

# **Analyzing Access to Long Term Debt Effects on Firms Growth: Evidence of China. Counting on your usual Support**

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## **Abstract**

Seeking to answer questions surrounding the use of long term debt access and its effects on firm's debt growth structure has been the driving force of this study and by using the National Statistical bureau, CIEC and other field survey to determine the exact objective relating to the effects of debt on firm growth. Targeted population of various firm sizes as major determine factors was considered in the study with the help of the collected data. Statistical package of social studies version 22 was used to analyze the data and by correlating as well as regression model assisted the study. It was discovered that, long term debt negatively affects firm growth when sizes and maturity remain major considerate option to access long term finance, though not statistically significant as perceived. In this paper we document the maturity structure of firms' debt in China and further discuss how it has been affected by banks intervention in credit markets and financial liberalization. Using firm-level panel data, we then investigate the determinants of access to long-term debt and provide evidence on the impact of the maturity structure of debt on firms' growth, particular on productivity and capital inflows.

**Keywords:** Debt, maturity, access. Capital.

## **1. Introduction**

The choice of debt policy or capital structure is one of the most important decisions for companies within the corporate finance sector, given that this is a fundamental decision, related to the impact it can have on the value of the organization. In general, the capital structure represents the combination of third-party capital and social capital used to finance the operations of a particular company or firm. There are several possibilities to build a capital structure, this includes ways to measure these diverse possibilities of capital structure in long-term debt, which consists of an indicator of the capital structure used in the financial analysis and expresses the relationship between debt long-term and total debt (Abor, 2007). The theoretical and empirical analysis of the financing of companies has mainly emphasized the choice of debt in shares (internal or external). There is the decision of debt against capital (capital structure) and also the decision on the structure of the debt. Capital structure refers to the way a company finances its assets through a combination of capital and debt, but the structure of

the debt can include short-term debt and long-term debt. Although the idea of debt as a homogeneous source of funds is a solid theoretical construction and a useful first step, going beyond the decision of leveraging and investigating other dimensions of the choice of debt is a useful part of the step. In particular, the nature of the debt and its incentive properties may differ accordingly, for example, at maturity (long and short) and to suppliers (banks or markets). The alternative way of raising additional funds to meet the daily needs of many different organizations has been a debt that refers to the funds of borrowed funds with expectations of payment. According to Kajirwa, 2015. The exhaustive analysis of the state of the financial situation of the commercial banks under study reveals that the proportion of borrowed funds increased progressively between 2010 and 2014, according to Quartz media, private companies in China are the engines of your economy, generating seven tenths of its GDP and employing 85% of its labor force. As such, the country's long-term growth depends on its success. But they face a formidable opponent for their own government. This study addresses the debt maturity structure of companies or organizations and offers some empirical evidence for China. Both foreign and local government institutions and policymakers have perceived that problems of contract law enforcement and asymmetric information can eventually lead to a shortage of long-term financing. It is believed that scarcity has a cost in terms of productivity growth and capital accumulation, and may justify some kind of government intervention. Most developing countries created long-term credit institutions, such as development banks in many countries, to encourage the provision of long-term credit and, in fact, were the political response to this problem. According to Schiantarelli and Jaramillo, 2002. The emphasis on long-term finances and the possible adverse consequences when scarce is somewhat contrary to recent theoretical contributions that emphasize the fact that the use of short-term debt may be associated with higher quality and may have better incentive properties. In particular, the possibility of a premature liquidation can act as a disciplinary device that improves the performance of companies. The study's attempt to establish the link between long-term debt and its effects on the company's growth in China and also provides empirical evidence on the impact of long-term debt access on companies' products, as well as the accumulation of capital or the entries in China.

