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The Effect of Financial Constraints and Financial Risk on Capital Structure with Profitability and Tangibility as Moderating Variables

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ABSTRACT

Optimal capital structure is an important decision in corporate financial management, but it is often influenced by financing limitations and the level of risk faced. This study investigates the effect of financial constraints and financial risks on corporate capital structure, with profitability and asset tangibility as moderating variables. This study uses a quantitative method with secondary data obtained from the annual financial reports of companies listed on the Indonesia Stock Exchange (IDX). The results of the study indicate that financial constraints and financial risks have a significant effect on capital structure. Profitability and tangibility are proven to moderate the relationship, where profitability weakens the effect of financial constraints on capital structure, while tangibility strengthens the effect of financial risk on capital structure. These findings provide important implications for financial managers in determining adaptive funding policies to the company's internal and external conditions.

Keywords: Financial Constraints; Financial Risk, Capital Structure, Indonesia

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INTRODUCTION

Capital structure is one of the important financial decisions made by a company, namely related to the balance of the proportion of equity and debt used to fund the company's capital. The decision on capital structure has a long-term impact because the funds used will be embedded in the company for several years to come, thus also affecting the company's value, cost of capital, and business risk.

Classical theories such as those proposed by Modigliani and Miller (1958) initially stated that capital structure is irrelevant in a perfect market. Based on several assumptions, any proportion of debt and equity used by the company does not affect the company's value. They illustrate that various compositions of debt and equity do not increase the area of the pizza as a representation of the company's value. Furthermore, financial researchers developed capital structure theories that recognize the existence of certain variables that affect the company's capital structure so that they can affect the company's value. Some of these variables include information symmetry, agency costs, and transaction costs. These theories explain empirically that capital structure becomes relevant in affecting the company's value.

Trade-off theory (Myers, 1984) states that companies have the option to choose between the benefits of tax savings because debt is beneficial for tax reductions, and the costs of bankruptcy that may occur due to increased risk due to the use of debt as a source of funding. Meanwhile, Pecking Order Theory (Myers & Majluf, 1984) states that companies choose internal funding as a priority because of its low cost, followed by debt, and equity as the last source of funding. In imperfect market conditions, various factors, both external and internal to the company, can influence capital structure policies. Two important variables that are often highlighted are financial constraints and financial risk. Financial constraints refer to a company's limited access to external funding sources, forcing the company to rely on internal funding or adjust its debt levels (Fazzari et al., 1988). On the other hand, the financial risk variable refers to the volatility of the company's profitability or cash flow which can affect the company's ability to meet its financial obligations. The company's ability has an impact on the creditor's desire to provide loans.

Previous studies have examined many factors that influence capital structure decisions. However, the integration of financial constraints and financial risks with several control variables such as profitability and tangibility to explain variations in capital structure still needs further exploration, especially in the context of emerging markets such as Indonesia, where the level of debt use by companies has a significant proportion. The profitability variable is one of the important factors that influences a company's courage to borrow, and reflects the company's ability to generate internal funding through retained earnings, although the size of retained earnings is highly dependent on the level of dividends paid by the company.

Meanwhile, asset tangibility indicates the extent to which a company's assets can be used as collateral, which can affect the company's ability to obtain debt. As is customary, the banking world will ask for collateral in the form of real company assets when the company borrows funds from the bank. Therefore, this study aims to comprehensively analyze how financial constraints and financial risks affect capital structure, by considering profitability and tangibility as control variables that can moderate or mediate the relationship.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Capital Structure

Capital structure refers to the composition of debt and equity financing to fund a company's assets and operations (Brigham & Houston, 2012). Some common measurements used to view a company's capital structure are the debt-to-equity ratio or the debt-to-total assets ratio. The debt-to-equity ratio shows the composition of funding provided by creditors compared to funding provided by the company's owners. Companies that are funded with a high equity composition are in an ideal condition because the company has a low risk of bankruptcy. However, the company loses the opportunity to get tax relief. In other words, companies that do not utilize their debt capacity will lose the opportunity to grow faster through debt financing and lose the opportunity to get tax relief.

