
Capital Structure and Firm Value: Evidence from Listed Food, Beverage and Tobacco Companies in Sri Lanka

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A B S T R A C T

This study examines the relationship between capital structure and the firm value of listed Food, Beverage and Tobacco (FBT) companies on the Colombo Stock Exchange (CSE) during 2020-2024. The study is motivated by the conflicting predictions of capital structure theories and by the macroeconomic shocks Sri Lanka faced, such as the COVID-19 pandemic and the 2022 economic crisis. The study design was explanatory and quantitative, using secondary data drawn from the audited annual reports of 25 sampled companies and CSE market data over a five-year balanced panel, producing 125 firm-year observations. Firm value was measured using Tobin's Q ratio, capital structure was measured as total liabilities to total assets, and the control variables were profitability, firm size and asset tangibility. The panel data were analysed using EViews, and the Hausman test indicated that the Random Effects Model is the best estimator. Panel Estimated Generalized Least Squares (EGLS) results indicate that capital structure is significantly and negatively related to firm value, while profitability and firm size are significantly and positively related to firm value; asset tangibility is not statistically significant. The model accounts for about 73.7 per cent of the variation in firm value, showing that financing decisions, profitability and firm scale are key determinants of market value in Sri Lanka's FBT sector. Findings have implications for the current financing situation in Sri Lanka's FBT sector, which is capital-intensive, in the face of macroeconomic instability, for current managers of the companies, investors and policymakers.

Keywords: *Capital Structure; Firm Size; Firm Value; Profitability; Tobin's Q*

1. Introduction

Firm value is the central concern of corporate financial management. It represents the market's cumulative assessment of a company's earning potential, risk and growth prospects, and is the common standard by which shareholders judge management performance (Brealey et al., 2020). Capital structure occupies a central position in this assessment because financing decisions directly affect the cost of capital, risk exposure, and the value created for investors.

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Capital structure theory offers conflicting predictions about this relationship. Modigliani and Miller (1958, 1963) argued that, absent market frictions, financing decisions are largely irrelevant to firm value, while trade-off, pecking order and agency perspectives each propose different mechanisms through which leverage may enhance or erode value (Kraus & Litzenberger, 1973; Jensen & Meckling, 1976; Myers & Majluf, 1984). These theories make conflicting predictions about empirical phenomena. Existing evidence, furthermore, is limited with regards to understanding how that relationship is manifested in Sri Lankan companies in the capital-intensive Food, Beverage and Tobacco (FBT) sector, especially during a macroeconomic shock like the severe crisis that Sri Lanka has currently faced (Rajan & Zingales, 1995; Booth et al., 2001; Frank & Goyal, 2009). This study comes into the field to fill the void. It explores the relationship between capital structure and firm value for the listed FBT companies in Sri Lanka over the years 2020-2024 which includes the economic crisis of 2022 and the COVID-19 pandemic.

This study focuses on the FBT sector of the Colombo Stock Exchange (CSE), a capital-intensive segment that is particularly exposed to commodity price volatility, currency fluctuations and regulatory pressure, making it a relevant setting in which to examine these theoretical predictions.

1.1. Research Problem

Although financial theory suggests that there is an association between capital structure and firm value, the previous empirical findings are inconsistent. Trade-off theory predicts that firms achieve maximum value at a moderate level of debt: high leverage reduces firm value through distress costs, while low leverage forfeits the benefit of the interest tax shield (Kraus & Litzenberger, 1973). Pecking order theory views leverage as an outcome of financing choices rather than a value-maximising choice (Myers & Majluf, 1984). In contrast, agency theory argues that leverage can either create or destroy value, depending on which conflict prevails (Jensen & Meckling, 1976).

