IMPACT OF CAPITAL STRUCTURE ON COMPANY PROFITABLITY: A STUDY OF NEPALESE HOTEL INDUSTRY

A Dissertation Submitted to Office of the Dean Faculty of Management In Partial Fulfillment of the Requirements for the Degree of Master of Business Studies (M.B.S.)

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CHAPTER ONE
INTRODUCTION

1.1 Background

Capital structure has a crucial role to play on determining company's financial performance and fulfils the expectations of stakeholders who always demand the increase of their company's value. Capital structure decision is critical for any firm for maximizing return to the various stakeholders and also enhances firm's ability to operate in a competitive environment. Moreover, Awunyo and Badu (2012) stated that "even though generally firms have a choice on how to combine debt and equity, managers attempt to ascertain a particular combination that will maximize profitability and firm's market value". Ross (2002) also showed the importance of capital structure decision to finance managers by stating that, "finance managers try to find the capital structure that maximizes the value of the firm". His argument shows that capital structure decision is one of the crucial decisions that help to maximize company value.

The idea of relating hotel capital structure and its value started since the establishment of irrelevancy theory of capital structure by Modigliani and Miller in 1958. This theory was cited by Toraman (2013) which stated that, "firm value is independent of its capital structure". In recent years, researchers come up with different perspectives of their studies; some revealed the positive relationship between capital structure and hotel profit while others revealed the negative relationship between the variables. Safiuddin (2015) and Adesina (2015) in their study results, they found that capital structure was strongly associated with firm's performance. Narayanasary (2015) and Mwangi (2013) concluded a negative relationship between capital structure and company profitability. Because of the controversial results revealed by previous researchers, that situation provided an opportunity for a researcher to add the knowledge by analyzing the effect of capital on profitability of listed Hotels in Nepal. The results obtained were compared with the trade off theory of capital structure.

Researcher revealed mixed results; positive relationship between the variables which was consistent with the trade off theory and negative relationship which was not consistent with the trade off theory Since most of researchers in Nepal managed to the relationship between capital structure performance, this study based on measuring the relationship between capital structure and profitability of listed Hotels. Gautam (2014) conducted the study on the relationship between performance and capital structure in Nepal. There are several researchers who analyzed the effect of capital structure on firm performance in developed countries. However, empirical studies on the impact of capital structure on firm performance in developing countries especially in Nepal are very little. This study filled the gap and adds the new knowledge by analyzing such kind of relationship here in Nepal.

This study used Nepal stock exchange as a data collection point. It is a stock market where investors can buy and sell financial securities such as shares and bonds. The stock market was established in 1983 under security exchange act 1983 and started trading in 1994. Up to now the stock market has managed to list companies in more than 14 sectors among which there are 4 hotels listed in Nepal Stock Exchange.

The hotel industry is the servicing business conducing another significant branch in the economic development of the country. The hotel industry associates many types of industry, such as the tourist industry, the transportation industry, and the food servicing industry. It is apparent that every country emphasizes on the significance of this kind of industry, with a belief that this is a source for employment, disseminating the income of the country, conducing the country's progression, especially the progressing country such as Thailand. It is accepted that the hotel industry brings a high income to the country. Therefore, the government sector and the public sector should cooperate in promoting this kind of business. Whereby, the public sector would make the investment, and the government sector would support. It is complacent that generally the hotel industry in Thailand is being internationally accepted, due to the modernization of the hotel and the optimum service. The Thai amiability to foreigners avails the progression of this kind of business. The Oriental Hotel is an example ofsuccess for Thai Hotel, in receiving the world best hotel award for eight consecutive years. This enables the image for the Thai hotel business to become in one ofthe top levels in the eyes offoreigners. Presently, various hotels expanded the network and

branches, with a belief that the hotel business is still going well in Thailand, because people are still much interested to make a tour in this region of the world. Moreover, the booming tourist industry is enchanting people to put in more investment. These factors would conduce a great income to the country. More people give better interest in the study of the Hotel Academic. There was the intense teaching, training, and learning in this subject, to concur with the growth of this business. On the overall, this is directly advantageous to the hospitality industry. Because administrators and the operators attained the knowledge in the hotel business administration with a correct servicing knowledge, this would also be advantageous to other relevant business.

The hospitality industry is a broad category of fields within the service industry that includes lodging, food and drink service, eventplanning, themepark, transportation, cr uise line, traveling, airline and additional fields within the tourism industry.

The hospitality industry is an industry that depends on the availability of leisure time and disposable income. A hospitality unit such as a restaurant, hotel, or an amusement park consists of multiple groups such as facility maintenance and direct operations (servers, housekeepers, porters, kitchen workers, bartenders, management, marketing, and human resources etc.).

Hospitality industry concentrates on customer's satisfaction by creating good services and products that will meet their needs. This is a very competitive industry since there can be various types of product and service such as the diversity of cuisine, dining options, drive-through option, variety of beverage, different hotel's themes, etc. Therefore, it is important for service providers to establish a good relationship with customers, so that they will come back for more.

Before structuring as an industry, the historical roots of hospitality was in the western world in the form of social assistance mainly for Christian pilgrims directed to Rome. For such a reason, the eldest public hospital in Europe was the Ospedale di Santo Spirito in Sassia founded in Rome in the 8th century. on the model of the oriental world.

1.2 Problem Statement

The hospitality industry is a wide group of subject in service industry which indulge event planning lodging etc. Unit of hospitality is such hotel holds the various group of faculties like as kitchen staff, management, human resources, housekeepers, etc. Hotel

business supply lodging paid in short term basis. Facilities that offer to customers are all kind of like start from basic to grand as much one can afford or will prefer to spend their money for the comfort. With the increase of travel and tourism hotel business also get increase any country or place where tourism are high in rates there hotel business can run smoothly with a good aspects of income.

It is the major problem faced by the hotel industry that employees of particular organisation are not engaging to maintain the service operations in the hotels. Due to severe loss to the organization in the terms of bad quality, productivity and also harming to the reputation of the hotels. The service industry (Hotel Industry) deals with the identification of the contemporary issue of Human resource management along with the discussion on the employee engagement process as the contemporary issue. According to my personal experience in a hotel where I was working have seen a lot of issues between Department supervisor and employees. For example in Food and Beverage department have seen that wait staff and even kitchen staff use to work hard and working in same position from couple of year and never got any raise in salary as a reward or promotion in job position, not even appreciation for the employee 's hard work in department.

Hotel usually needs resources for them to grow and develop their operating activities however; there are constraints in financing company resources. For that case, hotel resources should be applied with care so as to create enough shareholders value and for users of hotel resources. This study was intend to assist finance managers and company managements to have guidance on attaining optimal financing decisions of using debt and equity in order to improve their company's financial performance. This argument was supported by Kibet (2011) cited by Mwangi (2014) who argued that company managers lack adequate guidance for attaining optimal financing decisions.

The study about capital structure is a crucial tool used in maximizing company financial performance which is the best interest of shareholders who expects dividends and capital gains from the company. Mansoon (2014) stated that "the decision of capital structure choices is of paramount importance for firms and optimal capital structure is such a mix of debt and equity that maximizes the firm's value and reduces the weighted average cost of capital". Capital structure decision also helps managers to accomplish their financial strategies like investment and daily operational

activities. The argument supported by Toraman (2013) who stated that the selection of capital structure components and uses play an important role during the determination of financial strategies of the company. Mireku (2014) also argued that capital structure is strongly linked to the capability of organization to fulfil the expectations of their stakeholders.

Researcher got an opportunity to add the knowledge by analyzing such relationship in Nepal because for many years, the link between capital structure and company profitability of the firm has been the subject of global debate and yet there is insufficient evidence to support this argument.

1.3 Research Questions

The research questions have been selected in order to advance the theoretical development of the subject and generate practical implications. If we consider the situation of research on the outcomes of capital structure at this point, we note that, on the one hand, there is a continuous effort to expand capital structure component with rigorous impact. On the other hand, there is a lack of rigor in past research studies and ambiguous results regarding the impact of capital structure in hotels. Therefore, the thesis study will deal with the impact of capital structure, and research questions are formulated accordingly. In the following, an overview of the research questions is provided.

1) What impact does capital structure component have on hotel profitability?
2) How these more important capital structure components impact profitability of a company?
3) What is the position of profitability of listed hotels?

1.4 Objectives of the Study

The main objectives of this study are to analyze the effect of capital structure on profitability of Hotels listed in Nepal stock exchange. Specific objectives of the study are as follows:

(i) To analyze the profitability Position of Hotels listed in Nepal stock exchange.

(ii) To analyze capital structure of Hotels listed in Nepal stock exchange.

(iii) To determine the relationship between capital structure and profitability of hotels listed in Nepal stock exchange.

1.4 Hypothesis

Hypothesis 1:

H1: There is a significant relationship between total debt to equity ratios and return on asset of the hotel .

Hypothesis 2:

H1: There is a significant relationship between total debt to equity ratios and return on equity of the hotel .

Hypothesis 3:

H1: There is a significant relationship between total debt to asset ratio and return on asset of the hotel.

Hypothesis 4:

H1: There is a significant relationship between total debt to asset ratios and return on equity of the hotel.

1.5 Significant of the Study

The results of this study will provide financial guidance to managers, business consultants and investors with the necessary techniques of combining debt and equity and being able to maximize company performance. This study will assist decision makers especially finance managers and policy planners of both public and private companies to formulate better policy decisions in respect of the mix of debt and equity capital and therefore increase shareholders value and reduce bankruptcy costs. This study will be used by investors and other people with the intention of investing to analyze the companies and see what kind of capital structure mix generates more profit for the company. This study will assist other academicians to write further studies concerning financial issues and add the knowledge to the community.

Academicians who intend to write dissertations for Bachelor and Masters Degree programs provided in Nepal and in other parts of the world may use the study results as the reference to support their studies.

This study will assist finance managers and other finance officers in public listed companies to advice on their management about the best source of finance which contribute more profitability of the company. Investors and other company stakeholders after reading this study will be in a position to know the profitability and capital structure indicators of the companies in which they would like to invest and acquire returns in terms of dividends or capital gains.

1.6 Limitations of the Study

The scope of this study was limited to the examination of the impact of capital structure on profitability of core business operations of Hotels in Nepal over the period of 10 years. In order to make generalization from sample to population, and to increase number of observation of the study, a combination of the maximum number of hotels and years in which audited financial statements available were taken into account. As a result, the researcher achieved 48 number of observation by taking sample of the only 4 hotels that have been operating and provided audited financial statements during the period of 10 years. To meet its objectives, the study was limited to examining the impact of capital structure on profitability of core business operation of hotels using independent variables: Total Debt to Asset, Debt to equity and the dependent variable was return on asset and return on equity (as a measure of profitability of core business operations of hotels).

Despite every attempt to bring forward this research work to a fully furnished and recommendable version, it will still be limited by various reasons and as a master's degree thesis this study also certainly have certain limitation. The major limitation that hinder the study were absence of active secondary market which forced the researcher to measure the dependent variable as well as the proxies of the independent variables with reference to four hotels only. Other limitation in this report is as follows:

- The first limitation concerns the measurement time lag
- The literature on the study of the capital structure for the companies is rare. Hence, the information we obtained from the existing literature is very limited.

- The result of analysis might not be able to use in all hotel industry as there are limited number of hotels listed in Nepal Stock Exchange.
- This thesis is entirely based on the ex-post studies due to the lack of time.

1.7 Structure of the Report

Following research report has been divided into five different chapters for systematic presentation of the report. Each chapter deals with the different aspects of the entire report. Following are the arrangements of the chapter as it is done in the report.

Chapter One: Introduction

The introduction chapter deals background of the study, statement of the problem, research questions, objectives of the study, research hypothesis, rationale of the study, limitations of the study and organization of the study.

Chapter Two: Literature Review

This chapter is a review of the literature and it incorporates the theoretical review of literature. This chapter provides a comprehensive review of theoretical and empirical literature regarding the visual identity and its components, branding and sales, and finally the impact of the brand visual identity on sales. It explains why each literature was chosen for the critical review and how it helped to build the conceptual framework and identify problem statement needed for the study.

Chapter Three: Research Methodology

This chapter includes various techniques and methods employed for conducting the research. It basically defines: what research design was used for the research, what methods were used to gather data from the respondents and what is the data processing and analysis procedure and the methodology used for the study.

Chapter Four: Results and Discussion

This chapter first defines the type of analysis used to process the data gathered for the research. Then it identifies the degree of relationship between various independent variables and dependent variables being identified for the study. Basically, this chapter

analyses various data gathered and tried to find out relationship between factors identified for the research.

Chapter Five: Summary and Conclusion

Finally, this chapter summarizes the whole research findings and appropriate recommendations are forwarded on the basis of the conclusion of the research. The summary of findings reiterates the measures developed, in different sub-headings, found out from the analysis of data gathered. It relates the data findings in a logical, rational fashion to the problem area and research hypothesis within the framework of the theory structure established in Chapter one.

Besides all the chapters at the end of research bibliography and appendices are also presented.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

The literature review section of the study cover the overview of the Nepalese hospitality and capital requirement, the theoretical and empirical studies review in the areas of capital structure and profitability. Moreover, it presents the variable summary and conceptual framework as well as the knowledge gap and conclusion. Also it covered literature and views of other researchers who supported the research topic. This chapter covered definitions of key concepts and clarifications of theories related with the study topic and clarified ideas of other researchers presented in their research reports, journals and books related to this study called empirical literature review.

2.1.1 Conceptual Definitions

This section defined the key concepts of the study and those concepts were capital structure and profitability of a company which were the study variables.

2.1.1.1 Capital Structure

Capital structure is how a firm would be able to fund its future investments projects via debt, equity or mixed. Capital structure was also defined by Roshan (2009) as a mix of debt and equity capital maintained by a firm. There is a sign of stability about the meaning of capital structure if newest definition by Narayasanary (2015) is compared with the older definition by Roshan (2009) because both of them considers a mix of debt and equity capital which form a company capital structure.

