

An Empirical Study on the relationship between financial leverage (FL) and Company growth and financial strength in the Listed Companies Traded in Colombo Stocks Exchange

by
W. P. Wijewardana

Abstract

This paper investigates relationship between Financial Leverage (FL) on Company Growth (CG) and Financial Strength (FS) in the listed companies traded in Colombo Stocks Exchange (CSE). Many scholars (Gupta, 1968; Jensen and Meckling, 1976; Ross, 1977; Scott, 1977; Warner, 1977; Bredly, Jarrell and et al 1984; Senbent and Traggart 1984; Myers and Majluf, 1984; Titman, 1984; Titman, and Wessels, 1988; Rajan and Zingales, 1995) have argued that the FL is one of the most influencing factors in determining the CG. The common approach in empirical Capital Structure (CS) studies has been to examine the relationship between observed FL and value of the firm and share prices. The problem of this study is to investigate whether the FL influences negatively or positively on signaling the firms' growth. Sample size of this study is 30% of thirteen sectors which represent sixty-three quoted companies randomly selected from the CSE, and a period of ten years from 1990 to 2000. The required data and information for the study were gathered from published annual reports, Handbook of listed companies in CSE from 1994, 1997 and 2001 and Central Bank annual report of 2000. The growth of the companies is represented by total assets, profit, and sales, which were calculated using the growth index. Altman (1968) multiple discriminant function was constructed to ascertain FS of the sample companies. The relationship between independent variable FL of the sample companies, sectors and dependent variables growth and FS of the sample companies and sectors were tested by regression analysis.

The overall results of the study indicate that the FL had a positive relationship between growth and FS. Conversely, this situation supports this view that there is a positive rather than a negative relationship between FL and other growth variables as implied by the negative signals about the future growth of the company. This results that the researchers and interested parties of this research area are able to obtain information.

Key Words: Financial Leverage; Financial Strength; Company Growth; Capital Structure, Financial Distress.

1. Introduction

The capital is an important resource in the firm's financial decision making process along with the other resources. The capital can be basically classified as ownership or non-ownership capital in corporate financial aspect. These two usually represent equity capital and debt capital. The combinations of equity and debt capital are known as CS or FL. It is dynamic position and varies under different conditions like, cost of capital, capital market, manager's perception, organizational strategies, firm size, growth etc. In this context, CS is one of the attractive fields in finance and financial management.

The historical attempt for building theory of CS began with the presentation of a paper by Modigliani and Miller (MM)(1958). They revealed the situations under what conditions that the CS is relevant or irrelevant to the value of the firm and cost of capital. Most of the decision-making processes related to the CS are deciding factors when determining the CS, a number of issues e.g. cost, various taxes and rate, interest rate have been proposed to explain the variation in FL across firms (Van Horne, 1993; Hampton, 1998; Titman and Wessels, 1998). These issues suggested that the depending on attributes that caused the cost of various sources of capital the firm's select CS and benefits related to debt and equity financing. Various costs of capital and their benefits directly affect the ultimate goal of the firm.

An ultimate goal of a firm is the maximization of wealth or value of that firm (MM, 1958, 1963; Miller, 1977). The relationship between CS and maximization of wealth has been the subject of remarkable milestone over the past decade throughout the irrelevance theory. In the seminal article, presented by MM's (1958) irrelevance theory, they argued that the FL is unrelated to firm's value. In the presence of corporate income tax and the cost of capital in MM's (1963) they argued that the market value of a firm is positively related to the amount of long term debt used in its capital structure. Miller (1977) added personal tax to the analysis and revealed that the firm's value and FL is positively related. Senbet and Taggart (1984) have generalized Miller's argument.

The modern industrial firm must conduct its business in a highly complex and competitive business environment. Therefore, these types of theoretical and empirical research findings have benefited in selecting the capital structure to achieve the optimum level of firm's wealth. The implications of capital structure changes are signals for the various parties of a firm.

