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The Determinants of Capital Structure Decisions: New Evidence from Turkish Companies

Ayşegül GÜNER[a*]

[a]*Ayşegül GÜNER, Istanbul, 34980, Turkey*

Abstract

This study conducts a comparative test of trade-off theory and pecking order theory using 131 publicly traded Turkish companies' firm-level data between 2008 and 2014. The study also tries to exploit the differences between the capital structure decisions for various degrees of free float rate and foreign paid in capital, and for those that have various market values. According to the empirical results, although pecking order theory seems to better describe the capital structure of the firms, some of the determinants are suitable for trade-off theory. The results of the study also reveal that companies that have a free float rate between %50 and %75 have lower degrees of leverage and the degree of leverage varies for different market values of companies.

Keywords: Economic growth; development index; development indicator; harmonic index

1. Introduction

Modern capital structure theory begins with the irrelevance theory of Modigliani and Miller (1958). Their pioneering work showed that in a perfect market- without taxes, information asymmetry, and transaction and bankruptcy costs, the degree of leverage is not associated with the firm value. Later, Kraus and Litzenberg (1973), took the effects of costs in their research, and pointed out a tradeoff between leverage and agency and bankruptcy costs with tax benefits. As an alternative to the trade-off theory, Myers and Majluf (1984), comes with the pecking order theory suggesting that, due to adverse selection, firms follows a financial hierarchy from internal to external financing and from debt to equity. Although each of these theories can explain only some aspects of capital structure formation, neither of them can extensively describe full aspects of capital structure.

[*] Corresponding author. Tel.:+90-216-528-7106
E-mail address: aysegul.guner@isikun.edu.tr

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Since mid-1980s, there has been an extensive work that compares two major capital structure theories that are trade-off and pecking order with various data sets. Studies both from developed and developing world provide mixed results that some are supporting trade-off and some are supporting pecking order theories.

This paper contributes to the literature by testing two major theories with a relatively bigger listed firm data compared to many research with Turkish data and by investigating the degree of leverage for various degrees of free float rate, foreign paid in capital and for different market values of the firms. Panel data regression analyses is conducted to test the applicability of trade-off and pecking order theory using a number of firm-specific capital structure determinants as dependent variables and financial leverage representing capital structure as a dependent variable. Furthermore, degrees of leverage for different levels of free float rate, foreign paid in capital and for different market values of the firms are graphed to exploit the differences in capital structure decisions.

This paper follows with literature review, information about data and the methodology used. After revealing the empirical evidence, in last part, the study pinpoints the results and concludes.

2. Literature Review

After Modigliani and Miller (1958) pointed out the existence of an optimum capital structure and stated the irrelevance of leverage and firm value, Kraus and Litzenberg (1973) laid the foundations of trade-off theory pointing out the trade-off between leverage and costs. As pecking order theory has been explained by Myers and Majluf (1984), modern capital structure theories have started to being tested for various data sets for various time settings.

There is a vast amount of empirical studies that exploits the capital structure determinants mainly in USA for both listed and non-listed companies since early 1980s. Titman and Wessel (1998) showed a negative relationship between firm size and short term debts and a positive relationship between total debt and non debt tax shields, earnings volatility, tangibility, and growth opportunities. Harris and Raviv (1991) pointed out a negative relationship between debt/equity and profitability, growth opportunities and investment expenditures. In the work of Rajan and Zingales (1995), there appeared a negative relationship between the degree of leverage and profitability and a positive relationship between the degree of leverage and size with the tangibility. According to the results of the study, there does not exist a significant difference between the capital structure determinants among G-7 nations. Frank and Goyal (2009) found a positive relationship between financial leverage and tangibility, firm size, and negative relationship between financial leverage and growth opportunities with profitability. Empirical results of the study points that trade off theory better describes the capital structure.

Research in the determinants of capital structure and capital structures theories applicability has been a popular area also in Turkey since 1980s. The Turkish literature is mainly based on listed companies on Borsa Istanbul for various firms for various time periods. Empirical evidence in Turkish studies reveal that capital structure decisions of Turkish firms are mostly in accordance with pecking order (Durukan, 1997; Acaravcı and Doğukanlı, 2004; Sayılgan et.al., 2006; Demirhan, 2009; Ata and Ağ, 2010; Gülşen and Ülkütaş, 2012; Sarıoğlu et.al., 2013). On the other hand, while some empirical evidence shows that only trade-off theory is applicable (Sayılgan ve Uysal, 2011), some empirical evidence shows that both trade-off and pecking order theories are applicable (Korkmaz et.al., 2007; Yıldız et.al., 2009; Okuyan and Taşçı, 2010; Köksal and Orman, 2015).

This paper investigates the applicability of capital structure theories with a new data set of Turkish companies, and tries to reveal the differences in capital structure for different levels of free float rate, foreign paid in capital and for different market values of the firms.