

Research Article

The Effect of Capital Structure on Firms Performance

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ABSTRACT

The central theme of the study was to examine the effect of capital structure on the firm financial performance of non-financial companies in Pakistan. Data was collected from the annual reports of non-financial companies listed on Pakistan Stock Exchange (PSX) for the period 2010 to 2015. Return on Assets (ROA) and Return on equity (ROE) were used to measure the firm's financial performance whereas Debt to Equity ratios were used to measure Capital Structure. For analyzing data the panel regression analysis method had been used as a statistical technique. The results showed no connection between capital structure and firm's financial performance.

Introduction

Industries generate revenue by producing goods and services. It is one of the crucial sectors and hence formulates the foremost segment of the economy. For economic development of a country the industrial sectors can play its crucial role. It is obvious that countries having well-built industrial sector demonstrates increased economic growth, development, improved national income and has encouraged living standard of population. Industrialization results in higher productivity which help in increasing the value of output per worker and ultimately the income of the labor increases on account of higher productivity. These rises in their income improve the living standard of the people.

The hypothesis opines that capital structure of an association isn't associated with its value in flawless market. In undeniable reality, capital structure of an association isn't anything but difficult to build up. Money related chiefs think that it's hard to precisely decide the ideal capital structure. A fused association needs to give an assortment of protections in a various mix to run over specific mixes that can most extreme its general worth which means ideal capital structure. Ideal capital structure infers that with a littlest sum weighted-normal expense of capital there is expansion of the value of the associations. Albeit ideal capital structure is an idea that has been investigated on severally, yet one can't discover any equation or hypothesis that with sureness gives ideal capital structure to an association (Tian and Zeitun, 2007).

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The significance of financing choices can't be over stressed since huge numbers of the factors that add to business disappointment can be tended to utilizing techniques and budgetary choices that drive development and the accomplishment of authoritative targets (Salazar, Soto and Mosqueda, 2012).

The money factor is the primary driver of monetary misery (Memba and Nyanumba, 2013). Financing choices bring about a given capital structure and imperfect financing choices can prompt corporate disappointment. An incredible problem for the board and financial specialists the same is whether there exist an ideal capital structure.

According to Pandey (2005), the combination of debts and equity gives us the concept of capital structure of an enterprise. For the growth of corporate sector and different commercial activities organizations needs funds for which equity capital, retained earnings and debt could be used as key sources.

According to signaling theory, different tools had been used by the managers for sending signals to the market to know them regarding the discrepancies which exist between them and unhealthy firms. Liability could be used as an earnings tool for sending these signals.

To restore the opportunity for future performance inclusion of debt in capital structure is required whereby terrible report about the firm execution later on will be given via equity.

The blend of both debt and equity or mix of different securities which a firm utilizes for its operation is described as capital structure.

Theoretical Foundation

If different concepts and theories about capital structure are reviewed, could provide a clue of the basis on account of which different researches are done. It will likewise see how the research thesis is improving the industries. The study of Capital Structure based on different theories offered by many researchers Modigliani and Miller. Before proceeding towards the basic discussion on those theories firstly the central point of view on capital structure by different researchers will be stated as:

In growing economy and developing country like Pakistan different companies finance their operations and meet the requirements of capital investment mostly through banks debt. As a result they did not involve in debt financing on striking conditions and therefore large number of banks in the country got privatize. These sources of finances become difficult for those firms having increased unsure earnings (volatile) earnings and consequently firms go for less borrowing from the markets on account of more unsure earnings. .

Likewise, firms in Pakistan mostly depend on the inside sources of funds due to restrictions of equity markets and a hike in the cost of raising funds for running their business operations. Information asymmetry problems exist in Pakistani market has affected the decisions made about capital structure.

The optimal capital structure of a company assists in maximizing the share market value. As we know that capital structure is the mixture of both debts and equity and every firm utilize it for running of businesses. Therefore it is strongly recommended that a balance should be made between them and companies are advised to practice the same for maximizing the value of their markets and will also add to the wealth of shareholders. According to Jerry and Gordon (1987), this is a key consideration for the finance managers to know about a firm's target capital structure.

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For maximizing the company performance and enhancing market worth of the company every business organization should made decisions about an appropriate level capital structure.

