The Influence of Corporate Financial Decisions on Corporate Performance: Evidence From S&P SL20 Companies Listed in Colombo Stock Exchange

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Abstract: Corporate financial decisions are important because they determine the manner in which firms mobilise funds, finance assets and balance financial risk against expected returns. This study examines the relationship between corporate financial decisions and financial performance among companies included in the S&P SL20 index and listed on the Colombo Stock Exchange (CSE). Capital structure is represented by the debt-to-asset ratio (D/A) and debt-to-equity ratio (D/E), while performance is measured using return on assets (ROA), return on equity (ROE) and earnings per share (EPS). The study adopts a quantitative approach using secondary data obtained from company annual reports. The sample comprises 20 companies. Descriptive statistics, Pearson correlation analysis and multiple regression analysis are employed. The findings indicate a positive and statistically significant relationship between D/A and ROA. D/E is not significantly associated with ROA or ROE, while D/E exhibits a positive and significant relationship with EPS. D/A is not significantly associated with ROE or EPS. The results demonstrate that the association between financing decisions and performance differs according to the performance indicator. The study contributes evidence from Sri Lanka's listed-company context and highlights the importance of evaluating financing structure against more than one measure of corporate performance.

Keywords: *Corporate financial decisions; Corporate financial performance; ROA; ROE; EPS; Debt to Asset; Debt to Equity; S&P SL20; CSE*

1. Introduction

Capital structure is a central corporate-finance decision because it determines how a firm finances its assets and investments. Firms generally rely on internal funds, debt and equity, and the proportions selected can influence financing costs, risk, financial flexibility and the returns available to investors. Capital structure is therefore more than a balance-sheet composition; it is a strategic choice with potential implications for corporate value and performance (Myers, 2001; Harris and Raviv, 1991).

Debt financing can provide access to funds without diluting ownership and may generate tax benefits where interest is tax-deductible. Nevertheless, borrowing creates contractual interest and principal obligations and may increase the likelihood or cost of financial distress. Debt can also affect managerial incentives and the distribution of risk between shareholders and creditors. Accordingly, the benefits of debt must be considered alongside its costs, and the performance implications may depend on the firm's circumstances and use of borrowed funds (Myers, 2001; Jensen, 1986).

The theoretical relationship between capital structure and firm performance has been widely debated. Modigliani and Miller (1958) established a benchmark proposition under idealized assumptions in which financing structure does not affect firm value. Their subsequent work recognized the implications of corporate taxes for debt financing (Modigliani and Miller, 1963). Later theoretical perspectives developed explanations for financing choices under conditions that depart from these assumptions. Trade-off theory emphasizes balancing the benefits of debt against the costs of financial distress; pecking-order theory

explains financing preferences in the presence of information asymmetry; and agency theory considers how financing arrangements may influence managerial behavior and conflicts among stakeholders. These perspectives suggest that the relationship between leverage and performance may not be uniform.

Empirical research has similarly produced varied findings. The relationship between leverage and performance can differ across firms, countries, industries, periods and measures of performance. Reviews of capital-structure research emphasize that no single theory explains financing decisions in every setting and that the relevance of competing explanations is conditional on firm characteristics and institutional circumstances (Harris and Raviv, 1991; Myers, 2001). Consequently, a relationship observed using return on assets may not necessarily be replicated using return on equity or earnings per share.

This issue is relevant to companies listed on the Colombo Stock Exchange, where financing decisions are made within the Sri Lankan financial and economic environment. Sri Lankan empirical studies have also examined capital structure and performance, including work focused on listed firms and banking institutions (Abor, 2005; Kajananthan and Nimalthasan, 2013; Nirajini and Priya, 2013; Sivalingam and Kengatharan, 2018). The S&P SL20 index provides a focused setting for examining financing decisions among selected prominent listed companies. Earlier Sri Lankan evidence also reported a negative influence of debt measures on corporate performance among listed firms, while a study of Sri Lankan commercial banks examined capital structure and financial performance within a sector-specific setting (Chandrasiri et al., 2018; Sivalingam and Kengatharan, 2018).

Although capital structure and performance have been examined in different countries and among Sri Lankan listed firms, the findings reported in the literature are not consistent. This creates a need to examine the relationship in a specific sample and period using multiple financial-performance indicators. The present study addresses this issue by analysing the debt-to-asset ratio and debt-to-equity ratio in relation to ROA, ROE and EPS among S&P SL20 companies over 2017–2021. Rather than assuming that leverage has one uniform effect, the study evaluates each capital-structure indicator against each performance measure.

