

# **CHAPTER - I**

## **INTRODUCTION**

### **1.1 Background of the Study**

Nepal is a land-locked mountainous country situated between two Asian giants China and India, both having well-developed economic condition. It is a small country with an area covering 1,47,181 square kilometer and also ranked to last developing country with per capital income U.S. \$ 210. Around 38% of the Nepalese are under poverty line. The poverty eradication plan of Nepal is not efficient due to the difficult geographical structure and corruption. The nation has not been able to exploit the natural researches scattered all over the country. It is one of the richest counties for hydropower with potentiality of 83,000 megawatts but due to its developing nature is not being able to utilize its full capacity and has been using only about 0.6% of full capacity. The development of a country is measure on its economic indices. Nepal like all underdeveloped countries has been facing problem of accelerating the economic development. Development of industrial sector: Among other sectors, is equally essential for the rapid economic development of the country. But it is impossible without the development of different sector like banks, Agriculture and Industry etc. of the economy. Nepal, like any other country has been laying emphasis on the uplifting of its economy. The process of economic development depends upon various factors. To develop the nation investment is essential. Investment simply means capital. Capital is one of the prime factors that is necessary for the development and advancement of the country. The development countries are facing difficulties in capital because they have only small amount of household to be used for investment. This is very small saving amount for this purpose. Nepalese government is directed the policies toward foreign direct investment to fulfill the lack capital. Since from past few years, the situation of country is deteriorating day by day. Uncertainty and fear have bounded every sectors of the economy. So, the FDI is not possible on that situation. Every year the government is assigning fewer funds for development purpose. This has seriously hit not only the economic growth of the country but also the investment environment in the country.

Banks and Financial institutions are viewed as catalyst and lubricant in the process of economic growth and the prosperity of the country. The mobilization of domestic resources, capital formation and its proper utilization plays an important role in the economic development of a country. Every financial institution, big or small, be it a commercial bank or a finance company or a cooperative bank, play an important role in the development of a country.

In the contest of capital formation, the bank and financial institution play important and vital role of capital formation. Banks collect saving from its customer and it earns profit investing this saving in business and industries, which led country to develop. Banks are necessary for every country at any economic condition. Without bank, economy cannot improve and development of every country becomes impossible.

Banking industry is one of the fast growing businesses in Nepal. After the government affected the liberalization policy, this sector has been developed dramatically. Banks are major financial institutions, which occupy an important place in the economy because through the deposits they collect, they provide much needed capital for the development of industry, trade and business and other deficit sectors, thereby contributing to the economic growth of the nation. Now more than two dozen of commercial banks are in operation. Commercial banks have huge collection from depositors. Effective utilization of collected fund is possible only through sound investment policy. They mainly invested upon the instructions and guidelines issued by NRB. They are unable to estimate the future; they should make sound capital structure so that they can able to minimize the overall cost and make profit maximization. Insufficient fund decrease the profit or increase opportunity cost and excess capital also increase the cost of capital. To identify the optimum capital structure is difficult .the bank is increase the branch overall the country and increase its market. But the investment area is limited. In this contest to determine, the sound capital structure of the company is complicated. The bank should have clear view towards capital structure policy. The main reason attributed to unsound capital structure is lack of proper analysis on financial risk, interest rate risk, liquidity risk, business risk etc.

The banking sector is largely responsible for collecting household saving in different types of deposit and regulating them by lending in different sectors of economy. The banking sector has now reached to the most remote areas of the country and has experienced a good deal in the growth of the economy.

In Nepal banking activities were started after the establishment of Nepal Bank Limited (NBL) in 1937. In 1955, the Central Bank was established with objectives of supervising, protecting and directing the functions of commercial banking activities. Rastriya Banijya Bank was established in 1966 as second commercial bank owned by the government.