This a very critical decision regarding capital structure and have a vital role due to a company need for funds and also have a crucial impact on the capability of a company to stay in competition and to deal in a market having tough competition. According to Arthur William et al. (1998), Regular sources of funds should be used in such a way that results gave increased in a company stock price. Therefore when a balance amid the debt and equity shall be required in respect of every company's capital structure can be achieved.

Statement of the Research Problem

Kinsman & Newman (1999) stated that a number of reasons exists for investigating the connection of capital structure with firm's performance as the debt level have been increased substantially since lasts periods which definitely require an clarification of the firms' financial performance is effected by different level of debt. Consequently, suitable and proper decisions should be made about a level of debt used in capital structure necessary for an enterprise. For the lasting continued existence of a business organization it is important to associate capital structure and firm performance. The effect of capital structure will be analyzed on firm performance which is a critical decision in corporate finance. For this purpose, the non-financial firms from PSX-100 Index have been chosen and will be analyzed for the period of 2010 to 2015.

Research Significance

We could inspect the effect of capital structure with financial performance of a firm having great value for its long-term continued existence. Since the interest which has been paid on debt has not tax to be imposed (deductible), therefore addition of more debt with capital structure may enhance and maximize the firms' financial performance. This research has a great importance for the investors, government and for the entire industry of Pakistan.

Objectives of the study

Following is the objective of this research study:

1. To study the effect of capital structure on firms' financial performance of non-financial firms listed in Pakistan stock exchange.

Research Question

This study will provide answer to question given below.

1. What is the effect of capital structure on financial performance of firms' in Pakistan?

REVIEW OF LITERATURE

Capital structure is basic one among every one of the parts of capital speculation choices since association's exhibition is influenced by such judgments, So while choosing about capital structure appropriate consideration and care must be paid. Capital structure is essential segment of monetary record undoubtedly; capital structure is a piece of money related structure .really capital structure of a venture is mix of long haul obligation, value and inclination shares.

Capital structure choice is another significant piece of our examination. Modigliani and Miller (1958) proposed capital structure immateriality hypothesis and depicted capital structure as totally

superfluous factor in deciding the firm worth, i.e., it doesn't make a difference whether a task is financed by value or debt the worth expansion by the venture will remain the same. They supported preservation of speculation esteem. As per them venture firm worth relies on fundamental productivity and hazard instead of debt value division.

Hence later they reexamined their hypothesis and prohibited the tax-exempt presumption. In the nearness of corporate charges Modigliani and Miller (1963) expressed that the debt wellsprings of capital are beneficial for association because of the upsides of assessment shield gain on intrigue installments to bondholders.

Whenever the discourse on capital structure is begun then names of Modigliani and Miller hypothesis comes into the brain of specialists; as the business fund current world beginnings with that hypothesis of capital structure unimportance suggestion in mid-1958. Before them no one successfully create a hypothesis regarding existing of capital structure. Modigliani and Miller had accepted the reality that companies were in position to arrange the expected return.

Capital structure is in a general sense on how a firm funds its general activities and development by utilizing assorted wellsprings of assets (Tsuji, 2011). The premier contemporary hypothesis of capital structure began with the article of Modigliani and Miller (1958). Since, at that point, different examinations have been done to explore the ideal capital structure without Modigliani-Miller's supposition. As indicated by MM Theorem, capital structure hypotheses work under flawless economic situation. Various suspicions of immaculate market have been distinguished and they include: nonappearance of duties, sane financial specialists, impeccable challenge, and proficient market.

Hypothesis additionally accept an ideal capital market, for example, no exchange costs, no assessments, no cost, the protections are unendingly separable and the chiefs demonstration in line of a reasonable alarm for people who are investing and the companies can be collected into comparable threat classes on the basis of their business choices. The focal consequences of current corporate account, the Modigliani-Miller unimportance recommendations, that the marketplace valuation of any company is free of its capital structure which may be gained via guaranteeing its usual profit (Modigliani and Miller, 1958).

Merton Miller likewise contended equivalent to Modigliani-Miller a sole suggestion when there is no duty that the changes occurred in Capital Structure does not influence the value of different companies. However, it stands out strongly from corporate assessment change article (1959), in which they were of the opinion that debt has considerable preferred position for the organization. Organizations will give debt until duty rate for insignificant bond holder is equivalent to corporate expense rate. He in his model proposes that at edge, individual assessment rate on debt would approach the duty rate of corporate sector.