### **1.1. Brief Long Term Debt History in China**

Literature regarding China's debt sustainability analysis is scarce, except that the sustainability of local government debt in China has recently attracted much attention Zhang et al. 2014, Lu and Sun (2013). For a company, long term debt often includes any leasing or financial obligations that have a maturity period exceeding 12 months. A study by Burnside (2005) provides many useful approaches and instruments for fiscal sustainability analysis. IMF (2011) and Sun, 2015 reveals a range of 49 to 58% for the long-run debt level and 63 to 78% for the maximum sustainable debt level by re-estimating public debt thresholds for a sample of Emerging Markets (EM) for the 1993–2009 period. Until repayment is due common division of government debt is by duration. Short term debt is generally considered to be for one year or less, long term is for more than ten years. According to Lane, P.R, 2012, and Sun, 2015 Economic and financial crises are closely connected with excess indebtedness and the defaults of the public and private sectors. Excess indebtedness often triggers a debt crisis, currency crisis and financial distress on the one hand; the bailouts of government on the financial sector during the crisis and the expanding expenditures of the government for enhancing the aggregate demand after the crisis increase the public debt level on the other hand. Therefore, a sustainable debt level is a key factor for preventing financial distress and promoting stable economic growth. As the international regulator of the financial markets and long-term debt is normally made up of loans and financial obligations that have lasting period beyond one year.

### **1.2. The Long Term Debt Benefits**

Long-term debt is financing that has a repayment or maturity term of more than one year or that companies use between 20 and 30 years to buy assets, such as equipment and buildings, which are mostly considered loan guarantees. This form of financing branch has many benefits in the following way.

*Lower interest rate:* the guarantee against debt or long-term loans is made through assets and is often associated with the low cost of loans, especially through central banks or Federal Reserves, which they maintain low loan rates to support the housing market and the growth of businesses. It also has relatively low financing costs, that is, the interest paid for the assets acquired for the business is generally tax deductible and further reduces the total cost of loans with long-term debt.

*Capital retention:* Capital financing involves financing by investors in exchange for partial ownership of the companies, where shareholders and owners often prefer to maintain ownership and control of the company through the support of the company. Debt. After paying the debt with interest, they still have their ownership or control of the bank and, in general, they are considered an alternative to debt as a long-term source of capital funds for business growth. Stability rate: the long-term debt is mostly structured and stable over time, with the payment time of the payments and the interest rate often remains constant during the repayment of the loan or before maturity in comparison with short-term credit accounts or capital investment. The financing must consider the interests of the investors and maintain records of the distributions of income, as well as of the shareholders, before changes can be made.

*General growth:* with short-term financing, debt is used to cover inventory costs and other short-term supply needs, long-term debt is used for the company's operational and infrastructure growth, including tangible assets as the acquisition of new office buildings or equipment, etc. Chen and others, 2014, in their study that determined the capital structure in China, pointed out that large companies favor debt financing, but profitable companies depend more on internal capital accumulation. In addition, they observe a strong industrial and property effect, in which real estate firms borrow much more, but the utilities and manufacturing industries use more long-term debt compared to commercial firms. State companies tend to borrow more, while companies with foreign companies choose more capital financing.

## **2. Reviewed Literature**

Trade-off theory by Lichtenberger, 1973 argued that a firm is faced with increased financial risk when obtaining tax saving from debt financing. However, according to Kraus, Modigliani and Miller (1958, 1963), noted that capital structure is irrelevant in determining the market value of a firm in a perfect market without taxes, transaction, bankruptcy costs and higher leverage which increases the required return on equity because of higher risks associated with taxes where leverage can lower a firm's tax payment, since interest payments are deductible before tax and thus optimal capital structure exists as the leverage level increases the weighted average cost of capital (WACC) decreases.