The central research problem concerns the uncertain relationship between corporate financing decisions and financial performance. Debt may support investment and improve returns when funds are deployed efficiently, but excessive debt may increase financial obligations and risk. The mixed findings in previous empirical studies make it difficult to generalise the performance implications of leverage across firms and markets. Within the Sri Lankan listed-company context, further evidence is useful to assess whether different measures of capital structure are associated with different dimensions of financial performance.

The study provides empirical evidence on the association between two capital-structure measures and three financial-performance indicators within a selected group of Sri Lankan listed companies. By considering ROA, ROE and EPS separately, the analysis recognizes that corporate performance can be assessed from different perspectives. The findings may be useful to corporate managers when evaluating financing arrangements, to investors when interpreting financial indicators, and to researchers seeking evidence from the Sri Lankan capital market. The study's contribution is context-specific and should be interpreted in light of its sample, period and analytical design.

2. Literature Review and Hypotheses Development

2.1. Capital Structure and Corporate Financial Performance

Capital structure refers to the mix of financing sources used by a firm to fund its assets and activities. Debt represents borrowed funds, while equity represents capital contributed by shareholders and retained within the firm. Capital-structure decisions may influence performance through financing costs, tax effects, risk exposure, investment capacity and the allocation of returns. The theoretical literature identifies several mechanisms through which financing choices may affect firm value and managerial decisions (Harris and Raviv, 1991; Myers, 2001). Empirical findings remain mixed: Ayaz et al. (2021)

used alternative econometric approaches to investigate leverage and performance among Malaysian listed non-financial firms, while Vu Thi and Phung (2021) found negative debt-ratio associations with ROA and ROE in Taiwanese SMEs. Such variation reinforces the importance of examining the relationship within the characteristics of each market and sample.

The effect of capital structure on performance is therefore expected to depend on how financing is used and on the firm's ability to generate returns from financed assets. Leverage may be beneficial when investment returns exceed the cost of borrowing, but it may reduce performance when returns are insufficient to meet financing obligations. This conditional relationship is consistent with capital-structure theories that balance debt benefits against financial distress, agency and information-related costs (Myers, 2001). Similarly, Jee et al. (2021) found that the relationship differed across performance measures in Malaysian plantation firms, with some debt measures showing significant associations with ROA but not ROE. The results demonstrate that the choice of performance indicator may affect conclusions about leverage.

2.2. Theoretical Perspectives

2.2.1 Modigliani–Miller Theory

Modigliani and Miller (1958) argue that, under restrictive assumptions including perfect capital markets and the absence of taxes and financial distress costs, a firm's value is independent of its financing mix. This proposition provides a theoretical benchmark for evaluating the relevance of financing decisions. The assumptions, however, do not fully reflect real-world financial markets. Their later proposition incorporates corporate taxation and recognises the tax advantages associated with debt (Modigliani and Miller, 1963).

2.2.2 Trade-off Theory

Trade-off theory proposes that firms consider the benefits and costs of debt when determining their financing structure. Tax advantages may encourage borrowing, whereas expected financial-distress costs may discourage excessive leverage. The theory suggests that firms weigh these competing effects when choosing their financing mix, although the optimal balance may differ across firms and circumstances (Harris and Raviv, 1991; Myers, 2001).

2.2.3 Pecking-order Theory

Pecking-order theory suggests that firms may prefer internal funds, followed by debt, and use external equity as a last resort. This preference is commonly linked to information asymmetry between managers and external investors. Myers and Majluf (1984) explain that information differences can make external equity costly, leading firms to favour internal financing and debt where possible. Financing choices under this theory reflect funding needs and the relative costs of financing sources rather than necessarily a single target capital structure.

2.2.4 Agency Theory

Agency theory considers conflicts of interest between managers, shareholders and creditors. Debt may constrain managerial discretion by requiring firms to meet contractual payment obligations and by reducing funds available for discretionary spending. However, debt can also intensify conflicts between shareholders and creditors, particularly when firms undertake riskier investments. These mechanisms suggest that financing decisions may influence corporate outcomes through governance and incentive-related channels (Jensen and Meckling, 1976; Jensen, 1986).