A firm's capital structure is the mix of its' financial resources available for carrying on the business and is a major determinant on how the business operates. As financial capital is an uncertain but critical resource for all firms, suppliers of the finance are able to exert control over firms. The two major classes of financing for a business are debt and equity. While debt holders exert lesser control over the company, and do not determine how the business is run, they earn a fixed rate of return and are protected by contractual obligations. The contractual obligations dictate what return is to be paid for the finance and when it is due. Equity holders are the residual claimants of all the business' returns, bearing most of the risk and having greater control over

decisions, Kochhar (1997).

Hotels and restaurants attract many tourists for leisure, rest and recreation. Employment in hotels has been increasing continuously with years. The United Nations World Tourism Organization (UNWTO) stated that international traveling for business, leisure, and other purposes had a decreased worldwide by 4% in 2009 to 880 million. On the other hand, there were signs of an increase in the final quarter of the year, when tourist arrivals grew by 2%. According to WCB, an increase in demand for hotel rooms resulted in more construction of new hotels. Growth in the tourism sector increased the demand for employment. Due to these changes in the demand for hotels, they are employing more and more young workers stated by WCB of British Columbia. This shows the needs for recruiting seasonal and part time workers in those industries. They require more workers during the summer season and mostly on weekends, where young workers are readily available to work. Although hotels are seen as places they can have comfort and enjoy, those places are an environment with full of real hazards and accidents.

Although Medical and social sciences have done researches, collecting data about physical and mental health of citizens and trying to reduce accidents at work, individuals involving men, women and children continue to suffer from injuries sustained in home, at play and most importantly at work. "Though a continual watch and record is kept of work accident and these are analyzed at regular intervals by Government departments, safety organizations, and individuals having expertise in safety, accidents continue to happen, Pramod and Govind Swaroop Pathak (2011)

The capital structure of a firm is described as the components of its sources of financing, broadly categorized as equity and debt finance, Brockington (1990).

Equity finance is finance provided by owners of the business and it is the risk bearing finance. The holders of this finance own a portion of the firm denominated in shares and they are entitled dividends. However, it is not mandatory to pay a dividend all the time as the hotel may retain the profits for financing expansion of its operations. Equity owners also share in the risks of the business and are the last to benefit when a business is wound up after debt holders have been paid.

Debt finance is finance generated through borrowing from external sources such as banks or from issues of bonds, all of which attract a fixed return. Debt may be short

term, (repayable over periods shorter than one year) or long term, (repayable over periods longer than one year). The lender does not gain a control of the business, but is paid interest for the use of his funds. The borrower has a contractual obligation to pay the interest and to repay the principal when due, inspite of the performance or profitability of the business.

Brealey and Myers (2003) defined capital structure as the firm's mix of different securities. The firm may issue dozens of different securities, but it attempts to find a combination that maximizes its overall market value by minimising the cost of capital. When the firm is financed entirely by common stock, all its resultant cash flows will go to the stock holders. When it issues debt alongside the equity, the cash flows are shared between the common stockholders and the debt holders, with the debt holders getting a fixed amount, while the common stockholders get the residual amount depending on the overall performance of the business.

2.1.2 Hotel Profitability

This is an outcome or result of hotel business operations. That hotel result is the difference between the company revenue and expenditure. Burja (2011) defined company profit or performance as the direct result of managing various economic resources and of their efficient use within operational, investment and financing activities. In this study, hotel profit was a dependent variable measured by Return on equity and return on asset.

The word profitability is composed of two words, namely, profit and ability. The term profit has been explained above and the term ability indicates the power of a business entity to earn profits. The ability of a concern also denotes its earning power or operating performance. The profitability may be defined as the ability of a given investment to earn a return from its use. Profitability is a relative concept whereas profit is an absolute connotation. Despite being closely related to and mutually interdependent, profit and profitability are two different concepts. In other words, in spite of their generic nature, each one of them has a distinct role in business. As an absolute term, profit has no relevance to compare the efficiency of a business organization. A very high profit does not always indicate sound organizational efficiency and low profitability is not always a sign of organizational sickness. Therefore, it can be said that profit is not the prime variable on the basis of which the

operational efficiency and financial efficiency of an organization can be compared. To measure the productivity of capital employed and to measure operational efficiency, profitability analysis is considered as one of the best techniques (Tulsian, 2014)

2.1.3 Components of Financial Statements

In this study, researcher described two types of financial statements as a guide for data collection purpose from listed hotels industry. Those financial statements were balance sheet and income statement

2.1.3.1 Balance Sheet

Pandey (2010) defined balance sheet and income statement of a company as follows. He defined balance sheet as a statement that indicates the financial condition or the state of affairs of a business at a particular moment in time. To provide more clarification on this, balance sheet consists of information about resources (assets) and company obligations (liabilities) and owners funds (equity) at a particular point of time. Normally balance sheet prepared at a particular date reveal the firm's financial position at that specific date.

Moreover, Pandey (2010) defined company assets as the valuable economic resources owned by the firm which are divided into current and noncurrent assets. Current assets are short term in nature while noncurrent assets are long term in nature. Liabilities represent debts payable in the future by the company to its creditors. They are divided into current and long term liabilities; where current liabilities are debts payable within an accounting period while long term liabilities are the obligations in period longer than one accounting period. Another part of balance sheet is owners equity which is the capital contributed by shareholders of the company. Owner's equity according to Pandey (2010) is divided into two parts, "paid up share capital and reserves (retained earnings)". Paid up capital is the amount of funds directly contributed by the shareholders through purchase of shares while reserves or retained earnings are undistributed profit?

2.1.3.2 Profit and Loss Account

Pandey (2010) defined profit and loss account as a score board of the firm's performance during a period of time. Since the profit and loss account reflects

the results of operations for a period of time, it is a flow statement. Profit and loss account represents the summary of revenues, expenses and net income or net loss of a company, and net income is the difference between company revenues and expenses at a particular financial year.

2.1.4 Capital Structure Ratios

Capital structure ratios as represented by leverage ratios indicate the proportion of debt and equity in financing the firm's assets, Pandey (2010). To judge the long term financial position of a firm, financial leverage or capital structure ratios are calculated. These ratios indicate a mix of funds provided by owners and lenders. As a general rule, there should be an appropriate mix of debt and owners equity in financing the firm's assets. The use of debt magnifies the shareholders earnings as well as increases their risk. Creditors treat the owner's equity as a margin of safety that is if the equity base is thin, then creditors risk will be high.

2.1.5 Profitability Ratios

Chandy (2012) defined profitability ratio as a measure of the operating efficiency and performance of the company. Users of financial statements like management, shareholders, suppliers and customers are interested with performance ratios because they help them to judge the hotel performance. Shareholders require profitability information because help them to judge the survival of the hotel in which they have invested. Creditors of the hotel want to get interest and repayment of principal regularly. Moreover, for owners of the hotel a good profitability ratio assure them to acquire a huge required rate of return.

2.1.5.1 Return on Asset

This is the ratio showing the contribution of hotel assets on profitability of the company. The greater the ratio the greater the company performance contributed by company assets of that company.

2.1.5.2 Return on Equity

This is the contribution of shareholders fund (equity) in generation of company profit. It is a ratio of company profit to shareholders fund. The greater the ratio the greater the performance of a company generated by equity.

2.1.6 Determinants of Capital Structure

Capital structure theories which discussed in the first part, aim to determine an optimal capital structure. In this section, the factors determining firm's capital structure are represented. These factors can influence firm's capital structure significantly and can be listed as the age of the firm, the firm size, asset structure, profitability, growth opportunities, firm risk level, taxation and ownership structure.

2.1.7 Theories of Capital Structure

2.1.7.1 Modigliani Miller Irrelevance Theory

Modigliani - Miller (1958) theorem is considered the greatest breakthrough in theory of optimal capital structure. The theorem specifies the financial decisions by firms that are irrelevant to the firm's value. Modigliani- It has four prepositions which are;

i) The value of a firm is the same regardless of whether it finances itself with debt or equity. The weighted average cost of capital is constant. The assumptions of Modigliani- Miller theorem are; Perfect and frictionless markets, no transaction costs, no default risk, no taxation, both firms and investors can borrow at the same interest rate; there is homogeneous expectation homogeneous risk and equal access to all relevant information.

ii) The rate of return on equity grows linearly with the debt ratio implying that the higher the debt equity ratio the higher the expected return on equity.

iii) The distribution of dividends does not change the firm's market value it only changes the mix of Equity and Debt in the financing of the firm.

iv) In order to decide an investment, a firm should expect a rate of return at least equal to cost of capital no matter where the finance would come from. Hence the marginal cost of capital should be equal to the average cost of capital. The constant cost of capital is sometimes called the "hurdle rate" (the rate required for capital investment).

In summary the theory states that the value of a firm is invariant with respect to its leverage policy in an arbitrage-free market when there is no corporate income tax and no bankruptcy cost: whether firm is financed through debt or equity, its value remains

the same.

2.1.7.2 Pecking order theory

Pecking order theory of capital structure states that firms have a preferred hierarchy for financing decisions. Firms will borrow instead of issuing equity when internal cash flow is not sufficient to fund capital expenditure. The highest preference is to use internal financing before resorting to any form of external funds. Internal funds incur no flotation costs and require no additional disclosure of financial information that may lead to a possible loss of competitive advantage. If a firm must use external funds, the preference is to follow a certain order of financing sources: debt, convertible securities, preferred stock, and common stock, Myers (1984). This order reflects the motivations of the financial manager to retain control of the firm, reduce the agency costs of equity, and avoid negative market reaction to an announcement of a new equity issue. The amount of debt will reflect the firms' cumulative need for external funds.

The theory has two key assumptions about financial managers. The first of these is the likelihood that a firm's managers know more about the company's current earnings and future growth opportunities than outside investors. There is a strong desire to keep such information proprietary. The use of internal funds prevents managers from having to make public disclosures about the company's investment opportunities and potential profits to be realized from investing in them. The second assumption is that managers will act in the best interests of the company's existing shareholders. The managers may even forgo a positive-NPV project if it would require the issue of new equity, since this would give much of the project's value to new shareholders at the expense of the old, Myers & Majluf (1984).

However the theory has some limitations since it does not explain the influence of taxes, financial distress, security issuance costs, agency costs, or the set of investment opportunities available to a firm upon that firm's actual capital structure. It ignores the problems that can arise when a firm's managers accumulate so much financial slack that they become immune to market discipline. As such the theory is offered as a complement to, rather than a substitution for, the traditional trade-off model.

2.1.7.3 Trade off Theory

In this theory, the firm is viewed as setting a target debt-equity ratio and gradually moving towards it. The firms seek debt levels that balance the tax advantages of additional debt against the costs of possible financial distress. In particular, capital structure moves towards targets that reflect tax rates, assets type, business risk, and profitability and bankruptcy costs. The firm is balancing the costs and benefits of borrowings, holding its assets and investment plans constant Myers, (1984).The firm's optimal capital structure will involve the trade-off between the tax advantage of debt and various leverage-related costs.

Due to the distinctions in firm-specific characteristics, target leverage ratios will vary from firm to firm. Institutional differences, such as different financial systems, tax rate and bankruptcy law etc, will also lead the target ratio to differ across countries. The theory predicts that firms with more tangible assets and more taxable income to shield should have high debt ratios. Firms with more intangible assets, whose value will disappear in case of liquidation, should rely more on equity financing. In terms of profitability, trade-off theory predicts that more profitable firms should mean more debt-serving capacity and more taxable income to shield, thus a higher debt ratio will be anticipated. Under trade-off theory, the firms with high growth opportunities should borrow less because they are more likely to lose value in financial distress.

2.1.7.4 Agency Costs Theory

The theory posits that firm's capital structure is determined by agency costs, which includes the costs for both debt and equity issue. The costs related to equity issue may include: the monitoring expenses of the principal (the equity holders), the bonding expenses of the agent (the manager), reduced welfare for principal due to the divergence of agent's decisions from those which maximize the welfare of the principal.

Besides, debt issue increases the owner-manager's incentive to invest in high-risk projects that yield high returns to the owner-manager but increase the likelihood of failure that the debt holders have to share if it is realized. If debt holders anticipate this, a higher premium will be required which in turns increase the costs of debt. The agency costs of debt include the opportunity costs caused by the impact of debt on the investment decisions of the firm; the monitoring and bond expenditures by both the

bondholders and the owner-manager; and the costs associated with bankruptcy and reorganization Hunsaker (1999). Since both equity and debt incur agency costs, the optimal debt-equity ratio involves a trade-off between the two types of cost.

Agency costs arise due to the conflicts of interest between firm's owners and managers.

Jensen and Meckling (1976) introduce two types of conflicts:

i) Shareholders-managers conflicts

This kind of conflict stems from the separation of ownership and control. If managers do not completely own the firm, they can only capture a fraction of the gain earned from their value enhancement activities but they need to bear the entire costs of these activities.

Jensen (1986) argues that, instead of working under shareholders interests to maximize firm's value, managers prefer to increase firm's size to enjoy the benefit of control. Managers have incentives to cause their firm to grow beyond the optimal size and accept negative net present value (NPV) projects. The over investment problem can be made worse by more free cash flow and less growth opportunities. Issuing debt helps to mitigate agency problems since debt commits firm to pay out cash so prevents managers from investing in negative NPV projects. Jensen refers to the non-discretionary nature of debt as the disciplining role of debt.

ii) Shareholder-bondholder conflicts

The shareholders or their representatives make decisions transferring wealth from bondholders to shareholders. The bondholders are aware of the situations in which this wealth expropriation may occur and will demand a higher return on their bonds or debts to guard against this. The conflicts may be minimized by firms with high growth opportunities having a lower leverage and using a greater amount of long-term debt than firms in more mature industries. The issue of convertible debt or debt with warrants can serve as another way of mitigating the conflicts as shown by Jensen and Meckling (1976) because the convertible debt will have lower agency costs than plain debt.

2.1.7.5 Information Signalling Theory

This theory contends that the choice of firm's capital structure signals to outside investors the information of insiders. It further notes that the problem of asymmetric or incomplete information in firms makes it difficult for lenders to accurately assess the level of risk. Managers are motivated to communicate insider information about a firms value to the public stock market and their willingness or undertake costly capital structure reorganization change programs act as validated signal of this information. Ross (1977) argues that a firm signals an increase in the firm's asset value by increasing its leverage (debt) while Leland and Pyle (1977) however posits that a firm signals the increase in firm's value by reducing it leverage (debt). Arising from the two signalling hypothesis above, increase in debt will lead to increases in price based on the Ross (1977) model while based on Leland and Pyle (1977) increase in debt will lead to reduced prices.