### **2.1. Concept of Firm Growth**

Taking into account the importance of the capital structure and its relationship with the growth of the company, the participation of all interested parties was required to reach an effective decision. Cole et al. (2015) in their study, stated that, in the beginning, it may seem that the way in which a company chooses how its operations are financed and independent of its current performance or growth. The theory of capital structure and its relation to corporate performance have been a controversial issue in corporate finance over the years, Cole, Yan and Hemley (2015). Many arguments argue that companies need to use third-party capital as the main source of financing to enjoy tax benefits since the interest paid on the debt is deductible from the tax payable, which can increase the net profit in the period. Abor (2005), Abor (2007), Zeitun and Tian (2007), Lara and Mesquita (2008), Ebaid and Pratheepkanth (2011) have shown a statistically significant relationship between the structure of capital and performance or growth. According to Crabtree & DeBusk, 2008, financial performance or growth is measured using the Key Performance Indicators, such as the return on assets, earnings before interest and taxes. The studies of Smith and Watts (1992) and Barclay and Smith (1993) reveal that companies with more growth opportunities will use less debt, favoring internal sources of financing. In addition,

Wald (1999) came to a positive relationship between growth opportunities and the use of long-term debt for companies in the United Kingdom, France, Japan, and Germany. Upneja and Dalbor (2001) also had a similar relationship with the housing industry in the United States. Warner, of 1977, said that an optimal capital structure can be achieved when the present marginal value of the fiscal shield is equal to the present marginal value of the costs of the financial difficulties arising from the additional debt. Previous studies, debt affects the cost of capital, ultimately influencing the profitability of companies and the prices of shares (Higgins, 1977, Miller, 1977, Myers, 1984, Sheel, 1994).

## **2.2. Debt maturity and Firm's Growth**

This part of the study addresses the effect of the maturity structure of the debt on the performance or growth of companies. The debt that has a resource or a fund the time is extended beyond a year. On the other hand, if it is less than or equal to one year, it is classified as a short-term debt. The company can also benefit from the effect of the fiscal shield of the debt and the financial leverage when this can help the growth of the company, but when the company has interest in the creditors of the costs and is exempt from the corporate income tax, the Dividends paid to shareholders are deducted from net profit after the corporate income tax, the measure of interest rates are interest earnings and taxes. However, these activities improve the company's debt ratio and will definitely increase tax-free income and appreciate the market value of the company. First, it is to find out the availability of a long term. The reasons are linked to what access to long-term debt can improve the productivity of companies. According to Jaramillo and Schiantarelli, 2002, the company's access to the best and most productive technologies, the firm may be a relationship with short-term debt due to the fears of liquidation. On the other hand, lack of long-term availability can be the capital of work, and this can have adverse consequences on productivity. Second, it is the consultation about the availability of long-term financing. What is not in the hand of the company, reduces growth and is a type of very risky debt for large companies. A study conducted by Nima, Mohammad, Saeed and Zeinab (2012) examined the relationship between the capital structure and the performance of the company of the Companies of the Stock Exchange of Tehran, carried out between 2006 and 2011, and uses three measures of performance, including the profit margin. Assets as a dependent variable and three capital structures, including long-term debt, short-term debt and debt ratios as an independent variable, maintain that there is a significant relationship. Between the dependent and independent variable, except with the debts. Valeriu and Nimalathan (2010), research on the structure of capital and its impact on profitability: a study of manufacturing companies listed in Sri Lanka. The results of the debt (gross profit index, operating profit index and net profit index), except the return on capital employed and the ROA. The decision to choose the structure of capital, in general terms, has a weak influence or on the financial performance of listed companies from 1997 to 2005 in Egypt as to the drafting of accounts, Ebaid (2009), the use of measures based on the accounting of financial performance, return on capital, gross margin, empirical evidence in the study the result, the structure of capital, especially short-term debts and total debts have a negative impact on performance of an organization that is measured by the performance of assets. According to Jaramillo and Schiantarelli, 2002, in their study, the long-term debt and its effect on the performance of the company or the result of the company. Higher productivity, there is also some evidence that long-term debt can actually bring about improvements in productivity. As in other countries, leverage in companies increases the size of the company and fixed assets and profitability, the opportunity for growth, the management shares and the relationship with relationships. Industries Companies were considered the effect of debt in the future. The companies were reduced over time. Huang and Song, 2005.

