INTERNAL AND INSTITUTIONAL FACTORS OF SPEED OF ADJUSTMENT TO THE TARGET CAPITAL STRUCTURE: EVIDENCE FROM DEVELOPED AND EMERGING CAPITAL MARKETS

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Abstract

This paper considers capital structure management from the perspectives of dynamic trade-off theory and, more specifically, analyzes determinants of speed of adjustments (SoA).

The authors review results of the previous theoretical and empirical studies about adjustment costs and SoA related to developed and emerging markets where an influence of internal and macroeconomic factors was identified. Next, the authors hypothesize that recapitalization costs/earnings may also be dependent on the development of the institutional environment.

The empirical testing in this paper is based on the data of 3973 companies from 35 developed and emerging countries (including Russia) for 2005 – 2010. The partial adjustment model with Blandell-Bond method is used to test the influence on SoA of such internal variables as capital size, return of total capital, growth opportunities and assets tangibility, and such macroeconomic variables as GDP growth rate and time dummies

Such groups of factors as «Getting Credit», «Protecting Investors» and «Resolving Insolvency» from «World Development Indicators» and «Doing Business» data bases of the World Bank are considering as the main indicators of the institutional environment. The influence of these factors on the SoA was estimated by dividing the sample based on a variable value and applying a graphical analysis.

Finally, the authors conclude that due to the financial crisis of 2008, the SoA for the majority of companies decreased both in the developed and emerging countries. The internal factors are the most significant in the determination of SoA for companies in the Western Europe. On the other hand, for emerging markets the GDP growth rate and time dummy are the most important variables. With regard to the Russian companies the authors point out that in 2005 – 2010 capital structure decisions were determined only by the current debt level and the overall economic situation in the country.

Besides the authors identified that there is a non-liner dependence between SoA and variables of credit institute and institute of insolvency. Moreover, the hypothesis about positive influence of variables of protecting investors institute on SoA was confirmed both on the sample of developed and emerging countries.

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Keywords: capital structure, dynamic trade-off theory, speed of adjustment, institutional factors

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