Financing decision is one of the important basic function more than the other functions of corporate financing decision making which helps financial manager to decide when, where and how to acquire funds to meet the firm's investment needs. The choice of debt and equity capital of a firm is to consider the long-term funds from three sources. Donaldson (1963) reported the three sources influencing the long-term funds; such as retained earnings, long term debts, and issue of new equity. In addition, Titman and Wessels (1988) presented various determinants of capital structure choice or levels of FL. These determinants are denoted as collateral value of assets, non-debt tax shields, growth, uniqueness, industry classification, size, earnings volatility and profitability. The determinants, its relation to the FL and their observable implications are different.

Among these determinants growth is a controversial factor when determining firm's CS (Titman and Wessels, 1988). Growth defines as the annual percentage

change in total assets; sales and operating profit (Hampton, 1998). According to Kim and Sorensen (1986), Titman and Wessels (1988), and Mehren (1992) revealed that a firm's growth opportunities are an indication for the agency cost of debt. They proposed that the tendencies to invest sub-optimally to expropriate wealth from firm's debt holders is likely to be higher for firms in growth may also be an indicator of profitability and success of the firm. If this is the case, growth will be the proxy for available internal funds. When a firm performs well and earns profits, there should be sufficient internal funds available for their investment.

Both private sector and the public sector investment are the primary contributions for the economic growth in the most of the countries under the open market economy. One of the major entities is quoted company of the economy, which represents individual economic entity in the country where as they practice open economic policy. Quoted company investments growth is playing the important roll in the overall economic development process.

The objective of this paper is to identify the relationship between FL position and growth rate of the quoted companies traded on the CSE. The Main problem of this paper is to study how the FL negatively or positively influences on signaling the firms' growth and FS.

The rest of the study is organized as follows. Section 2 reviews theory regarding the FL, CG and, FS. Section 3 describes the data and methodology used in the study and. Section 4 provides the empirical results. Finally, summary and concluding remarks are given in Section 5.

2. The Concept of CS Literature

CS is the composition of debt and equity capital that is required for a firm to finance its assets. The choice of amount of debt and equity capital is determined after comparison of internal and external factor related to the each firm operations environment and certain characteristic of source of fund that can affect the firm. When analyzing the operating performance of a firm, one has to be careful about understanding the behavior of the CS. The behavior of the CS of the firm influences by many factors which can strive for income variability, tangibility, expected growth, size, profitability, non debt tax shields, uniqueness, and industry classification (Titman and Wessels, 1988; Banerjee et al.2000). Capital structure can exist with many factors ranging from retain earnings, long-term debt, and equity capital (Donaldson, 1963).

Determinants of CS

According to Titman and Wessels 1988; Banerjee et al. 2000) determinants of CS are the followings; asset structure, non-debt tax shields growth, uniqueness, industry classification, size, earnings volatility, and profitability. The relevance of these factors is situational.

Capital Structure Theories

CS theory is mainly concerned what happens to the value of the firm and firms' cost of capital when the ratio of debt to equity or level of leverage is changed. According to one of the earliest formal study was conducted by Durand (1959) area of corporate finance identified three approaches such as the Net Income (NI), the Net Operating

Income (NOI), and Traditional Approach. Diacogiannis (1994) reported three concepts relating to the CS such as firm's capital structure, cost of capital, and firm market value. These approaches are mainly divided into two groups based on the excluding of tax and including of corporate or personal tax. In the absence of taxes, there are four approaches; NI; NOI, Modigliani and Miller (MM), and traditional approach. Assert of the NI approach is that the total market value and the Weighted Average Cost of Capital (WACC) of a firm depend on its CS (Diacogiannis, 1994). According to the NOI approach, the total market value and WACC of a firm are independent from its capital structure. The MM (1958) findings are same as the NI. Furthermore they reveal that its real assets determine the firm's value, not by securities it issues. The traditional view suggests that the value of the firm can be increased or cost of capital can be reduced to a certain level of debt and equity capital (Pandey, 1994; Diacogiannis, 1994). Under this approach the firm reaches an optimum CS at the same time the firm does not use its highest possible level of debt capital. The traditional approach is similar to the NI approach. In the presence of taxes, Diacogiannis (1994) reported two approaches, which are MM with both corporate and personal taxes and, Miller corporate taxes and equal debt and equity tax rates.