Vale Stane, (1967) picked 255 enterprises in US for instance and thought the connection of affiliation's a motivation with favorable circumstances and held remuneration in 1961 and 1962. Significant stone, (1967) articulated that there is basically delicate attestation that budgetary specialists support points of interest to future capital advancement. These exposures likewise displayed negative relationship between progress of alliance and tendency of favorable position.

Farrar and Selwen (1976) assume that speculators gain acceptable sum from the pay which is after assessment. In a setting of halfway balance, speculators have two options. People choose as indicated by their circumstance whether to get profits or procure sum as capital additions. The consistent behind this idea is that when investor feels that over all they will win less after the

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installment of assessment on the profit earned from the offers they hold, as contrasted with after assessment measure of capital increase then they chose to go with the choice of no profit. For instance if the duty rate is high on capital increases than duty rate inferred on salary from profit then speculators decision might want to be the organization who has bounty hold in hold income. Stulz (1990), combat that debts can have both a positive and negative impact on the estimation of the firm (even without corporate debts and cost). He built up a model in which debts financing can both decline the over hypothesis issue and the underinvestment issue. He expects that manager have no worth having a place in the firm and get utility by dealing with a more prominent firm. The "power of trough" may animate oneself intrigued heads to attempt negative present worth undertaking. To deal with this issue, theorists power firms to give debts. Notwithstanding, if firms are obliged to pay out assets, they may need to oversee without positive present worth activities. Accordingly, the ideal debts structure is overseen by changing the ideal office cost of debts and the affiliation cost of administrative friendliness.

Davidson et al. (1994), utilized the example comprises of 183 firms. Single list advertise mode was utilized; their investigation demonstrates that the market doesn't seem to think about the connection between an association's influence proportion and the business' influence proportion. Huang and Song (2000) utilized the example of at most 1000 Chinese enterprises that were listed till year 2000. The paper tried the theory through the exchange off model and pecking request model. The outcomes demonstrate that influence is increments with the expansion in the firm size. Scientists additionally expressed that proprietorship structure influences influence. The features of capital structure for Chinese recorded associations are better clarified by the exchange off model instead of pecking request theory.

Bevan and Danbolt (2002) utilized 822 organizations of U.K. The monetary proportions are assessed for the factors; value, debts and market esteem. This paper concentrated on the challenges of estimating equipping, and the affectability of Rajan and Zingale's outcomes to varieties in outfitting measures. The determinants of outfitting seem to differ essentially relying on which part of debt is being broke down. They articulated that exchange credit is proportional by and large represents in excess of 62 percent of complete debt the outcomes are especially delicate to whether such debt is incorporated into the equipping measure.

Theriou et al. (2000) concentrated on effectiveness of capital structure. Analyst drew an example from 96 Greek enterprises listed in the Athens Stock Exchange (ASE from four distinctive monetary divisions. The different relapse models were utilized for estimations and investigation.

An ideal capital structure could be found out by contrasting individual expense of capital acquired. Concurring, Owualah (1998) an ideal capital structure is itself one where the blend of these extents makes a monetary structure for an organization that it's potential incentive for the proprietors. The association's capital structure is viewed as ideal when the market estimation of offer is expanded.

The idea of ideal capital organizing suggests that an organization's decision of financing blend among debts and value matters a lot yet anyway in all actuality it has been found that there is an adequate harmony among debts and value financing that most organizations ought to endeavor to accomplish so as to boost their fairly estimated worth or increment investor's riches. As indicated by Jerry and Gordon (1987), the association's objective capital structure is a significant thought to its monetary director.

An appropriate capital structure is an essential decision for any business affiliation and this decision is huge not in perspective on its needs to intensify speculator's wealth or augmentation

the market estimation of the association, yet furthermore by virtue of the impact such decision has on the association's ability to deal with the engaged condition.

According to Arthur William et al. (1998), Regular sources of funds should be used in such a way that results gave increased in a company stock price. Therefore, a balance between debts and equity is supposed to be achieved regarding capital structure of an enterprise.

Ebaid (2009) did an examination to explore the effect of decision of capital structure on the exhibition of firms in Egypt. Execution was estimated utilizing ROE, ROA, and gross overall revenue. Capital structure was estimated by transient debts to resource proportion, long term debts to resource proportion, and complete debts to add up to resources. Different relapse examination was applied to gauge the connection between the influence level and execution. In any case capital structure influences execution for each situation. Onaolapo also, Kajola (2010) did an investigation on various degree of execution on various organizations. They had chosen nourishment and division organizations of Nigeria. They demonstrated that presentation markers and influence are touchy.