Nepal's reform efforts in the financial sectors began in 1980s when NRB eased the entry restrictions of foreign banks with an amendment to the Commercial Bank Act 1974. As a result, the banks namely Nepal Arab Bank Limited (Nabil, Nepal Indo-Suez Bank and Nepal Grind lays Bank (NGBL) came into operation prior to 1990s. However, only in 1992, after NRB adopted a liberal attitude in permitting commercial banks to open, the financial liberalization really took place. Eleven new joint venture banks were opened after the real financial liberalization took place.

## **1.2 Origin and Growth of Modern Banks**

Despite strong criticism from the Church regarding charging of interest, Modern Banking sowed its seed in the Medieval Italy and Bank of Venice was setup in 1157A.D. in Venice. It is regarded as the first modern bank. Subsequently, Bank of Barcelona (1401) and Bank of Genoa (1407) were established. The Lombards migrated to England and other parts of Europe from Italy and are regarded for their role in the development and expansion of the Modern Banking. Bank of Amsterdam, set up in 1609 was very popular then. The Bank of Hindustan established in 1770 is regarded as the first bank in India.

Though Bank of England was established in 1694, the growth of banks accelerated only after the introduction of 'Banking Act 1833' in United Kingdom as it allowed opening Joint Stock Company Banks.

## **Development of Banking in Nepal**

Banking concept existed even in the ancient period when the goldsmiths and the rich people used to issue the receipts to the common people against the promise of safe-keeping if their valuable items. On the presentation of the receipts, the depositors would get back their gold and valuables after paying a small amount for safe-keeping and saving. The goldsmiths and the moneylenders became bankers of those days who started performing two functions of modern banking- accepting deposits and advancing loans.

The stage wise development of banking can be presented as follows:

### **The First Phase of Banking Development**

- ) Eight century, king “Gunkamdev” renovated the Kathmandu city by taking loan. At the end of same century merchant named “Shankhardhar” has started the ‘New year’ Nepal sambhat after freeing all people of Kathmandu from the debt.
- ) In the 11th century, during Malla reigns, there was an evidence of professional money lender and buyer.
- ) Tejarath Adda was established in 1877 A.D. which provided loan at very low rate of 5%.

### **The Second Phase of Banking Development**

- ) The modern banking in Nepal has started with established of Nepal Bank Ltd. in 1994 B.S.
- ) Having felt the need of development of banking sector and to help the government formulate monetary policies, Nepal Rastra Bank was set up in 2013 B. S. as the central bank of Nepal.
- ) In B.S. 2022, Government set up Rastriya Banijya Bank as a fully government owned commercial bank.
- ) The agricultural development bank was established B.S. 2024. This bank was established with the objective of increasing the life standard of the people who are involved in agriculture.

### **The Third Phase of Banking Development**

The process of development of banking system in Nepal was not satisfactory. Nepal was observing the events that were taking places in the world also. The country can't change its status by using only its own capital in the country without importing the new technology from Foreign country and accordingly, law and policy have been enacted by the state to encourage the foreign investment on banking sector. From this, the real form to the development of the banking system started in Nepal. In order to establish and develop other Joint venture commercial banks and other financial institution, Nepal adopted liberal free economic policy. Accordingly, Nepal is allowed to establish different joint venture banks under the collaboration with foreign banks.

### **The Fourth Phase of Banking Development**

From 2041 B.S, His Majesty's Government of Nepal established 5 rural development banks. They are as follows:

- ) Eastern Rural Development Bank
- ) Central Rural Development Bank
- ) Western Rural Development Bank
- ) Mid-western Rural Development Bank
- ) Far-western Rural Development Bank

In order to establish and develop other joint venture commercial banks and other financial institution, Nepal adopted liberal free economic policy. After 2041 B.S., the government gradually liberalized and opened up the financial sector, resulting in the rapid entry of the foreign banks. Later, in 2041 B.S., with the grand opening of NABIL Bank Ltd., other commercial banks started emerging in the private sectors. As a result, now there are altogether 26 commercial banks operating at different parts of the country. At present, the banking sector is more liberalized and there are various types of bank working in modern banking system. This includes central, development and commercial banks. Evolution of the information technology has revolutionized the banking sector is saving lots of time and money by implementing IT. Technology has changed the traditional method of the services of bank. Invention of different software and hardware, which are very essential and available for functioning bank

such as Banking software, ATM, E-banking, Mobile Banking and card like Debit card, Credit card, Prepaid card etc which helps the customer as well as banks to operate and conduct their activities more efficiently and effectively. This helps bank to generate more customers, goodwill and profit.