MM hypothesis under corporate tax, that the value of the firm with debt or levered firm is higher than the value of the firm with equity or unlevered firm. Conversely, WACC of the firm decreases as the firm increases the level of debt or FL in its CS (MM, 1966). These results make the debt financing advantage. MM hypothesis with corporate and personal tax, that the total market value of the firm is positively/negatively related to the amount of long-term debt used (Diacogiannis, 1994). Miller (1977) argued that as long as the value of the firm increased with FL, firm will prefer more debt in their CS. The remarkable essence of the model is that there is no optimum CS for individual firm, but taking the economy as a whole, it identifies equilibrium level of aggregate debt. MM (1958) pointed the direction that such theories must take by revealing under what condition CS is irrelevant. Harris and Raviv (1991) have collected through a survey based on the forces that determine CS. They have identified four types of determinants of CS such as.

Model Based on Agency Cost; Conflict between interest parties with claims to firm's resources, including stockholders and stakeholders is the Model based on Agency. This conflict has reviewed as the agency approach.

Asymmetric Information; It conveys private information to the capital market or interested parties. This situation has reviewed as the asymmetric information approach.

Model Based On Product/Input Market Interactions; It investigates the influence the nature of products or competition in the product/input market.

Theories Driven by Corporate Control Considerations; It reveals that the affect the outcome of corporate control contests.

Defining FL

Many terms are used as FL such as interest charge leverage, financial gearing, and degree of financial risk, fixed debt financing. There is however no protocol on the meaning of these terms. Therefore it is essential to make the concept more precise and specific. This attempt is to derive a formal and specific definition for FL in this article.

The Encyclopedic dictionary of Financial Management (1996) defines FL as financial leverage is often synonymously used with the fixed charge in the literature on corporate finance. Hampton (1994) defines the FL as interest charges leverage (some time called) exists whenever a firm has debt that requires the payments of interest. Pandey (1994) defines FL as "the use of fixed charges source of funds, such as debt (and preference capital) along with equity in the capital structure is described as FL or trading on equity. Taking into consideration the all above definitions it can be concluded that the FL comprises of degree of fixed charge capital on the CS.

Measures and Arguments for FL

There are various measures of FL, but most relevant measures depend on the objective of the analysis (Rajan and Zingales, 1995). The broadest definition of measures of FL is the ratio of total liabilities to total assets. This measure can be indicated as a proxy for what is left for shareholders in case of liquidation. Total liabilities consist of current liabilities and long term liabilities that are inclusive of long term and short-term liabilities. Total assets include current assets and fixed assets.

Another more appropriate measure of FL is calculated by ratio of debt to total assets, debt that includes short term and long-term debts. It is usually expressed as Debt divided into total assets; total debt divided into net assets here net assets equal to capital employed; earning before interest and tax (EBIT) divided into interest charge.

According to Bowman (1980), the FL can be measured in three ways such as Book value equity is equal to book value debt divided in the book value equity; Book value debt to market value equity is equal to book value debt divided in the market value equity; Market value debt to market value equity is equal to market value debt divided into market value equity. Book value equity was defined as common stockholders' equity. Book value of debt is defined as total asset minus common stockholders' equity. Market value of debt is a reasonable approximation for their market value. Market value of equity is equal to number of equity multiplied by market value per share.

