Factors Affecting Capital Structure: A Study on DSE Listed Textile Sector of Bangladesh

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Abstract

Debt financing in a company's capital structure is a significant source of funding in the textile sector of Bangladesh. Almost all businesses use debt financing in their capital structure to get tax blessings and increase profitability. Given the widespread use of debt as a financing source, the study's objective is to identify the aspects influencing capital structure in the Bangladeshi textile sector. The study is based on secondary data. Regression analysis is applied to identify the factors affecting capital structuring. The study found that profitability affects the proportion of debt financing in capital structure, whereas the firm's size, capital intensity ratio, asset turnover, and return on capital employed do not affect capital structure. The study's findings suggested that managers should make prudent decisions regarding changes in the capital structure, considering the impact of the firm's profitability, which would help suggest financial reforms for the textile sector. Managers of large, profitable companies can use the tax benefits of debt, as well as its disciplinary role, to increase corporate value.

Keywords: Asset turnover; Capital intensity ratio; Debt financing; Profitability; Size of the firm; Textile sector; Return on capital employed.

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1. Introduction

In terms of economic growth, employment, remittances, and Gross Domestic Product (GDP), the Ready-Made Garments (RMG) sector is more important than anything else in Bangladesh [18]. Bangladesh has consistently averaged more than 6% GDP growth over the last decade, making it one of the world's fastest-rising economies. Because of its smaller land area and larger population, the country is heavily reliant on international trade for financial prosperity. It has successfully devised trade techniques that rely on the careful use of its near-work blessing. The country's development has been fueled by its immediate growing articles of clothing (RMG) industry, where politicians and business visionaries have leveraged near advantage in wealth work. In any case, because RMG accounts for over 80% of all outgoing mail, the country's fare container remains small. Bangladesh's textile sector is one of the major industrial sectors that play an essential role in the country's economic growth. Garment business is considered Bangladesh's economy's lifeblood. Bangladesh is the world's second-largest Ready-made Garment (RMG) exporter, just behind China. The country's exports of 83.49% (2017-2018) came from the RMG sector; the Textile and Apparel sector contributes 11.17% (2017-2018) to Bangladesh's GDP. The study's empirical findings demonstrate that RMG exports have been steadily increasing from 1985 to 2018, with an annual growth rate of 8.76 percent in 2018 [18]. They also predicted that RMG exports in the fiscal year 2022-23 would be around 31712.82 million USD. All businesses worldwide, including textile mills, need investment to finance their assets through debt, equity, or hybrid securities [1], and from here comes the notion of capital structuring.

A company's capital structure is the mix of debt and equity capital used to fund its assets. Because of its interaction with other financial choice variables, capital structure is one of the most complicated areas of economic decision. The different options a company uses in funding its assets are capital structure. Capital structure plays a vital role in the financial decision-making process and can maximize its performance and value. Every financial decision has a significant impact on the financial health of a company [3]. A firm's financing can be categorized into two major types: equity financing and debt financing. Debt financing is a very significant source of funding in Bangladesh's textile industry, and virtually most companies across different industries are using debt financing in their capital structures to boost the company's tax benefits and profitability. A company's profitability that cannot compete well in the market will decrease. In opening to foreign markets, enterprises should also develop strategic tactics by analyzing the industrial structure and competitors. Such businesses may first look for domestic sources that are the preferred alternative. However, if this is not available, they must choose between issuing preferred shares and debt financing, which will impact their market position. Management must also consider the risk factor associated with debt financing, as more debt implies a greater risk to pre-financing. It also impacts the company's overall value.

Equity financing is a means of raising money by selling stock. Companies raise money for various reasons, including short-term cash flow needs or long-term plans that necessitate additional resources for growth. Equity capital comes from various sources, including an entrepreneur's friends and family, partners, or an initial public offering (IPO). While the term equity financing refers to publicly listed exchange companies' funding, the word also applies to private firms' financing.
The more they go to debt financing, the greater the risk, and the future becomes uncertain as investors get detracted, which ultimately impacts their share prices and market position. Hussain and his colleagues (2021) showed that large textile firms finance long-term through debt compared with small ones. As debt and equity financing challenges the company faces may be associated with size, capital intensity, return on capital employed, asset turnover, tenure, etc., this study examines different factors affecting the decision of the company's capital structure.