Financial Constraints

Financial constraints occur when a company cannot access sufficient external funding sources or at a reasonable price to finance profitable investment projects (Kaplan & Zingales, 1997). In this condition, the company experiences limitations in obtaining external funds through loans or capital from investors to finance its operational or investment activities. Financial constraints have a significant impact on the company, both in the short and long term. If the company experiences financial constraints, it is difficult for the company to expand its business, difficult to increase production capacity, and limits profitable investments. Financial constraints cause companies to have to pay higher interest to obtain loans because funders will consider the company to have a high risk and the cost of obtaining funds becomes

more expensive. Moreover, companies facing financial constraints will tend to make conservative and careful financial decisions that hinder the company's long-term growth, and choose to focus on short-term survival. A further impact is that the company will experience underinvestment or even myopic behavior (short-term decisions that are detrimental to the company's future). Financial constraints can also cause a decrease in the company's value because investors do not see that the company is able to finance its growth. Financial constraints reduce market confidence. Measurement of financial constraints can be done using indices such as the SA Index (Hadlock & Pierce, 2010). Companies facing financial constraints tend to rely more on internal funding, as a result when internal funding is insufficient, the company will seek alternative external funding that is more expensive, which can affect their capital structure.

Hypothesis 1: Financial constraints negatively affect capital structure

Financial Risk

Financial risk refers to the risk associated with a company's capital structure and its ability to meet its debt obligations (Ross et al., 2016). Risk arises from the use of debt so that the company bears a fixed financial burden in the form of interest and principal repayments. Financial risk indicators can be debt ratios, earnings volatility, or interest coverage ratios. Financial risk affects Capital Structure through several mechanisms as follows: Companies with high financial risk tend to have limitations in obtaining new debt because they have a higher potential for default. Creditors will refuse to provide loans because of the high risk of default and lenders will demand higher interest rates.

Financial risk negatively affects capital structure because the high risk makes companies more careful in using debt as a source of financing. high risk. Companies that face income instability, or companies that have high profit volatility and are in an uncertain business environment, will find it more difficult to guarantee interest and principal payments. In this condition, creditors are reluctant to provide loans to companies, or are only willing to provide loans with strict conditions such as high interest rates and sufficient collateral. Companies that have high financial risks will bear higher debt costs which will further increase the cost of capital. High debt costs make debt less attractive as a source of financing and choose to use internal funding sources. Another external funding alternative if the company does not use debt is to choose equity financing to avoid fixed interest burdens.

Excessive use of debt amid high financial risk can increase the possibility of default or bankruptcy. Financial managers tend to avoid financial distress, so they choose a more conservative capital structure when conditions are unstable because it can reduce the value of the company and increase the risk of bankruptcy. Another aspect related to financial risk is public trust in the company. Credit rating agencies can lower the company's rating, so that access to the debt market is increasingly limited. In high-risk conditions, the use of debt can also create a conflict of interest between owners and creditors. For example, the owner makes an aggressive decision to add debt to increase the company's capital strength, but risks increasing the possibility of bankruptcy. Referring to agency costs, the capital structure tends to be directed towards internal financing or equity, so that the fixed burden borne by the company is minimal. The higher the financial risk, the less likely the company will use debt. This is because debt increases fixed costs, increases the risk of bankruptcy, and increases the cost of capital. Therefore, financial risk has a negative effect on capital structure.

Hypothesis 2: Financial risk has a negative effect on capital structure.

Profitability

Profitability is the company's ability to generate profit from its business operations (Weygandt et al., 2015). Commonly used profitability indicators include Return on Asset (ROA) or Return on Equity (ROE). ROA measures how much a company's assets generate profit. The higher this ratio, the greater the

effectiveness of the use of assets in generating operating profit. Meanwhile, ROE indicates how much shareholders claim on the profit obtained from each rupiah of funds invested in the company.

Companies that are more profitable tend to have a higher ability to maximize the resources they have, both financial and non-financial. The company is able to optimize its internal resources to fund its operational activities and is able to reduce dependence on external debt. However, profitability can also be used as an opportunity to increase the company's capacity to add new debt because the company is able to repay its debt. The role of profitability on capital structure can be two-way depending on the theory used (Pecking Order Theory vs. Trade-off Theory). The pecking order theory explains that companies prioritize the use of internal funding sources because they provide low capital costs, compared to the use of external funds. Thus, the greater the profitability of the company, assuming a constant dividend payment percentage, the greater the company's ability to retain its profits and the less likely the company is to increase debt. In this context, profitability can moderate or mediate the relationship between financial constraints and financial risk on capital structure. On the other hand, profitability can increase public trust and improve the company's financial performance so as to reduce the company's risk. The greater the company's profitability, the lower the company's risk, which in turn can increase the company's possibility of increasing its debt or external funds.

