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# The Effect of Capital Structure and Profitability on Current Debts Solvency with Emphasis on the Life Cycle Stages of Firms

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## 1. Introduction

In today's competitive business environment, the ability of firms to optimize capital structure and manage current liabilities is crucial for financial stability and sustainability. Current liabilities management serves as a key indicator of financial health, mitigating liquidity risks and potential bankruptcy, while capital structure directly affects cost of capital, risk, and returns. Profitability further strengthens cash flow, enhancing a company's capacity to meet short-term obligations.

Capital structure plays a pivotal role in determining a company's financial performance, as decisions regarding debt and financing directly affect profitability and the current debt solvency. Profitability itself reflects how efficiently a company utilizes its resources to generate earnings, which is especially critical for firms at different stages of their life cycle, each facing unique challenges and opportunities. The interaction between capital structure, profitability, and the management of current liabilities can vary significantly across these stages.

This study aims to investigate the impact of capital structure and

profitability on a company's ability to manage current liabilities, with particular emphasis on the moderating role of the corporate life cycle. Understanding this relationship can provide managers and investors with valuable insights into effective financial strategies and resource management across different phases of a company’s development. Ultimately, the findings are expected to highlight how firms can optimize their financial decisions to enhance liquidity, stability, and long-term performance throughout their life cycle.

## 2. Hypotheses

Firms’ capital structure and profitability influence their current debt solvency. The stage of the corporate life cycle may moderate these relationships, as companies at different stages face distinct financial challenges and opportunities.

Hypotheses: Based on the theoretical foundations of the study, the following hypotheses are proposed:

H1: Profitability has a significant effect on the current debt solvency.

H2: Capital structure has a significant effect on the current debt solvency.

H3: The corporate life cycle moderates the effect of profitability on the current debt solvency.

H 4: The corporate life cycle moderates the effect of capital on the current debt solvency.

## 3. Method

The main objective of this study is to examine the effect of profitability and capital structure on the current debt solvency, with an emphasis on the stages of the corporate life cycle. To achieve this, the variance in firms’ ability to pay current liabilities was analyzed based on changes in profitability and capital structure across different life cycle stages. Multiple linear regression analysis was employed to test the proposed relationships. The research utilized data from 160 companies listed on the Tehran Stock Exchange over the period 2015-2024.

## 4. Results

The results of the analysis indicate that both profitability and capital structure have a significant impact on firms’ current debt solvency. In the

first hypothesis, profitability (measured by return on assets) showed a positive and significant relationship with liquidity capacity, confirming that more profitable firms are better positioned to manage their short-term obligations. Among the control variables, sales growth had a significant positive effect, while firm size was not significant.

The second hypothesis demonstrated that capital structure, represented by the equity ratio, has a positive and significant effect on the current debt solvency. Similar to the previous model, sales growth was significant, but firm size had no meaningful impact.

When considering the moderating role of the corporate life cycle, the findings revealed that the effects of profitability and capital structure on current liability payment capacity vary across different life cycle stages. Specifically, in the introduction, maturity, and decline stages, both profitability and capital structure positively affected liquidity capacity, while in the growth stage, these effects turned negative—likely due to increased reinvestment demands and resource allocation toward expansion projects, which reduce available cash flows.

Overall, all hypotheses were supported, confirming that the stages of the corporate life cycle significantly moderate the relationship between profitability, capital structure, and the current debt solvency.

## 5. Conclusion and Discussion

The findings of this study revealed that profitability has a positive and significant impact on companies’ ability to manage their current liabilities. This result highlights the importance of asset efficiency and genuine profitability in enhancing liquidity and overall financial health. Moreover, the study showed that capital structure plays a crucial role in managing liquidity risk and maintaining financial stability. An increase in the proportion of shareholders’ equity within the capital structure significantly improves the ability to meet short-term obligations, emphasizing the importance of sustainable internal financing and building trust among creditors.

The moderating analysis further demonstrated that the effects of profitability and capital structure on liquidity capacity vary across different stages of the corporate life cycle. Specifically, these effects are positive during the introduction, maturity, and decline stages, but become negative

during the growth stage. This inverse effect in the growth phase may result from higher resource allocation to expansion and reinvestment projects, which reduce cash availability for short-term debt payments.

While this study did not encounter major limitations, it should be noted that, as with all research based on sampling, generalizing the findings to the broader population should be done cautiously. Based on the results, it is recommended that financial departments continuously assess their company's position within the life cycle and adjust financial policies—particularly capital structure and current liabilities management—accordingly. Furthermore, companies in the growth stage should adopt more conservative liquidity and debt management strategies and exercise greater caution in the use of leverage to avoid potential liquidity challenges in future operations.

**Keywords:** Liquidity, Profitability, Capital Structure, Current Debt Solvency, Company Life Cycle.