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Capital Structure and Business Groups: Evidence from Pakistan

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Abstract: *The purpose of this study is not only to test the effects of group affiliation on capital structure decisions of Pakistani firms, but also to compare the determinants of capital structure of group's affiliated firms with those of independent firms. This study also investigates the differences in financial decision of both group affiliates and independent firms during the period of energy crisis.Using the 2-step GMM method, this study finds that business group affiliated firms use relatively more debt financing as compared to independent firms in Pakistan. Overall, this study verifies the existence of standard determinants as suggested by capital structure theories. However, practical differences exist regarding the determinants (e.g., firm size, firm growth, firm profitability and firm tangibility) between both group's affiliated firms and independent firms specially. Moreover, larger and more profitable groups are using more debt financing, while the highly leveraged and diversified groups have a limited access to debt financing.The findings also suggest a high level of accessibility to the debt financing for the group affiliates as compared to independent firms without a significant shift in the firm level determinants of capital structure during the energy crisis. It is the group's overall risk that appears to be an important attribute for the external finance providers during the energy crisis.*

Keywords: Capital structure, business groups, energy crisis, and Pakistan.

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