2.1.7.6 Free Cash Flow Theory

Free cash flow is the amount of cash that a company has left over after it has paid all of its expenses, including investments. It is important because it allows a company to pursue opportunities that enhance shareholder value. This theory expresses that mitigation of free cash flow by paying interest of debt and dividends prevent a manager from abusing company's income for personal purposes. Due to law requirements, paying the principal and interest of debt is preferred to paying dividends to diminish the level of free cash flow. (Jensen,1986).

2.1.7.7 Life Cycle Theory

The theory contends that firms use different types of financing for different stages of growth. Disiboshi (1989) proposed corporate life cycle theory which proposes that organizations get conceived, grow into adulthood and die Upstarts look for the benefits of debt, most upstarts make losses .Entrepreneurs use personal guarantors since no one is keen to lend to them. There is no separation between ownership and the management, they are intertwined. At this stage decision flexibility is very valuable since future prospects are unknown, there are no assets to act as collateral. Growth stage has similar characteristics to the upstart. Fast growing firms hardly want to borrow significantly as this would affect flexibility to take up projects. At old stage, borrowing is significant and affordable. Firms have grown a substantial asset base. As

firms become mature and grow there is separation between management and ownership. Management discipline becomes critical hence need to borrow significantly. The firm's investment needs are predictable. In old ages firms do not have investment needs and tend to retire most of their debt

2.1.7.8 Contemporary Capital Structure Theories

Graham and Harvey (2001) advance the observation that Corporate Finance Officers (CFOs) consider the most important factor as maintaining financial flexibility, keeping debt low in order to be ready for unforeseen opportunities. CFOs tend to be very wary of taking on debt. Kumaret et al (1999) in Buringuriza and Hyltenstam (2002) affirm that industries dependent on external finance tend to have smaller firms on average, indicating low growth and low performance, as do countries with low levels of financial development. They also state that equity financed industries tend to grow more slowly in countries that are more financially developed and tend to undertake less research and development. In contrast to what happens in the developed countries, bank dependent industries in countries with low GDP grow faster as the banking system develops.

2.1.8 Debt Financing

Business enterprises use debt in their businesses, because it offers them potential to increase the volume of their operations and increase the average return on their equity funds. The use of debt will have this effect only if the rate of return on the investment is greater than the rate of return on the debt, Watkins (2002). The borrowing firm takes a chance to use debt in the hope that it will elevate the firm to a more valuable level, by increasing the turnover and therefore increase the profits. The financial leverage chance will arise if the rate of interest charged to the firm is lower than the internal rate of return (IRR) for the company, in which case the firm will be making enough to pay the interest charged and the principal repayment and retain the surplus for the shareholders.

On the other hand the firm may experience a financial leverage risk that the returns of the business are not enough to cover the interest charged. This occurs when the rate of interest exceeds the internal rate of return of the company. To avoid liquidation, the firm will have to use part of the shareholders' funds to repay the interest and

principal. This could eventually lead to erosion of the equity and the collapse of the business.

The simplest way to assess whether borrowing has increased the return on equity is to contrast the return on the investment with the loan interest rate. When the return is higher than the loan interest rate, there is positive leverage (that is the return on equity increases as more is borrowed, Rowland (2002).

2.1.8.1 Measurement of Indebtedness

Bierman (1999) defines *financial leverage* as the use of debt in the capital structure and enumerates four ways of measuring it. The static measure of indebtedness using *book values* is the proportion of debt to the total capital or debt to the sum of debt and common stock, given as:

$$I_1 = \frac{D}{D + E}$$

Where D represents the book value of debt and E is the book value of equity (or shareholders' funds). A second measure of indebtedness is the static measure of indebtedness using market values and is defined as the proportion of debt to total capital or the sum of debt and common stock, with the debt and equity taken at market value. It is expressed mathematically in the same way as the first measure above.

The third measure is the flows measure of indebtedness which uses interest and income and is expressed as the ratio of the earnings before interest and tax (EBIT) to the interest for the period. It is represented by:

$$I_2 = \frac{\text{EBIT}}{\text{Interest}}$$

This ratio measures the firm's debt servicing capacity and shows the number of times the interest charges for the period are covered by funds that are ordinarily available for the interest payment.

A fourth measure is the flows measure of leverage, using cash flows and employs the ratio of cash inflows (income including depreciation and other non-cash expenses) and cash outflows (in terms of payment of debt). It is a measure of the ability of the firm to finance its debt obligations of paying the interest and the principle debt as they fall due.

Nivorozhkin (2000) expresses a primary concern with the use of book values versus market value data, in the measurement of indebtedness and prefers to use market values, as they provide a more accurate description of future cash flows and their risks. This however, introduces the problem that market prices are frequently fluctuating. He concludes that the final and perhaps best measure of leverage is the ratio of total debt to the sum of total debt and shareholders' equity, using the book values.

2.1.8.2 Debt and Shareholders' Returns

Watkins (2002) illustrates the effect of leverage on the shareholder's risk by describing, mathematically the rate of return on equity in terms of the rate of return on the debt and the rate of return on the asset that the debt is financing. Thus;

$$Req = ra + L\ (ra/\ rd) \quad (2.1)$$

Where *req* is the return on equity, *ra* is return on asset, *rd* is return on debt and *L* is the leverage (debt/equity ratio).

This relationship is a major factor in the choice of funding for an asset, because when the return on debt (*rd***)** exceeds the return on the asset (*ra*), the return on equity will be less than the return on the asset. It follows then that the asset cannot benefit the investor as the return on equity is reduced by the financing of the excess of return to debt over and above what the asset is generating, and the higher the leverage ratio, the more the negative effect on the return on equity.

Myers and Majluf (1984) argue that a theory of capital structure can be constructed by ranking securities, where investment is financed first with internal funds, then by issue of debt before the issue of new shares can be considered. Other scholars yet base their arguments on the Pecking Order Theory which states that businesses choose their source of finance in a hierarchical manner preferring internal financing, where available, and if external financing is required, preferring debt to external equity sources, because debt is considered less risky than external equity.

Mayer and Sussman (2002) advance the thought that the Pecking Order Theory denies the existence of an optimal capital structure. They argue that firms have a ranking of instruments to satisfy their financial needs without a tendency to revert to any particular capital structure. The capital structure therefore is a result of the supply of

the preferred source(s) of funding.

2.1.8.3 Debt and Risk

Risk is the variability in the earnings of a company which increases the likelihood of bankruptcy and the cost of debt. Risk can be broken down into two components:

i) Operating risk is the variability in earnings due to the environment in which the firm operates and is unavoidable risk

ii) Financial risk is the variability in the earnings after interest and tax that is due to the use of financial leverage. Financial risk affects the shareholder's value in varying the Earnings Per Share (EPS) and rate of Return on Equity (ROE). This risk arises as a result of fixed payments related to debt, namely interest and principal payments, that have to be paid regardless of whether the business is making profits or not.

According to Brealey and Myers (2003), in most years in a business' life there is a gap between the cash that the company needs and the cash it can generate internally for its operations and this is called the financing gap. To make up this gap, companies must sell new equity or borrow.

They are faced with a decision on what proportion of the deficit must be financed by borrowing and how much by internal funds. This assumes that the borrowings at a fixed charge can be obtained at a cost lower than the firm's rate of return on its total assets, and the surplus of the return after paying off the interest will be distributed to the shareholders, then the earnings per share or the return on equity will rise. However, return on equity will fall if the company obtains the fixed charge funds at a cost higher than the rate of return on its total assets as the interest charged will erode the profits.

Reilly and Brown (2003) define financial risk as the uncertainty introduced by the method by which the firm finances its investments. If it employs only common stock to finance investments, it incurs only the business risk, the uncertainty arising from the nature of the business. If it borrows money to finance its investments, it must pay fixed financing charges prior to providing income to the shareholders, so the uncertainty of returns to equity holders increases by the risk introduced with the borrowing. If the profits are low, the business must still pay the lenders before the shareholders can be paid their return. This increases the variability of the return to them.

Taking and managing risk is part of what companies must do to create profits and shareholder value, Buehler and Pritsch (2003). Risk is defined here broadly to include any event that might push a company's financial performance below expectations. It comes in four main categories namely:

i) Market risk (exposure to adverse market price movements),
ii) Credit risk (exposure to the possibility that a borrower or client might fail to honour their contractual obligations),
iii) Operational risk (the exposure to losses due to inadequate internal processes and systems)
iv) Business-volume risk (exposure to revenue volatility arising from changes in demand and supply or competition).

A company must formulate a strategy that takes into account all these risks and plan their mitigation. One major aspect of the risk assessment and management involves decisions on the capital structure or the business financing of the company.

2.1.8.4 Debt and Dividends

A dividend is set by the firm's board of directors and it is announced at the annual general meeting of shareholders that the payment will be made to all shareholders who are registered on a particular date. The dividend declaration may be restricted by debt holders or lenders, who are concerned that the payments may not leave enough to cover their debts. Companies are legally not allowed to pay a dividend out of legal capital. Brealey and (Myers,2003). Companies pursue a dividend policy that maximizes the shareholder's return so that the value of his investment is maximized. A dividend policy determines how much of the profit of a firm is distributed as dividends to the shareholders and how much is retained as reserves for financing the firm's growth. A high payout ratio policy implies less retained earnings resulting in slower growth and maybe lower market price per share. A low payout policy on the other hand may accelerate earnings and raise the share price and investors will realize most of their return through capital gain. The dividend per share may be low for such companies, but the market value to book value of the share will be high

Managers tend to have a target dividend pay-out rate but tend to smooth it out to keep dividends as predictable as possible, in order to have a stable market value. A fall in dividend can send bad signals to the market and cause the value to fall drastically. They have an option to buy back shares or issue bonus shares instead. Brealey and

Myers (2003).

2.1.8.5 Debt and Share Value

The Mayer and Sussman (2002) report the development of a new approach to testing the capital structure theory. On performing tests and event studies on financing of specific projects, they found that around time of investment spikes, both the trade-off and the pecking order theories played an important role in the firms' financing decisions. Profitable and large firms have a clear preference for debt over equity and increased their debt in line with their financing requirements. However, small firms are forced to turn to equity markets to finance their investments.

2.1.8.6 Debt and Interest rates

Interest rates represent the cost of borrowing capital for a given period of time. According to Myers and Stewart (1984), prevailing interest rates are key to many firms, because of indexing of interest rates to inflation. Studies show that interest rates affect capital structure decisions. Jalilvand and Harris (1984) in a study of United States of America(USA) Corporation obtained results which suggested that financial decisions are interdependent and firm size, interest rate conditions and stock price levels affect speed of adjustments to capital structure implying that they do influence it. Singh (1993) notes that if the interest rate is high investment falls, a low rate of interest may lead to increase in investment activity. Increased investment may imply use of more debt. It can thereby be concluded that a relationship exists between investment and use of debt and level of interest rates

2.1.8.7 Debt and Agency Costs

Agency costs are the disputes that occur between interested parties in an organization due to their various competing interests. Conflict of interest between the debt/bondholders and the equity holders may arise due to under investments. Myers (1977) argues that investment decisions in a firm can be affected by the presence of long term debt in the firm's capital structure. Shareholders may under invest and pass up positive NPV projects if they perceive that the profits will be used to pay off existing debt holders. This cost can be most acute among the growing firms, Myers argues that the firms may want to limit the total debt or use short term debt in order to limit underinvestment costs. Froot and Stein (1993) propose that firms may want to hedge or otherwise maintain financial flexibility to avoid cost of underinvestment.

At high debt ratios, friction between management and lenders escalates. Lenders will want to introduce restrictive covenants to prevent their wealth from being distributed to shareholders. At high debt ratios investors will want to engage in risky investments because incase of best outcomes major beneficiaries are their shareholders because lenders have fixed interest irrespectively of the projects undertaken.

Asset substitution is where the shareholders are able to capture returns above those amounts required to service debt repayments and other liabilities and at the same time have a limited liability when the returns are insufficient to fully pay off the debts and the debt holders may have to write off the debts. Therefore shareholders will prefer high risk projects and the bondholders will prefer risk free projects that will guarantee repayments. Leland et al (1996) argue that the use of short term debt reduces agency conflict while Green (1986) argues that asset substitution can be avoided by use convertible debt so that if the shareholders insist on undertaking riskier project the bondholders can enjoy benefits of the project by converting their bonds to equity.

In making debt decision managers take into account how it affects their ability to take additional projects in the future In practice many firms that have a high substantial investment opportunities will preserve their borrowing capacity to enable them have flexibility. This explains why there is lower debt financing in new industries.

2.1.8.8 Factors Influencing Debt Financing

Safdar et al (2009) analysed the relationship between large external equity holder's ownership and financial leverage and realised that relationship between management ownership and leverage ratio is not significant in the presence of a large outside equity holders. An ownership structure with dispersed ownership, no single shareholder has a substantial controlling stake, hence no one is able to call on the management to account. In such cases managers will have substantial decision making ability and debt levels will be low. In concentrated ownership where there is only a handful shareholders who have significant stake and control they are able to call on management to account and shareholder power is immense hence debt ratio will be higher

2.1.8.8.1 Advantages of Debt Financing

Firms which experience high tax rates will have comparatively higher leverage ratios and likewise lower tax rate will lead to lower debt ratio. Mackie-Mason (1990)

concluded that firms that have non debt tax shields are likely to borrow less than those that have no debt tax shield i.e. other shield like depreciation (Wear and Tear) or Accumulated losses.

If taxes were to increase over time it is expected that industry debt ratio will go up with time. Country differences in taxes may explain country differences in debt ration i.e. with higher tax rates firms would tend to have higher debt ratios. Agreeing with this assertion Desai (1998) found that tax advantage is most important for large dividend paying corporations and companies that probably have a high corporate tax rate and therefore tax incentive to use debt. Firms also issue foreign debt in response to relative tax incentives.