## **2.3. Capital Structure**

Various discussions have taken place to establish the relationship between the capital structure and the company, which focused on whether the proportion of use of the debt is irrelevant to the value of the

individual company or whether there is an optimal capital structure for an individual company. The capital structure of a company analyzes the combination of debt and capital that the company uses in its activities. The choice of the capital structure is basically the marketing issue of Brealey and Myers (2003) and, in addition, the company can offer more different values in innumerable combinations by finding the one that will improve the market value. The optimal capital structure is the one that maximizes the market value of the outstanding shares of the company, Weston and Brigham (1992). Modigliani and Miller (1958) also argued that the capital structure provided a substantial impetus in the development of the framework. The theoretical theory within which several theories were about to emerge in the future and then concluded with the widely known theory of the "irrelevance of the capital structure", where financial leverage does not affect the market value of the company. In very restrictive assumptions that do not hold in the real world, assumptions include perfect capital markets, homogeneous expectations, no taxes and no transaction costs, bankruptcy costs and favorable tax treatment of interest payments lead to the notion of an "optimal" capital structure that maximizes the value of the company or minimizes its total cost of Odigliani and Miller (1963) to reconsider their previous position by incorporating tax benefits as determinants of the capital structure of companies. The key feature of taxation is that interest is a tax-deductible expense and a tax-paying company receives a "tax shield" of partially compensating interest in the form of lower paid taxes, for that reason, they propose that companies should use so much debt. In order to maximize the value with corporate taxes, researchers were also interested in analyzing the case of personal taxes imposed on people. According to MacKie-Mason, J. K. (1990), although taxes are thought to affect the capital structure, the effective tax rate cannot be expected to have an impact. In China, the regular corporate tax rate is 33%. However, many companies included in the list can request a preferable tax rate of 15% or even lower (in fact, the average and standard deviation of the effective tax rate are 15.6% and 6.4% respectively). The marginal revenue tax seems quite similar in all companies. Therefore, we do not expect to find a positive relationship between the tax rate and the leverage suggested by the theories.

### **3. Methodology**

This study uses a longitudinal research design, using secondary quantitative data of thirteen years (2004-2017). The data was extracted from the National Bureau of Statistics of China, the CIEC and the published books of the accounts of the companies listed on the Chinese Stock Exchange. The population for this study includes the main industries (micro, small, medium, and large). The stratified survey has been part of this study where companies with a history of long-term debt were considered. The study further engages the secondary data collection process to arrive at reliable data. Additional data were collected through review of documents, annual reports of companies, accounting manuals, and published accounting books. The data were analyzed using the Statistical Package for Social Sciences (SPSS) Version 22, inferential statistics to analyze the available data, correlation model and regression of Pearson's product momentum.

### **4. Empirical Analysis and Results**

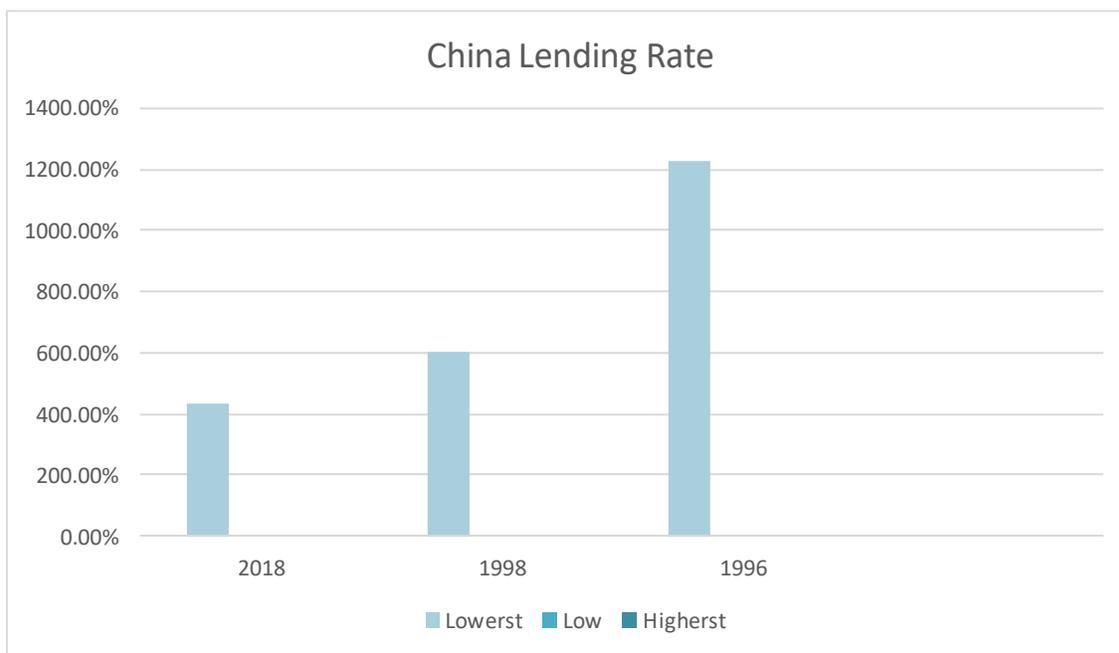
**Table 1:** Quarterly Gdp of China in Percentages