Meaning and Measurers of Firm's Growth

Gupta (1968), Pandey (1993), Diacogiannis (1994), and Hampton (1998) showed that the financial manager as believes the growth of the firm an increasing of size and activities of a firm in the long run. Conversely, growth implies that the expansion of a firm activities in terms of sales, profits and assets. There are two types of firm growth have been identified in the field of financial management; internal growth and, external growth. The growth and development of the firm internally and externally is directly influenced by the financial policies adapted by the management. Hence, the growth of the firm actions determine solvency of the firm.

According to Hampton (1998) three measures are being used to measure the corporate growth; increases in sales, increases in profits and increases in assets. The assumption that sales, profits and assets remain constant is unrealistic. Sales and profit of most firms grow over time at least, because of their survival. These situations help to increase the shareholder's equity at the same time firms' objective is fulfilled. Conversely profit is the most important measure of the firm's performance. In the open market economy, profit is a signal for allocating resource efficiently. According to

Pandey (1993) Earning per Share (EPS) is a most important indicator for investors. Variability of EPS and other most important indicators depend on the growth and stability of sales. Further, the magnitude of EPS and other most indicator variability with sales will depend on the degree of firm growth. It is, therefore necessary to invest in fixed assets in order to sustain growing production and sales. This will in turn increase assets to support enlarged scale of operations. In this context financial management, following parameters generally assists corporate growth.

- **Increase in sales**

According to Hampton (1998) increase in sales is a widely accepted measure. There are optimizing competitive market positions, increasing size or market share and large volume of sales with maintaining stability. Conversely, firm operating activities are reflected by rapid growth in sales.

- **Increase in profits**

Expectation of shareholders of a firm is the profit increasing. Financial community and the shareholders are often interested in increasing of profit. Profit growth shows that the firm's ability to convert growth in terms of sales and operations into accelerate returns to shareholders. This indicator is normally measured in term of EPS.

- **Increase in assets**

Rapid increase in firms' operating resources is another appropriate proxy for growth. This measure is the least desirable method of measuring growth. Although if firms accelerate its assets to increase the capacity of production and sales, firm's assets increases without increase in sales or EPS is an indication of inefficiencies rather than growth.

- **Increase in EPS**

EPS is an interesting index for investors' steady increase over year is encouragement. As a result of these the price of the share of a firm may also increase. The increasing signals of share price results in an increase in the value of a firm that is a fundamental indicator of the growth of the firm.

- **Increase in the market value of share**

Ultimate objective of the managers is to maximize the shareholders' wealth under the optimal conditions. It can be acquired either by increasing return without changing the existing business risk or reducing the existing return. If a firm earns maximum returns at a minimum risk it may experience favorable share price in the stock market.

- **Price Earning Ratio (PER)**

PER is the most important measure used by the investors in the market place. Conversely PER is an interesting figure for already investors into the business. If any firm is able to maintain higher rate of growth in comparison to the other firm in the industry eventually the particular firm could achieve higher PER among the rivals.

Internal and External Growth

Hampton (1993) explained that the means of internal growth is the firm's ability to increase sales and expand its own operations. Firm may purchase new plant or machinery to expand its capacity to produce existing products or firm purchases plant or machinery and train its sales force to produce and sell a new product. In addition, for

expansion of existing production, the firm seeks a larger volume of sales with the existing product, captures the new market and emphasizes product diversification.

The internal fund derived from retained earnings, depreciation, tax shield, and from other non-cash transactions. The outside funds generate by debt and equity or both. However, the firms, which generate internal funds, are at the advantage for its internal growth than firms depending on external funds. The firm depends on internal fund has the greater ability to compete with the other firm in the market.

The external growth means that it has potentiality to acquire operations of another firm. According to Hampton (1993) the term acquisition is generally used to refer to the taking over assets in the process of external growth. Takes over process seem to be the purchases of the assets or stock combined with another firm or firms. According to Hampton (1993), number of advantages is occurred when the firm is acquired external growth such as rapid expansion; immediate cash inflows; reduction of risk; economics. Number of reason for firm seeking growth most important reasons are diversification, stability, operating economics and, profit from turnaround situation.

