

**Investigating the Dynamics of Capital Structure Affecting Firm Performance: Evidence
from Nonfinancial Listed Companies from KSE Pakistan**

By

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01-229112-021

A thesis presented to Bahria University, Islamabad in partial fulfillment of the
requirements for the degree of Master of Philosophy



December 2013

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Acknowledgements

I am so thankful to Almighty ALLAH, the kindest and the most compassionate, WHO always impounds everything unrest and disrupting in my way and bestowed me with countless blessings.

I am indebted to **Dr. Muhammad Ayub Siddiqui**, my supervisor for this study, for the plentiful knowledge he shared with me, his professional guidance, advice, support and encouragement. I am also grateful to all the authors I cited in my dissertation.

Last, I have no words to express my gratitude and love to all my family members for their enormous support and special thanks to my friends for their phenomenal companionship and noteworthy advice.

Dedication

Dedicated to the vision of my father that always motivated me, to my brother Hasan who is the strength that keeps me walking, to my Amma who is the light that's leading me to the place, to my both sisters who always shared my laughter & wiped my tears and to my best friends Zubair & Mehwish who are the hope that keeps me trusting in every step of my life.

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ABSTRACT

Capital structure is considered amongst the most important elements in developing the financial structures of any firm. The present study focuses on testing the existence of capital structure irrelevance, presented by Modgiliani and Miller (1958), in nonfinancial sector of Pakistan. Agency Cost, corporate Taxes and Cost of Financial Distress are taken as control variables. The sample of the study comprises of 100 nonfinancial companies listed at Karachi Stock Exchange, Pakistan for the period of 2005 to 2012. Fixed Effects Model is applied for the analysis. The study concludes that capital structure show no significant effects on EPS, Tobin's Q and ROCE without considering Tax effect and only Net profit shows to be positively influenced by capital structure. Measures of capital structure show no significant effects on EPS and Tobin's Q after incorporating agency cost and cost of financial distress separately, whereas Net profit and ROCE are significantly influenced by capital structure. In short, the capital structure irrelevance theorem by Modgiliani and Miller is fully supported by the results of the study considering Tax as a government intervention to create an imperfect market situation. For agency cost and cost of financial distress, the capital structure irrelevance theorem is partially supported in nonfinancial sector of Pakistan.

Key Words: capital structure, financial leverage, capital structure irrelevance, agency theory, pecking order theory, trade-off theory, tax provision, cost of financial distress, agency costs, firm performance.