**Table 1.2.1 Major Players in Nepalese Financial System**

S. No	Organization	Number
1	Central Bank	1
2	Commercial Bank	30
3	Development Bank	70
4	Financing Companies	77
5	Co-operatives	15
6	Micro Credit Financial Institutions	16
7	NGOs licensed by NRB	45
8	Insurance Companies	26
9	Employee Provident Fund	1
10	Citizen Investment Trust	1

Source: Naya Patrika Tuesday, 15 Dec. 2009

### **Commercial Banking System in Nepal**

Banking in modern sense started with the inception of Nepal Bank Limited (NBL) on B.S.1994/07/30 with 51% Government Equity. NBL had a staggering responsibility of attracting people towards banking sector from predominant moneylenders net and of expanding banking services. Being a commercial bank, it was natural that NBL paid more attention to profit generation business and preferred opening branches at urban centers.

The Government however had duty of stretching banking services to the nooks and corners of the country and also managing the Financial System in a proper way. Thus Nepal Rastra Bank (NRB) was established on B.S. 2013/01/14 with full government ownership as a Central Bank under NRB Act 2012 B.S. Since then it has been functioning as the Government's Bank and has contributed to the growth of financial sector. The major challenge before NRB today is to ensure the robust health of financial institutions. Accordingly, NRB has been trying to change itself and has introduced a host of prudential measures to safe guard the interest of the public. NRB

is yet to do a lot to prove itself as an efficient supervisor. NRB really requires strengthening their policy making, supervision, and inspection mechanism.

For the integrated and speedy development of the country, the Government set up Rastriya Banijya Bank (RBB) in B.S.2022/10/10 as a fully government owned commercial bank. As the name suggests, commercial banks are to carry out commercial transactions only. Nevertheless, commercial banks had to carry out the functions of all types of financial institutions. Hence, Industrial Development Centre (IDC) was set up in 1933 B.S. for industrial development but in 1966 B.S., IDC was converted to Nepal Industrial Development Corporation (NIDC), after that in 2024 B.S. Agricultural Development Bank (ADB) was established to provide finance for agricultural producers so that agricultural productivity could be enhanced by introducing modern agricultural techniques.

In the late 1930s, to meet the need of healthy competition in the Financial System, Nepal allowed the entry of foreign banks as joint ventures with up to a maximum of 50% equity participation. Responding to this, Nepal Arab Bank Limited (now changed name as Nabil Bank Ltd) became the first bank to be established under such policy in the year 2041 B.S.

**Table No 1.2.2**  
**Growth of Commercial Banks In Nepal**

S.N	Name of commercial bank	Operation Date (A.D.)	Head office
1	Nepal Bank Ltd.	1937/11/15	Kathmandu
2	Rastriya Banijya Bank	1966/01/23	Kathmandu
3	Agriculture Bank Ltd	1968/01/02	Kathmandu
4	Nabil Bank Ltd.	1984/07/16	Kathmandu
5	Nepal Investment Bank Ltd.	1986/02/27	Kathmandu
6	Standard Chartered Bank Nepal Ltd.	1987/01/30	Kathmandu
7	Himalayan Bank Ltd.	1993/01/18	Kathmandu
8	Nepal SBI Bank Ltd.	1993/07/07	Kathmandu
9	Nepal Bangladesh Bank Ltd.	1993/06/05	Kathmandu
10	Everest Bank Ltd.	1994/10/18	Kathmandu
11	Bank of Kathmandu Ltd.	1995/03/12	Kathmandu
12	Nepal Credit & Commerce Bank Ltd.	1996/10/14	Siddharthanagar