Some studies find that moderate leverage is rewarded through tax benefits, while others find that leverage is penalised during macroeconomic stress on tax benefits (Rajan & Zingales, 1995) and on size-moderated leverage penalties during stress (Ibhagui & Olokoyo, 2018). Numerous studies have examined this relationship both in developed and developing countries. While Rajan and Zingales (1995) examined this area in relation to the United States, Booth et al. (2001) have examined it across ten developing economies. Frank and Goyal (2009) studies this area with an international sample. Yet, a little scholarly attention has been given to emerging markets such as Sri Lanka. Sri Lanka is a particularly suitable context in which to test these theories, given that the 2022 financial crisis and the impact of COVID-19 have significantly influenced interest rates and economic conditions over the past five years, which may have substantially altered historical leverage-firm value relationships (Central Bank of Sri Lanka, 2024).

Accordingly, this study is conducted with reference to listed FBT companies in Sri Lanka to examine the impact of capital structure on firm value. The research questions addressed are: (i) Is there a significant relationship between capital structure and the firm value of FBT companies listed on the CSE? (ii) Do profitability, firm size and asset tangibility significantly influence the firm value of these companies? The FBT sector was selected because it is extremely capital intensive, needing constant investment in production and distribution infrastructure. It also deals directly with imported raw-material costs, exchange-rate changes and excise control measures such as investment in consumption tax, which make financing

decisions in this sector sensitive to the macroeconomic shocks Sri Lanka experienced during 2020-2024.

2. Review of the Relevant Literature

2.1. Theoretical Framework

The theoretical foundations for this study are the three capital structure theories in the literature; "trade-off", "pecking order" and "agency" theories, which start from the Modigliani and Miller (1958, 1963) "irrelevance proposition". It demonstrated that, under the assumption of the absence of market inefficiencies in the form of taxes, costs of bankruptcy protection and asymmetry of information, the value of a firm is independent of its financing structure. If those tensions are added, the financing decisions start to take a value dimension. According to trade-off theory (Kraus & Litzenberger, 1973), the interest tax-deductibility of debt provides a tax advantage to a firm, which they estimate to be the value of the firm, but this cost is offset by financial distress and bankruptcy costs that increase with leverage in the form of debt (Myers, 1977; Frank & Goyal, 2009). The value maximising target of the concentration of capital in the firm is therefore to be expected to be somewhere between the minimum and the maximum level of debt (marginal tax benefit equals the marginal cost of distress). Pecking order theory (Myers & Majluf, 1984) proposes that financing decisions are made in response to an information asymmetry between management and outside investors, where investors value the adverse deviation risk that comes with the external financing so firms choose to fund investment first with internal funds and then with debt, and finally as a last resort with new equity (Fama & French, 2002; Booth et al., 2001). According to this theory, what you see is what you get; leverage is the result of the financing shortfall, it is not a goal. The agency theory perspective (Jensen & Meckling, 1976; Jensen, 1986) is concerned with the problem of conflict of interest that can occur when there is a separation of ownership and control. Debt can affect firm value through disciplining, limiting free cash flow for wasteful or self-serving investments, and also amplify shareholder-creditor conflict by inducing equity holders to accept riskier projects that benefit at the expense of the creditors, all of which is likely to be more prevalent in the coming volatile situation of 2020-24 in Sri Lanka.

2.2. Empirical Evidence and Research Gap

Prior scholarly evidence broadly supports the trade-off theory. Rajan and Zingales (1995) documented that leverage is negatively correlated with market-to-book value. Frank and Goyal (2009) validated profitability, tangibility and size as uncontroversial indicators of leverage and value. The leverage-performance relationship is moderated by firm size (Ibhagui & Olokoyo, 2018) while the firm size-tangibility-leverage relationship is reportedly negative (Titman & Wessels, 1988). In emerging markets, Booth et al. (2001) found profitability negatively related to leverage, consistent with pecking order behaviour (Demirguc-Kunt & Maksimovic, 1999; Sharif et al., 2015).