Jansen (1986) brought the rationale that use of debt facilitates discipline in management. Managers tend to make wasteful decisions with free cash flows when given discretionary powers on how to use them. Free cash flow is the firm's cash that the management has discretionary powers and can be used to invest in new assets, pay dividends and finance management perks. Many companies with huge free cash flow and cash reserves and little or zero debt financing tend to have a huge cash cushion against mistakes and no incentive to be efficient. Debt payment obligations will generally force managers to make the most competitive investment decisions. Debt can also be valuable in monitoring the implementation of investment decisions, ensuring that there is efficiency. This is done by ensuring that the free cash flow available to management is extremely small or insignificant, forcing managers to meet debt serving obligations. Also, the lenders to the firm will always do their own monitoring hence managers may not borrow much.

2.1.8.8.2 Disadvantages of Debt Financing

At high level of debt financing a firm is exposed to possibly of default (Bankruptcy cost). Bankruptcy costs of debt are the increased costs of financing with debt instead of equity that result from a higher probability of defaulting on debt repayments. They can be categorized into two; direct bankruptcy cost which is less significant (4% of company asset value) and indirect cost which is more significant and includes loss of credit facilities from suppliers leading to firms having to dip into their cash resources or set cash reserves in cases where credit terms are reduced. Firms in this situation have to invest in more liquid assets. Implicit bankruptcy costs can be the positive NPV projects the firm may have to forego due to its obligations to service debt repayments.

2.1.9 Factors affecting firm's choice of capital structure

i) Tangibility

Tangible assets can be used as collateral in external borrowing, the presence of large tangible assets can help a firm get bank loans at a lower interest rate, it also helps to reduce the risk of the lender suffering from the agency cost of debt. Since the debts can be secured by the collateralization of tangible assets, the firm's opportunity to engage in asset substitution is reduced by the presence of a large fraction of secured debts. Johnson (1997) the costs of capital for firms with more intangible assets, are higher since monitoring is more difficult. Hence, a firm with a large fraction of tangible assets is expected to have more debt.

ii) Effective tax rate

Interest from loan is tax deductible; firms with higher taxable income ought to have more debt to benefit from tax-shield gain, Hauge and Senbet (1986). As a result, effective tax rate is expected to be positively associated with the level of debt. However, higher effective tax rate also reduces internal funds and increase the cost of capital. Therefore a negative relationship between effective tax rate and level of debt is expected.

iii) Size

Size is positively related to leverage; larger firms are usually more diversified and have more stable cash flow. The probability of bankruptcy is smaller for large firms compared with small ones. Many studies suggest that large firms prefer to issue long-term debt while small firms choose short-term debt to finance their projects. Large firms bear lower costs in issuing debt and equity compared with small firms, Michaelas et al. (1999) because of the advantage of economies of scale and bargaining power with creditors.

iv Growth Opportunities

Studies generally suggest a negative relationship between growth opportunities and leverage. In underinvestment situation, firms with high growth opportunities may forgo positive NPV projects because of existence of outstanding debt, Myers (1977). Since the returns from such investment will be transferred to debt holders rather than

shareholders. If management pursues growth objectives, management and shareholder interests tend to coincide for firms with strong investment opportunities. In overinvestment, debt limits the agency costs of managerial discretion. Hence firms with high growth opportunity may not issue debt in the first place and an inverse relationship between growth opportunities and leverage is expected to hold

v) Volatility of earnings

Firms with high volatility in earnings face a higher risk of earnings level dropping below the debt service commitment. This may force firms to arrange funds at high cost to pay the debt. However, if financed by equity, firms can choose to forgo dividends payments during the period of financial distress. This indicates that firms with high earnings volatility will borrow least and prefer equity to debt when facing external financing choices.

vi) Liquidity

Pecking-order theory suggests that firms prefer internal financing to external financing, firms are likely to create liquid reserves from retained earnings. If liquid assets are sufficient to finance the investments, firms will have no need to raise external funds. Thus, liquidity is expected to be negatively related to leverage.

2.1.10 Firm Performance and its Measurement

A firm's financial performance, in the view of the shareholder, is measured by how better off the shareholder is at the end of a period, than he was at the beginning and this can be determined using ratios derived from financial statements; mainly the balance sheet and income statement, or using data on stock market prices, Berger and Patti (2002). These ratios give an indication of whether the firm is achieving the owners' objectives of making them wealthier, and can be used to compare a firm's ratios with other firms or to find trends of performance over time.

Charreaux (1997) states that an adequate performance measure ought to give an account of all the consequences of investments, on the wealth of shareholders. The main objective of shareholders in investing in a business is to increase their wealth. The measurement of performance must give an indication of how wealthier the shareholder has become as a result of the investment over a specific time.

The ratio of profits of the company over shareholder capital employed measures the use of the owners' funds in producing the overall profit of the firm and is given as:

$$\text{Return on Equity (ROE)} = \frac{\text{Net Profit after Tax}}{\text{Equity}}$$

Where, equity is the shareholder's funds at the end of the same period.

Other ratios employed to measure the performance of a firm in relation to shareholders' interests are the dividend rate, which measures the cash return to the shareholder from his investment in the share of the firm, and the market value of the company compared to its book value, which measures the change in shareholders' value of investment. Brockington (1990) gives the dividend payout rate as:

$$\text{Dividend Payout Rate} = \frac{\text{Dividend} \times 100}{\text{Share price}}$$

Where the dividend is the amount of dividend per share and the share price is the nominal price.

The ratio of market value (MV) to book value (BV) of the share denotes how the share has appreciated from the nominal value to the market price, and is expressed as:

$$\text{MV: BV} = \frac{\text{Market value per share}}{\text{Book value per share}}$$

2.1.11 Hotels and Hospitality in Nepal

Hospitality is a part of life in Nepali society since long back. However, it was the second periodic plan (1962/65) that emphasized on the need of modern hospitality industries in the country. The 1972 Tourism Master Plan reiterated the need and significance of modern hotel accommodation and travel facilities for tourism development in the country. To this end the government established Hotel Management and Tourism Training Centre in 1972 basically to cater the human resource needs for tourism and hospitality industry in the country. Similarly Tara Gaon Culture and Tourism Centre were established in 1974 for the promotion of Nepali type hospitality in the country. Hyatt Regency Hotel of Kathmandu is an outcome of Tara Gaon Development Committee's (formerly Tara Gaon Culture

and Tourism Centre) noble efforts to establish unique Nepali type hotel industry in the country.

During the initial phase of the growth of hospitality industry, Nepal Industrial Development Corporation invested a large sum of money for the establishment of Star Hotels. It could not be that much effective and, thus did not last long. However, it is the private sector that truly initiated developing the hotel industry in the country; and, is continuing to lead the sector. Dwarika Hotel is a testimony of Nepali type architectural heritage. Pioneer star hotels like Soaltee Oberoi and Hotel de'la Annapurna had really a great contribution in establishing and flourishing hospitality industry in the country, Ghimire (2009).

History of Hotel Industry in Nepal has turned into positive aspect after the peace process taken action in 2008. House operated technically and in an estimated location. The word Hotel originated from the word hostel and again the word hostel from the word host. The word hotel was used in England in about 1760. Hotels may be generally defined as place, which provides over night furnished and serviced accommodation in return of payment. According to British law hotel is a place where benefited travellers can receive Food and Beverage, shelter if he is in a fit condition to receive hence hotel must provide Food and Beverage, shelter to the travellers on payment and has might to refuse if the traveller is drunk disorderly and is not in a condition to pay for the service. The Nepal hotel industries are perhaps one of the oldest commercial endeavours in the world. The earlier Inn where ventured by husband and wife team, who provided large hall for travellers to make their own bed and sleep on the floor. The industrial revolution changed travel from social travel to business travel. There was a need to clean and quick service. The lead in Hotel was taken by Europe especially Switzerland. The real growth of modern hotel took place in the U.S.A beginning with opening of "City Hotel" in New York in 1794.

The real boom in Nepal Hotel industry comes in 20th when two new concepts emerged.

- Hotel
- International chain operation.

International chain operation provide modern technology that individual owner merged themselves to large international chain such as Sheeraton, Hyatt, Holiday Inn, Ramida Inn, Hilton, etc.

The first hotel opened in Nepal was “Nepal Hotel” in Patan Jawalakhel in 1151 to 1952 this hotel was opened and closed in one fiscal year. Mr. Boris Lisanevich Russian nationality arrived in Nepal with his Denish wife Inger in 1951 and established “Royal Hotel” in “Seto Durbar” or “Dip Bahadur Bhawan” in Kathmandu. In 1952 “Parash Hotel” and in 1954 “Snow View Hotel” was opened. In 1956 hotel “Coronation” was opened in Bagbazar was first purposely built hotel in Nepal.

Snow View was host to some of the earliest tourists visiting Nepal, including dignitaries, and a party for Queen Elizabeth. It showed faded black and white pictures of the hotel located at the same spot in Lazimpat where the Mahaguthi building stands today. In its brochures, the Snow View Hotel advertised itself as “your home away from home”. It listed among its facilities single and double rooms with private bathrooms, private car touring trips and moderate rates, which came to about IRs. 100. The brochure also announced in bold letters: Meet the fascinating people of Nepal. This is how we publicized the hotel back then The market was composed of the occasional European and primarily pilots from Indian Airlines who wanted good accommodations. (Niroula & Shakya 2011 Nov Issue 121)

In these 50 years, a perception has been created that Nepal is a tourism capital of South Asia. There are a few contributing factors in this regard. Tourism in Nepal began with the start of modern tourism in the world. Another reason has been that joint tourism packages of Bhutan, Sikkim, and the Tibet autonomous region of China are created keeping Nepal in mind. Similarly, short flight distances from Kathmandu to the capital cities of many South Asian countries have been the other reason. They can be reached within around one and half hours by air from Kathmandu which is centrally located in the region. Likewise, also the apex bodies of hospitality, travel and tour businesses such as Hotel Association Nepal (HAN) and Nepal Association of Travel and Tour Agents (NATTA) that were established 50 years ago. This shows we are seniors in this industry in the South Asia region.

One of the strongest points has always been the friendlier approach of Nepali citizens towards the foreigners. The organic hospitality which the Nepali has been providing

attracts many people from across the world to revisit Nepal. In the meantime, the diversification in the areas of tourism has also contributed largely. Nepali tourism which was centred in sightseeing and mountaineering in the beginning has now expanded to watching wildlife and engaging in vacation activities. In places like Thamel, Pokhara Lakeside and Sauraha of Chitwan, you can experience the world's best foods rarely found elsewhere in the region. Similarly, transportation facilities like green number-plate vehicles that are not affected even during the strikes as well as the arrangement of tourist police who provide safety and assist foreign visitors have also been creating some difference in the tourism business in Nepal, (Joshi, 2017).

Nepali hotel industry has come to this stage after many ups and downs. Starting from eight hotels, this business has taken both quantitative and qualitative leaps. We have been successful in establishing thousands of small and medium hotels to five-star standard hotels.

HAN is celebrating its golden jubilee with the slogan 'Development of Hotel Industries in the Next Decade' as we have realised that the achievement so far by the hotel industry is not enough. That is why we think that we need to move this industry forward in an advanced manner. We don't have any option other than to move ahead realising the dimensions of the learning. But, perhaps we did not really accomplish what we needed to in the last 50 years.

The hotels have been affected due earthquake, economic blockade and political instability in the country which are the main reasons why the hotel business was not, been able to run efficiently.

(Shakya, 2017).

2.2 Review of Related Studies

2.2.1 Review of Previous/ Related thesis and Article

Over the past several decades' corporate finance researchers have devoted considerable efforts to transform rationalism of capital structure into empiricism. The problem of developing a conclusive theory of capital structure and designing empirical tests those are powerful enough to provide a basis for choosing among the various theories is still unresolved. The literature on the relationship between firm performance and capital structure has produced mixed results (Taani,

2013). Hence, the relationship between capital structure and firm value has been the subject of considerable debate. Apart from the seminal work of Modigliani and Miller (1958) emphasizing on the irrelevance theory of capital structure and their subsequent revision taking in to account the tax benefit of debt financing Modigliani and Miller (1963), as well as succeeding arguments and researches such as Static Trade-off Theory of Myers (1984) and pecking order theory of Myers & Majluf (1984) which argues in the contrary of static trade-off theory, there are empirical studies that emphasis on the relationships between capital structure and profitability/performance of firms.

Davis (2002) researchers investigated on health problems among hotel workers and their results showed that "physical workload, time pressure, low job control, high psychological demands, high job stress " increase the risk of ill health among employees and cause accidents.

Davis (2011) in 65 separate hotels where 164 employees were questioned. They identified two frequent stressors in the hotel industry. They were "interpersonal tensions and workloads". The staff in the hotels that were surveyed stated that those stressors always existed to 40-60% during the work days as compared to 25-44% by U.S employees in other different industries. In the Hotel industry, 50-75% of illnesses have been identified to be the result from stress, (the stressful price, 1978). A survey carried on 58 large employers by Hilton and Whiteford (2010), identified that "moderated-high physical stress" raised the rate of workplace injuries.

Chiang,Birtch and kwan(2010) on catering sector in a four star hotel discovered that excessive job demands, low control on the tasks and poor work-life balance led to increased .

Salim & Yadav (2012) examined the relationship between capital structure and firm performance. The investigation was performed using panel data procedure for a sample of 237 Malaysian listed companies on the Bursa Malaysia Stock exchange during 1995-2011. The study used four performance measures (including return on equity (ROE), return on asset (ROA), Tobin’s Q and earning per share (EPS)) as dependent variable. The five capital structure measure (including long term debt (LTD), short term debt (STD), total debt (TD) ratios and growth) as independent

variable. Size is a control variable. The data are divided into six sectors which are construction, consumer product, industrial product, plantation, property, trading and service. The empirical tests indicate that capital structure (especially TD and STD) negatively impacts performance measured by ROE. On the other hand capital structure (LTD and TD) has negative significant impact on firm's performance measured by ROA. Furthermore, findings of this study suggest that there is a significantly positive relationship between Tobin's Q (firm performance) and capital structure measured by LTD and STD. Finally, the results show that Tobin Q has a positive and significant relationship with size (as control variable) for all sectors under study except for property sector a negative effect on the Tobin's Q observed.

