed to long-term financing in least twenty Sri Lankan non-financial companies with market capitalizations, with the remaining 92.8% of variations in firm value coming from other factors that were not taken into account in this study.

F-value was 4.567, and while p-value was less than 0.05, it was significant at the 5% level. The model was found to be adequate for explaining the effects of long-term financing (capital structure) on the value of the firm in least twenty non-financial companies with non-financial market capitalization. The Durbin-Watson value, 1.876, was outside of the acceptable range of 1.5 to 2.5. The analysis came to the conclusion that there was no issue with autocorrelation.

5.5 Coefficients

The coefficient values of multiple regression analysis were used to measure the impact of independent variables on dependent variable.

Table 4 showed the coefficient values of long-term financing variables in least twenty market capitalization non-financing companies to report those values impact on value of firm

Table.4. Coefficient of least Twenty Market capitalization companies in Sri Lanka

Model	Unstandardized coefficient (B)	t	Sig	Collinearity Statistics	
				Tolerance	VIF
(Constant)	77.725	1.828	0.070		
DE	2.566	0.340	0.734	0.999	1.001
DA	-139.029	-2.988	0.003	0.999	1.001

According to Table 4, there was no multicollinearity issue because DE and DA's tolerance levels were larger than 0.1 and their VIF values were less than 5 or 10. The same correlation analysis outcomes were previously reported. It was determined that there was no correlation between the study's independent variables. As a result, the impact of long-term financing variables on the value of the firm in least twenty market capitalization non-financing companies in Sri Lanka was examined using a regression model.

As the p-value of those variables was larger than 0.05, the coefficients of DE had no discernible impact on the firm's worth; nevertheless, the coefficients of DA had a discernible impact because the p-value of those variables was less than 0.05. It was concluded that, long-term financing had little bit significant impact on value of firm in the least twenty market capitalization nonfinancing companies in Sri Lanka. Capital structure was little bit important variable to determine the value of firm in the least twenty market capitalization non-financing companies in Sri Lanka.

VI. SUMMARY OF FINDINGS AND CONCLUSION

Market capitalization companies are more and more conscious of the need of having a large profit margin and a market share. Market capitalization organizations prioritize learning the best strategies to improve their financial performance among other risky conditions. So, those businesses attempt to manage their financial structure appropriately. The long-term existence of the companies depends much more on the capital structures of their long-term performance. Therefore, it has been demonstrated by past studies that long-term financing policies have a good impact on financial performance.

The overall goal of this study was to determine the impact of long-term financing on the value of the firm of least twenty market capitalization non-financing companies that are listed on the Colombo Stock Exchange, based on the research gap that was described in chapter one. This study's analysis used a variety of methodologies. To obtain the outcome, descriptive analysis, correlation analysis, and regression analysis were performed. Applications from SPSS (20.0) and Microsoft Excel were used to analyze them. According to the descriptive statistics, the capital structures of least twenty non-financial companies with market capitalizations in Sri Lanka were comparable for both company classifications.

According to correlation and multiple regression analysis, the long-term financing had a negligible impact on the value of the firm in least twenty Sri Lankan non-financial companies with market capitalization. This resulted in the conclusion that the capital structure (long-term financing) had a negligible impact on the value of the firm in least twenty Sri Lankan non-financial companies. It was intended to imply that figuring out the firm's value in those companies was rather crucial. Nonetheless, the impact on the firm's worth was only 7.2%.

According to the previous researches, some researchers argued that there is a significant positive effect; Pandey(1999), Dhankar and Boora (1996), DeAngelo and Masulis (1980), Kester (1986), George W.Rester and Mansor MD Isa (1989), Chakraborty (1977) and Baskin (1989) while some researchers argued that there is significant negative effect; Myers (1977), Titman and Wesels (14988), Barclay ((1995), Lasfer (1995), Maritala (2012), and Rajan and Zingales (1995). And some ther researchers found that there is no significant relationship; Ebaid (2009), Hayajenah (2012) and Chadler, (1977).

The debt-to-equity ratio and the debt to asset ratio of those companies have a partial impact on their market capitalization and earnings per share, which is why there has been a partially significant effect of long-term financing on the value of the firm in least twenty market capitalization non-financial companies.

LIMITATIONS:

This study collected data over a six-year period from a sample of forty Sri Lankan non-financial enterprises. The task of gathering and analyzing data for every company was extremely challenging and impractical. The study has the following main shortcomings. The selection of the sample size for this analysis's main restriction is its small size. Only 20 non-financial companies were chosen for the sample from a total of 298 companies traded on the Colombo Stock Exchange. To compare the goals of the two classifications, least twenty non-financial enterprises with least 25 billion in market capitalization were chosen. The study only included data going back six years, and the data gathering was constrained by annual reports in CSE that had already been released.

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