In the Sri Lankan FBT sector, Mithushana & Kevin (2019) noted that capital structure significantly determines market value which aligns with trade-off theory while Anojan (2014) reveals that leverage and liquidity significantly impact financial performance. Similar findings are reported by Dissanayake & Wanigasekara (2021) and Kasthury & Anandasayanan (2020) which concludes that Financial Performance has a strong impact on the share price in the FBT sector. However, they were limited due to not considering recent data and selection of different measures to evaluate financial performance. Therefore, this study aims to fill this gap and consider most recent data for the analysis spanning from 2020 to 2024 using firm value measures. It is important to acknowledge that Anojan (2014) and Kasthury and Anandasayanan (2020) employed financial performance and share price, respectively, as their

dependent variables. These are related to, but conceptually different from, the Tobin's Q measure of firm value used as the dependent variable in the current study. For instance, for the FBT-sector studies prior to them, performance variable such as financial performance and share price mainly reflects past accounting or trading results, while Tobin's Q also reflects the valuation of the firm by the market in the future, hence this study will use Tobin's Q as an additional book of novelty or new insight to the previous FBT-sector studies.

2.3. Conceptual Review of Variables

The literature reveals that previous researchers have conceptualized the variables investigated in this study through various different measures, which are considered here prior to the specific measure used in this study in Section 3.3. There are many ways to measure the firm value in recent years such as Tobin's Q (market value of a firm/ replacement cost of total assets, or book value) (Chung & Pruitt, 1994; Lang et al., 1996; Jeewanthi et al., 2021). Two measures of capital structure (leverage) have been employed: total debt to total assets, long-term debt to total assets or debt to equity (Rajan & Zingales, 1995) and the investor risk placed on investment and assets financed by debt in this study are used to measure capital structure. ROA, which has been used widely as a proxy for profitability, is included since more profitable firms have higher market valuations and depend less on debt finance, is used in this study (Myers & Majluf, 1984; Frank & Goyal, 2009; Bui et al., 2023). The number of employees, total fixed assets, total capital and the natural log of total assets are used to proxy the size of the firm, with larger firms assuming a lower information asymmetry and lower cost of capital (Rajan & Zingales, 1995; Sharif et al., 2015); this study uses the natural log of eligible assets as a measure of size of the firm. In this study, the asset tangibility measurement is used as the ratio of net fixed assets to total assets, which was suggested by Titman and Wessels (1988) as well as Alathamneh et al. (2025). Theoretically, asset tangibility cannot be predicted to have a positive or negative impact on the firm value, so it is considered a non-directional control.

3. Methods

3.1. Research Design and Approach

This is a quantitative research study conducted based on secondary data collected from sampled FBT companies' publicly available annual reports. This study follows an explanatory deductive approach featuring the testing of hypotheses against panel data with regression analysis as per previous studies on financing decisions and market-based firm value (Rajan & Zingales, 1995; Frank & Goyal, 2009). Using the three theories reviewed above, as well as the Modigliani-Miller baseline, the four hypotheses were guided in developing and testing them empirically. The conceptual framework guiding this design, distinguishing the independent variable, the three control variables and the dependent variable, is presented in Figure 1.

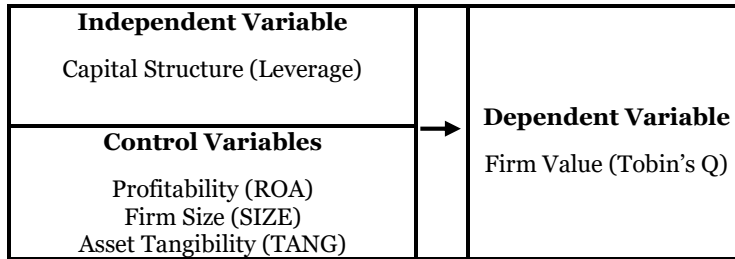


Figure 1: Conceptual Framework of the Study

Source: Authors developed based on literature review

3.2. Population and Sample

All the FBT companies listed on CSE will comprise the population. This was approximately 45 businesses in 2025. The reporting cycles of individual companies were not synchronized, and the publication of the results, as well as the content of those reports, were dependent on the specific characteristics of each company, so purposive (criterion-based) sampling was used to find the best sample. The main criteria for the sample selection is the availability of complete audited financial statements for all five years, and publicly available information required to compute Tobin's Q. Accordingly, data were collected from 25 companies covering the period from 2020 to 2024 which satisfy the data availability criteria for the considered period. This approach is considered as 'judgemental' because the most appropriate method for selecting a sample from a sector, especially when there is no data and disclosure inconsistent.