Hypothesis 3a: Profitability moderates the effect of financial constraints on capital structure.

Hypothesis 3b: Profitability moderates the effect of financial risk on capital structure.

Tangibility

Tangibility refers to the proportion of tangible assets in the company's total assets (Graham & Harvey, 2001). Tangible assets such as property, plant, and equipment can be used as collateral for loans. More tangible assets can reduce the risk for creditors, making it easier for companies to obtain debt at a lower cost. Therefore, companies with more tangible assets tend to have higher debt levels. Tangibility shows the company's ability to pay existing debts using long-term physical assets or fixed assets. Companies that have financial constraints will have limited access to funds. The influence of financial constraints and financial risk on capital structure is strengthened by the presence of profitability and tangibility variables.

Hypothesis 4a: Tangibility moderates the influence of financial constraints on capital structure.

Hypothesis 4b: Tangibility moderates the influence of financial risk on capital structure

METHODOLOGY

Data

This study uses a quantitative approach with a causal-comparative design to analyze the effect of exogenous variables on the dependent variable. The population of this study is all non-financial companies listed on the Indonesia Stock Exchange (IDX). While sampling uses a purposive sampling method with the following criteria: (i) Non-financial companies listed on the IDX for the period between 1995 and 2019. The research period was chosen to avoid the year of Covid 2020. By using data for 25 years, this study is expected to provide more accurate results; (2) Publish annual financial reports of research variable data completely and continuously during the research period, and (iii) not delisted during the research period. The data used is secondary data, in the form of annual financial reports of companies obtained from the official IDX website (www.idx.co.id) and financial databases from Osiris.

Operational Definition of Variables and Measurement

This study uses the dependent variable of capital structure measured by the ratio of total debt to assets.
Independent Variables:
Financial Constraint
Measured using the SA Index (Hadlock & Pierce, 2010).
SA Index = −0.737∗Size+0.043∗Age
Where: Size = Ln (Total Assets); Age = Number of years since the company was listed.

- (Financial Risk): Standard deviation of Operating Profit for the last 5 years divided by the average Operating Profit.
- Profitability: Measured by Return on Asset = Net Profit/Total Assets.
- Tangibility: Measured by the Net Fixed Assets/Total Assets Ratio.

Data Analysis Model

This study will use panel data regression analysis. The models to be used are as follows:

- Model 1

$$SM_{it}=\beta0+\beta1FC_{it}+\beta2FR_{it}+\beta3PR_{it}+\beta4TG_{it}+\epsilon_{it}$$

- Model 2 with Interaction (to test the moderation effect):

$$SM_{it}=\beta0+\beta1FC_{it}+\beta2FR_{it}+\beta3PR_{it}+\beta4TG_{it}+\beta5(FC_{it}*PR_{it})+\beta6(FR_{it}*PR_{it})+\beta7(FC_{it}*TG_{it})+\beta8(FR_{it}*TG_{it})+\epsilon_{it}$$

Where:
SMit: Capital Structure of company i in year t
FCit: Financial Constraints of company i in year t
FRit: Financial Risk of company i in year t
PRit: Profitability of company i in year t
TGit: Tangibility of company i in year t
β0: Constant
β1−β8: Regression coefficient
ϵit: Error term

ANALYSIS AND DISCUSSION

Descriptive Analysis of Data

Table 1. Summary of descriptive statistics

Variable	Obs	Mean	Std.Dev	Min	Max
Leverage	6,337	0.3455	0.2875	0.000	2.3509
Financial constrain	7,860	1.1111	2.1501	-3.620	10.910
Risk	5,401	0.0339	1.0002	-12.186	9.8719
Profitability	6,828	0.0513	1.3898	-109.988	21.040
Tangibility	7,033	0.3955	0.2476	0.000	0.9852
Assets	7,049	20.968	1.7908	13.7113	26.573
Age	7,163	3.3784	0.5276	1.7918	4.6821

Table 1. presents a summary of descriptive statistics for the research variables including the number of observations, mean, standard deviation, minimum, and maximum. Leverage (represents capital structure) has a mean of 0.3455 which indicates a moderate average debt ratio in the capital structure. This ratio indicates that the company's debt is slightly above one-third of its assets. However, with a fairly high standard deviation value (83% of the mean) indicating heterogeneity in leverage policies between companies. A minimum of 0 indicates that some companies do not use debt at all, while

a maximum value of 2.3509 indicates that there are companies with leverage above 2.3 times their assets which may be due to short-term debt or aggressive expansion.