13	Lumbini Bank Ltd.	1998/07/17	Narayangadh
14	Nepal Industrial & Commercial Bank	1998/07/21	Biratnagar
15	Machhapuchhre Bank Ltd.	2000/10/03	Pokhara
16	Kumari Bank Ltd.	2001/04/03	Kathmandu
17	Laxmi Bank Ltd.	2002/04/03	Birgunj
18	Siddhartha Bank Ltd.	2002/12/24	Kathmandu
19	Global Bank Ltd	2007/01/02	Birgunj
20	Citizens Bank International Ltd.	2007/6/21	Kathmandu
21	Prime Commercial Bank Ltd.	2007/9/24	Kathmandu
22	Bank of Asia Nepal Ltd.	2007/10/12	Kathmandu
23	Sunrise Bank Ltd.	2007/10/12	Kathmandu
24	Development Credit Bank Ltd.	2001/01/23	Kathmandu
25	NMB Bank Ltd.	1996/11/26	Kathmandu
26	Kist Bank	2003/2/21	Kathmandu
27	Janata Bank Nepal Ltd.	2010/06/20	Kathmandu

Source: (www.nrb.org.np).

“Today in Nepal 27 commercial banks, 69 Development Banks, 77 Finance Companies and more than 100 Micro financial institutions are in operation.”

### **Role of Commercial Bank in Economic Development:**

A well development banking system is a necessary pre-condition for economic development in a modern economy. Besides providing financial resources for the growth of industrialization, banks can also influence the direction in which these resources are to be utilized. In a modern economy, banks are to be considered not merely as dealers in money but also the leaders in development. They are not only the storehouses of the country’s wealth but also utilize the resources necessary for economic development. It is the growth of commercial banking in 18<sup>th</sup> and 19<sup>th</sup> centuries that facilitated the occurrence industrial revolution.

The main objective of commercial banks is to mobilize the resources for productive use after collecting them from different places. It brings about greater mobility of resources to meet the emerging necessity of the economy. There are various roles played by a commercial bank for the development of an economy, which are capital formation, encouragement to entrepreneurial innovations, influencing economic



activity, promotion of trade and industry, development of agriculture and other neglected sectors.

Therefore, the fate of the country is greatly determined by the active role of commercial banks. Banks provide facilities to their customers by providing loans, remitting funds, purchase and sale of bills and other market information. These services help to run the business and other economic activities rapidly as well as smoothly which ultimately helps in economic development.

### **1.3 Profile of Siddhartha Banks Limited**

Siddhartha Bank Limited (SBL) commenced operations in 2002. The Bank is promoted by a group of highly reputed Nepalese dignitaries having wide commercial experience, In Nepal, today stands as one of the premier banks in the country. While the promoters come from a wide range of sectors they possess immense business acumen and share their valuable experiences towards the betterment of the bank. Siddhartha Bank now boasts of strong retail banking and trade operations complementing its longstanding corporate finance expertise. Within a short span of time, Siddhartha Bank has been able to establish itself as a healthy and strong institution, with profitability, capital adequacy and portfolio quality of the highest order. The bank provides a full range of commercial banking services through its twenty five branches established in Katmandu.

Siddhartha Bank provides various products and services. Siddhartha Bank Limited offers a wide variety of services ranging from a small saving account to large finances. It has something for every section of the society and its services are tailor-made to suit every customer. The services provided so far are as follows:

1. Various deposit products such as Current, Saving & Fixed Deposits
2. Funds Transfer (Swift, Draft, T.T. & Fax, Western Union Money Transfer etc.)
3. Purchase & Sale of Traveler's Cheque.
4. ATM / Debit Card for easy to operate the accounts.
5. Trade Finance including Bank Guarantee, Letter of Credit etc.
6. Loan products, Like Corporate Financing, Consumer Loans etc.
7. Clearing / Collection Facility/ABBS system.
8. Safe Deposit Lockers.
9. Other Allied services.