Mohammed Omran (2001) assesses the budgetary and working exhibition of recently privatized Egyptian state-possessed ventures and decides if such execution contrasts crosswise over firms as indicated by their new proprietorship structure. The Egyptian privatization program gives one of kind post-privatization information on various proprietorship structures. Since most investigations don't recognize between the kinds of proprietorship, this paper gives new knowledge into the effect that post privatization possession structure has on firm execution. The investigation covers 69 firms, which were privatized somewhere in the range of 1994 and 1998.

Fama & Babik (1968), Fama (1974) strengthened the perspective on linter. Black and Scholes (1974) consequence of their investigation distinguish that no association exists between revenue approach and price of regular offers. They likewise clarify that reliance just relies upon the risk-takers choice to choose to keep increase or less return protections.

Rachim (1996) recognize no linking of profit yield with cost regarding market. Other they show positive connection between offer value and firm size (all advantages esteem) gaining and influence negative connection are found payout proportion and offer cost in the wake of examining 173 Australian stocks recorded. Denis & Osobov (2008) has provided us the concrete evidences supporting profit superfluity hypothesis as applicable to the price of stocks. Bayezid et al, (2010) Irum et al, (2012) to find that profit declaration have no noteworthy effect on offer cost.

Hypothesis

Here we have two hypotheses. One of them is a null hypothesis which is to be denoted by H_0 and the other is called alternative hypothesis which is denoted by H_1 .

We can formulate hypothesis which is given as under.

H_{01} : There is no relationship exist between capital structure with the financial performance of firms.

H_{11} : There is a relationship exist between capital structure with the financial performance of firms.

Methodology

Population and Sample

Herein the ongoing research study population had the companies recorded on the Pakistan Stock Exchange. A total 100 non-financial companies from PSX had been taken as a sample. The

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research study data is collected from the financial statements of the 100 sample non-financial companies from 2010 to 2015.

Data Collection

The data covered a period of 5 years that is from 2010-2015. Balance sheets and annual reports belongs to 100 selected non-financial firms listed in Pakistan Stock Exchange (PSX) have provided the requisite annual data to analyze the problem. The two main sources used to get the required data are as given as under:

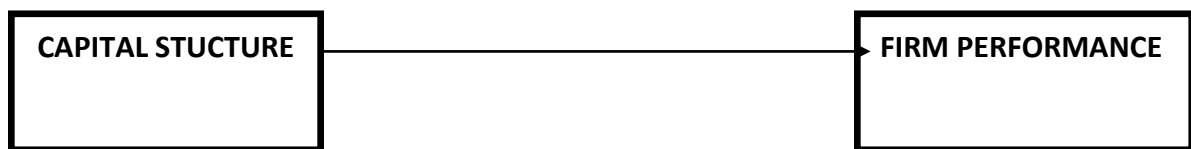
1. State Bank of Pakistan (SBP)
2. Pakistan Stock Exchange (PSX)

Theoretical Framework

A legitimate measure of advantages, capital and stock in hand is the basic need and requirement for every single person or firm in order to establish a good business. No doubt if you want to establish a good business in today global world, you need to get a plummet capital structure. The Following conceptual frame work can enlightens causes of capital structure effects the financial problem of a company. The agency cost can be lover of during the process of convincing and attracting new equity, firms have focus towards monitoring and disciplining of the markets.

When the concepts and theories are reviewed it shall give broader impression and idea regarding the base on account of which theses researches are carried out. This study will assist us to know that it has improved the industries. The study of Capital Structure is based on different theories offered by many researchers Modigliani and Miller, Myers and Majluf, and Baker and Wurgler. Before proceeding towards the basic discussion on those theories firstly the central point of view on capital structure by different researchers will be stated as:

Theoretical/Conceptual Model



Variables

A value that changes and not constant is termed as variable. Variables used in this research thesis are explained as under. The variables chosen for this research thesis are mention as follow.

- Debt to equity ratio
- Debt to asset ratio
- Return on asset ratio
- Return on equity ratio

Independent Variable

A variable which is not depended for their support on any other variable is termed as Independent Variable. The research has used the given Independent variables.