Financial Constraint has a positive mean value of 1.1111 which indicates that most companies experience constraints on access to funding. While the std. the deviation is quite high (2.1501) which reflects the diversity of the level of constraints, namely there are companies that easily access finance while other companies have limitations in accessing financial sources. The minimum value of -3.6200 (negative) indicates companies with excess liquidity or rarely constrained, while the maximum value of 10.910 indicates that there are extreme constraints so that they have the potential for liquidity difficulties or difficulties in investment.

The risk measured using the EBIT standard deviation has a mean of 0.0339 or close to zero, but Std.Dev 1.0002 indicates that the data is likely standardized. Companies with very low risk (-12.1863) indicate relatively small profit fluctuations, with a maximum (9.8719) indicating companies with very high risk such as technology startups or volatile sectors).

Correlation Analysis

Table 2. Correlation between variables

	Leverage	Fina_const	Risk	Profitability	Tangibility	Assets	Age
Leverage	1						
Fina_constrain	-0.0110	1					
Risk	-0.0602	0.0655	1				
Profitability	-0.0312	0.0467	-0.0060	1			
Tangibility	0.2137	0.0909	-0.0283	0.0181	1		
Assets	0.0092	0.9001	0.0573	0.0751	0.0943	1	
Age	0.0261	-0.1633	-0.0614	-0.0041	-0.0016	0.1044	1

Table 2 shows the correlation coefficient between variables. Negative values indicate that if one variable increases, the other variable decreases. This can be seen from several variables such as financial constraints, risk and profitability having a negative relationship with leverage. Meanwhile, profitability and tangibility have a negative correlation with risk. From the coefficient values as seen in the table, there are no values above 0.7, so it can be concluded that these variables do not have multicorrelation and in statistics, all variables can be regressed simultaneously.

Regression Analysis with The Pooling Method

Table 3. Pooling Method Regression Results of The İnfluence of İndependent Variables on Leverage as A Dependent Variable

Variables	(Model 1)	(Model 2)	(Model 3)	(Model 4)
Financial constraint	-0.0161**			0.00281
	(0.0063)			(0.0071)
Risk	-0.0136***			-0.0191**
	(0.0042)			(0.0079)
Profitability	-0.0053**			-0.468***
	(0.0023)			(0.0274)
Tangibility	0.236***			0.202***
	(0.0180)			(0.0278)
Fin_constraint* profitability		-0.0025**		-0.126***
		(0.0012)		(0.0076)

Variables	(Model 1)	(Model 2)	(Model 3)	(Model 4)
Fin_constraint* tangibility		0.0403***		-0.0115
		(0.0039)		(0.0092)
Risk*profitability			-0.0020	0.232***
			(0.0028)	(0.0294)
Risk*tangibility			-0.0199**	0.0127
			(0.0081)	(0.0157)
Assets	0.0158**	-0.0127***	-0.0018	0.0207***
	(0.0071)	(0.0023)	(0.0020)	(0.0068)
Age	-0.0035	0.0361***	0.0298***	0.0219**
	(0.0105)	(0.0068)	(0.0069)	(0.0100)
Constant	-0.0499	0.463***	0.284***	-0.197*
	(0.1200)	(0.0508)	(0.0482)	(0.114)
Observations	3,592	6,306	6,306	3,592
R-squared	0.052	0.020	0.004	0.152

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Using the pooling method, model 1 shows a negative and significant influence between explanatory variables on capital structure, namely financial constraints, risk and profitability. While tangibility and assets have a positive and significant relationship. The higher the financial constraint, the lower the company uses debt in its capital structure. The higher the company's risk, the smaller the company's debt value, indicating that companies with a high level of risk do not have enough courage to go into debt. While the relationship between profitability and leverage indicates that the higher the profitability, the lower the leverage. This gives a signal that in general companies are more careful in going into debt, even though the company is able to pay off debt with their profits.

