

ABSTRACT

This study empirically tests the Burger and Udell Life Cycle Model and Myers (1984) Pecking Order Theory for Small and Medium sized Enterprises' (SMEs) capital structure decisions amongst 200 SMEs in Ratnapura District employing a survey method for the financial year 2007. The analytical technique employed is logistic regression framework with various capital structure measures as dependent variables are with age, size, ownership structure, asset structure, growth options information asymmetry and industry's independent variables. Further, relationships are also found between age, size, ownership, capital structure, growth options, information asymmetry and industry and means of collateral used to secure debt financing.

The results show that larger firms as measured by total number of employees between age 5-15 would eliminate information asymmetry by holding a higher proportion of fixed assets and tend to acquire long-term debts as opposed to insider financing consistent with Life Cycle Theory (LCT). In line with previous studies, financing choices of SMEs follow a pattern of Pecking Order as proposed by Myers (1984). The qualitative analysis reveals that the underlying motives for these choices are desire for independence and control and perceived lack of information available in debt markets.

Keywords: Financing Decisions, Small and Medium Size Enterprises, Pecking Order Theory, Life Cycle Theory, Logistic Regression