

# How Cost Of Capital Moderates When Firms Use Equity Financing To Increase Firm Value. Empirical Evidence From Pakistan

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## Abstract

This study investigates the capital structure and Pakistani corporate profitability. The study sample includes KSE-100 non-financial enterprises. From 2015 through 2020, annual panel data is compiled using participant financial accounts. According to empirical models, the cost of capital affects a company's performance and value. Pakistani businesses rely substantially on bank loans due to a small bond market. By introducing an appropriate policy, Pakistani enterprises could be guided to avoid equity financing, company size, and value difficulties. Managing capital structure is key to increasing corporate value.

**KEY WORDS:** Profitability, WACC, Tobin's Q, KSE 100 Index, ROE

## 1 INTRODUCTION

Financing decisions have always significantly impacted how much money a company has available to operate and grow; therefore, managing the cost of capital has always been a significant concern. The cost of capital and the company's value depends on the decision made regarding the company's capital structure (Kurfi, 2003). Companies must choose an optimal capital structure to maximize stakeholder value (Morris, 2001). The risk and cost of a company's funding (capital) are indicators of what stakeholders expect in return for lending their money to the company. This

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funding is typically backed by assets, such as bonds and shareholders. On the other hand, firms create value when they offer a benefit more significant than the cost of investment, and the best mix of capital structure reduces the firm's overall cost of capital (Khadka, 2006). As a result, this study examines how the cost of capital affects equity financing and the firm's value.

Due to a lack of suitable capital combinations, corporate operations worldwide are degrading (Aziz & Abbas 2019). In emerging countries like Pakistan, the decision on the appropriate capital mix for more excellent corporate performance is a concern. The capital structure's explanatory power may be hampered by Pakistani enterprises' reliance on short-term loans. Numerous Pakistani businesses have been forced to shut down because of their inability to service their debts, which is especially common in emerging economies like Pakistan. According to a correlation between growth potential and debt, high-growth Pakistani enterprises borrow more money to fund new investments.

Furthermore, most privatized commercial banks choose to offer conventional short-term rather than long-term loans. Because of these reasons, short-term financing is often used to finance long-term investments. According to market analysis, debt financing losses have been enormous for many listed companies in Pakistan over the past decade. This situation can be ascribed to a lack of and lousy management to decide on the optimal capital for business operations. Various financial theorists disagree on the impact of a company's capital mix on its financial performance. However, according to the classical perspective of the corporate capital structure, many researchers like (Saunders, Lewis & Thornhill, 2009), if there is a feasible capital mix, the firm performance may be improved. Numerous investigations and theoretical affiliations have been discussed on the ideal capital structure for highly productive businesses (Brealey & Myers, 2003). Due to the lack of a developed bond market in Pakistan, enterprises rely mainly on bank financing. A good solution could therefore direct Pakistani enterprises away from challenges connected to equity financing and the value of firms. Managers and other stakeholders will benefit from this research by being better equipped to make informed decisions on the optimal mix of capital for a company's growth.

The cost of capital has been shown in empirical studies to influence a company's performance and value significantly. Due to the lack of a developed bond market in Pakistan, companies rely mainly on bank financing. As a result, enterprises in Pakistan could be guided to remove themselves from concerns linked to equity financing, firm size, and value by enacting an appropriate strategy. Managing capital structure is one of the most critical financial decisions to maximize organizational value. However, how does a business figure out its ideal cost of equity? Is it appropriate for the managers to utilize more equity? Does the value of the company alter if the cost of capital changes? In today's business world, managers must deal with these issues. Additionally, academic researchers are stimulated by these questions, which pique their interest and encourage them to investigate further.

Managers at the company are concerned about all of the issues listed above. Managers must understand the impact of the cost of capital on equity financing and the company's value. This way, they can match their firm equity financing policies with their competitors and make well-informed decisions. It is therefore predicted that this study will deal with this issue.