3.3. Data Sources and Variable Measurement

The secondary sources for data collection were the audited annual reports of the 25 sampled companies, CSE market data, and company investor relations sites (Saunders et al., 2019). Data were collected for the five-year period from 2020 to 2024 to capture the effects of the COVID-19 pandemic and subsequent economic fluctuations in the sector. This yielded a balanced panel of 125 firm-year observations from 25 firms selected on the basis of continuous listing throughout 2020-2024, availability of complete audited financial statements for all five years, and publicly available data required to compute Tobin's Q. Table 1 summarises the measurement of each variable used in the analysis. The data for the 2025/2026 financial year were not included for this study as they were not available for all the FBT companies by the time current study was undertaken.

Firm value (FV) is measured using Tobin's Q, calculated as market capitalisation plus total debt divided by total assets (Chung & Pruitt, 1994; Lang et al., 1996). Capital structure (LEV) is calculated as total liabilities divided by total assets (Rajan & Zingales, 1995). Profitability (ROA) is net income divided by total assets (Frank & Goyal, 2009). Firm size (SIZE) is the natural logarithm of total assets, which stabilises the distribution and reduces heteroscedasticity (Gujarati & Porter, 2009). Asset tangibility (TANG) is calculated as net fixed assets divided by total assets (Titman & Wessels, 1988).

Using the three theories reviewed above, as well as the Modigliani-Miller baseline, the four hypotheses were guided in developing and testing them empirically.

Table 1: Operationalisation of Variables

Type	Variable	Symbol	Measurement	Source / Justification
Dependent	Firm Value	FV	(Market Cap. + Total Debt) / Total Assets	Chung & Pruitt (1994)
Independent	Capital Structure	LEV	Total Liabilities / Total Assets	Rajan & Zingales (1995)
Control	Profitability	ROA	Net Income / Total Assets	Frank & Goyal (2009)
Control	Firm Size	SIZE	Ln (Total Assets)	Rajan & Zingales (1995)
Control	Asset Tangibility	TANG	Net Fixed Assets / Total Assets	Titman & Wessels (1988)

3.4. Model Specification and Hypotheses

The relationship between capital structure and firm value is estimated using the following panel regression model:

$$FV_{it} = \beta_0 + \beta_1 LEV_{it} + \beta_2 ROA_{it} + \beta_3 SIZE_{it} + \beta_4 TANG_{it} + \varepsilon_{it}$$

where FV_{it} is the firm value of firm i in year t ; LEV_{it} , ROA_{it} , $SIZE_{it}$ and $TANG_{it}$ are leverage, profitability, firm size and asset tangibility respectively; β_0 is the intercept; β_1 to β_4 are slope coefficients; and ε_{it} is the error term. Panel regression accounts for unobserved, firm-specific heterogeneity (Gujarati & Porter, 2009). The Hausman (1978) test chooses between the fixed effects model (FEM) and the random effects model (REM) for panel analysis; the REM is preferred when firm-specific effects are not correlated with the regressors (Baltagi, 2005). The four hypotheses developed based on literature review are given below.

H1: Capital structure has a significant impact on the firm value of FBT companies listed on the CSE.

H2: Profitability has a significant impact on the firm value of FBT companies listed on the CSE.

H3: Firm size has a significant impact on the firm value of FBT companies listed on the CSE.

H4: Asset tangibility has a significant impact on the firm value of FBT companies listed on the CSE.

3.5. Data Analysis Procedure

The analysis was performed in several steps using EViews software. The 125 firm-year observations in the balanced panel were first subjected to descriptive and correlation analysis. The Hausman test was then conducted to choose between the FEM and the REM, and the REM was selected as the most appropriate estimator for the dataset.

