THE DETERMINANTS OF CAPITAL STRUCTURE IN CHINESE LISTED COMPANIES

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Abstract

This paper attempts to investigate the determinants of the capital structure of a sample of 1456 listed companies on the Hong Kong Stock Exchange from 2005 to 2010. However, 226 companies have to be excluded from the analysis because the data is not complete. This study uses 1230 companies to make the investigation to determine the capital structure of Chinese listed companies. The relationship between size, profitability, liquidity, growth opportunity, asset structure, business risk and tax shield with leverage are highlighted. The findings show that size, profitability, business risk and tax shield are highly significant at 1% level in determining the capital structure while liquidity is significant at 10% level. However, growth opportunity and asset structure are not significant determinants of capital structure in China.

Key words: Capital structure, determinants, Chinese listed companies

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DEDICATION

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LIST OF ABBREVIATIONS

GDP	Gross domestic product
CSMAR	China Stock Market Research Database
WTO	World Trade Organization
NTDS	Non-debt Tax Shield
TANG	Asset Structure

Growth	Growth Opportunity
Profit	Profitability
OLS	Ordinary Least Square

CHAPTER ONE

INTRODUCTION

1.0 Chapter overview

This chapter describes the capital structure of Chinese listed firms. Specifically, it looks into the determinants of debt to equity. Traditional and specific factors that affect capital structure decision have been highlighted by previous researchers (Chen, 2003; and Brealey et al., 2006). The traditional factors contain the firm size, profitability, asset structure and tax shield effect. The specific factor is variable like ownership of company. In order to maximize company's values, this study investigates the determinants of capital structure, which is the choice of debt to equity in Chinese listed companies from 2005 to 2010.

Capital structure is the mix of debt and equity used by a company which is financing their assets (Miller and Modigliani, 1958). The decision of capital structure is one of the most significant decisions made by financial managers. Brigham (2003) points out that factors which influence the firm's capital structure are business risk, tax position, profitability, managerial conservatism and growth opportunity. Assuming a perfect capital market which includes no transaction or bankruptcy costs, perfect information, companies and individuals can borrow at the same interest rate, and no taxes, value of company is not affected by financing decisions. Modigliani and Miller

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