2.2.5 Signaling Perspective

Financing decisions may also communicate information about management's expectations and the firm's prospects. In the presence of information asymmetry, the choice between debt and equity may convey information to investors, although the interpretation depends on circumstances and is not necessarily unambiguous (Myers and Majluf, 1984). The signalling perspective provides another explanation for why capital-structure choices and performance may be related.

2.3. Debt-to-Asset Ratio and Performance

The debt-to-asset ratio measures the extent to which a firm's assets are financed through debt. It provides an indication of the proportion of asset resources supported by borrowing and is commonly used to assess leverage and financial risk. A higher ratio may indicate that a firm has obtained greater financing capacity through debt, potentially supporting investment and operations. It may also indicate greater obligations relative to the asset base. The relationship between D/A and performance may therefore be positive, negative or insignificant depending on the productivity of financed assets and the burden of debt. Empirical studies have frequently used debt ratios to examine leverage and profitability, although the direction and significance of reported relationships differ. Vu Thi and Phung (2021), for example, reported a negative relationship between the debt ratio and both ROA and ROE.

ROA evaluates earnings relative to assets and is relevant when considering whether asset financing contributes to operating or overall profitability. ROE reflects returns relative to shareholders' equity and may be influenced by leverage and the earnings available to equity holders. EPS measures earnings attributable to each ordinary share and reflects the earnings outcome from a shareholder perspective. These measures may respond differently to changes in debt financing.

2.4. Debt-to-Equity Ratio and Performance

The debt-to-equity ratio compares borrowed funds with shareholders' equity and reflects the relative contribution of debt and equity financing. A higher D/E ratio indicates a greater level of debt relative to the equity base. Debt may magnify shareholder returns when investment performance is favourable, but it may also magnify losses and increase financial risk. The relationship between D/E and ROA may be less direct because ROA focuses on assets rather than the financing claims against those assets. D/E may nevertheless be associated with ROE and EPS through its influence on the financing structure and the earnings attributable to shareholders. Evidence from listed companies also suggests that debt-equity relationships may vary by outcome measure and sample characteristics (Ayaz et al., 2021; Jee et al., 2021).

2.5. Empirical Evidence and Research Hypotheses

The study examines corporate performance (CP) of companies listed on the S&P SL20 Index of the Colombo Stock Exchange as a function of two independent variables: Debt-to-Asset Ratio (D/A) and Debt-to-Equity Ratio (D/E). Corporate performance is measured using Return on Assets (ROA), Return on Equity (ROE), and Earnings per Share (EPS). Based on the literature reviewed above, the following hypotheses were formulated to examine the influence of corporate financial decisions on corporate performance:

H1: Debt-to-asset ratio has a significant relationship with return on assets.
H2: Debt-to-asset ratio has a significant relationship with return on equity.
H3: Debt-to-asset ratio has a significant relationship with earnings per share.
H4: Debt-to-equity ratio has a significant relationship with return on assets.
H5: Debt-to-equity ratio has a significant relationship with return on equity.
H6: Debt-to-equity ratio has a significant relationship with earnings per share.

3. Methodology

3.1. Conceptual Framework

Based on the research objectives and theoretical background, the conceptual framework illustrated in Figure 1 was developed.

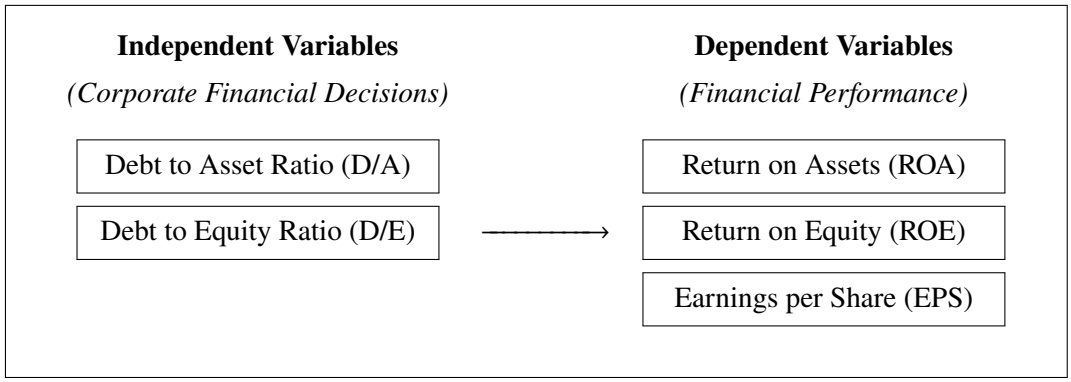


Figure 1: Conceptual Framework

Source: Developed by author.