4. Data Analysis and Findings

4.1. Descriptive Statistics

Table 2 summarises the descriptive statistics for the variables considered in this study. They include firm value, leverage, Return on Assets, firm size and assets tangibility.

The mean firm value ($M = 1.24$) ($SD = 0.47$) as reported in table 2 means that on average the sampled firms were valued more than the replacement cost of their assets (Chung & Pruitt, 1994). Leverage (LEV) was averaged at $M = 0.48$ ($SD = 0.12$) for the sample, ranging from 0.24 to 0.72 across the panel, with an average of almost half of all assets being financed with debt in the average firm's balance sheet for the sample. Profitability (ROA) averaged $M = 0.12$ ($SD =$

0.04), firm size (SIZE) averaged $M = 17.80$ ($SD = 1.89$), and asset tangibility (TANG) averaged $M = 0.33$ ($SD = 0.13$).

Table 2: Descriptive Statistics

Variable	Mean	Median	Std. Dev.	Min	Max
FV (Tobin's Q)	1.2412	1.2796	0.4749	0.2000	2.2128
LEV	0.4806	0.4855	0.1234	0.2402	0.7244
ROA	0.1177	0.1228	0.0435	0.0154	0.1964
SIZE	17.7986	17.9239	1.8889	14.6980	20.5453
TANG	0.3318	0.3314	0.1332	0.0999	0.5821

Note: FV = Tobin's Q; LEV = leverage (total liabilities / total assets); ROA = return on assets; SIZE = natural logarithm of total assets; TANG = asset tangibility (net fixed assets / total assets).

These figures are reported descriptively only; the extent to which they are consistent with any particular capital structure theory, or with the effects of the 2020-2024 macroeconomic shocks, is assessed formally through the regression results in Section 4.3 rather than inferred from the descriptive statistics alone.

4.2. Correlation and Multicollinearity

The correlation among the study variables is summarised in Table 3.

Table 3: Pearson Correlation Matrix

Variable	FV	LEV	ROA	SIZE	TANG
FV	1.0000				
LEV	-0.1831	1.0000			
ROA	0.5840	-0.3595	1.0000		
SIZE	0.5301	0.3289	-0.2462	1.0000	
TANG	0.1958	0.1308	0.1222	0.0058	1.0000

Note: Computed from 125 firm-year observations.

Based on the correlation analysis, the relationship between FV and LEV is negative, and it is expected by the trade-off theory that excess leverage leads to increased required returns, and thus lower Tobin's Q (Rajan & Zingales, 1995). FV is positively correlated with ROA ($r = 0.5840$), SIZE ($r = 0.5301$) and TANG ($r = 0.1958$), supporting H2, H3 and H4. Interestingly, LEV-ROA displays the highest interpredictor correlation ($r = -0.3595$), which is in line with the findings of pecking order theory (Myers & Majluf, 1984). Variance inflation factors: 1.053 to 1.280, mean 1.173, which are reason not to be concerned with multicollinearity issues.

4.3 Panel Regression Results

The Hausman test was conducted to choose between the FEM and the REM, producing a chi-square statistic of 2.9362 (d.f. = 3, $p = 0.4016$), which does not reject the null that the REM is the more efficient and appropriate estimator for this dataset (Hausman, 1978; Baltagi, 2005). Accordingly, the Panel Estimated Generalized Least Squares (EGLS) random effects estimator, using the Swamy-Arora component variance estimator, was applied. Table 4 presents the results.