Farhad & Aliasghar (2013) also studied the relationship between capital structure and profitability using data from 252 non-financial companies in the period from 1999 to 2008 in Tehran Stock Exchange. Consistent with earlier theories, found a positive association between the return on equity (ROE) and short-term debt. This suggests increasing short-term debts with low interest rate will lead to increase in profitability. Furthermore, the results revealed a negative association between ROE and long-term debt. So, when firms increase long-term debts, this results to decrease in profitability. Finally, the results also indicate a positive relationship between ROE and total debt.

Abor (2005) investigated the relationship between capital structure and profitability of Hotel listed firms on the Ghana Stock Exchange (GSE) during a five-year period (1998-2002). Panel data methodology and regression analysis were used in the estimation of functions relating the return on equity (ROE) with measures of capital structure. And, the finding revealed a significantly positive relation between the ratio of short-term debt to total assets and ROE. However, a negative relationship between the ratio of long-term debt to total assets and ROE was found. This implies that an increase in the long-term debt position is associated with a decrease in profitability. With regard to the relationship between total debt and return rates, the results show a significantly positive association between the ratio of total debt to total assets and return on equity.

Shubita and alsawalhah (2012) extended Abor's (2005), and Gill (2011)

findings regarding the effect of capital structure on profitability by examining the effect of capital structure on profitability of the industrial companies listed on Amman Stock Exchange during a six-year period (2004-2009). The study sample consists of 39 companies and applied correlations and multiple regression analysis. The results revealed significantly negative relation between debt and profitability. These findings imply that an increase in debt position is associated with a decrease in profitability; thus, the higher the debt, the lower the profitability of the firm. The results also show that profitability increases with control variables; size and sales growth. The findings of this paper contradict with prior empirical studies like Abor (2005). Yet recommendations based on findings are offered to improve certain factors like the firm must consider using an optimal capital structure and future research should investigate generalizations of the findings beyond the manufacturing sectors.

In consistent with the Shubita & alsawalhah (2012) findings, Chechet & Olayiwola (2014) examined capital structure and profitability of the Nigerian listed firms from the Agency Cost Theory perspective with a sample of seventy (70) out of population of two hundred and forty-five firms listed on the Nigerian stock exchange (NSE) for a period of ten (10) years: 2000 - 2009 with the aid of the NSE Fact Book covering the period under review. Panel data for the firms are generated and analyzed using fixed- effects, random-effects and Hausman Chi Square estimations. Two independent variables which served as measure of capital structure were used in the study: debt ratio (DR) and equity over the period (EQT) while profitability (PROF) as the only dependent variable. The result showed that DR is negatively related with PROF, but EQT is directly related with PROF.

Nirajini & Priya (2013) studied the Capital structure and financial performance Hotel industry during 2006 to 2010 (05 years) financial year of listed trading companies in Sri Lanka. For the purpose of this study, the data was extracted from the annual reports of sample companies. Correlation and multiple regression analysis were used for analysis. The results revealed a positive relationship between capital structure and financial performance. And also capital structure is significantly impact on financial performance of the firm showed that debt asset ratio, debt equity ratio and long term debt correlated with gross profit margin (GPM), net profit margin (NPM), Return on Capital Employed (ROCE),

Return on Asset (ROA) & Return on Equity (ROE) at significant level of 0.05 and 0.1.

Mohammadzadeha et al. (2013) in their study scrutinized the relationship between the capital structure and the profitability Hotel industry of pharmaceutical companies in Iran. To meet the purpose of the study, top 30 Iranian pharmaceutical companies defined as study samples and their financial data were gathered for the period of 2001-2010. In this study, the net margin profit and debts to asset ratio were used as indicators of profitability and capital structure, respectively and sales growth was used as a control variable. Results showed that there was significant negative relationship between the profitability and the capital structure which means that the pharmaceutical companies established a Pecking Order Theory and the internal financing has led to more profitability.

Apart from non-financial institutions, there are some empirical studies in the financial sectors. Taani (2013) examined the impact of capital structure on performance of Jordanian banks. The annual financial statements of 12 commercial banks listed on Amman Stock Exchange were used for the study which covers a period of five (5) years from 2007-2011. Multiple regressions was applied on performance indicators such as Net Profit (NP), Return on Capital Employed (ROCE), Return on Equity (ROE) and Net Interest Margin (NIM) as well as Total Debt to Total Funds (TDTF) and Total Debt to Total Equity (TDTE) as capital structure variables. The results showed that bank performance, which is measured by net profit, return on capital employed and net interest margin is to be significantly and positively associated with total debt; while total debt is found to be insignificant in determining return on equity in the banking industry of Jordan.

Opoku, Adu, and Anarfi (2013) also studied the impact of capital structure and profitability of listed banks on the Ghana Stock Exchange using a panel data methodology. Capital structure theories were utilized to provide the theoretical basis for the work. The study considered all the 9 banks listed on the Ghana Stock Exchange over the period 2005-2012. The distribution patterns of data and applied statistical techniques used in the study include descriptive statistics, correlation analysis and regression analysis. The study variables also include Return on Asset, Return on Equity, Tobin's q ratio, Economic Value Added (EVA) being the

dependent variables and independent variables are: Total Leverage, Debt to Equity ratio, Total Liability of the banks, Size and the Age of the banks. The finding reviled that, profitability measured by returns on equity is inversely and significantly influenced by the total leverage ratio which is also dependent of the capital structure of the banks. The debt equity ratio of the bank has a positively significant relationship with returns on equity.

The capital structure variable, total liabilities of the listed banks also recorded statistics clearly indicating that, the total liabilities of the listed banks does not make a significant contribution on their return on equity. As far as the size of the banks is concerned, the study reveals that the size of the banks does not have a significant impact on their returns on equity. However there was a sort of positive relation between the two variables during the study period. Meanwhile, the results for returns on equity and their years of operation had a significantly negative relationship between them, meaning as the banks grow in age, their profitability levels reduces significantly. The relationship between Capital Structure and Profitability, as well as the impact of Capital Structure on Profitability across the banks by returns on equity, reveals that the profitability of the listed banks on the Ghana Stock Exchange decreases significantly with increase in their total leverage. Therefore there is a clear indication that, Capital Structure has a significant impact on the profitability of the listed banks on the Ghana Stock Exchange. Also at an average total leverage ratio of about 76%, there exist a negative relationship between profitability and capital structure therefore indicating that, the optimal capital structure for the sector is definitely not 76% or more.

In addition to the above studies in banking industries, Goyal (2013) also investigated the impact of capital structure on profitability of public sector banks in India listed on national stock exchange during 2008 to 2012. Panel data and multiple regression models were used to find out the association between capital structure characteristics and banks performance in the context of India. The findings of study validated a strong positive dependence of short term debt to capital (STDTC) on all profitability measures (ROA, ROE and EPS). Whereas, Long term debt to capital (LTDTC) & TDC having a negative relationship with return on assets (ROA), return on equity (ROE) and earnings per share (EPS). Firm

size (SIZE) experienced an optimistic connection with variables (ROA, and EPS) and negative with ROE. Assets growth (AG) proposed a positive relationship with return on asset and return on equity and earning per share.

Besides, Yegon, Cheruiyot, & Sang (2014) empirically investigates the relationship between capital structure and the firm's profitability of banking industry in Kenya, by using panel data extracted from the financial statements of the companies listed on the Nairobi Stock Exchange from year 2004-2012. Linear regression model were used to investigate the nature of relationship between Capital Structure and profitability. The author's rationale behind the industry specific analysis is the fact that exogenous variables appear to force institutions in the same industry in similar fashion, thus leading to the existence of an industry specific capital structure. On the basis of findings, it is documented that short term debt has significant positive relationship with the profitability.

This suggests that short-term debt tends to be less expensive, and therefore incremental short-term debt in capital structure will lead to an increase in profit levels. Therefore short term debt is the preferable source of financing for the profitable institutions. Whereas long term debt has significant negative relationship with the profitability that envisage long-term debts are relatively more expensive due to certain direct and indirect costs, therefore employing high proportions of long term debt in financial structure results in low profitability. Empirical results indicate no significant association between total debt and profitability the inclination of individual results provide the logical justification for surprising result. On the basis of these findings it is concluded that the relationship between short term debt and the profitability is consistent with the static trade-off theory not because of the tax shield rather some other unexplored factor. The underlying rationality is, interest on long term debt is also tax deductible expense like short term debt but the results are quite opposite in direction. Pecking order theory is true but with the addition of short term debt on top of the hierarchy of preference. Implicit in such testing is that both theories have certain elements that are mutually exclusive. Both the theories as a whole can hold true but with the suggested accompaniments.

In their study of the Effect of Capital Structure on the Performance of Palestinian

Financial Institutions, Abbadi & Abu-Rub (2012) used Return on Equity (ROE) as accounting performance measure while Tobin's Q was used to measure the market performance of the firms. The independent variables used in both measures were the bank deposits to total assets, total bank loans and other investment and net profit. The deposit to total asset was used as a measure of bank leverage. Using Multiple Linear Regression they found strong correlation between return on assets and efficiency; and total deposit to total assets and efficiency. The same variables have the same effect on market value while loans have a weak effect.

In Ethiopia, there is no empirical study directly related with the subject matter of this study, "The impact of capital structure on profitability of Commercial Banks of Ethiopia" with an emphasis on core business operations profitability of banks. However, there are a few studies in some areas of corporate finance. Usman (2013) examined the determinants of capital structure of large taxpayer share companies in Ethiopia. Econometric analysis were performed for a panel of 37 listed companies in Ethiopian Revenue and Customs Authority (ERCA) large taxpayers' branch office in Addis Ababa for the study period of 2006–2010. Nine conventional explanatory variables were adopted in the study, including profitability, size, age, tangibility, liquidity, and non-debt tax shield, growth, and dividend payout ratio and earnings volatility.

As a result of the improvement in the existing estimation methods that enables to employ cross-sectional and time-series data concurrently, random-effect panel data regression was applied to study the effect of selected independent variables on capital structure. The result showed that size, age, tangibility, liquidity position and non-debt tax shield of a company are positively correlated with leverage, whereas profitability, earnings volatility and dividend payout ratio are negatively associated with leverage. Growth variable was found to be statistically insignificant in affecting leverage of large taxpayer share companies in Ethiopia. Based on the sign of these relations the Author also indicated that, Agency cost theory provide more convincing evidence than other capital structure theories in elucidating the capital structure of large taxpayer share companies in Ethiopia.

Weldemikael (2012) examined the relationship between leverage and firm specific (profitability, tangibility, growth, risk, size and liquidity) determinants of capital

structure decision, and the theories of capital structure that can explain the capital structure of banks in Ethiopia using a mixed method research approach by combining documentary analysis and in-depth interviews. More specifically, the study used twelve years (2000 - 2011) data for eight banks in Ethiopia.

The findings reviled that profitability, size, tangibility and liquidity of the banks are important determinants of capital structure of banks in Ethiopia. However, growth and risk of banks are found to have no statistically significant impact on the capital structure of banks in Ethiopia. In addition, based on the results of the analysis the Author indicated that pecking order theory is pertinent theory in Ethiopian banking industry, whereas there are little evidence to support static trade-off theory and the agency cost theory. Hence, the author recommended banks to give due consideration to profitability, size, liquidity and tangibility in their determination of optimum capital structure.

On the other hand, Amdemikael (2012) also assessed the factors that affect bank profitability in Ethiopia covering the period of 2000-2011. Mixed research approach (data obtained through the structured document reviews and in-depth interviews) were applied. The analysis also managed through the multiple linear regressions model, OLS. The dependent variable was ROA as a single measure of profitability and it was measured as net profit before tax divided by total assets. The independent variables includes; equity-to-total asset ratio (the inverse of the leverage ratio), Operational efficiency, Income diversification, Liquidity risk, Asset Quality, Real GDP growth and Inflation. The result indicated that capital strength is one of the main determinants of profitability of banks in Ethiopia.

2.3 Research Gap

Many researchers who tested the relationship between capital structure and firm profitability came up with controversial results; some discovered the negative relationship between the variables, some discovered positive relationship while others revealed no relationship between capital structure and profitability. That situation gave the chance for a researcher to add the knowledge by testing the relationship between capital structure and firm's profitability using listed hotel industry in Nepal. Because this topic is still debatable, therefore it was high time to be analyzed, and compare its

results with the capital structure theories and see whether there is any relation between them. Also many similar studies about capital structure in Nepal relied on analyzing the relationship between capital structure and commercial bank performance. No study has looked after the relationship in hotel industry in Nepal.

CHAPTER THREE
RESEARCH METHODOLOGY

The previous chapter presented the literature review along with the knowledge gap which this study intended to address. The purpose of this chapter is to discuss the methods adopted throughout the study to accomplish the research objectives. This was an essential part of the research activity which showed research procedures plans and techniques used during the whole process of data collection and processing. This chapter covered different aspects like data collection methods, research design, research approach, survey population, and sample size and data analysis techniques.

3.1 Research Design

This study investigates the impact of capital structure on profitability of various hotels listed in Nepal Stock Exchange. This study used quantitative approach because this study used quantitative data to analyze the relationship between dependent variable (company profitability) and independent variable (company capital structure)

This study used descriptive approach where capital structure theory that describes the relationship between capital structure and company profitability was used to develop a proposition. And finally the results of this study confirmed the applicability of the trade off theory by listed Hotels in Nepal for some variables but others did not confirm its applicability. Trade off theory of capital structure supports the use of debt by a company and suggests that, debt finance increases company profitability due to tax advantage of acquired by companies because of interests deducted before tax.

This is an analytical study where researcher used already available information which was secondary data of three listed hotels, analyzed them and came up with study results. Data has been from three hotels listed in Nepal stock exchange from their annual financial statements. Research studied the impact of the Capital structure components on profitability. In order to carry out the research assignment, Researcher used descriptive research design which aimed at testing associations of relationships. The researcher used secondary data from NEPSE published financial statements for companies under the study. Statistical model that study can attempt to explain what has been observed regarding the relationship of capital structure and company profitability.

Researcher used a secondary data from published financial statements, during

the period of data collection process. Data were collected and analyzed using correlations, regression analysis and descriptive statistics techniques and then interpreted. Microsoft Excel was used to analyse and interpret the quantitative data.