1.1. Objective of the research

The research aims to identify different factors such as the company's size, profitability, asset turnover, return on capital employed, and capital intensity, which may affect the capital structure of the firms operating in the textile industry of Bangladesh.

1.2. Research question

How do capital intensity, asset turnover, return on capital employed, company size, and profitability influence capital structuring (equity ratio and debt ratio) in Bangladesh's textile industry?

1.3. Significance of the study

Bangladesh has Asia's second-most pro-free-market economy. Bangladesh's economy is demonstrating the growth of free enterprise. In nominal terms, it is the 35th largest country in the world. The textile sector is the backbone of Bangladesh's economy; it is one of the prime sectors contributing to its export businesses. Various countries have experienced different development levels due to their openness to foreign trade [7]. To make this sector grow, there is an obvious need for financing; however, capital structuring has to be done to ensure that it leads to sustainable business growth. Otherwise, the businesses may face substantial financial risk. Currently, businesses in Bangladesh can choose between two methods of funding: equity and debt finance. These two types of financing offer their own set of benefits compared to one another. Capital markets allow businesses to raise equity and debt finance. Debt instruments, shares, and managed funds are Bangladesh's three primary financial markets. Debt security markets are divided into wholesale and retail segments, depending on the kind of instrument, issuer, buyer, maturity, and risk profile.

Over the last two decades, the country has enjoyed sustained economic growth, with the export-oriented Ready-Made Garments (RMG) sector playing a pivotal role in this development [7]. The government aided the expansion of RMG industries by implementing required institutional reforms. Bangladesh's export-oriented RMG business began in 1973, fueled by local entrepreneurs and subsequently funded by the government. From humble beginnings, the country has risen to become the world's second-largest clothes exporter after China, with a 6.5 percent share of global textile exports in 2017. RMG now makes up 84.4 percent of Bangladesh's export portfolio (Bangladesh Bank, 2019). This is the most important manufacturing sector in job creation, with roughly 4 million people employed (The Daily Star, 2019). So, before financing decisions regarding capital structure, there is a need to identify the effect of various factors on capital structure. This study will help us understand the effects of the company's size, profitability, return on capital employed, asset turnover, and capital
intensity on capital structuring, which would help suggest financial reforms, if needed, for the textile sector in the future.

2. Literature Review

Capital structuring in the company funding decision has been an excellent consideration over the past 60 years. The capital structure hypothesis begins with MM. They proved their famous MM irrelevance argument formally. The insignificance of the firm's general value of its capital structure could be revealed in the non-existence of taxes [26] and other assumptions indicated in their prior studies. Its operation and size significantly impact its capital structure in both developed and developing nations. They demonstrated that the business worth is sovereign of its financial structure in viable capital markets without corporate income taxation, bankruptcy costs, or other market flaws. Rendering to MM, the debt-to-equity ratio has no bearing on the company's overall worth. The fundamental theories of capital structure, the trade-off theory, and the pecking-order theory were created in the literature based on this theory. Each theory has attempted to explain why people choose debt over equity financing [8, 12]. The pecking order and trade-off theories attempt to explain company funding decisions.

Due to information gaps between the company and investors, the company will prioritize retained earnings over-leverage, short-term debt over long-term debt, and debt vs. equity [11]. According to Signaling Theory, investors want a clue because they have information asymmetry. The market has a positive reaction to debt issues and an adverse reaction to equity issues [24]. According to Agency Theory, agency cost arises as a result of the fact that managers do not always act in the best interests of shareholders, who in turn do not always act in the best interests of creditors [24]. Every firm's goal capital structure should be designed to balance the benefits and costs of leverage at the margin, optimizing the firm's value [2]. According to the capital structure trade-off hypothesis, three opposing forces drive a firm's goal leverage: (a) agency conflicts, (b) costs of financial distress (bankruptcy expenses), and (c) taxes.

Altman (1968) performed the first study on financial distress evaluation utilizing financial ratios analysis as a tool, which revealed a 90% accuracy rate in correctly diagnosing bankrupted enterprises and an 80% accuracy rate in estimating financial issues. Although Altman's Z-score model was initially established for forecasting bankruptcy of manufacturing firms with an accuracy rate of 80 percent, it was later modified for analyzing insolvency in the financial sector with a 70 percent average accuracy of forecasting. Many studies have utilized the Altman Z-score model to predict the financial crisis and evaluate the soundness of financial institutions over time.

