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Trade-off theory, pecking order theory and market timing theory: a comprehensive review of capital structure theories

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Abstract

This study examines the role of different capital structure theories in decision making regarding the debt preferences. The study includes the seminal work of Modigliani and Miller (1958) which was a novel study of its kind in the field of capital structure. Purpose of this study is to look into the three theories; Trade-Off Theory, Pecking Order Theory and Market Timing Theory. Literature shows that the two theories i-e; Trade-Off and Pecking Order have always dominated the capital structure decisions but recent theoretical and empirical work shows that Market Timing Theory has also challenged the basic theories as managers are always keen to take advantage of "market timing".

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