3.2 Sample Description

3.2.1 Population

The entire Hotel Industries are considered as the total population for the study. The research studies the impact of capital structure on profitability based on the Nepalese hotel industry Therefore the population of the study is the entire hotel industry registered under the government of Nepal.

i) Oriental Hotel Limited

ii) Soaltee Hotel Limited

iii) Taragaun Regency Hotel Limited

3.2.2 Sample Size

Samples of this study have three hotels listed in Nepal stock exchange out of four hotel companies listed in Nepal stock exchange from 2071/72 to 2075/76. The selected Hotels companies were observed over five year period from 2071/72-2075/76 periods, allowing a researcher to form a panel data of 15 observations to make a sample of this study valid. Researcher used this technique in order to avoid the problem of using small sample by pooling observations on a cross section of units over several time periods. Researcher collected data from the following companies presented in the table below where company information were collected from annual financial statements of the below companies. Financial statements used for ratio computations were annual balance sheets and company's income statements of Hotels listed in Nepal Stock Exchange published from 2071/72 up to 2075/76. This sample of the study represents the whole population of the study.

3.3 Sources of Data

Secondary sources of data were used in conducting this research. This research has several secondary data while collecting required information. The sources of secondary data include books, newspaper, magazine, journals, data from instructor, internet search, articles, published financial statements etc. This has helped identify how others have defined and measured key concepts, their findings and the data sources they have used. Use of these sources has also helped to discover the relevant information and also revealed how this research project is related to other studies.

3.4 Variables and Measurable Procedures

The dependent variable of this study was company profitability while independent variable was capital structure of companies. The dependent variable was measured using company profitability indicators of return on equity (ROE) and return on asset (ROA) while independent variables were measured using capital structure indicators of total debt to equity ratio and total debt to asset ratio.

3.5 Methods of Data Collection

Data were collected from the secondary source by reviewing annual financial statements of listed Hotels in Nepal stock exchange. Annual statements collected by a researcher were audited balance sheets and income statements from organization and shares website. A panel data of three hotels from 2071/72 up to 2075/76 were used as a targeted sample which created 20 observations. Observations of a study justified the use of Sample selected by a researcher

All financial ratios were computed on the basis of book value. Chisti (2013) included ten automobile companies as his study sample for five year period from 2071/72 to 2075/76. The data set of his study was completely base on secondary data which was collected from various websites and annual financial reports of the sample firms after searching from the DSE web sites. Researcher collected the financial information from three hotels for the period from five years (2071/72-2075/76) from Oriental Hotels Limited, Soaltee Hotel Limited and Taragaun Regency Hotels Limited.

3.6 Data Processing and Analysis

Data were collected and entered into STATA software program in order to meet the

computations of independent variables of capital structure and dependent variables of company profitability. Data were analyzed using multiple regression statistical tools, partial correlations, summary of descriptive statistics and bar graphs used to indicate capital structure and company profitability trend. This study used a panel data of three listed hotels using a period from 2071/72 to 2075/76 to measure the relationship between capital structure and company profitability. The capital structure ratios of TD/EQ and TD/AST were independent variables of the study while profitability ratios of ROA and ROE were dependent variables of the study. Researcher adopted the same variables used by Kipesha (2014) who used partial correlations and fixed effect regression model to estimate the impact of capital structure on commercial bank performance in Tanzania. He measured the relationship between capital structure and bank performance using independent variables of TD/EQ, LT/DEQ, STD/EQ, TD/AST, LTD/AST, STD/AST and dependent variables of ROE, ROA and EFF. Higgins J (2005) defined multiple regression as a statistical tool that allows a researcher how multiple independent variables are related to a dependent variable. He also defined correlation coefficient as a single summary number that tells a researcher whether a relationship exists between two variables and whether the relationship is positive or negative.

Computations of the study variables were done with the help of STATA software computer program which handles panel data analysis. Capital structure ratios and company profitability ratios were computed using data collected from targeted companies. Researcher used the Haussmann test to get an appropriate method of measuring a panel data between random effect and fixed effect regression model. After testing Haussmann, researcher selected fixed effect regression to measure the relationship between capital structure and return on asset and used the random effect method to measure the relationship between capital structure and return on equity. Researcher used a summary of descriptive statistics to find out the relationship between capital structure ratios and profitability ratios. Moreover, Pearson correlation was used to measure the relationship between independent and dependent variables of the study. Financial statements of three listed hotels for the period from 2014 to 2019, and the average values of each item was considered for the purpose of ratio computation before analysis process.

3.6.1 Capital Structure and Profitability Ratios Computations

After computation of the below ratios, the results were entered into ms excel and then transferred computations. The data acquired were then analyzed using descriptive statistics, correlations and regressions model in order to get the intended results. The following table indicates a method used by a researcher to compute capital structure and profitability ratios of listed hotels for five years from 2071/72 up to 20/75/76.

Table 3. 1: Capital Structure and Profitability Ratios

Capital structure ratios	Td/Eq	Total debt/Equity×100
	Ld/Eq	Long debt/Equity×100
	Sd/Eq	Short debt/Equity×100
	Td/Ast	Total debt/Assets×100
	Ld/Ast	Long debt/Assets×100
	Sd/Ast	Short debt/Assets×100
Company profitability ratios	ROA	Net income/Assets×100
	ROE	Net income/Equity×100

Statistical Tools*;*

i. Arithmetic Mean

Most of the times when we refer to the "average" of something, we are talking about its arithmetic mean. To find out the arithmetic mean, we sum the values & divide by the number of observations. The mean can be calculated as;

$$\overline{X} = \frac{\sum X}{N}$$

Where,

N = Number of elements in the sample

$\sum X$ = Sum of values of all observations

ii. Standard deviation

The standard deviation is the square root of the average of the squared distances of the observations from the mean. It enables us to determine, with a great accuracy, where the values of a frequency distribution are located in relation to the mean. To compute the sample standard deviation, we use the following formula;

S.D. (σ) = $\sqrt{\frac{\Sigma(X - \overline{X})^2}{N}}$

3.6.2 Conceptual framework

The conceptual framework below identifies the identified independent variables that affect the dependent variable which profitability.

Dependent variable Independent variables

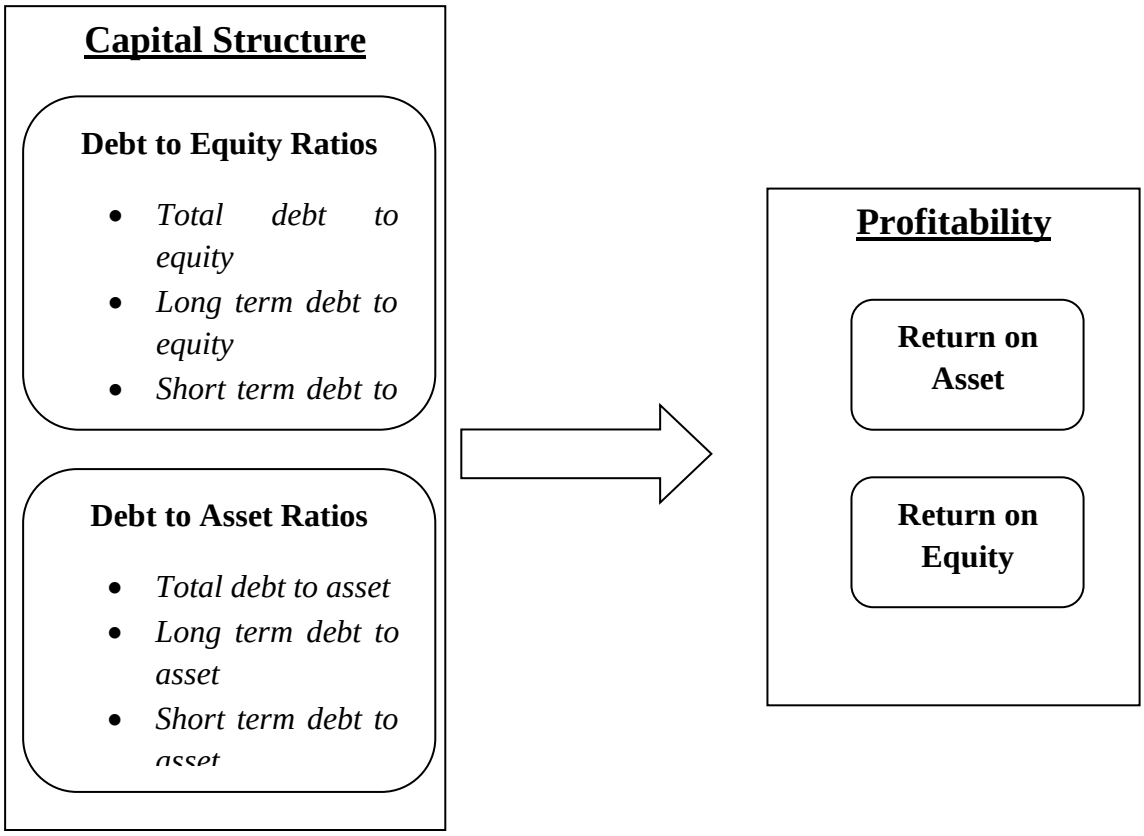

Figure 2.1: Conceptual Framework

The sources of funding for a business are divided into two main categories, owners' funding (equity) and borrowed funding (debt). The objective of the business owners is to increase their wealth and the performance of firms. In relation to this objective the increase in the performance is measured by the increase in return on the shareholders' funds.

The independent variable in this study is capital structure and the dependent variable

was profitability. The concept illustrated above assumes that increasing the level of the debt in the capital structure will increase the turnover of the business and hence its profit, resulting in an increase in returns to the business owners. An increase in interest rate is expected to result in reduced borrowing, increased interest expenses and thus reduced returns to business owners.

CHAPTER FOUR
RESULTS AND DISCUSION

4.1 Introduction

This chapter deals with the systematic presentation, interpretations and analysis of the data. In addition, the discussion of the results obtained has been made based on the statistical tools described in previous chapter. Data analysis is the process of developing answer to the questions through the examination and interpretation of data. The basic steps in the analytical process consist of identifying issues, determining the availability of suitable data, deciding the method appropriate for answering the questions of interest, applying the methods and evaluating, summarizing and communicating the result. This chapter provides the systematic presentation and analysis of secondary data to deal with various issues associated with capital structure and financial profitability of Nepalese hotels.

Also, chapter discussed about the study findings after analyzing the relationship between capital structure and company profit. Secondary data were collected from annual financial statements of listed hotels and analyzed in order to get the results. Results were also compared with the previous theories and previous studies.

4.2 Structure and Pattern of Selected Variables in Nepalese Hotels Sectors

This section fulfils the first objective of this study by analyzing the structure of hotels performance indicators namely debt to equity ratio, short term debt to equity, long term debt to equity, debt to assets, long term debt to assets, short term debt to assets, ROA and ROE from 2013 to 2018. The mean and standard deviation of each individual hotels separately as shown in the following table. The structure has been shown year wise along with average value and standard deviation. The results of structure for selected hotels are fluctuating. The methods used for this purpose are (N x n).

Table 4. 1: Structure of Total Debt to Equity of Selected Hotels in Nepal

Variables	Fiscal Year					Mean	SD
	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	1.26	1.03	0.75	0.42	0.30	0.75	0.40
Soaltee Hotel Limited	-	0.01	0.01	0.01	0.01	0.01	0.007
Taragaun Regency Hotels Limited	0.17	0.05	0.05	0.03	0.02	0.06	0.06
Mean	0.61	0.37	0.27	0.15	0.11		
SD	0.92	0.60	0.42	0.24	0.17		

(Source : Appendix 1,2,3)

The above table 4.1 explain the structure of total debt to equity for Nepalese hotels showed that average total debt to equity is Oriental Hotel (0.40 times), Soaltee Hotels (0.007 times) and Taragaun Regency (0.06 times). The average total debt to equity computed across the year is fluctuated widely over a period of time. It has decreased from 0.61 times in 2071/72 to 0.11 times in 2075/76. According to the table, total debt to equity fluctuates widely within the individual hotels also. It decreased from 1.66 times to 0.3 times for Oriental Hotels, from 0.01 times to 0.00 times for Soaltee Hotel Limited and from 0.17 times to 0.02 times for Taragaun Regency.

The total debt to equity is highest for Oriental Hotels and Taragaun Regency in 2071/72 but it is highest in 2072/73 for Soaltee Hotels. Total debt to equity is lowest for Soaltee Hotel throughout the five year period 2075/76. The variation in total debt to equity as indicated by standard deviation is lowest for Soaltee Hotel followed by Taragaun and Oriental.

Table 4. 2: Structure of Long Term Debt to Equity of Selected Hotels in Nepal

Variables	Fiscal Year					Mean	SD
	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	1.50	1.06	0.75	0.38	0.26	0.73	0.42
Soaltee Hotel Limited	-	0.01	0.01	0.01	0.01	0.01	0.007
Taragaun Regency Hotels Limited	0.15	-	-	-	-	0.03	0.07
Mean	0.55	0.36	0.25	0.13	0.08		
SD	0.83	0.61	0.43	0.22	0.14		

(Source : Appendix 1,2,3

The above the table 4.2 explain structure of long term debt to equity for Nepalese hotels showed that average long term debt to equity is Oriental Hotel (0.42 times), Soaltee Hotels (0.007 times) and Taragaun Regency (0.07 times). The average long term debt to equity computed across the year is fluctuated widely over a period of time. It has decreased from 0.55 times in 2071/72 to 0.08 times in 2075/76. According to the table, long term debt to equity fluctuates widely within the individual hotels also. It decreased from 1.50 times to 0.25 times for Oriental Hotels, from 0.01 times to 0.00 times for Soaltee Hotel Limited and from 0.15 times to 0.00 times for Taragaun Regency.

The long term debt to equity is highest for Oriental Hotels and Taragaun Regency in 2071/72 but it is highest in 2072/73 for Soaltee Hotels. Long term debt to equity is lowest for Soaltee Hotel throughout the five year period 2075/76. The variation in long term debt to equity as indicated by standard deviation is lowest for Soaltee Hotel followed by Taragaun and Oriental.