The model explains 73.66% of the variation in firm value (weighted $R^2 = 0.7366$; adjusted $R^2 = 0.7278$), with a significant F-statistic (83.8958, $p = 0.0000$), Durbin-Watson = 2.0604, and a White (1980) test ($p = 0.2234$, no heteroscedasticity). Capital structure (LEV) has a significant

negative coefficient ($\beta = -0.7852$, $p = 0.0004$), supporting H1: both distress costs and creditor conflict, as predicted by trade-off theory and agency theory, appear more prevalent than the tax shield beyond an optimal threshold (Kraus & Litzenberger, 1973; Jensen & Meckling, 1976). Profitability (ROA) has a large positive coefficient ($\beta = 7.2035$, $p = 0.0000$), strongly supporting H2 (Frank & Goyal, 2009). Firm size (SIZE) has a significant positive coefficient ($\beta = 0.1943$, $p = 0.0000$), supporting H3 (Rajan & Zingales, 1995; Sharif et al., 2015). The coefficient of asset tangibility (TANG) is not statistically significant as per the test conducted ($\beta = 0.3583$ and $p = 0.1147$) and therefore the direction of the coefficient is not of any significance, thus H4 is not supported (Titman & Wessels, 1988).

**Table 4: Panel EGLS Random Effects Regression Results
(Dependent Variable: FV)**

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Decision
C (Intercept)	-2.8071	0.3268	-8.5890	0.0000	–
LEV	-0.7852	0.2150	-3.6523	0.0004	H1 Supported
ROA	7.2035	0.5044	14.2806	0.0000	H2 Supported
SIZE	0.1943	0.0174	11.1703	0.0000	H3 Supported
TANG	0.3583	0.2255	1.5890	0.1147	H4 Not Supported

Note: R^2 (weighted) = 0.7366; Adjusted R^2 = 0.7278; F-statistic = 83.8958 ($p = 0.0000$); Durbin-Watson = 2.0604; $n = 125$. Decision indicates the outcome of the corresponding hypothesis test (H1–H4) at the 5% significance level.

4.4 Hypothesis Testing Summary

Table 5: Hypothesis Testing Summary

Hypothesis	Statement	p-value	Decision
H1	Capital structure has a significant impact on firm value.	0.0004	Supported
H2	Profitability has a significant impact on firm value.	0.0000	Supported
H3	Firm size has a significant impact on firm value.	0.0000	Supported
H4	Asset tangibility has a significant impact on firm value.	0.1147	Not Supported

As shown in the Decision column of Table 4 and summarised in Table 5, three of the four hypotheses H1, H2 and H3 are supported at the 5 per cent significance level (and, in fact, at the more stringent 1 per cent level as well, since all three p-values are below 0.001); only H4 (asset tangibility) is not supported.

5. Discussion and Conclusion

5.1 Discussion of Findings

The negative relationship between capital structure and firm value (H1 supported) is the most theoretically relevant result. It is also the most commonly reported finding in the capital structure literature, and this study's result supports it. The result is consistent with trade-off theory: at the leverage levels observed among CSE-listed FBT firms during 2020–2024, distress costs outweigh the interest tax shield (Kraus & Litzenberger, 1973). It is also consistent with agency theory, since shareholder-creditor conflicts are likely to be more acute in highly leveraged firms (Jensen & Meckling, 1976). These patterns align with evidence from other countries (Rajan & Zingales, 1995) and with prior Sri Lankan findings (Mithushana & Kevin,

2019). The economic size of the impact is also significant. A one standard-deviation increase in leverage (0.12) is associated with a negative, non-trivial change in Tobin's Q of 1.24. This effect was plausibly amplified by macroeconomic conditions over 2020-2024, including the economic downturn and the sharp rise in domestic interest rates in 2022, which would have raised both the likelihood and the cost of financial distress for highly leveraged firms (Central Bank of Sri Lanka, 2024). These conditions would have brought creditor-shareholder conflict and distress costs to the forefront of the leverage-value relationship.

The positive effect of profitability (H2 supported) is consistent with the literature showing that more profitable firms rely more on retained earnings than their less profitable counterparts, face lower financial risk, and benefit from a greater valuation premium (Frank & Goyal, 2009; Myers & Majluf, 1984; Dissanayake & Wanigasekara, 2021).