## **1.4 Statement of Problem**

Banking industry is one of the fast growing businesses in Nepal. After the liberalization policy was affected by the government. This sector has been developed dramatically. Now more than two dozen of commercial banks are in operation. Commercial banks have huge collection from depositors. Effective utilization of collected fund is possible only through sound investment policy. They mainly invested upon the instructions and guidelines issued by NRB. They are unable to estimate the future; they should make sound capital structure so that they can able to minimize the overall cost and make profit maximization. Insufficient fund decrease the profit or increase opportunity cost and excess capital also increase the cost of capital. To identify the optimum capital structure is difficult .the bank is increase the branch overall the country and increase its market. But the investment area is limited. In this contest to determine the sound capital structure of the company is complicated. .the bank should have clear view towards capital structure policy. The main reason attributed to unsound capital structure is lack of proper analysis on financial risk, interest rate risk, liquidity risk, business risk etc.

The problem that still persists for a bank even today is to find a proper and viable project to ensure healthy profit. They have always feared high degree of risk and uncertainty owing to lack of profitable sectors for their investment. The high liquidity position of banks has resulted in a decrease in investment in productive sectors. Thus, the present study will make a modest attempt to analyze capital structure policy of this bank.

## **1.5 Objective of the Study**

Capital structure decision is one of the major decision functions of financial management. The main purpose of this study is to assess the capital structure policy and strategies followed by Siddhartha bank.

The major objective of the study is to analyze the overall capital structure management of Siddhartha Bank Limited and other specific objectives are as follows:

- To find out the combination of capital structure.
- To explore the sources of capital of Siddhartha bank.
- To explain the position of capital adequacy in different periods.

## **1.6 Significance/ importance of the Study**

The financing sector of Nepal is expanding day by day. In recent days, the nation is facing with lot of obstacle. In this situation the manufacturing and trading sector is also running slowly, beside that, banks are increasing and they expanding their market. So the Capital is essential. Capital is a backbone of every organization. Various factors affect the capital structure. Stability and growth rates, cost of capital, management attitude, taxes, investment opportunity, control and flexibility etc. this studies will helpful to the company's overview to their capital structure management and to formulate future strategies to do much better in their horizon.

So capital structure is essential indicator of company's financial decision making. It is the large extent determinant of the company profitability. This study shows the effect in cost of capital with the help of better combination of capital structure.

This study will provide a useful feedback to academic institutions, bank employees, trainees, investors, policymaking bodies and those concerned with banks in the formulation of appropriate strategies for improving the performance of banks.

Since from past few years, the situation of country is deteriorating day by day. Uncertainty and fear have bounded every sectors of the economy. Every year the government is assigning fewer funds for development purpose. This has seriously hit not only the economic growth of the country but also the investment environment in the country. So being active members of the country, commercial banks of Nepal are also affected by this situation. On this ground, management of banks should have to think precisely before making any investment. Therefore, all these events have raised the necessity for formulating sound capital structure policy.

With this connection, by this study having topic “CAPITAL STRUCTURE ANALYSIS OF SIDDHARTHA BANK LIMITED.” The research is tries to find out the investment policies of the commercial banks. Further, this study tries to explore, whether the policies they have formulated are sufficient or not, whether they have managed their invest-able fund in proper source or not and so on.

## **1.7 Limitations of the Study**

Like every research study, this study also has some limitations viz-inadequate coverage of commercial banks, time period taken and other variables. The following factors are the basic limitations.

- a) Although direct interview was taken with the staff but the most of the study is based on secondary data collected from the banks, particularly based on data gathered from the published annual report of the banks.
- b) This study is limited to only a period of five years of this study deals with only one, no other commercial banks have not been considered in this study.
- c) The data are presented at rounding figure.
- d) Concerned banks and hence the conclusion drawn only confines to the above period (FY 2061/2062 to 2065/2066).

## **1.8 Organization of the Study**

This research study has been divided into five chapters. They are as follows:

### **Chapter – I**

In the first chapter, introduction part of the study. It has introduction of commercial bank as well as the introduction of selected banks Siddhartha Bank Limited, General background of the study, commercial banking scenario in Nepal, statement of the problem objective of the study, significance of the study, limitation of the study, organization of the study are arranged.

