

**DETERMINANTS OF CAPITAL STRUCTURE OF NEPALESE
COMMERICAL BANKS**

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1. Background of the study

Capital structure is considered as the mix of debt and equity to operate any firm smoothly in long run prospect. A firm must concentrate in its proportion. A firm can raise required fund by issuing various types of financial instruments. Capital structure refers to the proportion of debt and equity capital. The capital structure concept has an important place in the theory of financial Management. The financing decision of a firm relates to choice of proportion of debt and equity to finance the investment requirement. A proper balance between debt and equity is necessary to ensure a trade-off between risk and return to the shareholders. A capital structure with reasonable proportion of debt and equity capital is called optimal capital structure. However, it can be expected that the capital structure decision affect the total value of the firm should select such a financing mix. Which maximize the shareholder wealth? Optimum capital structure may define as the capital structure or combination of debt and equity that leads to the maximum value of the firm.

A firm fulfills its financial needs using different sources of financing. These sources of financing may be long term, and short term. Short –term sources of financing mature within one year or less whereas fund raised from long-term sources of financing can be used for several years. When a firm expands its business or activity, it needs capital. The term capital denotes the long-term funds of the firm. All of the items on the liabilities side of firm's balance sheet, excluding current liabilities, are sources of capital. The total capital can be divided into two components: debt capital and equity capital. Capital structure is the liabilities part, therefore it is highly riskier and sensitive. Bank is the main financial institution, which plays an important role in the economic development of the nation. It is the backbone as well as the foundation for the development of the country. Its principal operations are concerned with the accumulation on the temporary idle money of the public for advancing others for expenditures. In other words, Bank is an institution that deals and makes loans and derives a profit from the difference in the interest rates paid and charged, respectively. Depositors may be either individuals or institutions. These deposits may be current, saving or fixed and the tenure depends upon the mutual agreements between the bank may be either an individual of institutions. The tenure of the loan may vary as per the demand, criteria and the usefulness of the loan.

2. Problem Statement

Banking industry in Nepal is making remarkable progress and growth, it's not without the problems. At the present context, the main problem faced by the business sector as well as bank is the unstable political and economic condition of the country. At the same time, there are very few profitable sectors where a bank can invest. This has forced the banks to lower down their interest rates to discourage deposit and, at the same period encouraged loan and advances. Due to security problem and political instability, government could not be able to pay sufficient attention to business and industry sector. Regulation and monitoring by government has been weakened in the banking sector as like others and unfair competition is increasing.

The optimal Capital Structure is very essential to accommodate the smooth operations of any organization. Nepalese commercial banks are operating in the competitive environment. In this situation, banks have to adopt suitable strategies for their existence. They should balance and coordinate the different functional areas of business concern. The success or failure of any organization depends on its strategy. Optimal capital structure decision is the crux of problem to prepare the proper strategy on its favor. So, the study might be very helpful for the management of the concerned bank as well as it might be valuable for the researchers, scholars, students, general public etc. who wants to study into the capital structures of the joint venture banks. Here are some question raised for which the study chosen this topic for my research work.

- i. What are the determinants of capital structure in Nepalese commercial banks?
- ii. What is the impact of ROA, Bank size, Growth rate, Tangibility on TDA?
- iii. What is the impact of ROA, Bank size, Growth rate, Tangibility on TDE?

3. Objective of the study

Each and every research study will conduct with a view of achieving some objectives and this study is of no exception. The main objectives of the study are to examine and

analyze the capital structure of Nepalese commercial banks. The specific objectives of this study are as follows:

- i. To examine the determinants of capital structure in Nepalese commercial banks.
- ii. To identify the impact of ROA, Bank size, Growth rate, and Tangibility on TDA.
- iii. To identify the impact of ROA, Bank size, Growth rate, and tangibility on TDE.

4. Rational of the study

The study will do in reference to the periodical performance of Everest bank limited. The study tries to focus on capital structure of the bank so the study could be significant in revising the bank capital structure for past five years at a glance. The study could be beneficial to various groups of people in following ways:

- i. Investors: This study provides the valuable information about the debt and equity (leverage) ratio of the selected Nepalese enterprise. Investors will be benefited by such information to perform securities analysis before taking investment decision.
- ii. Financial manager: Financial managers of Nepalese enterprise will be benefited because they will get important information regarding optimum capital structure which will help them to make least cost combination of debt and equity.
- iii. Future Researchers: Researcher will get additional information in capital structure and cost of capital in the literature of finance. They will be benefited by getting secondary data in this context.