The positive effect of firm size (H3 supported) is consistent with the view that larger firms in the FBT industry benefit from lower information asymmetry, stronger bargaining power, stronger brand equity, and better access to capital markets (Rajan & Zingales, 1995; Sharif et al., 2015).

The insignificant result for asset tangibility (H4 not supported) reflects the theoretical ambiguity surrounding this variable: while higher tangibility can reduce the cost of secured debt (Titman & Wessels, 1988), it may also signal a capital-intensive, lower-growth business model that investors discount (Lang et al., 1996). This may arise from the relatively homogeneous tangibility levels among FBT manufacturers, with investors instead focusing on profitability and leverage during periods of economic stress.

5.2 Implications

Theoretically, the findings suggest that trade-off and agency mechanisms complement one another in explaining capital structure behaviour during periods of macroeconomic stress, while the profitability effect aligns with pecking order and signalling perspectives (Myers & Majluf, 1984; Booth et al., 2001). Practically, managers should pursue conservative leverage policies and prioritise profitability as the most effective lever for enhancing firm value; investors should treat leverage as a key risk-screening criterion; and policymakers should consider how interest rate volatility affects equity valuations through the capital structure channel during periods of economic distress (Central Bank of Sri Lanka, 2024). Specifically, managers of FBT firms should establish a low tolerance threshold for leverage, and manage the accumulation of debt in conjunction with internally generated money, or “retained profits” (RPs), before seeking additional financing, and in particular, issuing more debt during high domestic interest-rate periods. Leverage and profitability can be used in tandem as indicators to evaluate and screen FBT companies, with the most leveraged, low-profitability stock companies considered high risk investments. Ultimately, policymakers and regulators should continue to track the impact of interest-rate policy and exchange-rate volatility on capital-intensive sectors, specifically on listed companies' market valuation, as this channel has been found to materially impact market valuations in times of macroeconomic stress.

5.3 Limitations and Future Research

This study has a few limitations. First, the results are developed based on the FBT sector for 2020-2024 and may not be generalised to other sectors or time periods. Second, the total liabilities/total assets ratio fails to differentiate between short- and long-term debt (Rajan & Zingales, 1995). Third, macroeconomic variables such as interest rates and inflation were not modelled directly. Fourth, the linear specification does not reflect non-linear, threshold effects predicted by trade-off theory (Kraus & Litzenberger, 1973). Fifth, it appears that endogeneity

problem could be handled better by implementing dynamic panel estimators such as System GMM (Wooldridge, 2010). These factors could be addressed in future research by expanding the analysis to other sectors of the CSE or over a longer time horizon, testing for generalisability of the results. Moreover, future research can consider more recent data covering for the period 2025-2026, when complete audited data will be available. In addition, future research could extend the benchmark specification in several ways. It could decompose leverage into short-term and long-term debt components. It could also add macroeconomic variables, such as interest rates and inflation, directly into the model. Testing non-linear or threshold specifications consistent with trade-off theory is another promising direction. Finally, future research could explicitly address the potential endogeneity between leverage and firm value through dynamic System GMM estimation.

5.4 Conclusion

This study examined the relationship between capital structure and the firm value of 25 listed FBT companies over the five years from 2020 to 2024, using the random effects regression (Panel EGLS) estimator on a balanced panel of 125 firm-year observations. The findings revealed that capital structure has a significant negative effect on firm value, while profitability and firm size have significant positive effects; asset tangibility was statistically insignificant. The model accounted for about 73.7 per cent of the variation in firm value; diagnostics confirmed the absence of heteroscedasticity, autocorrelation, and problematic multicollinearity.

The results of this study are consistent with the findings of other studies conducted on similar businesses and support the notion that in the highly volatile period from 2020 to 2024, capital structure, profitability and size are important factors impacting FBT firm value, while tangibility of the assets remains slightly constant. The study provides sector- and context-specific evidence for firm value and the capital structure relationship in Sri Lanka, and provides some findings that would be relevant in practice to any of the three groups of manager, investors and policy makers.

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