

Capital structure is the proportions of debt instruments, preferred stock and common stock on company's balance sheet. Business entities choose different combinations of equity, debts and other options for the purpose of financing their assets. Some businesses choose more financing from the equity and less from debts, while others rely more on debts and less on equity financing depending upon nature of their business, industry and risk. Firms mostly go for that combination of debt and equity that optimizes their cost of capital and risk. Perfect combination of capital structure and working capital enhance the profitability and financial performance of the firms.

This study is conducted to examine the impact of capital structure and working capital management on the financial performance of selected non-financial firms in Pakistan. For this purpose 78 non-financial firms listed on Karachi Stock Exchange (KSE) have been selected for the period of seven years from 2005 to 2011. The data is obtained from the financial statements analysis published by the statistics department of State Bank of Pakistan.

For the purpose of analysis, descriptive, correlation and panel data analysis are used in this research. Twelve panel data (regression) models have been used to investigate the impact of capital structure and working capital management on financial performance of the firms. In these models three proxies are used as independent variables to measure the capital structure i.e. total liabilities to total assets, long-term liabilities to total assets and short-term liabilities to total assets. Three proxies are used as independent variables to measure the management of working capital i.e. receivable conversion ratio, inventory conversion ratio and current ratio while the natural logarithm of sales is used as control variable to measure the size of the firms. In these panel data (regression) models return on total assets, net profitability, return on shareholders' equity and earnings per share are used as dependent variables to quantify the financial performance of the firms listed on Karachi Stock Exchange.

The results of the analysis showed that debts lead to decrease the financial performance of the firms while all the measures of working capital management have positive impact on firms' performance. The results also revealed that good combination of capital structure and working capital has significant impact on financial performance of non-financial firms listed on KSE. So these firms have to give due consideration to the financing options and management of working capital to increase their financial performance.