Table 4. 3: Structure of Short Term Debt to Equity of Selected Hotels in Nepal

Variables	Fiscal Year	Mean	SD

	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	-	-	-	0.05	0.04	0.02	0.02
Soaltee Hotel Limited	-	-	0.00	0.00	0.00	0.00	0.00
Taragaun Regency Hotels Limited	0.01	0.05	0.05	0.03	0.02	0.03	0.01
Mean	0.06	0.02	0.02	0.03	0.02		
SD	0.09	0.03	0.03	0.02	0.03		

(Source : Appendix 1,2,3)

The above table 4.3 explain the structure of short term debt to equity for Nepalese hotels showed that average short term debt to equity is Oriental Hotel (0.02 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.01 times). The average short term debt to equity computed across the year is fluctuated widely over a period of time. It has decreased from 0.09 times in 2071/72 to 0.02 times in 2074/75 and increased to 0.03 in 2075/76. According to the table, short term debt to equity fluctuates widely within the individual hotels also. It decreased from 0.16 times to 0.05 times for Oriental Hotels, all time 0.00 times for Soaltee Hotel Limited and from 0.05 times to 0.01 times for Taragaun Regency.

The short term debt to equity is highest for Oriental Hotels in 2071/72 but it is highest in 2073/74 for Soaltee Hotels and it is 0.00 for Soaltee Hotel all the time. Short term debt to equity is lowest for Soaltee Hotel throughout the five year period 2075/76. The variation in short term debt to equity as indicated by standard deviation is lowest for Soaltee Hotel followed by Oriental and Taragaun.

Table 4. 4: Structure of Total Debt to Asset of Selected Hotels in Nepal

Variables	**Fiscal Year**	**Mean**	**SD**

	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	0.37	0.36	0.30	0.23	0.18	0.29	0.08
Soaltee Hotel Limited	-	0.00	0.00	0.00	0.00	0.00	0.00
Taragaun Regency Hotels Limited	0.12	0.03	0.03	0.02	0.01	0.04	0.04
Mean	0.19	0.13	0.11	0.08	0.06		
SD	0.24	0.20	0.16	0.13	0.10		

(Source : Appendix 1,2,3)

The above table 4.4 explain structure of total debt to asset for Nepalese hotels showed that average total debt to asset is Oriental Hotel (0.08 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.04 times). The average total debt to asset computed across the year is fluctuated widely over a period of time. It has decreased from 0.19 times in 2071/72 to 0.06 times in 2075/76. According to the table, total debt to asset fluctuates widely within the individual hotels also. It decreased from 0.46 times to 0.18 times for Oriental Hotels, from 0.01 times to 0.00 times for Soaltee Hotel Limited and from 0.12 times to 0.01 times for Taragaun Regency.

The total debt to asset is highest for Oriental Hotels and Taragaun Regency in 2071/72 but it is highest in 2072/73 for Soaltee Hotels. Total debt to equity is lowest for Soaltee Hotel throughout the five year period 2075/76. The variation in total debt to equity as indicated by standard deviation is lowest for Soaltee Hotel followed by Oriental and Taragaun.

Table 4.5: Structure of Long Term Debt to Asset of Selected Hotels in Nepal

Variables	Fiscal Year					Mean	SD
	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	0.37	0.36	0.30	0.21	0.15	0.27	0.09
Soaltee Hotel Limited	-	0.00	0.00	0.00	0.00	0.00	0.00
Taragaun Regency Hotels Limited	0.11	-	-	-	-	0.02	0.05
Mean	0.17	0.12	0.10	0.07	0.05		
SD	0.22	0.21	0.17	0.12	0.08		

(Source : Appendix 1,2,3)

The above table 4.5 explain the structure of Long Term debt to asset for Nepalese hotels showed that average long term debt to asset is Oriental Hotel (0.09 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.05 times). The average long term debt to asset computed across the year is fluctuated widely over a period of time. It has decreased from 0.22 times in 2071/72 to 0.08 times in 2075/76. According to the table, long term debt to asset fluctuates widely within the individual hotels also. It decreased from 0.41 times to 0.15 times for Oriental Hotels, from 0.01 times to 0.00 times for Soaltee Hotel Limited and from 0.17 times to 0.05 times for Taragaun Regency.

The long term debt to asset is highest for Oriental Hotels and Taragaun Regency in 2071/72 but it is highest in 2072/73 for Soaltee Hotels. Long term debt to equity is lowest for Soaltee Hotel throughout the five year period 2075/76. The variation in total debt to equity as indicated by standard deviation is lowest for Soaltee Hotel followed by Taragaun and Oriental.

Table 4. 6: Structure of Short Term Debt to Asset of Selected Hotels in Nepal

Variables	Fiscal Year	Mean	SD

	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	0.00	-	-	0.03	0.03	0.01	0.01
Soaltee Hotel Limited	-	-	0.00	0.00	0.00	0.00	0.00
Taragaun Regency Hotels Limited	0.01	0.03	0.03	0.02	0.01	0.02	0.01
Mean	0.02	0.01	0.01	0.01	0.02		
SD	0.02	0.02	0.02	0.01	0.02		

(Source : Appendix 1,2,3)

The above table 4.6 explain structure of Short Term debt to asset for Nepalese hotels showed that average short term debt to asset is Oriental Hotel (0.01 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.01 times). The average short term debt to asset computed across the year is fluctuated widely over a period of time. It has decreased from 0.02 times in 2071/72 to 0.01 times in 2074/75 and again increases in 2075/76. According to the table, short term debt to asset fluctuates widely within the individual hotels also. It decreased from 0.04 times to 0.03 times for Oriental Hotels, all over the period 0.00 times for Soaltee Hotel Limited and from 0.03 times to 0.01 times for Taragaun Regency.

The short term debt to asset is highest for Oriental Hotels in 2071/72, but it is highest in 2072/73 and 2073/74 for Taragaun Regency Hotels and 0.00 for Soaltee all over the period. Short term debt to equity is lowest for Soaltee Hotel throughout the five year period 2075/76. The variation in Short term debt to equity as indicated by standard deviation is lowest for Soaltee Hotel followed by Taragaun and Oriental.

Table 4. 7: Structure of Return on Asset (ROA) of Selected Hotels in Nepal

Variables	Fiscal Year					Mean	SD
	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	0.09	0/09	0.05	0.07	0.08	0.08	0.01
Soaltee Hotel Limited	0.15	0.12	0.05	0.07	0.13	0.10	0.04
Taragaun Regency Hotels Limited	0.08	0.06	0.05	0.09	0.09	0.07	0.02
Mean	0.13	0.09	0.08	0.07	0.08		
SD	0.06	0.11	0.04	0.02	0.01		

(Source : Appendix 1,2,3)

The above table 4.7 explain the structure of return on asset for Nepalese hotels showed that average return on asset is Oriental Hotel (0.01 times), Soaltee Hotels (0.04 times) and Taragaun Regency (0.02 times). The average return on asset computed across the year is fluctuated widely over a period of time. It has decreased from 0.13 times in 2071/72 to 0.07 times in 2074/75 and again increases in 2075/76. According to the table, return on asset fluctuates widely within the individual hotels also. It decreased from 0.11 times to 0.05 times for Oriental Hotels, from 0.21 times to 0.05 for Soaltee Hotel Limited and from 0.09 times to 0.06 times for Taragaun Regency.

The return on asset is highest for Oriental Hotels in 2071/72, but it is highest in 2072/73 for Soaltee Hotels and highest in 2074/75 for Taragaun Regency Hotels Limited. Return on asset is lowest for Oriental Hotels Limited throughout the five year period. The variation in return on asset as indicated by standard deviation is lowest for Taragaun Regency Hotels followed by Oriental and Soaltee.

Table 4.8: Structure of Return on Equity (ROE) of Selected Hotels in Nepal

Variables	Fiscal Year	Mean	SD

	71/72	72/73	73/74	74/75	75/76		
Oriental Hotels Limited	0.30	0.26	0.14	0.13	0.14	0.19	0.08
Soaltee Hotel Limited	0.25	0.19	0.09	0.12	0.19	0.13	0.05
Taragaun Regency Hotels Limited	0.14	0.10	0.08	0.14	0.12	0.11	0.02
Mean	0.23	0.10	0.14	0.12	0.13		
SD	0.14	0.11	0.05	0.03	0.02		

(Source : Appendix 1,2,3)

The above table 4.8 explain the structure of return on equity for Nepalese hotels showed that average return on equity is Oriental Hotel (0.08 times), Soaltee Hotels (0.05 times) and Taragaun Regency (0.02 times). The average return on equity computed across the year is fluctuated widely over a period of time. It has decreased from 0.23 times in 2071/72 to 0.10 times in 2072/73 and again increases in 2073/74 and fluctuates later. According to the table, return on equity fluctuates widely within the individual hotels also. It decreased from 0.38 times to 0.01 times for Oriental Hotels, from 0.21 times to 0.08 for Soaltee Hotel Limited and from 0.14 times to 0.10 times for Taragaun Regency. The return on equity is highest for Oriental Hotels in 2071/72, but it is highest in 2072/73 for Soaltee Hotels and highest in 2074/75 for Taragaun Regency Hotels Limited. Return on equity is lowest for Taragaun Regency Hotels Limited throughout the five year period. The variation in return on asset as indicated by standard deviation is lowest for Taragaun Regency Hotels followed by Soaltee and Oriental.

4.2 Descriptive statistics

The descriptive statistics used in this study consists of minimum, maximum, mean and the standard deviation associated with variables under consideration. Therefore, descriptive statistics enables to present the data in a more meaningful way, which allows simpler interpretation of the data.

Table 4. 9: Descriptive Statistics for Selected Nepalese Hotels

	Mean	Std. Deviation	Minimum	Maximum
Total Debt to Equity	0.30	0.47	-	0.84
Long Term Debt to Equity	0.27	0.45	-	0.79
Short Term Debt to Equity	0.03	0.03	-	0.05
Total Debt to Asset	0.12	0.17	-	0.31
Long Term Debt to Asset	0.10	0.16	-	0.29
Short Term Debt to Asset	0.01	0.01	-	0.02
Return on Asset	0.09	0.04	0.06	0.13
Return on Equity	0.14	0.03	0.11	0.16

(Source : Appendix 1,2,3)

The above table 4.9 explain the result shows the descriptive statistics of dependent and independent variables for the selected Hotels. Clearly, the total debt to equity ranges from a minimum of 0.00 times to a maximum of 0.84 times leading to an average 0.30 times. Similarly, The long term debt to equity ranges from a minimum of 0.00 times to a maximum of 0.79 times leading to an average of 0.27 times while the short term debt to equity ranges from a minimum of 0.00 to a maximum of 0.05 leading to an average of 0.03. Also, total debt to asset ranges from a minimum of 0.00 times to a maximum of 0.31 times leading to an average of 0.12. Similarly, long term debt to asset ranges from a minimum of 0.00 times to a maximum of 0.29 times leading to an average of 0.10. In addition, short term debt to asset ranges from a minimum of 0.00 times to a maximum of 0.02 times leading to an average of Rs 0.01. Also, return on asset ranges from a minimum of 0.06 times to a maximum of 0.13 times leading to an average of 0.09. Finally, return on equity ranges from a minimum of 0.11 times to a maximum of 0.16 times leading to an average of 0.14.

4.3 Correlation Analysis

Having indicated the descriptive statistics, Pearson correlation coefficients are computed and the results are presented in Table 4.12. More specifically, it shows the correlation coefficients of dependent and independent variables for selected Nepalese hotels limited.

4.3.1 Correlation between Capital Structure Variables and Return on Asset

Correlation between capital structure variables and returned on asset is explained in this section and the relation is shown in the table below.

Table 4. 10 Correlation results between capital structure and return on asset

Variable	**Correlation**	**Significance Level**
Total debt /equity	0.3033	0.141
Long debt/equity	-0.2705	0.191
Short debt/equity	-0.3215	0.117
Total debt/assets	-0.5977	0.002
Long debt/assets	0.0125	0.953
Short debt/assets	0.5839	0.002

(Source : Appendix 1,2,3)

Above results indicate a negative correlation between long debt to equity and short debt to equity against return on asset while long debt to asset and short term debt to asset indicated a positive relationship with return on asset. Researcher discovered that contribution of company assets to generate profit was greater than shareholders fund.

4.3.1 Correlation between Capital Structure Variables and Return on Equity

Correlation between capital structure variables and returned on equity is explained in this section and the relation is shown in the table below.

Table 4. 11 Correlation results between capital structure and return on equity

Variable	Correlation	Significance Level
Total debt/equity	0.2017	0.331
Long debt/equity	-0.1581	0.450
Short debt/equity	-0.2332	0.262
Total debt/assets	-0.5871	0.002
Long debt/assets	0.0753	0.721
Short debt/assets	0.6531	0.000

(Source : Appendix 1,2,3)

Correlation results above indicate significant negative relationship between debts to equity ratios against return on equity. Researcher also revealed a positive correlation between debt to asset ratios (long and short debt to asset) and return on equity. Due to the above results, researcher concludes that contribution of assets in profit generation in terms of return on equity was greater than contribution of shareholders fund.

To summarize the partial correlation results above, researcher revealed the mixed results between capital structure and performance of listed hotels. Some variables indicated a positive correlation and others indicative a negative correlation results. Researcher recommends to managements of listed hotels in Nepal to rely much on resources or assets as a guide for their debts because they have positive correlation with company profit in terms of both return on assets and return on equity. Researcher recommend to managers of listed manufacturing companies to rely on debt to assets ratios, especially short debt to assets ratios because they indicated a greater positive correlation with all profitability indicators than other variables. From the above results, positive correlation results between short debt to assets and return on equity is 0.6531 while positive correlation between short debt to assets and return of asset is 0.583

4.4. Regression Analysis

Following regression analysis is used to understand which among the independent variables are related to the dependent variable, and to explore the forms of these relationships.

4.4.1 Capital structure variables and Return on asset

Researcher used Housman test to test for appropriate method to use between fixed and random effect regression. Researcher used Housman statistical technique in order to avoid errors when testing the relationship between capital structure variables and profitability variable of return on assets (ROA). After testing, Researcher got the following Housman and regression results below.