The proposed study will help to enhance the level of understanding in capital structure for other researchers, management scholars and other stakeholders.

5. Limitation of the study

There are many issues related to the study topic, however not all issues will be touched. The thesis will only focus on the issues raised in the research questions. The limitations are therefore listed below:

- i. Other variable determinants of capital structure are totally ignored.
- ii. The overview of the study has taken into consideration some selected commercial banks so that the study might not cover the whole commercial banks.
- iii. The study is based on correlation and multiple regression methods of analysis and using secondary data of selected commercial banks so other research design and primary data is not taken into consideration.
- iv. This study focuses on specific internal variables that determinant the capital structure of banks such return on assets, bank size, growth rate, assets tangibility so other variables are not focus for the study.
- v. The study covers only 10-year data, beginning from 2010/11 to 2019/20.

6. Review of literature

Review of literature is the process of learning and understands the concept of the related topic. After selecting the topic of research, researchers should study different materials (like books, journals, magazines, newspapers, articles, etc.) to collect the information about the subject matter of the study. This process of studying different education materials which are related with the selected topic of the research is called “Review of Literature”. It helps to find out the research gap.

6.1 Theoretical Review

Capital structure refers to the combination of long term sources of funds such as debentures, long term debt, preferences share capital and equity share capital including reserve and surplus (Gautam and Thapa, 2061). Capital Structure is the composition of debt and equity securities that comprise a firm’s financing of its assets. Both debt and equity securities are used in most large corporations. The choice of the amount of debt and equity is made after a comparison of certain characteristics of each kind of securities of internal factors related to the firm’s operation and external factor that can affect the firm (Hampton, 1980:33). Capital Structure is the mix of long term debt and equity maintained by the firm (Gitman, 1988). Capital Structure is the mix (or proportion) of firm’s permanent long term financing represent by debt, preferred stock and common stock equity. (Van Horne & Wachowich,1997)

Timilsina (2020) analyze the determinants of capital structure in Nepalese Commercial Banks. The study mainly based on secondary data of 16 commercial

banks with 112 observations for the period 2011/12 to 2017/18. The total debt to total assets and total debt to total equity were selected as dependent variables while return on assets, bank size, assets tangibility, assets growth and liquidity are the independent variables. This research employed Pearson's correlation coefficients and regression models are estimated to test the significance and impact of bank specific factors on the capital structure of Nepalese commercial banks. The result showed that banks size and assets tangibility are positively correlated with total debt to total assets whereas return on assets, assets growth and liquidity are negatively correlated with total debt to total assets. Likewise return on assets, bank size, assets tangibility, assets growth and liquidity are negatively correlated with total debt to total equity. This study indicated that higher assets growth, return on assets and liquidity lower would be the total debt to total assets and total debt to total equity. Likewise, higher the bank size and assets tangibility higher would be the total debt to total assets. This research further concluded that return on assets, bank size and assets tangibility are the most influencing factors and assets growth and liquidity are the least influencing factor affecting the capital structure of Nepalese commercial.

Sofian (2013) investigated the determinants of capital structure of Iranian firms listed on Tehran Stock Exchange for the period between 2001 and 2010. The study use data set of 123 (1230 observation) companies for the 10-year period is collected from published annual reports of companies from Tehran Stock Exchange. The study explores the traditional financial theories (Trade-off theory and Pecking order theory) to investigate the determinants of capital structure. The variables of size, profit, growth, tangibility, and risk factors are included to represent the potential influence of traditional theories. The results indicated that the size and risk are positively related to capital structure. In addition, profitability, growth and tangibility are negatively related to capital structure. The study further showed that firm size is consistent with the trade-off theory and result of profitability is consistent with the pecking order theory.

Gagural (2005) capital structure pattern and its determinants for a penal set of 20 non-financial firms listed in NEPSE for 1992-2004. The study used decomposition analysis, properties of portfolio analysis, econometric analysis and opinion survey of managers. The study found that Nepalese firms are highly levered, however the long-term debt ratio is significantly low. Assets structure and size are observed positively

related to leverage whereas liquidity, risk, growth, non-debt tax shield are negatively related to leverage. The study concluded that both pecking order and tradeoff theories are at work in explaining capital structure of Nepalese companies. Also, the macroeconomic factors GDP, inflation and capital market influence in firm's capital structure decisions. The study further analysis shows that Nepalese managers prefer internal financing first followed bank loan financing.