Financial Strength (FS)

It has been proved that the growth is no longer in the firm due to the relative financial unhealthiness of a firm. The performance of a business enterprise is based on the number of factors, one of the main factors is firm FS and it directly affects the firms' growth ability. The assessment of firm's FS is very useful to the interested parties who are seeking firms' growth. The detection of firm strength and financial difficulties is a subject that has been particularly susceptible to financial ratio analysis. A firm with inadequate profitability and or solvency record may be regarded as a potential financial difficulty. However, inadequate liquidation position may not be considered serious. According to the Altman (1968) there are differences between bankrupt firm's strength and healthy firm's FS.

There are two types of FS, which the firm should achieve in the short term and long term. According to Pandey (1993) the short-term FS has a great effect on a firm's profitability, liquidity and its structural health. This can be reached by managing firm's current assets and current liabilities or managing a firm's working capital. Hampton (1993) has explained that the firms' working capital comprises permanent working capital and variable working capital. According to Hampton (1994), and Pandey (1993) if a firm acquired short-term strength it may achieve three goals such as adequate liquidity; minimization of risk and, contribution to Maximizing the Firm's value.

Short Term FS and the Growth of the Firm

It seems a large amount of working capital will be required for growing firms than the less growing firms. However, it is difficult to determine relationship between growth in the volume of business and increase in its amount of working capital but the composition of working capital and terms of the short-term funds also defer from economic circumstance and corporate culture. In addition, the need for increased working capital funds does not follow the growth in business activities but precedes it. Whatever the level of interest rates, the firm must maintain adequate level of working capital to efficiently conduct its business. Inadequate working capital produces a high

risk of liquidity problems. By maintaining the firm will enable to achieve highest return without unnecessary risk.

Long Term FS

According to Pandey (1993) the firm's long term solvency and survival concerns suppliers of long term debts. Expectation of the debt holders is firm's profitability over period of time and its ability to pay interest with a loan principle. The implication of financial position of the firm is seen financial gearing or CS ratios. These ratios indicate that the proportions of funds provided by owners and debt holders. As a general rule, there should be an appropriate mix of equity of debt in financing the firm's assets.

Debt Financing and Financial Distress

According to Pandey (1993), financial distress occurs when the firm finds it difficult to honor the obligations of creditors. The extreme point of financial distress is solvency. The cost of financial distress is important to the firm when it is formed its CS. Cost of financial distress include the legal and administration cost of bankruptcy (Myers, 1984). In contrast, raising of debt capital through equity is of much beneficial for these reasons; (i) the additional payments on the additional cash flow does not affect the debt financing, (ii) interest tax shield increases with debt borrowings. Hence, the use of debt in CS has both benefits as well as cost. Since debt tax is proportionate to amount of debt to enjoy the tax benefit the firm has increased in debt capital leads to financial distress of a firm, end result of this process is bankruptcy. If a firm has already employed higher percentage of debt in CS more important consideration is the inflexibility of raising funds when needed.

3. Methodology

The sample consists of 62 companies quoted in the CSE out of 13 sectors from the period of 1990 to 2000. Sample size is 30% of each sector. For the selection of 62 companies out of 235 traded and simple random sampling methods was used. If selected company was not cover the study period immediate company of the sector have been selected. To analyze whether the impact of FL on CG and FS of the firm's the table 1 shows the entire definition of variables.

