ABSTRACT

This study aims to investigate the relationship between leverage and firm value by using Panel Threshold Regression Model. The study explored the existence of optimal debt level of 182 firms listed at KSE for the period of 2007-2012. The study used Tobin's Q (market based measure of firm value), debt ratio (proxy of leverage), firm size (control variable) and growth rate (control variable). The findings of the study identified double threshold effect between leverage and value of firm operating in non-financial sector of Pakistan. The existence of threshold effect between leverage and firm value has also confirmed the asymmetrical relationship between the two variables. The studyexploredthat optimal debt ratioof 56.35%-56.72% for the firms operating in non-financial sector of Pakistan. Therefore, suggested that firms should use debt carefully within the identified limit to gain benefits of debt financing; using debt beyond the target level will deteriorate the value. Firm size and growth rate have insignificant effect on firm value showing the inefficient utilization of asset expansion and increase in sales. The results of study are consistent with Trade-off Theory that supports the existence of optimal capital structure; a point at which firms maximizes their value at a minimum cost of capital.

Key words: Capital structure; leverage; Optimal debt level; Firm value; Firm size; Growth rate; Panel threshold regression.