Table 4. 12 Housman test results (Fixed Vs Random effect regression method)

Variables	**Coefficient (fe),b**	**Coefficients (re), B**	**(b-B)**
Total/Equity	-0.3528801	3.97227	-4.32515
Long/Equity	0.5213898	-3.538455	4.059844
Short debt/Equity	0.2686853	-4.24231	4.510995
Total debt/Assets	-0.2221991	-1.938838	1.716639
Long debt/Assets	0.1185286	0.014474	0.104054
Short debt/Assets	0.1683276	2.252587	-2.08426
	Chi ^{2}(6)=(b-B)=42		
	Prob>chi^2=0.0000		

(Source : Appendix 1,2,3)

Haussmann test results in the table above supported the use of fixed effect regression model because p- value (0.0000) indicated above is less than confidence level of 0.05.

Table 4.13 Fixed effect regression results (Capital Structure Vs Return on Assets)

Return on assets	Coefficient	Std error	t	P > I t I	95% confidence
Total debt/Equity	-0.352880	2.074418	0.17	0.867	-4.711
Long debt/Equity	0.5213898	2.056519	0.25	0.803	-3.799
Short debt/Equity	0.2686853	2.087685	0.13	0.899	-4.117
Total debt/Equity	-0.222199	0.5572327	-0.40	0.695	-1.392
Long debt/Assets	0.1185286	0.1730035	0.69	0.502	-0.244
Short/Assets	0.1683276	0.6396691	0.26	0.125	-1.170

(Source : Appendix 1,2,3)

From the above results, Researcher discovered two types of study findings after using fixed effect regression model. The first test result in the table above indicated a significant negative relationship between Return on asset (ROA) and capital structure variables of total debt to equity (TD/EQ) and total debt to asset (TD/AST) at -0.3529 and -0.2222 respectively. These results were against the trade off theory of capital structure which supports the influence of company debt on generating profit.

These study findings indicating the negative relationship between capital structure variables and dependent variable of return on asset (ROA) were consistent with previous studies by Abbasali (2012) who measured the relationship in Tehran using Pearson correlation and multiple regression models, Odita (2012) who tested the relationship in Nigerian firms using Pearson correlation, Alawwad (2013) in Saudi Arabia, and Toraman et al. (2013) in Turkey. Also positive relationship results were consistent with Zuraidah (2012) in Malaysian firms, Narayanasamy (2015) in Malaysia, Goyal (2013) in India and other studies with similar results.

Moreover, the second type of study results indicated a positive relationship between return on asset (ROA) and capital structure variables of Long term debt to equity (LD/EQ) at 0.5214, short term debt to equity (SD/EQ) at 0.2687, long term debt to asset (LD/AST) at 0.1185 and Short term debt to asset (SD/AST) at 0.1683. The second group of study results supported the application of trade off theory which clarifies the influence of debt on profit generation. The results also indicate that Long term debt to equity ratio (LD/EQ) has a great positive effect on firm profitability

as indicated by 0.5214 confidence level. The study results indicating positive relationship were consistent with trade off theory which supports the use of leverage as an indicator of profit generation while the negative relationship between the variables rejects the application of trade of theory. Due to above results, researcher discovered that there is a positive relationship between capital structure of hotels and their profit (ROA) because both long term and short term debt ratios had a positive relationship with return on assets. That means the greater the capital structure ratio kept by a company the greater the profitability in terms of return on assets and the lesser the ratio kept by a company the lesser the profit to be acquired by that company. The overall results of this study which revealed the positive relationship between the variables were consistent with previous studies conducted by Hughes (2013) using listed firms in Ghana, Uremagu (2012) Olalebe (2013) and Adesina (2015) in Nigerian companies and priya (2013) tested such relationship between capital structure and performance using listed companies in Ghana, their studies revealed that profit depends on capital structure

4.4.2 Capital Structure Variables and Return on Equity

Researcher used Housman test to test for appropriate method to use between fixed and random effect regression. Researcher used Housman statistical technique in order to avoid errors when testing the relationship between capital structure variables and profitability variable of return on equity (ROE). The following regression results and Housman test results were discovered by a researcher after testing. Housman test assisted a researcher to know the regression method which tested the relationship between capital structure and profitability of hotels listed in Nepal stock exchange**.** Six capital structure variables which were treated as independent variables were tested against dependent variable of return on equity in order to analyze the relationship between capital structure and company profit.

Table 4.14 Housman test results (Fixed Vs Random effect regression method)

		Coefficients (re), B	
Total debt/Equity	-3.857744	6.70211	-10.55985
Long debt/Equity	4.866519	-5.230258	10.09678
Short debt/Equity	3.077945	-7.773576	10.85152
Total debt/Asset	-1.379302	-4.893065	3.513763
Long debt/Asset	0.252409	0.2260395	0.026370
Short debt/Asset	3.171389	7.00877	-3.837381
	Chi^2 (6)=10.67		
	Prob>chi^2=0.0991		

(Source : Appendix 1,2,3)

Housman test results above supported the use of random effect regression model since the p- value 0.0991 was greater than confidence level of 0.05

Table 4.15 Regression results (Capital structure Vs Return on equity)

Return on equity	**Coefficients**	**Std error**	**Z**	**p>I z I**	**95% confidence**
Total debt/Equity	6.70211	6.751746	0.99	0.321	-6.531068
Long debt/Equity	-5.230258	6.812504	-0.77	0.443	-18.58252
Short debt/Equity	-7.773576	6.75916	-1.15	0.250	-21.02129
Total debt/Assets	-4.893065	1.406882	-3.48	0.001	-7.650502
Long debt/Assets	0.2260395	0.6244482	0.36	0.717	-0.9978565
Short debt/Assets	7.00877	1.694554	4.14	0.000	3.687506

(Source : Appendix 1,2,3)

4.5 Major Findings

The study was conducted to measure the impact of capital structure on the company profitability. The study considered five components of capital structure and two variables of company profitability components. Various components for the research were total debt/equity, long term debt/equity, short term debt/equity, total debt/equity, long term debt /asset, short term debt/ asset and finally return on asset and return on equity to measure profitability.

The structures of various components are as follows:

- Average total debt to equity is Oriental Hotel (0.84 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.06 times) and has decreased from 0.61 times in 2071/72 to 0.11 times in 2075/76.
- Average long term debt to equity is Oriental Hotel (0.79 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.03 times) and has decreased from 0.55 times in 2071/72 to 0.08 times in 2075/76.
- Average short term debt to equity is Oriental Hotel (0.05 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.03 times) and has decreased from 0.09 times in 2071/72 to 0.02 times in 2074/75 and increased to 0.03 in 2075/76.
- Average total debt to asset is Oriental Hotel (0.31 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.04 times) and has decreased from 0.19 times in 2071/72 to 0.06 times in 2075/76.
- Average long term debt to asset is Oriental Hotel (0.29 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.02 times) and has decreased from 0.22 times in 2071/72 to 0.08 times in 2075/76.
- Average short term debt to asset is Oriental Hotel (0.02 times), Soaltee Hotels (0.00 times) and Taragaun Regency (0.02 times) and has decreased from 0.02 times in 2071/72 to 0.01 times in 2074/75 and again increases in 2075/76.
- Average return on asset is Oriental Hotel (0.06 times), Soaltee Hotels (0.13 times) and Taragaun Regency (0.07 times) and has decreased from 0.13 times in 2071/72 to 0.07 times in 2074/75 and again increases in 2075/76.

4.6 Discussion

Average return on equity is Oriental Hotel (0.16 times), Soaltee Hotels (0.16 times)

and Taragaun Regency (0.11 times) and has decreased from 0.23 times in 2071/72 to 0.10 times in 2072/73 and again increases in 2073/74 . above, on the relationship between capital structure and firm profitability in terms of return on equity indicate a significant negative relationship with capital structure ratios of long term debt to equity (LD/EQ) at -5.2303, Short term debt to equity (SD/EQ) at -7.7736 and Total debt to asset at -4.8931. On the other side the above results in table 6 indicate that return on equity had a positive relationship with total debt to equity ratio (TD/EQ) at coefficient of 6.7021, Long term debt to asset (LD/AST) at 0.2260 and Short term debt to asset at coefficient of 7.0088. Results showing the positive relationship between debt ratios and profitability ratio of ROE, support the application of trade off theory which encourages the influence of debt on firm profit generation while the results showing the negative relationship between debt ratios variables and profitability ratio of ROE, rejects the application of trade off theory.

The study findings indicated the negative relationship between capital structure variables against profitability variable of return on equity (ROE) were consistent with previous studies by Chisti (2013) in India, Marietta (2012) in Kenya, Shubita (2012) in Jordan and Feng (2013) in Sweden. Also results indicated the positive relationship between capital structure variables against profitability measure of return on equity (ROE) were consistent with previous studies by Uremagu (2012) in Nigeria, Priya (2013) in Srilanka, Naidu (2011) in South Africa.

From the above results, two contradicting results occurred because capital structure measures of long term debt to equity (LD/EQ), short term debt to equity (SD/EQ) and total debt to asset (TD/AST) indicated a negative relationship with performance measure of return on equity (ROE) at -5.2303 coefficient, -7.7736 coefficient and -4.8931 respectively while other remaining capital structure measures of total debt to equity(TD/EQ), long term debt to asset(LD/AST) and short term debt to asset (SD/AST) indicated a positive relationship against return on equity(ROE) at coefficients of 6.7021, 0.2260 and 7.0088 respectively.

These results also indicate that short term debt to assets ratio had a great positive relation with return on equity at 7.0088 confidence level. For that case, short term debts to assets are the most influential ratio on profit generation of Hotels. The partial correlations results supported the fixed effect regression through the ratio of total debt to asset ratio where both methods indicate a negative relationship between total debt to asset ratio against return on equity and return on asset. That means return on

assets indicated a higher amount of profit than return on equity. To summarize the above results, researcher revealed two kinds of results; first results indicated a negative relationship between debt to equity ratios and return on equity while the second type of results indicated a positive relationship between debt to asset ratios and return on equity. Second results were consistent with the trade off theory while the first results were against theory.

CHAPTER FIVE
SUMMARAY AND CONCLUSION

5.1 Summary

In the previous chapter, the data analysis and hypothesis have been carried out according to the objectives of the study. This chapter concludes the entire research work with the summary of findings and further recommendations. It also draws inferences from the findings which will lead to certain conclusion and generalization.

The capital structure choice of a manufacturing firm is the most significant decision taken by the management of the firm to maximize profits and at the same time minimize costs of capital leads to the maximization of stockholders wealth. Basically, there are two main sources of finance. One is internal finance which is equity and another is external finance which is debt. Most firms use a combination between equity and debt which appearance the capital structure. Modigliani and Miller (1963) stated that capital structure as the mixture between debt and equity that the firm uses in its operation. They also showed the impact of capital structure on firm's performance. After Modigliani and Miller, Jensen and Meckling (1976) discussed the relationship between capital structure and firm performance. Further, a significant number of researches have been done to depict the impact of capital structure on firm performance in developed and developing countries. In the developed countries aspect, Tailab (2014) did research on American energy, Tifow and Sayilir (2015) did research Turkey manufacturing firm and on United Kingdom manufacturing sector small and medium enterprise (SME). From 2013 forward, most of the research done in capital structure was carried on developing countries. Ogebe, et al. (2013) did research on Nigeria firm performance. Kajananthan and Nimalthasan (2013) did research on Sri Lankan manufacturing firm, Mwangi, et al. (2014) did research on Kenya non-financial listed companies performance, Zeitun and Tian (2014) did research on Jordanian non-financial listed companies and Akeem, et al. (2014) did research on Nigeria manufacturing companies performance. Still, many researchers are trying to find out a better relationship between capital structure and firm performance.

5.2 Conclusion

This study used panel data of 3 Hotels for the period of 5 years creating 15 observations of the data. Researcher analyzed the relationship between capital structure variables (independent variables) against profitability variables (dependent variable). Fixed effect regression method was used to measure the relationship between capital structure and return on asset (ROA) while random effect regression model used to test the relationship between capital structure and return on equity of hotel (ROE). Moreover, partial correlation technique also used to measure the relationship between the study variables in order to support the regression results.

After testing the relationship, researcher revealed the mixed results between capital structure variables and company profitability that means some capital structure variables indicated a negative relationship with company profitability variables while other capital structure variables indicated a positive relationship with profitability variables. Long term debt ratios and short term debt ratios were used as capital structure indicators of hotels. The random effect regression results indicated a negative relationship between Long term debts to equity (LD/EQ) against return on equity (ROE) at a coefficient of -5.2303 which was also supported by partial correlation results at -0.1581. In terms of short term debt to equity (SD/EQ) against return on equity (ROE), random effect regression results also indicated a negative relationship at -7.7736 which was supported by partial correlations results at -0.2303. Both long term debt and short term debt to equity indicated a negative relationship with return on equity, that means there is no relationship between capital structure and company profitability in terms of return on equity.

Fixed effect regression results indicated a positive relationship between short term debt to assets and return on asset at 0.1683 coefficient level .These results were supported by partial correlation results. Except negative results indicated between long term to equity and short term to equity against return on assets, the positive relation between the variables is consistent with the trade of theory.

Finally this study revealed that, capital structure of listed hotel in Nepal affect company profitability in terms of return on assets positively. On the other side, capital structure of listed hotel has negative relationship with company profit in terms of shareholders fund or return on equity. The results indicate that debt usage has more advantage for companies that depend much on assets to generate profit than those that depend much on equity or shareholders fund to generated company profit

5.3 Implication

To improve the profitability of listed hotel in Nepal, the following implication have to be observed. The company management of listed hotel should increase the use more short term debt to asset ratios because they have much influence on company profitability in terms of both return on equity and return on assets if compared with other capital structure ratios.

Moreover, investors of listed hotel in Nepal should review the capital structure of companies before investing in them because the strength of a company capital mix determines the level of returns. More companies in Nepal should put their financial information through Nepal stock exchange in order to allow investors to review their capital structure and attracts more investors in their companies

A study should be taken to analyze the effect of capital structure on profitability of other companies, especially financial companies, service companies and non listed companies. In addition, future studies could be done to analyze the determinants of capital structure in Nepalese companies. Moreover, study on relationship between the capital structures of Nepalese companies and companies of other nations should be done.

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