<b>YEAR</b>	<b>QUARTER(1) %</b>	<b>QUARTER(2) %</b>	<b>QUARTER(3) %</b>	<b>QUARTER (4) %</b>
2004	10.6	11.6	9.8	8.8
2005	11.1	11.1	10.8	12.4
2006	12.5	13.7	12.2	12.5
2007	13.8	15	14.3	13.9
2008	11.5	10.9	9.5	7.1
2009	6.4	8.2	10.6	11.9

YEAR	QUARTER(1) %	QUARTER(2) %	QUARTER(3) %	QUARTER (4) %
2010	12.2	10.8	9.9	9.9
2011	10.2	10	9.4	8.8
2012	8.1	7.6	8.1	8.1
2013	8.1	7.5	8.1	7.8
2014	7.6	7.4	7.5	7.1
2015	7	7	6.9	6.8
2016	6.7	6.7	6.7	6.8
2017	6.9	6.9	6.8	6.8

Source: National Bureau of statistics- China, indicating the percent change in the Gross Domestic Product from the same quarter last year using constant prices. (12.24 trillion year ending 2017)

**Table 2:**



Source: CIEC, 2018

The lending rate of China was high at 12.24 % pa in 30 Apr 1996 and started averaging 6 % pa from Sep 1988 and just after that has been constant at lowers rate 4.35 % pa in 29 Oct 2018 till now.

**Table 3:** Frequency of firm sizes and sectors

Item	Frequency	%	Frequency Cum	Cum %	Item	Frequency	%	Frequency Cum	Cum %
<b>Sectors</b>					<b>Firm Size</b>				
Foods	218	20.02%	218	20.02%	Micro	30	5.23%	30	5.23%
Textiles	121	13.12%	339	33.14%	Small	228	30.08%	258	53.31%
Lumber	70	7.13%	409	40.27%	Medium	362	46.73%	620	82.04%
Printing	81	10.09%	490	50.36%	Large	192	17.96%	812	100%
Chemicals	106	17.03%	596	67.39%					
Metallic minerals	44	7.18%	640	74.57%					
Ordinary minerals	23	2.80%	663	79.90%					
Electricals & plants	122	17.30%	785	97.20%					
Others	27	5.33%	812	100%					
<b>Total</b>	<b>812</b>	<b>100%</b>	<b>812</b>	<b>100%</b>	<b>Total</b>	<b>812</b>	<b>100%</b>	<b>812</b>	<b>100%</b>

Table 3 define sector and size by capital stock in the initial year: Food (218) 20.02% representing the highest and much granted access to long term debt .Electricals and plants (122) 17.30%, is the second most important consideration. (121) 13.12%. (106) 17.3%, (81) 10.09% (70) 7.13%, (44) 7.18% systemically represent the following sectors and consideration hierarchy, textile, chemicals, printing, lumber, metallic. Ordinary minerals and others contain the lowest rankings with (27) 5.33% and (23) 2.80% respectively. Micro {30} 5.23% the lowest and mostly neglected; Medium: (228) 30.08 % is the second highest but often denied access to long term debt. Large is made up of (192) 17.96% having much consideration. The medium size is the highest with (362) and 46.73% yet don't have much consideration with respect to access to long term financing. Large if real value of total assets.