## **1.1 RESEARCH OBJECTIVE**

The objectives of the study are:

- To investigate the effects of cost of capital on equity finance and firm value in Pakistan.
- To investigate the relationship between cost of capital and firm value.
- To investigate the impact of equity financing on firm value.
- To investigate the impact of the cost of capital on firm size

## **1.2 RESEARCH QUESTIONS**

- Does cost of capital affect equity financing and firm value in Pakistan?
- Does equity financing have any impact on firm value?
- What is the relationship between the cost of capital and the value of the firm?
- What are the effects of the cost of capital on the size of the firm?

## **2.0 THEORETICAL AND LITERATURE REVIEW;**

### **2.1 THEORETICAL REVIEW**

The capital structure concept and the cost of capital of a company go hand in hand. Is the cost of capital directly proportional to the value of a firm, and is there an ideal capital structure? Finance academics who hold this view strongly disagree with one another. Those who think there is such a thing as the "ideal capital structure" use a more time-tested approach to the problem.

#### **2.1.1 Pecking order theory:**

One of the essential concepts in corporate finance is the "pecking order" hypothesis of capital structure. According to the pecking order idea, businesses prioritize different forms of financing in different ways (Myers & Majluf, 1984). The company will prioritize retained earnings over debt, short-term debt over long-term debt, and debt over equity due to information asymmetry between the company and potential investors. The author further argues that companies should not issue any new securities to tackle the problem of information asymmetry, instead relying solely on retained earnings to fund investment possibilities. As the information gap between insiders and outsiders widens, the cost of issuing shares rises. Companies with significant information asymmetry may want to consider taking on debt to prevent the sale of securities at a discount. There is a negative correlation between a company's stock price and actions that weaken its capital structure, such as a new stock issue. The market reacts positively to reports of increased capital structure events because financial intermediaries like investment banks will have greater access to information about the company's performance. May know anything about the company that is not public knowledge. Investors can better understand the genuine distribution of corporate returns than those outside. Investors often restrict access to ownership to maintain power within the company (Hutchinson, 1995). Investors do not know the potential downside of the company's return. Investors may be undervaluing a company because the market relies on imperfect information, such as the firm's financial structure when assessing the safety of its investment (Myers & Majluf, 1984).

According to Myers (1984), a firm's value and capital structure are associated. This is because the proper form of capital can raise the value of an organization. According to this theory,

the value of a company can be increased if a capital structure hierarchy is followed. Put another way, using internal funds whenever possible instead of external funds. Debt should be preferred to equity when the company's internal funds are depleted due to decreased transaction costs, tax benefits, and other miscellaneous advantages.

### **2..1.2 The Trade-Off-Theory:**

In Corporate Finance, (Modigliani and Miller, 1958) first initiated this innovative study on capital structure. The MM Theorem states that leverage does not affect a company's value in ideal capital markets. This theorem shows that the debt-to-equity ratio does not affect a company's worth. According to static trade-off theory, the optimal debt ratio is determined by weighing the costs and benefits of debt. The optimal level of debt issuance is reached when the present value of the benefits outweighs the present value of the costs (Myers, 2001). A significant advantage of debt is the ability to reduce interest payments. These advantages encourage businesses to take on debt. Miller (1977) shows that personal taxes and, in some cases, non-debt tax shielding complicate what would otherwise be a direct effect (DeAngelo & Masulis, 1980). Also, equity issuance is a sign of departure from the optimal, which is disappointing. Myers (1984) provided additional evidence that companies choose to issue equity if they believe it is mispriced. However, when a company issues stock, investors start to question whether or not they got a good deal. Therefore, management is not keen to issue shares because of the unfavorable reaction it elicits from investors. According to Cambell and Kelly (1994), trade-offs are fundamental to economics, just as they are to life. In economics, the decision-maker and society cannot get everything they want. Trade-offs must be made when the criteria that govern social decisions are not all completely satisfied.