- (1) Capital Structure

Debt Equity Ratio

The financial force of company can be calculated via this ratio and be obtained if we divide its (total liabilities on stockholders' equity). It shows that if firms are financing their assets so how much amounts of equity and debts a firm have had. If the value of this ratio is large, it means that the company is using debts in its financing making development with debt. Additional interest cost results in volatile income

Debt to equity ratio = (Total Liabilities)/Total equity

TDTQ: Total Debt / Total Equity (Hasan, Ahsan, Rahaman and Alam, 2014),

Creditors can be provided with a margin safe to them. This ratio gives us knowledge about the security and insecurity of the creditors. If we got a smaller ratio, it means that the creditors will be more secured. The larger value of this ratio shows and provides the insecurity of the creditors.

Total Debt to Total Assets

Leverage ratio is the ratio of total debts to total assets in which is the the total quantity of debts as compared to its assets. This ratio compares the leverage which is taken into account among different companies.

If this ratio has higher results, we can understand that the degree of leverage is high. The higher ratio also gives information about the financial risk involved therein.

This ratio is consisted of all assets whether tangible or intangible along with their debts both for long and short-terms (borrowings which mature within the time span of one year).

Total Debts to Total Assets = Total Liabilities /Total Assets

TDTA: Total Debts / Total Assets (Hasan, Ahsan, Rahaman & Alam, 2014)

Dependent Variable

A variable which is depended for their support on any other variable is termed as dependent Variable. Dependent variables used in this research studies is given as follow.

- Firm Performance

Return on Assets

As an indicator this ratio can be used to be known about company profitability relatively to its total amount of assets. Return on Assets“(ROA)” generates an idea that how much the management has efficiently used assets of their organization for the sake of generating the revenue and earnings.

We can get this ratio of we divide the company's total annual earnings by the total assets of that company.

This ratio has given us knowledge about profitability of a company. If we got a higher ratio, it is a very good sign in favor of a company which means that the firms are getting more and more money on account of relative less investment.

ROA= Net (earned) Profit /Total Assets (Anupam and Mehta, 2012)

Return on Equity

This ratio gives us knowledge that how far a firm is efficient in order to generate the profits from every single unit of the shareholders' equity.

We can understand from the value of this ratio that how well the firms are using their resources for the sake of generating the earnings their movement towards their growth.

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The ROE is used to compare how much a firm is profitable as compare to other firms in that similar industry.

Return of Equity (ROE) = Net Income / Average (Total) equity
(Shubita & alsawalhah, 2012)

Analytical Tools

Collected data for this research studies is secondary and for the sake of getting a proper outcome we had analyzed data through using different statistical methods. As per different researches conducted in this area and by viewing different research papers we reached a conclusion that different techniques has been used by different researchers for analyzing the data. According to this data the panel data regression analysis had been used to analyze the collected secondary data.

RESULTS AND DISCUSSIONS

Descriptive Statistics:

The data have been taken from 2010 to 2015 of 100 non-financial companies which are listed on Pakistan stock exchange.

Descriptive statistics of the variables i.e. ROA, ROE, DCR, DPR, RR, Debts to Equity, Total Debts to Total Assets and size were analyzed which explain the essential characteristic of data like means, its standard deviation, the minimum value and their maximum values, skewness and kurtosis.

Descriptive statistics of these variables are as follow vide Table 1.

Table No. 1 Descriptive Statistics of these Variables

	ROA	ROE	DCR	DPR	RR	DEBT to QUITY	Total debt to total assets	SIZE
Mean	1.817	0.010	0.924	3.072	0.597	0.082	0.529	6.953
Median	2.153	0.010	0.881	3.107	0.651	0.062	0.520	6.896
Maximum	0.494	0.0204	2.542	4.909	1.364	1.099	1.192	8.695
Minimum	4.626	0.0004	-0.978	1.457	-0.038	-1.080	0.0030	5.547
Std. Dev.	1.381	0.0058	0.725	0.720	0.313	0.488	0.254	0.705
Skewness	0.187	0.004	-0.009	-0.021	-0.229	0.139	0.317	0.306
Kurtosis	1.884	1.806	2.657	2.592	2.870	2.672	2.809	2.596

Correlation Matrix

The results of correlation matrix are given Table No. 2. The Statistical tool used here is the Correlation analysis which explains the extent to which how different variables are co-related with each other. It will assist us to identify the level of connection among different variables. It was found that DPR and DCR are strongly correlated with each other whereas, the remaining all variables do not have a strong dependency with each other as shown in the table given below.