### **Chapter – II**

The second chapter deals with review of literature. It includes a discussion on the conceptual framework of the capital structure. It also reviews the major relevant studies with fund mobilization of a commercial Bank.

### **Chapter – III**

The third chapter explains the research methodology use to evaluate capital structure practices of joint venture bank in Nepal. It consists of research design, sources of data, population and sample, tools and method of analysis.

#### **Chapter – IV**

The fourth chapter deals with presentation and analysis of data through a definite course of research methodology. This chapter is to analysis different financial ratios and statistical analysis related to capital structure and fund structure of this sample bank.

#### **Chapter – V**

The fifth chapter discusses summary of the study and suggestion as well as recommendations. Besides this bibliography on appendices are also included.

## **CHAPTER II REVIEW OF LITERATURE**

The purpose of reviewing the literature is to develop some expertise in one's area, to see what contributions can be made, and to receive some ideas for developing a research design. Every study is based on past study. Thus, the past studies cannot be ignored. This chapter helps to take adequate feed back to broaden the information based an inputs to my study. This chapter is divided into three different parts, which arrange in to the following order.

2.1 Conceptual Review

2.2 Review of Journals and Articles

2.3 Review of Thesis

### **2.1 Conceptual Review**

This section is devoted to discuss briefly about the theoretical concept regarding the theories of capital structure.

#### **2.1.1. Concept of the Capital Structure**

Capital structure refers to the mix of long- term sources of funds. Such as debentures, long-term debt, preference share capital and equity share including reserve and surplus. Theoretically, the financial manager should plan an optimum capital structure for his or her company. If companies do not plan their capital structure, they may face difficulties in raising funds to finance their activities, thus the firms cannot achieve their goal. The capital structure decision affects the overall cost of capital, total value of the firm and earning per share. The optimal capital structure refers the combination of debt, preferred stock and equity that maximize the value of the firm and earning per share and minimize the cost of capital. The capital structure does not affect the total operating earning of a firm, but it affects the earnings per share and value of the firm.

"Financial structure referees to the way the firm's assets are financed; it is the entire right hand side of the balance sheet. Capital structure is the permanent financing of the firm, represented primarily by long-term debt, preference stock and common stock but excluding all short-term credit. Thus a firm's capital structure is only a part of its financial structure". (Weston and Braigham;)

"The term 'capital structure' means the proportion of different types of securities issued by a firm. The optimal capital structure is the set of proportion that maximizes the total value of the firm". (Schall and Haley).

"Capital structure is concerned with the analyzing the capital composition of the company." (Weston and Brigham 1982: 555).

"Capital structure refers to the mix of long-term sources of fund, such as debenture, long term debt, preference share capital and equity share capital including reserves and surpluses i.e. retained earnings." (Pandey 1999: 718)

"A part from short term finance from creditors and banks, companies are usually financed either by long term loans (debentures) carrying a fixed rate of interest on capital or by ordinary shares carrying membership of the company and dividends at rates which depend upon profits." (Francis)

"The two principal sources of long term financing are equity and debt capital. The composition of these two long term financing is known as capital structure. Under normal economic condition, the earnings per share can be increased using higher leverage. But leverage also increases the financial risk of the share holder." (Gautam and Thapa 2060: 223).

"The optimum capital structure may be defined as that capital structure or combination of debt and equity that leads to the maximum value of the firm." (Khan and Jain)

A sound or appropriate capital structure should have the following features. (Pandey; 1999: 719):

**A. Return:**

The capital structure of the company should be most advantageous. Subject to other consideration, it should generate maximum return to the shareholders without adding additional cost to them.

**B. Risk:**

The use of excessive debt threatens the solvency of the company. To the point debt does not add significant risk it should be used otherwise its use should be avoided.

**C. Flexibility:**

The capital structure should be flexible. Flexibility as company can raise helps to grab market opportunity as company can raise required funds wherever it is needed for profitable investment opportunities. It also when funds from debt and preferred stock are no more required in the business.