Model 2 shows the interaction between financial constraints and two moderating variables, namely profitability and tangibility. When financial constraints are moderated by profitability, the influence of these variables is negative on capital structure. This indicates that even though the company has quite high profitability, companies with high financial constraints are not able to increase their debt. On the other hand, companies that have high constraints moderated by the tangibility variable are able to change their relationship to the capital structure from negative to positive. This indicates that the company is able to increase its capacity and ability to increase its debt if supported by high tangibility as collateral for its debt.

Model 3 shows the interaction between the risk variable and profitability and tangibility, where the relationship between these variables and the capital structure is negative. When compared to Model 1, risk has a negative and significant effect, while after interacting with profitability, its effect becomes insignificant. This indicates that profitability can reduce the relationship between the level of risk and the structure of debt policy. Meanwhile, the effect of risk moderated by tangibility on the capital structure shows a negative and significant relationship. This can be explained that tangibility strengthens the relationship between risk and capital structure. Model 4 shows the results of simultaneous regression of all variables, both individual and interaction, on the capital structure. Almost all variables show a significant effect except for financial constraints, the interaction of financial constraints and tangibility, and age. The effect of financial constraints on capital structure is insignificant, indicating that when the company considers all variables in this study, financial constraints do not affect capital structure decisions.

Regression Analysis using Random Effect

Table 4. Random Effect Regression Results of The İnfluence of İndependent Variables on Leverage as A Dependent Variable

Variables	Model (1)	Model (2)	Model (3)	Model (4)
Financial constraint	-0.0252***			-0.0059
	(0.0061)			(0.0072)
Risk	-0.0048			-0.0114*
	(0.0032)			(0.0062)
Profitability	-0.0023			-0.456***
	(0.0018)			(0.0255)
Tangibility	0.207***			0.187***
	(0.0232)			(0.0320)
Fin_constraint* profitability	0.00991	-0.0197***		0.0172**
	(0.0077)	(0.0027)		(0.0073)
Fin_constraint* tangibility	-0.0039	0.0266		0.00816
	(0.0184)	(0.0174)		(0.0179)
Risk*profitability			-0.0016*	-0.124***
			(0.0009)	(0.00717)
Risk*tangibility			0.00774**	-0.0237**
			(0.0036)	(0.0104)
Assets		-8.14e-05	-8.14e-05	0.225***
		(0.0021)	(0.0021)	(0.0247)
Age		-0.0103*	-0.0103*	0.0112
		(0.0064)	(0.0064)	(0.0123)
Constant	0.103	0.650***	0.644***	-0.0471
	(0.145)	(0.0809)	(0.0827)	(0.138)
Observations	3,592	6,306	6,306	3,592
Number of firm	374	382	382	374

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Regression Analysis using Fixed Effects

Table 5. Fixed Effect Regression Results of The Influence of İndependent Variables on Leverage As a Dependent Variable

Variables	Model (1)	Model (2)	Model (3)	Model (4)
financial constraint	-0.0252***			-0.00125
	(0.0063)			(0.0075)
risk	-0.0031			-0.0114*
	(0.0033)			(0.00630)
profitability	-0.0012			-0.481***
	(0.0018)			(0.0277)
tangibility	0.181***			0.162***
	(0.0271)			(0.0352)
Fin_constraint* profitability		-0.0017*		-0.128***
		(0.0009)		(0.007)
Fin_constraint* tangibility		0.0015		-0.0303***
		(0.0037)		(0.0112)
Risk*profitability			0.0003	0.245***

Variables	Model (1)	Model (2)	Model (3)	Model (4)
			(0.0021)	(0.0267)
Risk*tangibility			-0.0103*	0.0134
			(0.0061)	(0.0124)
Assets	-0.00241	-0.0257***	-0.0253***	0.0023
	(0.00859)	(0.00302)	(0.00301)	(0.00811)
Age	2,633	3,764*	3,886**	-2,186
	(3,292)	(1,922)	(1,923)	(3,119)
Constant	-9,026	-12,711*	-13,121**	7,496
	(11,285)	(6,489)	(6,493)	(10,692)
Observations	3,592	6,306	6,306	3,592
R-squared	0.034	0.013	0.013	0.141
Number of firm	374	382	382	374

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Model 1 in Table 5 shows that financial constraints have a negative and significant effect on capital structure. This indicates that companies with high financial tend to have low debt. This is in accordance with the belief of most financial experts that debt is one of the biggest causes of companies going bankrupt which then causes liquidation. Tangibility has a positive and significant effect on capital structure, and variables are an absolute prerequisite as collateral for debt. Companies that have large tangible assets have the potential to encourage them to take out larger debt loans.