## **2.2 LITERATURE REVIEW**

Several studies have examined the relationship between equity financing and firm value. For example, studies by Nirajini and Priya (2013) show that equity financing directly impacts the performance of Sri Lankan firms. Shah and Khan (2014) examined the impact of capital structure on firm performance using Karachi-listed firms. The results show that equity assets positively impact a firm's performance. According to Kodongo and Mokoalel-Mokoteli-Maia (2014), adopting an incorrect capital mix in Nairobi negatively impacts firm value. Earlier research by Mwangi, Makau, and Kosimbei (2014) found a similar conclusion. In Vietnam, Vo and Ellis (2017) found that equity financing has a negative impact on the performance of Vietnamese businesses. Using data from 40 Kenyan non-financial firms, (Achieng, Mutur & Wanjare, 2018) assess the impact of equity financing on firm performance. The results suggest that equity financing condenses firm performance.

From 2006 to 2014, Aziz and Abbas (2019) found that equity financing has a detrimental impact on the value of Pakistani businesses. Using a sample of 533 small and medium-sized enterprises (SMEs) throughout Europe, (Salerno, 2019) investigate the impact of equity financing on business performance. The results show that equity financing boosts a company's success. Conventional economics focuses on a low-weighted average cost of capital (WACC) that maximizes market value per share through a well-balanced capital structure. However, the debt and equity ratios do not suffice to determine performance because various factors interfere with these connections. Business risk, taxation, management conduct, and financial flexibility all play

a significant part in the examination of firm performance, according to Akintoye (2009). Because the capital structure is predicated on the trade-off between risk and expected return, these are essential in setting a target capital structure. To achieve this goal, organizations should aim for a debt-to-equity ratio that reduces the cost of capital while increasing the company's value.

Additionally, any adjustments to the firm's debt or equity will alter its market value. According to tax benefits, corporations are encouraged to borrow more to function better under the tax load. Some believe that a company's total market value, or the sum of the stock market value plus the equity options, is a good indicator of its overall performance (Cole & Mehran, 1998; Merz & Yashiv, 2007). Others believe that the worth of a firm extends beyond its market capitalization to include the value of the company's operational assets (Mehran, 1995). A company's performance is directly related to how well it manages its resources. Many factors influence a firm's performance and profitability, including its financial structure. Previous research has found a positive correlation between short-term and overall debt and performance but a negative correlation between long-term debt and profitability expressed by return on equity (Abor, 2005).

### **2.2.1 The conceptual issue concerning the cost of capital and firm value :**

In addition to using its funds, a corporation may be able to obtain funding from a variety of other sources. Borrowing money from a bank or issuing bonds is one form of debt (pay a defined payment of principal plus interest rate per period, but retain complete ownership of the company). If you sell your firm's shares, you not only get your money back but also lose control of the company.

### **2.2.2 Cost of Capital for Equity Financing:**

Investing in a firm requires convincing investors that the company's value will rise at a rate that will give them a profit. As a general rule, investors can estimate the company's value at some point in the future, select an acceptable discount rate, and decide their maximum willingness to pay the current market price. The P/E ratio is the inverse of the return on investment assuming profits remain unchanged, but investors commonly use it to compare companies with similar predicted growth rates. The price-to-current-earnings ratio is standard metric investors use in the real world.

### **2.2.3 Relationship between the cost of capital and the firm value:**

Shadab and Sattar (2015) state that firm value and profitability are found to raise not only the size of the company but also the Gross Domestic Product (GDP), with the subsequent rise in economic potential benefiting the people of the Country. The primary purpose of the Cost of Capital is to determine whether or not a company has the resources to expand its operations and remain profitable at a high volume. Long-term debt, retained earnings, asset management, and capital management are just a few factors that must be carefully considered before making final decisions. Keeping this in mind, many firm financial executives actively seek to determine the optimal cost of capital. Amardeep (2013) argues that the cost of capital should serve as the starting point for any economic evaluation of proposed new investments. If the cost of capital is inaccurate, the finance manager will draw an erroneous conclusion. Decisions about capital structure must also take into account the cost of capital. The finance manager is responsible for securing funding from various sources while minimizing overall cost and risk.