According to Larry and his colleagues (1995), there is an adverse relationship between debt burden and future growth. This relationship is bad for companies whose development potential is unrecognized by the capital market or is not valued enough to offset the impacts of their over-indebtedness. They also found that leverage does not affect the growth of companies known to have high earning possibilities. They looked at the association between growth and leverage over 20 years and discovered a strong negative relationship between the two.
According to research conducted for South African corporations, insiders can choose to back more debt upfront [15]. The discovery bolstered the Pecking Order Theory of capital structure and offered a practical application of the Life Stage Model to assist businesses in determining how their funding is likely to evolve. Beattie and his colleagues (2006) found that companies' capital structure plans are varied, based on their planned leverage ratio of small and medium-sized UK firms. About half of companies claim to follow funding tiers, which is compatible with Pecking Order Theory, while 60% claim to try to maintain a target debt level, consistent with Trade-off theory [10].

Guncy and his colleagues (2009) found out that companies' profit has an adverse effect on the companies' capital structure and a favorable association between leverage and natural resources. The pragmatic results reinforced the literature's projections that companies with higher growth potentialities have reduced leverage ratios. A different noteworthy outcome is that size rarely has an adverse impact on the debt ratios of firms. Altunbas and his colleagues (2009) investigated what financial considerations are typically considered when making loan decisions. The study looked at non-financial corporations from 1993 to 2006 and found that large companies with more financial leverage, significant earnings, and higher liquidation values favored credit financing. Companies that use more short-term debt have more prospects for growth.

Shah and Hijari (2004) conducted a study on the KSE (Karachi Stock Exchange) listed non-financial companies to evaluate the capital structure determinants during 1994-2002. The study analyzed seven variables through the textile sector. All textiles were family-owned organizations and demonstrated the tax evasion loss. The study found that debt has a solid connection to the tangibility of property.

Companies' readiness to increase in size depends on several external and internal variables, such as the country's political and judicial status in which the company operates. However, in prosperous nations, this readiness primarily depends on the accessibility of external and internal causes of funding and its current market position and applying these fresh funds to its share price and brand. Large-scale companies can produce internal and external funding sources [35].

Mitra and Adhikary (2017) examined the determinants of the economic performance of companies in the textile sector listed on the Dhaka Stock Exchange (DSE). The study revealed that asset turnover and ratios were significantly promoted the return on assets of a firm. At the same time, leverage, cash in hand, and age deterred the identical. In contrast, factors like size, cost, and sponsorship shareholding failed to show any relationship with return on asset. Similarly, factors like ratio, asset turnover, and cost were found as significant and positive determinants of Earning per Share. At the same time, leverage, sponsor shareholding, and cash holding attended inhibit Earning per Share.

While the capital structure has a significant negative influence on return on assets (ROA) in Pakistan's petroleum and energy industry [22], Murtadlo and his colleagues (2014) found that asset turnover and capital structure had a remarkable impact on financial enactment, whereas asset structure had no impact. Unlike Mwadi and Birundu (2015), who discovered different results, there was no significant association between capital structure and ROA for Kenyan SMEs.
Murtala and his colleagues (2018) found a negative correlation between return on capital employed and the capital structure of Nigeria's sampled construction companies. The findings recommended that the managers of construction companies be cautious when using debt as a financing source; they should finance their operations with retained earnings, using debt as a last resort.

Zhang and Wang (2010) regarded the Chinese fabric industry's price structure, profitability, and efficiency and estimated RMB appreciation's 1999–2006 impact on this industry. The sector was discovered to have suffered from minimal profit margins and investment returns. According to Lim and his colleagues (2012), capital structure refers to how firms generate money to finance their operations and assign various financing options. It represents the firm's total capital to fund its business with a combination of debt and equity. Conversing to San and Heng (2011), the ability to fund its assets through various sources to fund its overall operations and growth depends on its capital structure. Adapt to Umar and his colleagues (2012), debt and equity are companies' most essential financing options. To run a firm, its debt level or equity alternative to funding its activities reflects the business's capital structure.

The moderating influence of business size on the link between capital structure and enactment in the Pakistani textile sector was investigated by Fatima and Bashir (2021). From 2010 to 2017, data was taken from annual reports of textile companies listed on the Pakistan Stock Exchange (PSE). According to the study's findings, debt finances 65 percent of the assets of Pakistani textile enterprises, implying that textile enterprises are operating with high levels of financial leverage. The average overall debt ratio of enterprises is roughly 65 percent, which indicates that they are somewhat highly leveraged. When debt borrowing could improve performance, the research has significant real-world implications that would assist textile sector financial managers in choosing the best capital structure mix.