7. Research Methodology

Research is a systematic and organized effort to investigate facts and methodology is the method of doing research in well manner and also the research for gaining the knowledge about method of goal achievement, which we desire is known as research methodology. So, research methodology means the analysis of specific topic by using proper method. In other words, research methodology is a process of arriving to the solution of problem through planned and systematic dealing with collection, analysis and interpretation of the facts.

Research methodology deals with research design, nature and sources of data collection adopt by a researcher in studying a problem with certain objectives in view or it is a various sequential steps to how research in accomplished, it depends on the researcher. Research methodology is the way of doing and completing research work.

7.1 Research Design

It will provide the framework for the study, guideline for the collection and analysis of data. This research study will be attempts to analyze the determinants of capital structure of Nepalese commercial banks. According to the objective of the study, descriptive and casual comparative research design will be used. Thus, to fulfill the objective of the study secondary data will be used.

7.2 Population and Sample

The total population of the study is 27 commercial bank in Nepal (until 2021). Among them the study covers the joint venture banks there are six joint venture banks. According to the convenience sampling Everest bank limited, Himalayan bank limited, Laxmi bank limited, Siddhartha bank limited is chosen as a sample of the study. The study aims to explore the determinants of Nepalese commercial banks. It is based on recent ten years data from F/Y 2010/11 to F/Y 2019/20.

7.3 Nature and Sources of Data

This study will base on secondary data provided by sampled bank annual reports. Data and information have been extracted from the annual reports of the bank collected from the concerned bank and downloaded from official websites. The supplementary data and information have been acquired from various sources like newspaper, magazines, brochures, booklets, periodicals and bulletins, related documents and journals available in library of Tribhuvan University, and other organization like and Nepal Rastra Bank.

7.4 Research framework and definition of variables

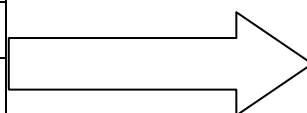
The conceptual framework is design to understand the factors that may affect the determinants of capital structure. In view of theories and major empirical evidences, it is expected that the determinants of capital structure of commercial banks may be influenced by debt to equity, debt to assets, assets growth, assets tangibility, bank size and Return on assets. The conceptual framework is developed to test the effects of these variables on the capital structure of listed commercial banks of Nepal.

Independent variables

Return on assets
Bank size
Growth rate
Tangibility

Dependent variables

Capital Structure
Total Debt to Equity
Total Debt to Assets



The variables

Return on assets

Return on assets is defined as net income divided by total assets. The return on assets which is often called the firm's return on total assets, measure the overall effectiveness of management in generating profit with its available assets.

Bank size

Bank size is measured by the total assets of the firm. Larger sized firms usually are more diversified and have more stable cash flow, therefore they are less risky. This will result in lower cost of debt as well as easier access to the external debt markets.

Growth rate

Assets growth is defined as the Percentage of assets of current year minus assets of previous year divided by assets of current year. Assets are the economic resources of a company expected to benefit the firm's future operations.

Tangibility

Assets tangibility is defined as net fixed assets divided by total assets. It is considered to be one of the most significant determinants of capital structure and firm's performance.

7.5 Method of data analysis

Different tools will be selected according to the nature of data as well as subject matter. The major tools employed for the analysis of the data are financial tools and statistical tools which established the quantities or numerical relationship between two variables of the financial statement. Besides these, there is software SPSS version 2007 are also used.

8. Chapter plan

The entire study is divided into 5 chapters. Brief information of what each chapter contains is given below.

Chapter I: Introduction

It is an introductory chapter, which includes general background of bank. It also discusses about focus and significance of study, statement of problem, objective and limitation of the study.

Chapter II: Review of Literature

This chapter deals with the review of literature. It includes reexamination or appraisal of the existing works in relevant areas and includes the concept of commercial banks, its roles, and a review of previous thesis too.

Chapter III: Research Methodology

It is concerned with research methodology. It includes research design, sources of data, population and sample and method of analysis.

Chapter IV: Data Presentation & Analysis

This is the heart of the chapter as it is concerned with presentation and analysis of relevant data and information. In order to find out the true picture of the Determinants of capital structure of Nepalese Commercial banks, various financial and statistical tools and techniques are used. Thus, this chapter will concern with the findings of the analysis.

Chapter V: Summary, Conclusion and Recommendations

This chapter will summarize the overall picture of the study, draws conclusions, offer suggestions and recommendations for improvement in the future

Reference and appendices have been given at the end of the study.

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