Spatareanu (2008) states that several qualitative, quantitative, and subjective aspects must be considered when planning and constructing a company's capital structure. In addition to these factors, a financial manager should determine which capital structure is the most favourable for the company and examine the capital structure holistically. The company should also take care of the interests of its owners, creditors, and management. Before anything else, consider any applicable legislative rules governing the company's capital structure. It should be highlighted that the entire risk of the firm is managed below acceptable limits by balancing both the financial and business risk. High-risk businesses should maintain financial risks to a minimum; otherwise, they will become high-risk investments with higher costs of capital because of their high risk.

Decisions about the structure of a company's capital are essential. A firm can use debt or equity to fund investment decisions (Amardeep, 2013). This is a financial decision and may impact a company's debt-to-equity ratio. Overall, the debt-equity mix significantly impacts shareholder risk and earnings. As a result, it is critical for enterprises' financial management to establish the appropriate mix of stock and debt financing (capital structure) to maximize the firm's value.

#### **2.2.4 The weighted average cost of capital (WACC):**

The total cost of capital refers to the sum of all financing expenses. The rate is applied as a discount factor when calculating the value of potential future investments. As Brealey and Myers (2003) point out, the relative benefits of debt and equity will change depending on the characteristics of every given case.<sup>6</sup> Modern capital structure theory was initially outlined by Modigliani and Miller in 1958. They insisted that choices about finances and investments are made separately. An argument favouring the Net Operating Income (NOI) approach was developed, which held that a firm value and total cost of the capital were used as independent capital structure of the firm. According to their theory, investors will always find a way to maintain the firm's WACC the same, no matter how profitable it is. Since then, much effort has been put into analyzing the results of a company's capital structure choices. The pecking order and trade-off models are two well-liked alternatives. A company can determine the best leverage level by comparing the marginal costs of debt versus equity financing.

#### **2.2.5 The equity and the firm value:**

Equity comprises solely the equity owned by the company's shareholders contrary to the long term debt. Shareholders have already contributed a portion of the call-up capital (Igben, 2004; Izedonmi, 2002). As a result, he also refers to reserves as amounts aside from the company's profits, which are not intended to satisfy any potential liabilities or commitments. The board of directors can establish reserves or be mandated by statute. The premium is the difference between the price at which a share is sold and the price at which it is offered for sale. Last but not least, retained earnings are profits reinvested in a company to generate more resources for operations and raise the company's value. Our first hypothesis is that equity and business value have a positive connection.

### **2.3 RESEARCH GAP**

Although much research was done through different articles, journals, websites, and other research studies, instead, in this research study, the moderating effect of the cost of capital on the relation

of equity financing and firm value in Pakistan has been checked, regarding which no sufficient research has been carried out.

## **2.4 HYPOTHESIS**

H1: There is a significant effect of the cost of capital on equity finance and firm value in Pakistan.

H2: There is a significant effect of equity finance on firm value.

H3: There is a significant impact of cost of capital on firm value.

H4: There is a significant effect of cost of capital on firm size.

## **3.0 METHODOLOGY**

Research is done for a variety of reasons, and it is done using a variety of methods, including experimental, explorative, active, and bookish. In order to better understand the role of cost of capital and firm value in equity financing in Pakistan, several studies have been carried out in established and developing nations, as well as in Pakistan. This study is descriptive. Ex post facto research is used in this study. This is to determine how an independent variable impacts a dependent variable. The ex-post facto research design also aids in the discovery of potential cause-effect relationships by finding inevitable already-existing consequences of explaining a particular variable (Sambo, 2005).

The study includes a review of 20 textile companies. This study uses the PSX (Pakistan Stock Exchange) classification of textile firms to make generalizations about the whole textile industry. In order to avoid population-related inaccuracies, the census method has been used to collect data, thus enhancing the validity of the data acquired (Saunders, Lewis & Thornhill, 2009). Ultimately, the census is just a head count from a small portion of the population. Additionally, censuses are favored when the population is small enough to be controlled, as Mugenda and Mugenda (2003) pointed out in their study. As a result, census data is utilized to determine the population's characteristics. Despite this, the census approach has provided an equal opportunity for everyone.

