A Discussion on Capital Structure –by the Three-Year Period Longitudinal Mediation Analysis Model

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Abstract

Based on the 2006-2008 financial data of Taiwan’s listed electronics companies, this study used the three-year period longitudinal mediation analysis model to analyze causal relationships between profitability, capital structure and firm value. Longitudinal mediation analysis means relationships in between variables will change over time. Some independent variable affects the mediator, and then the dependent variable. Therefore, the three variables may change over time. The study on one-year periodical data suggested, the current year profitability would affect capital structure, and furthermore affected firm value. Profitability had negative effect on capital structure, which was consistent with assumptions of the financing pecking order theory; capital structure had a negative effect on firm value, which indicated increasing debt ratio would lower firm value. During the extended period of three years of the study, the 2007 capital structure was also subject to the influence of the 2006 profitability and capital structure in addition to the current year profitability. The 2008 firm value was subject to the influence of the profitability and capital structure in the year 2006 and year 2007 in addition to the current year profitability and capital structure. Hence, the adjustment of capital structure and firm value was a dynamic process.

Keywords: Capital structure, firm value, longitudinal data, mediation analysis model

1. Introduction

The pursuit of firm value maximization is the goal of business operation. The business funding sources can be categorized into the external and internal funds, and the composition of funding from different sources is the enterprise capital structure. Capital structure is vitally relevant to business safety and growth and the protection of creditors. Effective and accurate financing decisions have a decision impact on the firm value and shareholder wealth. Managers must carefully deal with financing decisions as a bad financing decision will increasing financial pressure, and even lead to bankruptcy. In the highly competitive environment, how to combine various sources of funding to implement