3.2. Operationalisation of Variables

3.2.1 Independent Variables

- **Total Debt to Asset Ratio (D/A):** As per the definition given by Rajan and Zingales (1995), financial leverage can be measured through interest-bearing debt relative to total assets. Leon (2013) used the long-term debt-to-equity ratio to measure capital structure, whereas Dawar (2014) and Berger and Bonaccorsi di Patti (2006) utilized short-term debt to total assets and long-term debt to total assets as primary capital structure metrics. To assess the impact of leverage on firm performance, this research uses the total debt-to-total assets ratio.
- **Total Debt to Equity Ratio (D/E):** The debt-to-equity (D/E) ratio measures financial leverage by comparing total debt commitments to shareholder equity. Higher leverage ratios typically indicate that a firm possesses higher financial risk. Investors frequently modify the D/E ratio to focus on long-term debt because the risk profile of long-term liabilities differs markedly from short-term debt and trade obligations.

3.2.2 Dependent Variables

- **Return on Assets (ROA):** Return on Assets (ROA) is a financial profitability ratio measuring the efficiency with which a firm generates operating earnings from its total asset base. ROA reflects management's effectiveness in deploying available resources, with higher values indicating superior efficiency. Accounting-based profitability indicators are widely used in empirical corporate finance; for instance, Majumdar and Chhibber (1999) utilized ROA as a primary firm performance metric.
- **Return on Equity (ROE):** Return on Equity (ROE) measures profitability relative to shareholders' equity, calculated as net income divided by shareholders' equity. It indicates how effectively shareholders' equity capital is converted into net profit. Abor (2007) employed accounting-based performance measures including ROE and asset turnover to examine firm performance.
- **Earnings per Share (EPS):** Earnings per Share (EPS) represents the portion of net profit attributable to each ordinary share outstanding. It is calculated by dividing net profit available to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. EPS provides equity investors with a per-share measure of generated returns.

3.3. Sample Selection and Data Collection

The study employed a sample of 20 companies included in the S&P SL20 Index and listed on the Colombo Stock Exchange (CSE), covering a five-year period from 2017 to 2021 ($N = 100$ firm-year observations). Secondary data were collected from the published audited annual reports of the selected companies for the respective financial years. Annual reports served as the primary data source required to measure capital structure and financial performance variables. Relevant figures were extracted from audited financial statements, ensuring consistency across firms and years.

3.4. Model Specification

To examine the relationship between corporate financial decisions and performance across S&P SL20 companies, multiple linear regression models are specified with D/A and D/E as independent variables, and ROA, ROE, and EPS as dependent variables:

$$\mathrm{ROA}_{it} = \alpha + \beta_1 \mathrm{DA}_{it} + \beta_2 \mathrm{DE}_{it} + \varepsilon_{it} \tag{1}$$

$$\mathrm{ROE}_{it} = \alpha + \beta_1 \mathrm{DA}_{it} + \beta_2 \mathrm{DE}_{it} + \varepsilon_{it} \tag{2}$$

$$\mathrm{EPS}_{it} = \alpha + \beta_1 \mathrm{DA}_{it} + \beta_2 \mathrm{DE}_{it} + \varepsilon_{it} \tag{3}$$

where ROA_{it} is the return on assets for firm i in year t; ROE_{it} is the return on equity; EPS_{it} is earnings per share; DA_{it} is the debt-to-asset ratio; DE_{it} is the debt-to-equity ratio; α represents the constant intercept term; β_1 and β_2 are the regression slope coefficients; and ε_{it} is the stochastic disturbance term.

4. Results and Discussion

4.1. Data Presentation and Descriptive Analysis

Descriptive statistics provide an initial overview of the financial performance and capital-structure characteristics of the sampled S&P SL20 companies across the 100 firm-year observations (2017–2021), as presented in Table 1.