The regression analysis has been used to examine the data, which includes 132 observations, 12 cross-sectional units, and a time series of 6 years. The research examines the impact of the cost of capital on equity financing on the value of publicly traded textile companies in Pakistan.

Three types of variables are used in this research study: dependent, independent, and moderator.

### **3.1 Dependent Variables:**

The dependent variable of the study is given below.

#### **3.1.1 Firm value:**

Business valuation, also known as firm value (FV), enterprise value (EV), or simply the value of a company, is a term used in economics to describe the market value of an organization. It is a

measure of how much a company is worth at a given point in time. In theory, it is the money one must pay to acquire or take over a business.

### 3.1.2 Independent Variable:

The independent variables of the study are

### 3.1.3 Firm size:

There are many different sizes of businesses in an industry. Smaller companies have lower production expenses than larger ones. In economics, the ideal size of a business unit is one in which the average cost of producing a unit is the lowest.

The market value of equity is calculated by multiplying the number of its outstanding shares by the current share price. The market value of equity is also known as Market Capitalization.

### 3.1.5 Return on Equity:

The return on equity (ROE) ratio is determined by dividing net income by shareholders' equity. ROE is the return on net assets since shareholders' equity equals a company's assets, less its debt. ROE measures a company's profitability about its stockholders' equity, referred to as ROE. When calculating a company's profitability, the return on equity (ROE) is helpful.

An ROE's acceptability will be judged by how well it compares to the norms of the industry and its competitors. The S&P 500's long-term average ROE (14 percent) is acceptable, while anything below 10 percent is considered inadequate.

ROE can be determined for any corporation with a positive net income and equity and is expressed as a percentage. Dividends to common and preferred shareholders are subtracted from net income before interest and dividends are paid to lenders.

A company's net income for a given time is its revenue, less its expenses and taxes. The initial equity is used to compute the average shareholders' equity. Beginning and ending dates should correspond to when a net profit is made for the year.

### 3.1.3 Moderator Variable:

The moderator of the study is the cost of capital. The cost of capital is defined as the amount a company must pay to acquire all of its capital. When describing the total amount of equity and debt in a corporation, the term "cost of capital" is more accurate. During the study, the cost of capital was used as a moderator variable to examine the influence of business value and equity financing procedures on the independent and dependent variables.

So far, the most widely used method for calculating the cost of capital is the weighted average method (Massari, Roncaglio & Zanetti, 2008). The weighted average cost of capital was the sum of the equity and debt costs. Weighted average cost of capital is a fundamental concept in corporate finance because of these advantages (Farber, Gillet & Szafarz, 2007). Firms' cost of



capital was gauged by applying a weighted average cost of capital (Bozec and Bozec,2010). The weighted average cost of capital technique is still commonly utilized in research, according to (Massari et al., 2008).

### 3.2 Measurement is as follows:

$$WACC = Kd Rd + Ke Re (1-Tax Rate)$$

Mathematical formula Equity and debt financing were financed using those above weighted average cost of capital. Rd represents the cost of debt, and the cost of equity is represented by R. The debt and equity weights were denoted by the letters Kd and Ke. The debt-to-equity ratio was used to calculate the debt weights. The equity-to-debt-plus-equity ratio was used to calculate the weight of equity. An organization's taxable income is expressed as a percentage (Tc). In this equation, interest payments are deducted at the standard (1-Tax Rate) rate. Due to this, the cost of debt was lowered (Afkhami-Rad, 2014).