Table No. 1 Correlation Co-efficient

Variables	ROA	ROE	DCR	DPR	RR	DEBT TO EQUITY	Total Debt to	SIZE
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	Total Assets						
ROA	1						
ROE	0.06	1					
DCR	-0.16	-0.32	1				
DPR	0.17	0.32	-0.10	1			
RR	-0.26	-0.21	0.23	-0.14	1		
DEBT TO EQUITY	0.27	0.19	0.14	0.15	0.13	1	
Total Debt to Total Assets	0.01	0.18	0.09	0.08	-0.04	0.14	1
SIZE	0.13	0.24	-0.04	0.04	-0.06	0.02	0.11

Model Specification tests

Model Specification Tests	Model ROA (DCR)	Model ROA (DPR)	Model ROE (DCR)	Model ROE (DPR)
Chow test is used to take pooled or Fixed effect model if $\leq 0.05 \rightarrow$ Fixed effect	Prob>chi2 = 0.0000	Prob>chi2 = 0.0000	Prob>chi2 = 0.0000	Prob>chi2 = 0.0000
Hausman test is used to take Fixed or Random effect model if $\leq 0.05 \rightarrow$ Fixed effect	Prob>chi2 = 0.0000	Prob>chi2 = 0.0000	Prob>chi2 = 0.0000	Prob>chi2 = 0.0000
Decision	Fixed Effect Model	Fixed Effect Model	Fixed Effect Model	Fixed Effect Model

Fixed Effect Model Results

The results which are given by Fixed Effect Model are in table 3. It was observed that all of the variables except size have a significant effect on ROA. The DCR, Total debts to Total Assets and size of the firm positively affect the ROA as a unit change in DCR will change the ROA by 0.306 units and a unit change in TA affect the ROA by 1.75 units. This relationship between ROA, DCR, Total Debt to Total Assets and size of the firm is considered as statistically significant at 5% level of significance. The relationship between ROA and size of the firm is statistically insignificant as the coefficient of size indicate that a unit change in firm size will positively affect the ROA by 0.19 units. The remaining variables RR, and DEBT TO EQUITY have significant negative relationship with ROA, the coefficients of these variables are -1.22 and -1.78 respectively.

Adjusted R-squared is 0.3360. The value of coefficient of determination (R-square = 0.35) is the proportion of the variance in the dependent variable that is predictable from the independent variable. In our analysis 35% variation in ROA is due to DCR, RR, Total Debt to Total Assets, DEBT TO QUNITY and SIZE.

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Table 3.Fixed Effect Model Results

Dependent Variable: ROA and DCR

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DCR	0.306411	0.147709	2.074414	0.0391
RR	-1.222100	0.337702	-3.618870	0.0004
Total Debt to Total Assets	1.749867	0.343294	5.089021	0.0000
Debt to equity	-1.776840	0.179081	-9.921970	0.0000
SIZE	0.186446	0.102902	1.811876	0.0713
C	-3.447070	0.743398	-4.636920	0.0000
R-squared	0.3495			
Adjusted R-squared	0.3360			
F-statistic	25.79241			
Prob (F-statistic)	0.00000			

Fixed Effect Model ROA and DPR

In the Fixed effect model DPR given in Table 4, all the variables except the size are significant at 5% significance level. For the DPR the coefficient is 0.306883 which means that one unit increase in DPR will bring 0.306883 unit change in ROA, with Retention coefficient the value is -1.226. This means that one unit increase in RR will bring about -1.226 changes in ROA. Similarly the coefficients for Total Debt to Total Assets and Debt to equity are 1.748 and -1.779 respectively. However, the size variable turned out to be insignificant. Adjusted R-squared for this common effect model is 0.335492.