As with the random effect and pooling tests, the interaction between financial constraints and profitability still has a significant negative effect on capital structure, as seen in Model 2. This indicates that profitability moderates the effect of financial constraint variables on capital structure, but with a lower coefficient than without profitability moderation. In other words, profitability has not been able to change the negative effect of financial constraints on capital structure.

Discussion

Financial constraints have a negative and significant effect on capital structure as evidenced by three test models, namely pooling, random effect and fixed effect. This supports hypothesis 1 which states that financial constraints have a negative effect on capital structure. Companies that have financial constraints are reluctant to take on debt because access to debt funding sources is limited. These financial constraints are caused by the low ability to produce performance that is below the industry average.

Companies face financial constraints due to internal and external factors. Financial constraints occur when a company does not have sufficient access to funds or capital to finance operational activities, investments, or business growth. Risk has a negative effect on capital structure (Hypothesis 2). The higher the risk, the lower the company's debt-to-asset ratio. Conversely, the lower the risk, the more the company is able to make debt payments because the ability to pay is higher. From the three statistical tests, it shows that the relationship between risk and capital structure is negative so that the second hypothesis is proven. Risk represents the company's negative potential in the future.

Furthermore, Hypothesis 3a states that profitability moderates the effect of financial constraints on capital structure. Companies that have the ability to generate higher profitability have a smaller effect of financial constraints on capital structure. In other words, financial constraints decrease as the company's profitability increases so that profitability reduces the negative effect of financial constraints on capital structure. Hypothesis 3b states that profitability moderates the effect of risk on capital structure. Companies that are more profitable have a smaller effect of financial risk on capital structure.

Profitability is able to reduce the effect of risk on capital structure. Hypothesis 4a states that tangibility moderates the effect of financial constraints on capital structure. Companies that have higher asset tangibility have a smaller effect of financial constraints on capital structure. Meanwhile, Hypothesis 4b Tangibility moderates the effect of financial risk on capital structure.

Companies can experience financial constraints for various reasons, both internal and external factors. Financial constraints occur when a company does not have sufficient access to funds or capital to finance operational activities, investments, or business growth. Internal factors are caused by low cash flow so that it does not generate enough profit to finance the company's operations. The next impact is that the company has difficulty paying short-term obligations. A capital structure that relies too much on debt (overleverage) also has an impact on the company's ability to obtain sufficient cash flow because the company's cash is used to pay interest and debt installments. A high debt ratio has an impact on the reluctance of creditors and investors to fund the company because it increases the risk of bankruptcy and there is a possibility of default.

External factors that cause financial constraints are macroeconomic factors that are not friendly to the business world, such as inflation and high interest rates, so that credit costs increase and make it difficult to obtain loans or financing. In addition, regulatory factors such as taxes and complicated bureaucratic costs can hinder access to financing. High competition levels make profit margins thin, making it difficult for finances.

CONCLUSION

This study aims to analyze how financial constraints and financial risk variables affect capital structure. Furthermore, each of the two variables above is moderated by profitability and tangibility variables to see whether profitability and tangibility strengthen or weaken the influence of financial constraints and financial risk on capital structure. This study also considers two control variables, namely asset value and company age.

By using three types of statistical analysis, namely pooling, random effect and fixed effect, all hypothesis statements can be proven in this study. Financial constraints have a negative and significant effect on capital structure. Financial risk has a negative effect on capital structure. Profitability moderates the effect of financial constraints on capital structure. Profitability reduces the negative effect of financial constraints on capital structure. In addition, profitability moderates the effect of risk on capital structure. Companies that are more profitable have a smaller effect of financial risk on capital structure. Tangibility moderates the effect of financial constraints on capital structure. Companies that have higher asset tangibility have a smaller effect of financial constraints on capital structure. Tangibility moderates the effect of financial risk on capital structure.

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