**D. Capacity:**

The capital structure should be determined within the debt capacity of the company, and this capacity should not be exceeded. The debt capacity of a company depends on its ability to generate future cash flows.

**E. Control:**

Control power is the one of the most concerned part for the management. Management always wants to maintain control over the firm. The capital structure should involved minimum risk of loss control of the company. Issue of excess equity shares to new investors may bring threats to the control by existing manager. The term capital denotes the long-term fund 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 and equity capital.

**(I) Debt Capital:**

It includes all long term borrowing incurred by the firm. Debenture, bonds, long-term loan etc. are major sources of debt or borrowed capital. A firm employs subtotal amount of debt capital of tax deductibility of interest payment, flexibility, and lower effective cost. However, excess amount of debt exposes high risk.

**(II) Equity Capital:**

It consists of the long- term fund provided by the firm's owners, the stockholders. In other words, equity capital includes common stock, paid in capital or share premium, reserve and surplus and retained earnings. Joint Stock Company cannot be established with any equity financing. Preferred stock is neither purely a debt nor equity.

**Classification of Capital**

For the purpose of classification of Capital Fund, the capital of the licensed institution shall be classified into the following two components. The capital structure means the aggregate of the core capital and supplementary capital.



**A. Core capital**

The amounts under the following heads shall be included in the core capital:

- a. Paid Up Capital
- b. Share Premium
- c. Irredeemable Preference Share
- d. Accumulated Profit and Loss Account
- e. General Reserve Fund
- f. Capital Redemption Reserve
- g. Capital Equalization Reserve
- h. Other Free Reserve

The following items shall be deducted for the purpose of calculation of the core capital.

- a. Goodwill
- b. Entire amount of investment made in shares and debentures of organized institutions having a financial interest.
- c. Excess amount of investment in shares and debentures of organized institutions than prescribed by Nepal Rastra Bank.
- d. Fictitious Assets.

**B. Supplementary Capital**

The amount under the following heads, not exceeding one hundred percent of the core capital, shall be included under the Supplementary Capital.

- a. Cumulative and/ or Redeemable Preference Share
- b. Subordinated Term Debt
- c. General loan loss provision
- d. Hybrid Capital Instruments
- e. Exchange Equalization Reserve
- f. Investment Adjustment Reserve
- g. Assets Revaluation Reserve
- h. Other Reserves. ( Kiran Thapa; 2065:208)

## Maintenance of Minimum Capital Fund

The licensed institutions shall maintain minimum capital fund based on their risk – weighted assets, as follows:

Table No: 2.1.1

### Minimum Capital Fund

Institutions	Require Capital fund on the weighted risk assets (%)	
	Core Capital	Capital Fund
'A' Class	6.0 %	10.0 %
'B' & 'C' Class	4.0 %	11.0 %
'D' Class	4.0 %	8.0 %

*Source: www.nrb.org.np*

Financial decision must be very sensitive in misappropriate composition of debt equity in capital structure may lead to bankruptcy of the firm. The optimal capital structure is attaining at the level where the risk and cost perception of shareholder; is minimized and returns are maximized. As the return to shareholder; is maximized automatically, the market value of the firm is maximized. The capital structure affects the cost of the firm. The financial manager must be sensible while selecting the optimal capital structure for the firm. (Kiran Thapa; 2065:201, www. nrb.org.np)

### 2.1.2 Assumption of Capital Structure

To explain different theories, following assumptions are:

- a. There are no corporate or personal income taxes.
- b. There are no bankruptcy costs.
- c. The dividend payout ratio is 100%. That is total earnings are paid out as dividend to the shareholders and there are no retain earning.
- d. The ratio of debt to equity of a firm can change many times but the total assets remain constant.
- e. There are no transaction costs.
- f. The operating earnings of the firm remain constant; that is, growth rate is equal to zero.
- g. The operating earnings of the firm are not expected to grow.
- h. The expected value of the subjective probability distribution of expected future operating earnings for each company are the same for all investors in the market. ( Rabindra Bhattarai; 2006:340)

### **2.1.3 Theories of Capital Structure**

Different theories have been developed under the relevancy of capital structure to value of firm and cost of capital. Net income approach and traditional approach argued capital structure as relevant matter and net operating income approach and MM approach argued capital structure as irrelevant matter.