**Table 4:** ACCESS TO LONG TERM FINANCE Descriptive Variable Summary<sup>a,b</sup>

	Debt levels		Valid N	Firms	No	%	Firms	No	%
	N	Percent							
2015	21	42.9%	28	<b>Micro</b>	<b>30</b>		<b>Large</b>	<b>192</b>	
2016	20	40.8%	29	Never	16	53.3%	Never	15	7.8%
2014	19	38.8%	30	Sometime	10	33.3%	Sometime	44	22.9%
2017	17	34.7%	32	Always	4	13.4%	Always	52	30.7
2012	17	34.7%	32	<b>Small</b>	<b>228</b>		<b>Medium</b>	<b>362</b>	
2013	16	32.7%	33	Never	92	40%	Never	93	2.6%
2011	10	20.4%	39	Sometime	87	38%	Sometime	158	43.6%%
2009	10	20.4%	39	Always	47	22%	Always	111	53.8%
2008	7	14.3%	42						
2004	7	14.3%	42						
2010	5	10.2%	44						
2007	5	10.2%	44						

Long term credit

Long term + short term + trade debt

a. Maxi variables b. Min, percentage missing values for variable to be part: 10.0%

Between 2007 and 2010, only 10.2% of the companies had long-term debt, but that figure increases to 42.9% in 2015, which represents the highest and then drops slightly to 40% in 2016. This figure remained partly constant to moderate between the year 2017 and 2012 to 34.7%. In the previous table it can be seen that access to long-term credit varies positively with size. 52% of the large group of companies had a long-term debt in all the years of the period, 53% of medium-sized companies always get easy access to long-term debt. However, only 13% and 22% of microenterprises and small businesses had access to long-term financing, respectively. 53% of microenterprises and 40% of small businesses were denied access to long-term debt, while only 7.8% of large companies could not acquire long-term debt, while the second , 6% never had long-term financing. With respect to the correlation between access to long-term debt and size, it is clear that access to long-term financing depends very much on the size of the company. There are several unequal distributions of debt maturity structure in access training, because part of the spectrum of the spectrum, about 15% to 30% of all companies, never had access to long-term credit during the period available with liabilities of uncertainty. . The biggest probability of the determinant of access to long-term credit is the size of the company (proxy = fixed assets). There is a positive association between the availability of guarantees and obtaining long-term credit, but as the largest companies in China are often considered more profitable and capable, the result could also reveal the positive link between the quality of the company and access to long-term financing. In addition, larger companies are more likely to have better bargaining power and greater political influence in obtaining long-term financial resources.

## 5. Conclusions

The question still remains, will the access to long-term finance have any effects on a firm's performance in terms of productivity or capital inflows? For productivity, does long-term credit or finance increase production or will the less monitoring and easy access to long term debt actually reduce or increase productivity? Those questions produce unequal results from estimation and tend to suggest that a shorter maturity is not conducive to greater productivity and show evidence that long-term debt may contribute to increased productivity. Long-term debt may have a positive impact on the quality of capital inflows. The study finally concludes with three major suggestion to the banks, firms, and government.

The banks should not only concentrate on the medium and large firms when considering long term financial access but should give equal chance to all, especially the micro and small firms who mostly need those capital and better maturity period to increase production.

The firms should also strive for expansion and acquisition of the capital asset to make their operation attractive to such financial assistance and also should ensure successful repayment.

Government should initiate major reform to old existing regulation that makes it difficult for most firms and banks to arrive at understanding such as firm size as a determining factor to access to long term credit.

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