Table No. 4 Fixed Effect Model Results

Dependent Variable: ROA and DPR

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DPR	0.306883	0.151088	-2.031151	0.0433
RR	-1.225898	0.342905	-3.575041	0.0004
Total Debt to Total Assets	1.747604	0.343407	5.089021	0.0000
SIZE	0.186951	0.102936	1.816194	0.0706
DEQUITY	-1.778527	0.179330	-9.917622	0.0000
C	-2.220636	0.958735	-2.316215	0.0214
R-squared	0.349053			
Adjusted R-squared	0.335492			
F-statistic	25.73876			
Prob(F-statistic)	0.000000			

Fixed Effect Model ROE and DCR

In the RoE Fixed effect model given in Table 5, all the variables except the size are significant at 5% significance level. For the DCR the coefficient is 0.03113 which means that one unit increase in DCR will bring 0.03113 unit changes in ROE, with Retention coefficient the value is 0.01431. This means that one unit increase in RR will bring about 0.01431 changes in ROE. Similarly the coefficients for TA and Debt to equity are -0.005176 and -0.000342 respectively. However, the size variable turned out to be insignificant. Adjusted R-squared for this Fixed effect model is 0.198440.

Table No. 5 Fixed Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DCR	0.03113	0.000688	-4.522623	0.0000
RR	0.01431	0.001573	0.909671	0.3639
DEQUITY	-0.000342	0.000834	-0.410191	0.6820
Total Debt to Total Assets	-0.005176	0.001599	-3.235818	0.0014
SIZE	0.002114	0.000479	4.409814	0.0000
C	0.000410	0.003464	0.118258	0.9060
R-squared	0.214798			
Adjusted R-squared	0.198440			
F-statistic	13.13078			
Prob(F-statistic)	0.000000			

Fixed Effect model ROE and DPR

In the fixed effect model all the variables except the size are significant at 5% significance level. The coefficient of DPR (0.013) indicates that a unit increase in DPR increases the ROA by 0.013 units. The value of Retention coefficient is -0.55 means that a unit increase in RR will bring about -0.55 units changes in ROA. Similarly the coefficients of Total Debt to Total Assets and Debt to equity are 1.55 and -1.78 respectively. However, the variable size of the firm (SIZE) turned out to be statistically insignificant. The independent variables DPR, RR, TA, DEQUITY and SIZE are responsible for 64.4% variation in the dependent variable ROA and the remaining 35.6% variation is due to other variables which are not included to the model. The value of Adjusted R-squared for fixed effect model is 0.563912 as given in table 6.

Fixed effect model results

Dependent Variable = ROE

Table No. 6.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DPR	0.013072	0.150519	2.086845	0.0309
RR	-0.550313	0.322680	-1.705446	0.0897
Total Debt to Total Assets	1.546857	0.402255	3.845460	0.0002
DEQUITY	-1.773828	0.230439	-7.697605	0.0000
SIZE	-0.173274	0.146349	-1.183976	0.2378

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C	-0.945247	1.015250	-0.931048	0.3530
R-squared	0.644010			
Adjusted R-squared	0.563912			
Prob(F-statistic)	0.000000			

Conclusion

Because of significance of capital in the achievement and endurance of business research the capital structure & corporate performance is of utmost importance. According to Abu Tapanjeh (2006) significant research has been conducted to analyze the relationship of capital structure with the financial performance of different companies in relation to both the developed and developing countries.

For enhancing and maximizing the financial performance of different companies numerous arguments of the following strongly support a dire need for improving the decisions regarding capital structure and firms financial performance. (Gleason, et 2003; Philips and Sipahioglu, 2004; Abor, 2005; Carpentier, 2006; Abor, 2007; Madan, 2007; Chen et al., 2008).

Based on the abovementioned debate, we can draw the following conclusions from the study.

This study has been successful in finding out the effect of capital structure on firm financial performance. A significant and negative relation has been found of Retention ratio (RR) and size with Return on Assets (ROA), which means that if we increase the Retention ratio (RR) and SIZE, it will decrease the Return on Assets (ROA). Consequently, for increase in Return on Assets (ROA) the Retention ratio (RR) and SIZE need to decrease.

This investigation is significant and helpful for the academicians, strategy producers, theorists, financial specialists, and potential speculators. The extent of the investigation, be that as it may, is restricted as it concentrates just on firms recorded in Pakistan Stock Exchange.

On the other hand the relationship between Total Debt to Total Assets (TA) with Return on Assets (ROA) was significant and positive that is meant to increase the Total Debt to Total Assets shall increase the Return on Assets (ROA).

The study recommends that firms listed at the RSE should improve their capital structure and implement strategies that lead to a reduction in liquidity ratio as it leads to improved financial performance. The firms should keep its leverage level under control and have clear working capital management guidelines to avoid bankruptcy

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