Debt financing and importance of fixed assets and goodwill assets as collateral: dynamic panel evidence

ABSTRACT

This article analyses the effect of fixed assets and goodwill assets on South African firmsô debt ratios. The difference and system generalized method of moment estimation results reveal that fixed assets and goodwill assets have significant and positive relationship with firmsô debt ratios. To secure long-term debt, fixed assets and goodwill assets are required as collateral by creditors. Our results show firmsô adjust to long-run optimal debt level, but at a slow adjustment rate. Our results suggest there are costs preventing South African firms from adjusting faster to their long-run optimal debt level. The practical implication of the paper is that policy makers should promote policies that encourage further development of the capital market. Moreover, firms need both fixed assets and goodwill assets as collateral to raise the desired optimal debt that maximizes firm value.

Keyword: Capital structure; Debt ratio; Trade-off theory; Fixed assets; Goodwill assets; Panel GMM