### 3.3 ECONOMETRIC EQUATION

$$Y=\alpha + \beta_1X_1+ \beta_2X_2 + \dots \varepsilon$$

$$\text{Firm value} = \alpha + \beta_1(\text{firm size}) + \beta_2 (\text{ROE}) + \beta_3 (\text{company growth}) + \varepsilon$$

Regression 1 # Without Moderator

Table 01: REGRESSION 1 # WITHOUT MODERATOR

#### Model Summary

Model	R	R Square	Ad. R Sq.	Std. Error of the Estimate
1	.085 <sup>a</sup>	0.007	-0.013	733.6128986

a. Predictors: (Constant), Market value of equity, ROE

#### Model Summary

Model	R	R Square	Ad. R Sq.	Std. Error of the Estimate
1	.085 <sup>a</sup>	0.007	-0.013	733.613

a. Predictors: (Constant), Market Value of Equity, ROE

The value of R square is .007, which means that .07% of the variance in Tobin's Q can be predicted from the variables market value of equity and ROE. So, there is an insignificant relationship between Tobin's q (dependent) and the market value of equity and ROE (independent). The value of the adjusted R square is -0.31, and the F Value is .355, which means that the model is unfit, and it further may be interpreted that the explanatory variable is unable to bring a significant change in the dependent variable. This can be understood from the R Square value of .07%.

Table 02: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	381648.775	2	190824.388	0.36	.702 <sup>b</sup>
	Residual	52204224.85	97	538187.885		
	Total	52585873.62	99			

Dependent Variable: Tobin's Q

b. Predictors: (Constant), Market value of equity, ROE

These are the levels of freedom associated with the sources of variance's corresponding degrees of freedom. There are N-1 possible outcomes for the total variance. There were 100 participants in this experiment, so the DF was 99. The number of predictors minus 1 is the number of model degrees of freedom (K-1). If this were a two-team game, you might think it would be 2-1. (since there were two independent variables in the model, market value of equity and ROE). The residual degrees of freedom is the total degrees of freedom minus the degree of freedom model, which is 99 – 2 to get 97.

Table 03: Coefficients

Model		Unstand. Coef.		Stand. Coef.	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	452.854	87.707		5.163	0
	ROE	-236.22	304.117	-0.079	-0.78	0.44
	Market value of equity	1.15E-08	0	0.043	0.425	0.67

a. Dependent Variable: Tobin's Q

The ROE (b=-236.220) is not significant (p=.439), the t value is -.777, which is less than two, and the coefficient is negative, which would indicate that increase in ROE is related to a decrease in Tobin's q.

Next, the market value of equity (b=1.150) is not significant (P=.672), and the value of T is .425, which is less than two and seems unrelated to Tobin's q. This indicates that equity's market value is not a significant factor in predicting Tobin's q.

Table 04: REGRESSION #2 WITH MODERATOR

Model	R	R Square	Adj. R Sq.	Std. Error of the Estimate
1	.134 <sup>a</sup>	0.018	-0.002	729.6652651

a. Predictors: (Constant), moderator, Market value of equity

The value of R square is 0.018, which means that 1.8% of the variance in Tobin's q can be predicted from the variables market value of equity and WACC. So there is an insignificant relationship

between Tobin's q (dependent) and market value of equity and WACC (independent). The value

Table 05: Anova and

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	941967.91	2	470983.955	0.885	.416 b
	Residual	51643905.71	97	532411.399		
	Total	52585873.62	99			

a. Dependent Variable: Tobin's Q

b. Predictors: (Constant), moderator, Market value of equity

### Coefficients

Model		Unstandardised Coefficients		Stand. Coef.		Sig.
		Beta	Stand. Err	Beta	t	
1	(Constant)	481.675	90.14		5.344	0
	Market value of equity	-5.31E-08	0	-0.2	-0.967	0.336
	Moderator	-1.34E-07	0	-0.267	-1.289	0.2

a. Dependent Variable: Tobin's Q

of the adjusted R square is -.002 and the F Value is .885, which means that the model is unfit, and it further may be interpreted that the explanatory variable is to bring the 1% change in the dependent variable. This can be understood from the R Square value of 1.8%.

The market value of equity (b=-5.310) is not significant (p=.336) and the T value is -.967, which is less than two, and the coefficient is negative, which would indicate that increase in the market value of equity is related to a decrease in Tobin's q.

