

THE EFFECTS OF FINANCIAL MARKET DEVELOPMENTS ON CAPITAL STRUCTURE: A REVIEW OF LITERATURE

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The determination of a suitable combination of equity and debt is one of the most strategic choices confronting listed companies. Financial market can be defined as a market in which both the lender and the borrower meet to fulfill their purposes related to capital formation of the business and strengthen business operations. The development of financial market is an important factor affecting the distribution of capital from investment funds to companies, risk diversification and the creation of financial resources for companies. The common feature of most capital structure theories as well as empirical research model concentrates on company-specific factors to measure optimum capital structure. Less attention is paid to the impact of country-specific characteristics of the financial market on the capital structure of firms. This research aims to review the literature on the effects of financial markets development on capital structure. The literature review has found that market capitalization, volume of shares traded, size of the commercial banking system, credit growth and interest rates of commercial banks are the variables of financial markets developments and how these variables affect debt-equity ratio which refers to capital structure. The literature concludes that market capitalization is positive relationship with debt rate in capital structure while volume of shares traded, size of the commercial banking system and credit growth are negative relationship and interest rates of commercial banks is not statistical significance. Moreover, from literature point of view, financial markets generally lead to a decrease in cost connected with the use of internal finance and companies in the financial markets of developed and developing countries encounter different scenario when confronted with choices on capital and debt maturity. This research will further create a conceptual framework for the effects of financial market development on the capital structure.

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