

Capital Structure is the combination of various financing options. Business entities choose different combinations of equity, debts and other options for financing of 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 their nature of 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 can 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 firms listed on Karachi Stock Exchange. For this purpose, 130 non-financial firms have been selected for the period of six years from 2005 to 2010. The data is obtained from the financial statements analysis published by the statistics department of State Bank of Pakistan.

Descriptive statistics, correlation and regression analysis are done in this research. Nine 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 debts to total assets, long term debts to total assets and short-term debts to total assets. Three proxies are used as independent variables to measure the management of the working capital i.e. accounts receivables turnover ratio, inventory turnover ratio and current ratio, while the natural logarithm of sales is used as control variable to measure the size of the firms. In these regression models return on assets, net profitability and return on assets are used as dependent variables to measure the financial performance of the firms listed on Karachi Stock Exchange. The results of the analysis showed that debts lead to decrease in the financial performance of the firms. The results also showed that good combination of capital structure and working capital has significant impact on the financial performance of the firms listed on Karachi Stock Exchange. So, these firms have to give due consideration to the financing options and management of working capital to increase their financial performance and profitability.

Keyword: Working capital, Capital Structure, Financial Performance, Short-term Debts, Long-term Debts