Next, the moderator (WACC) is (b=-1.338) is not significant (P=.200) and the T value is -1.289, which is less than two, and the coefficient is negative, which would indicate that increase in WACC (moderator) would decrease Tobin's Q.

Table 06: REGRESSION 3# WITH MODERATOR

### Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.076 <sup>a</sup>	0.006	-0.015	734.1387667

a. Predictors: (Constant), moderator2, ROE

The value of R square is 0.006, which means that .06% of the variance in Tobin's q can be predicted from the variables ROE and WACC (moderator). So there is an insignificant relationship between Tobin's q (dependent) and ROE and WACC (independent). The value of the adjusted R square is

-.015 and the F Value is .285, which means that the model is unfit, and it further may be simply interpreted that the explanatory variable is to bring the decrease in the dependent variable. This can be understood from the R Square value, which is .06%.

Table 07: ANOVA and Coefficients

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	306779.932	2	153389.966	0.285	.753 <sup>b</sup>
	Residual	52279093.69	97	538959.729		
	Total	52585873.62	99			

a. Dependent Variable: Tobin's Q

b. Predictors: (Constant), moderator2, ROE

#### Coefficients

Model		Unstand. Coeff.		Stand. Coeff. Beta	T	Sig.
		B	Std. Error			
1	(Constant)	469.896	75.363		6.235	0
	ROE	-217.41	301.831	0.073	-0.72	0.473
	moderator2	-19.736	97.377	0.021	-0.203	0.84

The ROE (b=-217.406) is not significant (p=.473), and the T value -.720, which is less than two and the coefficient is negative, which would indicate that increase in ROE is related to a decrease in Tobin's Q.

Next, the moderator (WACC) is (b=-19.736) is not significant (P=.840) and the T value -.203, which is less than two, and the coefficient is negative, which would indicate that increase in moderator two will be related to a decrease in Tobin's Q.

#### CONCLUSION.

This study examines the impact of capital structure on Pakistani firm profitability. Non-financial companies listed on the Pakistan Stock Exchange, KSE-100 index, are included in the study sample. From 2015 to 2020, financial statements of participating companies are used to compile the annual panel data. Model 1 of our study shows that the correlation between the market value of equity and ROE is weak, with a P value of 0.192, indicating an insignificant relationship between these two variables. The correlation between the market value of equity and WACC is negatively weak, and the P value is 0.025, which shows a significant relationship between these two variables. The correlation between ROE and WACC is positively strong, and the P value is 0.113, which shows an insignificant relationship between these two variables. From model 2 of our study, we find that the coefficient of ROE is not significant, which would indicate that increase in ROE is related to a decrease in Tobin's q. The coefficient of the market value of equity is not significant. This indicates that the market value is not a significant factor in predicting Tobin's Q.

From model 3 of our study, we find that The coefficient of the market value of equity is not significant, which would indicate that increase in the market value of equity is related to decrease in Tobin's Q. The coefficient of the moderator (WACC) is not significant, which would indicate that increase in WACC (moderator) would decrease Tobin's Q. From model 4 of our study, we find that The coefficient of ROE is not significant, which would indicate that increase in ROE is related to decrease in Tobin's Q.

The coefficient of the moderator (WACC) is not significant, indicating that an increase in WACC would decrease Tobin's Q. This research laid empirical studies which show that the cost of capital is one of the crucial factors affecting the performance of a company and firm value. Since Pakistan's firms rely heavily on bank debt due to the small and undeveloped bond market. As a result, firms in Pakistan could be guided to remove themselves from issues related to equity financing, firm size, and value by enacting an appropriate measure. Managing capital structure is one of the most important financial decisions related to maximizing corporate value. Managers and stakeholders will benefit from this research by learning to make better management decisions regarding the proper combination of equity and debt financing (Equity financing) for more excellent firm performance. In addition, this research paved the way for future investigations. In order to obtain more precise results, future research should consider including additional variables and extending the period.

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