Saleem and his colleagues (2013) expressed that the firm's optimum capital structure is the best possible debt and equity share to increase the shareholder's wealth. They also revealed that some corporate finance experts believed that a firm's capital structure could maximize its total value by minimizing its cost of capital. This is a very controversial subject in capital structure corporate finance theory.

Gurmeet (2014) studied the relationship between capital structure and profitability in Indian FMCG firms. An econometric framework was used to examine the capital structure of publicly traded companies during five years. After doing regression analysis and evaluating the association of the estimated model using the Correlation Coefficient Test, he discovered that the firm's profitability and financial leverage do not affect the capital structure of the researched companies throughout the reviewed period. As a result, the study could not find any meaningful link between profitability and the impact of financial leverage on a company's capital structure.

3. Research Methodology

3.1. Hypotheses

Capital structure is defined as: "The way a firm finances its assets through Debt, Equity or Hybrid securities"
The firm's financing has a mixture of various arrangements. They include equity, different types of debt, and a few other financial arrangements such as bonds, bank loans, term financial certificates, leasing, etc.).

Hypotheses have been formulated based on research such as that cited above, including the following:

H1: There is an association between debt financing and capital intensity.

H2: There is an association between debt financing and the firm's size.

H3: There is an association between debt financing and profitability.

H4: There is an association between debt financing and return on capital employed.

H5: There is an association between debt financing and asset turnover.

3.2. Operation of variables

3.2.1. Capital intensity ratio

Capital intensity is the amount invested in producing output worth $1.

Capital Intensity = Average Total Assets/Turnover

3.2.2. Company size

The natural logarithm of total assets calculates company size.

3.2.3. Profit margin

The net profit margin of sales is used as an agent to measure the company's profitability. It is calculated as;

profit margin = net income / sales * 100

3.2.4. Asset turnover

The asset turnover ratio analyzes the relationship between the value of a company's sales or earnings and the value of its assets. It is calculated as follows:

Asset turnover ratio = Total revenue/Average total assets

3.2.5. Return on capital employed

The return on capital employed (ROCE) is a financial measurement that assesses the profitability and efficiency of a company's use of capital. In other words, the ratio assesses a company's ability to generate a return on its assets.
The formula of ROCE is, \( \text{ROCE} = \frac{\text{EBIT}}{\text{Capital Employed}} \)

Where:

\( \text{EBIT} \) = Earnings before interests and taxes

\( \text{Capital Employed} \) = Total assets – Current liabilities

### 3.2.6. Capital structure

Capital structure ratios are divided into three categories:

- The equity ratio expresses the proportion of the business's total funds invested in the owners' hands. According to the old law school, more equity is safe for the firm, and there should be more equity in total capital.

\( \frac{\text{Shareholders' Equity}}{\text{Total Capital Employed}} = \text{Equity Ratio} \)

- Total debt divided by total capital employed is the debt ratio.

Short- and long-term debt, financial institution borrowings, bonds, debentures, and bank borrowings are all included in total debt. In a nutshell, it refers to any form of external finance other than equity.

- The financial performance of the company; Debt to equity ratio is a factor or driver that shows the impact of a company's financial performance [20]. The debt-to-equity ratio is calculated as follows: 

\( \frac{\text{Debt} + \text{Preferred Long Term}}{\text{Shareholders' Equity}} \)

### 3.3. Sampling method

The study is done on 46 companies in the textile sector listed on the Dhaka Stock Exchange. Five years (2015-2019), annual reports of 46 companies have been considered for this study due to the availability, and most importantly, new firms were becoming listed every year. Under this circumstance, the researchers decided to go for only those listed companies to equalize the listed company numbers. They did not include any company which enlisted during this period. Therefore, convenience sampling was used to select the companies with data available during the study.

### 3.4. Data collection

The study is based on secondary data. The data collected in this study comes from the annual reports of selected companies.
4. Discussion & Analysis

The association between the variables analyzed is identified and measured using linear regression. The regression equation that is used to explain the association between the independent and dependent variables is:

\[ DR = b_0 + b_1 \text{(CIR)} + b_2 \text{(SIZE)} + b_3 \text{(NPM)} + b_4 \text{(RoCE)} + b_5 \text{(ATR)} + e \]

Where, \( b_0 \) = a constant

\( b_1 \) = coefficient of regression which evaluates the sensitivity of the debt-to-capital ratio to changes in the capital intensity ratio.

