

What's wrong with Positive Relationship between Growth Opportunities and Leverage?

Hayat. M. Awan

Faculty of Management Sciences
BZ University, Multan, Pakistan

M. Ishaq Bhatti

Dept of Economics and Finance
UAE University, AL-Ain, UAE and
La Trobe University, Melbourne, Australia

Abstract

Growth opportunity has been considered as a significant determinant of capital structure. The literature in this regard mainly favors the negative relationship between the growth opportunities and leverage of firms. The possible reasons behind such a negative relationship are perishability of growth opportunities, reduction of the flexibility (as caused by the debt) to grow further (needed by highly growing firms), low collateral value of growth opportunities due to intangibility, tendency of firms to issue stock when their stock price is high due to expected future growth opportunities and high risk involved in the growth opportunities, etc. But most of these studies have been conducted in developed economies of Australia, Western European countries and USA. The arguments supporting this positive relationship mainly include the disciplinary implications of debt and increase in debt-raising capacity for firms with higher growth opportunities. Surprisingly, in this paper, we observed positive relationship between the growth opportunities and debt levels of the corporate firms based on from Pakistani data. Moreover, finding in this paper validates the prominent role of growth opportunities in the theory of corporate finance.