Table 1 - Definition of Variable

Variables	Name	Sign	Calculating method
Dependent	Financial Leverage	LD/TA	Long term Debt/Total Assets
	Financial Leverage	LD/FA	Long term Debt/Fixed Assets
	Financial Leverage	TD/EC	Long term debt +loan + Borrowings repayable with in one year /Share Capital
	Financial Leverage	TD/TA	Long term debt +loan + Borrowings repayable with in one year/Total Assets
	Liquidity	LD	Current assets – Current Liability/Total assts
	Return on Total assets	ROT	Retained profit + Total assets
	Earning before interest and tax to total assets	EBIT/TA	Earning before interest and tax/Total assts
	Market value Equity to Book value of Total assts	MVE/ BVTa	Market value of the Equity/ Total assets
	Sales to total assets	SA/TA	Sales/ Total assets
	Growth Index	GI(ta,p,s)	(Selected year value _(total asset, profit, sales) – Based year value _(total asset, profit, sales)) / Based year value _(total asset, profit, sales)
	Financial Strength	Z- Score	$Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5$
Predictors	Working capital to total asset	X_1	Working capital /Total asset
	Retained earning to total asset	X_2	Retained earning/Total asset
	EBIT to total assets	X_3	EBIT / total assets
	Market value Equity capital to book value total asset	X_4	Market value Equity capital /book value total asset
	Sales to Total assets	X_5	Sales /Total assets

Above all, we educe the basic econometric model as bellow:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4$$

Where,

Y = Financial Leverage

β_1 to β_4 = Coefficient of Growth and FS

X_1 = Assets Growth(AG)

X_2 = Profit Growth(PG)

X_3 = Sales Growth(SG)

X_4 = Financial Strength(Z Score)(FS)

F- statistics was performed to test the significance of the β parameters in the above model at the 5% level of significance, multiple R and R square (R^2) indicate the correlation coefficient and goodness for fit the model of a firm separately.

Growth index

Growth variables of the study were calculated taking some items as trends from a base year 1989 the higher the index, the greater the growth. The growth index of the total assets, profit, and sales were calculated using the following.

$$\text{GROWTH INDEX} = \frac{\text{SELECTED YEAR} - \text{BASED YEAR (1989)}}{\text{BASED YEAR (1989)}}$$

Z- SCORE

Company's FS or weakness performs a growth ability of that company; Altman (1968) presented multiple discriminat function. It is constructed to ascertain FS of sample companies and it is namely Z Score. Using multiple discriminant function and Z-Score technique was developed by the Altman (1968). It is very useful to study the bankruptcy or FS.

The initial model for this was developed composing a sample of 66 firms. The author has used following ratios to develop his Z Score function.

- (I) Net working capital to total assets.
- (II) Retain earnings to total assets.
- (III) EBIT to total assets.
- (IV) Market value equity to book value debt.
- (V) Sales to total assets.

This analysis of the companies FS of sample companies is based on Altman (1968) multiple functions. It is as follows.

$$Z = 0.012X_1 + 0.014X_2 + 0.033X_3 + 0.006X_4 + 0.999X_5$$

Where, Z = Overall index

X_1 = Working capital/Total assets

X_2 = Retained earnings/Total assets

X_3 = Earnings before interest and tax/Total assets

X_4 = Market value equity Capital/Book value of total debts

X_5 = Sales/Total assets

The analyzed results are showed on table 2 to 9.

Table 2 - Model summary (1)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.4400(a)	0.1935	-0.3442	0.04136

a Predictors: AG,PG,SG,FS

b Dependent Variable: LD/TA

Table 3 - Model Coefficients (1)

Variables	Parameter Estimate	Std Error	T for Ho	Prob>T
Constant	0.1230	0.1630		
AG	-0.0040	0.0271	-0.1510	0.8850
PG	0.0252	0.0283	0.8900	0.4075
SG	-0.0120	0.0290	-0.4100	0.7060
FS	0.0135	0.0412	0.3220	0.7600

Dependent Variable: LD/TA

Table 4 - Model summary (2)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
2	0.7410(a)	0.5490	0.2483	0.0265

a Predictors: AG,PG,SG,FS

b Dependent Variable: LD/FA

Table 5 - Model Coefficients (2)

Variables	Parameter Estimate	Std Error	T for Ho	Prob>T
Constant	0.3660	0.1042	3.5110	0.0127
AG	0.0045	0.0173	0.2620	0.8017
PG	0.0030	0.0181	0.1610	0.8770
SG	-0.0157	0.0186	-0.849	0.4283
FS	-0.0105	0.0268	-0.3940	0.7074