Table 1: Results of Descriptive Statistics ($N = 100$)

Variable	Minimum	Maximum	Mean	Std. Deviation	N
Return on Assets (ROA)	−8.00	89.00	3.2656	9.49741	100
Return on Equity (ROE)	−9.00	9.70	1.4604	3.20754	100
Earnings per Share (EPS)	−23.00	61.90	8.0232	11.45492	100
Debt to Asset (D/A)	0.10	95.00	2.1615	9.79331	100
Debt to Equity (D/E)	−1.00	41.00	3.1760	5.14591	100

ROA recorded a mean of 3.2656 with a standard deviation of 9.49741 (ranging from −8.00 to 89.00). ROE exhibited a mean of 1.4604 with a standard deviation of 3.20754 (ranging from −9.00 to 9.70). EPS recorded a mean of 8.0232 with a standard deviation of 11.45492 (ranging from −23.00 to 61.90). The reported means for the D/A ratio and D/E ratio were 2.1615 and 3.1760, with standard deviations of 9.79331 and 5.14591, respectively. The dispersion in ROA, ROE and EPS confirms that the sampled companies display marked variation in operating performance and shareholder returns. The capital-structure measures also exhibit substantial dispersion, indicating that the sampled firms maintain diverse financing policies.

4.2. Correlation Analysis

Pearson correlation analysis was conducted to assess pairwise bivariate associations among the study variables, as reported in Table 2.

Table 2: Results of Pearson Correlation Analysis ($N = 100$)

Variable	Metric	ROA	ROE	EPS	D/A	D/E
Return on Assets (ROA)	Pearson Correlation	1	0.150	0.093	0.900**	−0.074
	Sig. (2-tailed)		0.144	0.369	0.000	0.473
	N	100	100	100	100	100
Return on Equity (ROE)	Pearson Correlation	0.150	1	0.009	−0.061	−0.085
	Sig. (2-tailed)	0.144		0.933	0.558	0.413
	N	100	100	100	100	100
Earnings per Share (EPS)	Pearson Correlation	0.093	0.009	1	0.028	0.440**
	Sig. (2-tailed)	0.369	0.933		0.789	0.000
	N	100	100	100	100	100
Debt to Asset (D/A)	Pearson Correlation	0.900**	−0.061	0.028	1	−0.026
	Sig. (2-tailed)	0.000	0.558	0.789		0.800
	N	100	100	100	100	100
Debt to Equity (D/E)	Pearson Correlation	−0.074	−0.085	0.440**	−0.026	1
	Sig. (2-tailed)	0.473	0.413	0.000	0.800	
	N	100	100	100	100	100

** Correlation is significant at the 0.01 level (2-tailed). *Source:* SPSS output.

The strongest bivariate correlation is observed between D/A and ROA ($r = 0.900$, $p < 0.01$), indicating a robust positive association in the sample. D/E is positively correlated with EPS ($r = 0.440$, $p < 0.01$). The remaining pairwise correlations are statistically non-significant at the 5% level. These bivariate findings provide initial evidence that capital-structure choices are selectively associated with particular performance metrics.

4.3. Multiple Regression Analysis

The model summaries for the three estimated regression equations are presented in Table 3.

Table 3: Multiple Regression Model Summary

Model	Dependent Variable	*R*	R^2	Adjusted R^2	Std. Error of the Estimate
Model 1	ROA	0.901[a]	0.813	0.809	4.15607
Model 2	ROE	0.105[a]	0.011	−0.010	3.22381
Model 3	EPS	0.442[a]	0.196	0.178	10.38400

[a] Predictors: (Constant), D/E, D/A Ratio. Dependent Variables: ROA, ROE, EPS. *Source:* SPSS output.

The regression results demonstrate substantial variation in explanatory power across the three dependent dimensions: the capital structure predictors explain 81.3% of the variation in ROA ($R^2 = 0.813$), 1.1% in ROE ($R^2 = 0.011$), and 19.6% in EPS ($R^2 = 0.196$).

4.3.1 Financial Performance Measured by ROA

The ROA regression model is statistically highly significant ($F = 201.549, p < 0.001; R^2 = 0.813$; Adjusted $R^2 = 0.809$), explaining 81.3% of the observed variation in return on assets. The

debt-to-asset ratio is positively and significantly associated with ROA ($B = 0.872$, $p < 0.001$), whereas the debt-to-equity ratio is statistically insignificant ($B = -0.093$, $p = 0.263$). Consequently, hypothesis H1 is supported, whereas H4 is not supported. The positive D/A coefficient indicates that within the sampled blue-chip firms, asset expansion supported by debt financing was accompanied by healthy operational returns, though care is required not to extrapolate this as an unconstrained causal rule.