\( b_2 \) = regression coefficient, which quantifies the sensitivity of a firm's debt-to-capital ratio to a change in its size.

\( b_3 \) = regression coefficient, which evaluates the sensitivity of the debt-to-capital ratio to the net profit margin percentage change.

\( b_4 \) = regression coefficient, which evaluates the sensitivity of the debt-to-capital ratio to changes in the return on capital employed

\( b_5 \) = regression coefficient, which reflects the sensitivity of a change in the debt-to-capital ratio to a change in the asset turnover ratio.

\( DR \) = change in debt ratio from one period to the next in percentage

\( \text{CIR} \) = Capital intensity Ratio

\( \text{NPM} \) = Net profit margin

\( \text{SIZE} \) = Firm size

\( \text{RoCE} \) = Return on capital employed

\( \text{ATR} \) = Asset Turnover Ratio

\( e \) = error term

According to the model summary, 62.3% of the variance in capital structure can be explained by the independent variables' variance. Concurrently, from the ANOVA table, it can be found out that the regression output is significant, as indicated by the p-value of less than 5%.
Table 4.1: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.790a</td>
<td>.623</td>
<td>.576</td>
<td>.16857</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Asset Turnover Ratio, Net Profit Margin, Return on Capital Employed, Size of Firm, Capital Intensity Ratio

Table 4.2: ANOVAa

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>1.881</td>
<td>5</td>
<td>.376</td>
<td>13.242</td>
<td>.000b</td>
</tr>
<tr>
<td>Residual</td>
<td>1.137</td>
<td>40</td>
<td>.028</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>3.018</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Debt Ratio
b. Predictors: (Constant), Asset Turnover Ratio, Net Profit Margin, Return on Capital Employed, Size of Firm, Capital Intensity Ratio

Table 4.3: Coefficientsa

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standard Coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>.782</td>
<td>.111</td>
<td></td>
<td>7.053</td>
</tr>
<tr>
<td>Capital Intensity Ratio</td>
<td>-.064</td>
<td>.049</td>
<td>-.155</td>
<td>-1.321</td>
</tr>
<tr>
<td>Size of Firm</td>
<td>-1.012E-11</td>
<td>.000</td>
<td>-.138</td>
<td>-1.392</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>-.033</td>
<td>.005</td>
<td>-.720</td>
<td>-6.968</td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>.002</td>
<td>.005</td>
<td>.037</td>
<td>.319</td>
</tr>
<tr>
<td>Asset Turnover Ratio</td>
<td>.030</td>
<td>.045</td>
<td>.068</td>
<td>.678</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Debt Ratio

The initial regression equation can be pointed out from the co-efficient table. According to the data above, the equation stands as:
Change from one period to the next in the debt ratio, expressed as a percentage = 0.782 – 0.064* Capital Intensity Ratio – 1.012E-11*Size of the firm – 0.033*Net Profit Margin + 0.002* Return on Capital Employed + 0.030* Asset Turnover Ratio

However, upon further inspection and taking the significance level of all the independent variables into consideration, it is found out that except for net profit margin, all the other independent variables have a p-value greater than 0.05. As a result, these variables cannot be included in the final equation.

Due to such high significance values of most independent variables, the researcher conducted a step-wise regression analysis to determine which independent variables had the most impact and justified significance level in explaining the capital structure variance.

Table 4.4: Model Summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.754*</td>
<td>.569</td>
<td>.559</td>
<td>.17193</td>
</tr>
</tbody>
</table>

a. Predictors: (Constant), Net Profit Margin

Table 4.5: ANOVA*

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Regression</td>
<td>1.717</td>
<td>1</td>
<td>1.717</td>
<td>58.100</td>
<td>.000*</td>
</tr>
<tr>
<td>Residual</td>
<td>1.301</td>
<td>44</td>
<td>.030</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>3.018</td>
<td>45</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Debt Ratio  
b. Predictors: (Constant), Net Profit Margin

Table 4.6: Coefficients*

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandard Coefficients</th>
<th>Standard Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td>1 (Constant)</td>
<td>.688</td>
<td>.042</td>
<td></td>
<td>16.568</td>
</tr>
<tr>
<td>Net Profit Margin</td>
<td>-.035</td>
<td>.005</td>
<td>-.754</td>
<td>-7.622</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Debt Ratio
Table 4.7: Excluded Variables