Dependent Variable: LD/FA

Table 6 - Model summary (3)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
3	0.8110(a)	0.6571	0.4285	0.1690

a Predictors: AG,PG,SG,FS

b Dependent Variable: TD/EC

Table 7 - Model Coefficients (3)

Variables	Parameter Estimate	Std Error	T for Ho	Prob>T
Constant	2.0947	0.6650		
AG	0.1880	0.1106	1.6980	0.1404
PG	-0.2472	0.1156	-2.1380	0.0763
SG	-0.0650	0.1186	-0.5450	0.6051
FS	0.3580	0.1713	2.0890	0.0817

Dependent Variable: TD/EC

Table 8 - Model summary (4)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
4	0.9825(a)	0.9655	0.9424	0.0101

a Predictors: AG,PG,SG,FS

b Dependent Variable: LD/TA

Table 9 Model Coefficients (4)

Variables	Parameter Estimate	Std Error	T for Ho	Prob>T
Constant	0.6566	0.0398		
AG	-0.0013	0.0066	-0.1970	0.8504
PG	0.0199	0.0069	2.8750	0.0283
SG	-0.0266	0.0071	-3.7540	0.0095
FS	-0.0327	0.0102	-3.1900	0.0188

Dependent Variable: TD/TA

4. Results and Discussion

Based on the regression result indicated in the table 2 to 9, it can prove that; first, we see table 2, 4, and 6, the adjusted R square -0.3442, 0.2483, and 0.4285 respectively. It shows that the interpreting power of the regression model is not very good and prediction that LD/TA, LD/FA and TD/EC are not a significant determination of the company growth of the listed companies. We see table 8, the adjusted R square 0.9424 It shows that the interpreting power of the regression model is very good and prediction that TD/TA is significant determination of the company growth of the listed companies.

Second, according to the table 3, 5, and 7 all growth indicators and FS that are seen remarkably in the proportion of the growth indicators and FS and LD/TA,LD/FA and

TA/EC relevant relations; Meanwhile, the relevant relations are not remarkable between the growth indicators and FS and LD/TA financial leverage ratio.

Third, Table 9 presents the results from coefficients of the growth variables and FS to TD/TA. Profit growth, Sales growth and financial strength and TD/TA financial leverage ratio have remarkable correlations. However, sales growth and financial strength are negatively related with TD/TA financial leverage ratio.

Finally, profit growth has remarkable positive correlation with the TD/TA financial leverage ratio.

Above results proves the same with the findings of Jensen Mackling(1976)and Myers and Majluf (1984). Increase the ownership capital may improve the profit, and debt capital inversely affects the sales growth and financial strength of the listed companies. Reason for the above results showed there is direct relationship between sales growth and financial strength, hence both negatively affect the financial leverage TD/TA ratio. At the same time, increasing capital in any type improve the company's performance (profit).

5. Conclusion

The object of this study was to investigate the relationship between financial leverage and growth and financial strength of the listed companies CSE in Sri Lanka.

First that higher profit growth rate is positively associated with TD/TA financial leverage ratio and this implication does not support the other financial leverage ratios and profit growth. Second, which the listed companies experiencing higher sales growth rate and FS would tend to have low TD/TA financial leverage ratio. This low TD/TA financial leverage ratio of the listed companies is related to large equity investment associated for large growth rate of sales and FS. Conversely, when higher profit growth and Fs growth are associated with listed companies, the TD/TA financial leverage ratio tends to be affect by positive affect of listed companies on these ratio but when listed companies have profit and FS decreases which are near zero or negative, their TD/TA financial ratio may be very high.

In addition, the empirical results suggest a number of potential areas for further research.

- (i) Investigate the Small firm and financial leverage and its effect on the firm growth.
 - (ii) Monitoring the financial leverage levels and growth cycle and its changes affects.
- Investigate the sector analysis.