4.3.2 Financial Performance Measured by ROE

The ROE regression model is statistically non-significant ($F = 0.522, p = 0.595; R^2 = 0.011$; Adjusted $R^2 = -0.010$) and accounts for only 1.1% of variance in return on equity. Neither D/A ($p = 0.544$) nor D/E ($p = 0.405$) shows a statistically significant relationship with ROE. Accordingly, hypotheses H2 and H5 are not supported. This indicates that shareholder equity returns in S&P SL20 firms are primarily driven by broader operational factors, asset turnover, and industry-specific market dynamics rather than capital structure alone.

4.3.3 Financial Performance Measured by EPS

The EPS regression model is statistically significant ($F = 11.303$, $p < 0.001$; $R^2 = 0.196$; Adjusted $R^2 = 0.178$), explaining 19.6% of the variance in earnings per share. The debt-to-equity ratio displays a positive and statistically significant coefficient ($B = 0.983$, $p < 0.001$), whereas the debt-to-asset ratio is not significant ($p = 0.674$). Therefore, hypothesis H6 is supported, while H3 is not supported. This indicates that leverage relative to equity is positively related to per-share earnings among the sampled listed firms.

4.4. Hypotheses Testing

Table 4 summarises the empirical results for the six research hypotheses.

Table 4: Hypotheses Testing Summary

Hypothesis	Relationship Tested	Statistical Result	Conclusion
H1	Debt to Asset Ratio and ROA	$B = 0.872$, $p < 0.001$	Supported
H2	Debt to Asset Ratio and ROE	$p = 0.544$	Not supported
H3	Debt to Asset Ratio and EPS	$p = 0.674$	Not supported
H4	Debt to Equity Ratio and ROA	$B = -0.093$, $p = 0.263$	Not supported
H5	Debt to Equity Ratio and ROE	$p = 0.405$	Not supported
H6	Debt to Equity Ratio and EPS	$B = 0.983$, $p < 0.001$	Supported

5. Finding and Conclusion

This study examined the empirical relationship between corporate financial decisions and corporate financial performance among 20 S&P SL20 companies listed on the Colombo Stock Exchange over the period 2017–2021. Capital structure was operationalised through the debt-to-asset ratio (D/A) and debt-to-equity ratio (D/E), while financial performance was multidimensionally captured via Return on Assets (ROA), Return on Equity (ROE), and Earnings per Share (EPS).

The empirical findings establish that corporate financial decisions do not exert a uniform impact across different performance dimensions. Specifically, the debt-to-asset ratio displays a strong, statistically significant positive relationship with return on assets, explaining 81.3% of its variation. Conversely, the debt-to-equity ratio exhibits a statistically significant positive relationship with earnings per share,

explaining 19.6% of its variation. Neither leverage measure demonstrated a statistically significant association with return on equity. These results demonstrate that evaluating financing decisions against a single performance metric produces an incomplete assessment of corporate outcomes. The study provides important empirical evidence from Sri Lanka's leading listed firms, supporting the view that capital structure effects are conditional upon the chosen performance dimension.

5.1. Recommendations, Limitations and Future Research Directions

Corporate financial managers should adopt a multidimensional perspective when structuring corporate debt, aligning borrowing with specific operational and shareholder-return objectives. Future researchers are encouraged to expand the empirical horizon by incorporating both financial and non-financial variables and adopting advanced dynamic panel econometric models. The present study is confined to 20 companies included in the S&P SL20 Index over a five-year window (2017–2021). Future investigations could extend the sample across broader CSE sector classifications, incorporate macroeconomic controls, and combine quantitative secondary data analysis with qualitative inquiries to uncover managerial motivations underlying corporate financing decisions in Sri Lanka.

Declarations

Author Contributions: Ahamathu Thaha Umama conceptualized the research, executed the literature review, gathered empirical data from the Colombo Stock Exchange, carried out the statistical econometric modelling, and compiled the manuscript.

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Conflicts of Interest: Ahamathu Thaha Umama declares no conflicts of interest.

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