

A New Test of Capital Structure

Abstract

This paper reports a new test of capital structure theories. It uses a filtering technique to identify large investment spikes. We find that the spikes are predominantly financed with debt by large firms and by new equity by small loss-making firms. In the process, firms move significantly away from their previous capital structures but then revert back to them by making frequent issues of small amounts of equity. Neither the pecking order nor the trade-off theories on their own provide satisfactory descriptions of these dynamic features of corporate financing.

Key words: Capital structure, corporate finance, pecking order, trade-off theory

JEL classification: G32