<table>
<thead>
<tr>
<th>Model</th>
<th>Beta In</th>
<th>t</th>
<th>Sig.</th>
<th>Partial Correlation</th>
<th>Collinearity Statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Capital Intensity Ratio</td>
<td>-.186^b</td>
<td>-1.887</td>
<td>.066</td>
<td>-.277</td>
<td>.950</td>
</tr>
<tr>
<td>Size of Firm</td>
<td>-.134^b</td>
<td>-1.372</td>
<td>.177</td>
<td>-.205</td>
<td>1.000</td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>.130^b</td>
<td>1.319</td>
<td>.194</td>
<td>.197</td>
<td>.987</td>
</tr>
<tr>
<td>Asset Turnover Ratio</td>
<td>.054^b</td>
<td>.536</td>
<td>.595</td>
<td>.081</td>
<td>.995</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Debt Ratio
b. Predictors in the Model: (Constant), Net Profit Margin

As per the regression output, only the Net Profit Margin has a p-value of less than 5%, explaining 56.9% of the variability in the dependent variable. Because of the higher p-value, SPSS has excluded all the remaining variables. According to the coefficients table, the final regression equation is:

\[
\text{Change from one period to the next in the debt ratio, expressed as a percentage} = 0.688 - 0.035 \times \text{Net Profit Margin}.
\]

According to these findings, H1, H2, H4, and H5 are rejected, whereas H3 is accepted. As a result, debt financing negatively correlates with capital intensity, company size, asset turnover, and return on capital employed, whereas it responds positively to profitability. Rather than the pecking order theory, this result is consistent with the trade-off theory. The health of a company's bottom line is reflected in its profitability [30]. They further mentioned that the more profitable a company is, the more money it retains in the form of retained earnings, which lowers its debt burden. Therefore, it is clear that a company's worth rises directly to its profitability. The majority of empirical investigations reveal that no consistent theoretical predictions exist for profitability effects on leverage. Conferring to the trade-off argument, more profitable enterprises should have more leverage since they have adequate money to invest in tax avoidance. In line with the free-cash-flow theory, more profitable corporations utilize more significant debt to restrain management and encourage them to pay out cash rather than invest in wasteful ventures [9]. As a result, several empirical investigations show a link between leverage and profitability [14]. According to the pecking order theory, firms favor in-house finance versus external finance. As a result, more profitable businesses require less external financing and lower leverage [9]. This finding is supported by many empirical studies (for instance, 19, 33, 36, 38, 39, 40).

5. Conclusion & Recommendation

A country that is 83 percent focused on one industry must prioritize tomorrow's leaders in that field. The textile industry in Bangladesh must capture the attention of the country's young by highlighting the numerous employment prospects available in the RMG sector. The limitation of this study is it has focused only on the textile sector whereas there are other sectors under manufacturing category. The future researcher can research
on other sectors.

According to the present study findings, it can be concluded that the net profit margin has a significant impact on the debt financing ratio (DER) or capital structure among all the selected variables. As a result, this study helps understand the effects of profitability on debt financing, which will aid in developing future financial reforms for the industry. Debt financing is an essential funding source in Bangladesh's textile industry; however, these businesses must be cautious. It will impact a company's market position; management must also evaluate the risk of debt financing. Therefore, textile companies that seek to extend their capital intensity and increase quality as a result, but getting the proper financing mode, for this reason, is very important because if the proper mode is not chosen, it could prove counterproductive and will adversely affect the company's performance and reputation. Profitable firms can expand in size through the generation of internal funding sources. However, they have to watch out about financing choice and price because it affects their market position and share price.

Bangladesh's textile sector has been going through a challenging period in recent years. Hence the companies find it difficult to thrive and compete with the world. In such a scenario, businesses need to handle the capital structure optimally to maximize and maintain profits. Consequently, informed decisions on improvements in the capital structure should be made, considering profitability. However, even though the current study shows that capital intensity, firm size, asset turnover ratio, and return on capital employed do not affect capital structure change, further study needs to be done to inspect other industries. Furthermore, future research can look into other factors that influence capital structure in different industries. A deeper understanding of capital structure determinants in our rising economy will be necessary for enhancing empirical studies in this field and for cross-economy company appraisal.

References


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