#### **2.1.3.1 Net Income Approach**

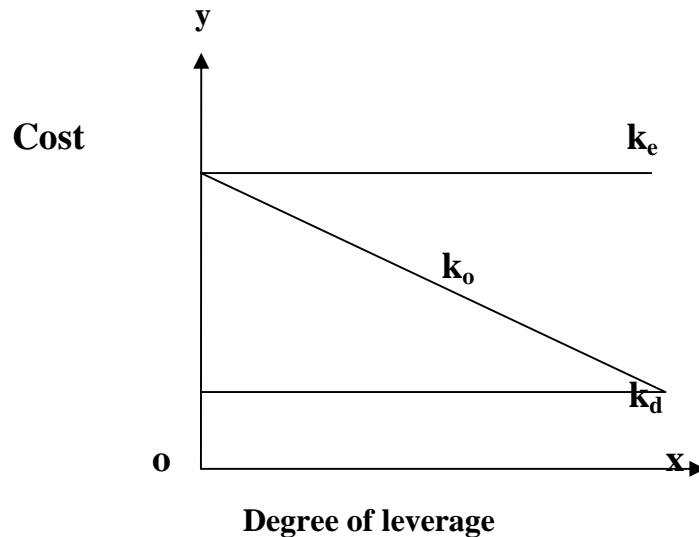
The net income approach support the traditional theory of capital structure. This theory is a relevant theory of capital structure. According to this theory, the capital structure decision is relevant to the valuation of the firm and the overall value of firm. In other word, a change in financial leverage (proportion of debt in a capital structure) will lead to a corresponding change in the overall cost of capital as well the total value of the firm. Therefore, if we increase the ratio of debt in the capital structure, the average weighted cost of capital will decline and the value of the firm as well the market value of the ordinary share will increase. In contrast, a decrease in the debt ratio will cause an increase in the overall cost of capital and a decline both value of the firm as well as the market price of equity share.

#### **Assumption of net income approach:**

The following are the basic assumptions of net income approach. To calculate the value of a firm and WACC, these assumptions are constantly used.

- a. There are no taxes.
- b. The cost of debt is less than the equity–capitalization rate or the cost of equity.  
(i.e.  $K_d < K_e$ )
- c. Cost of equity and cost of debt remain constant.
- d. The use of the debt does not change the risk perception of investors.
- e. Net operating income remains constant.
- f. Overall cost of capital decreases as leverage increases. (Rabindra Bhattarai; 2006:343)

Net income approach suggests that the existing optimal capital structure. It is that the firm can increase its value or lower the overall cost of capital by increasing the proportion of debt in the capital structure.



**Figure 2.1**

### 2.1.3.2 Net Operating Income Approach

This approach is opposite to the net income approach. Net operating income approach is an irrelevant theory of capital structure. This theory assumes that the capital structure (proposition of debt and equity) is irrelevant to the value of the firm and the overall cost of the capital. Under this approach, net operating income is capitalized at an overall capitalization rate to obtain the total market value of the firm. The market value of the debt, then, it deducted from the total market value to obtain the market value of the stock.

#### Assumption of net operating approach

The following are the assumptions of net operating approach.

- a. The overall cost of capital remains constant.
- b. The cost of debt remains constant.
- c. Cost of debt is less than cost of equity. ( $k_d < k_e$ )
- d. The required return on equity increases linearly with an increase in debt ratio.
- e. Total operating profit remains constant.

Any changes in leverage with not lead to any changes in the total value of the firm the market price of a share as well as the overall cost of capital remain constant. According to the net operating income approach, net operating income approach is capitalized at an overall capitalization rate to calculate the total market value of the firm to obtain market value of the equity. Note that the overall cost of capitalization

rate and cost of debt remain constant but the cost of equity increases linearly with leverage.

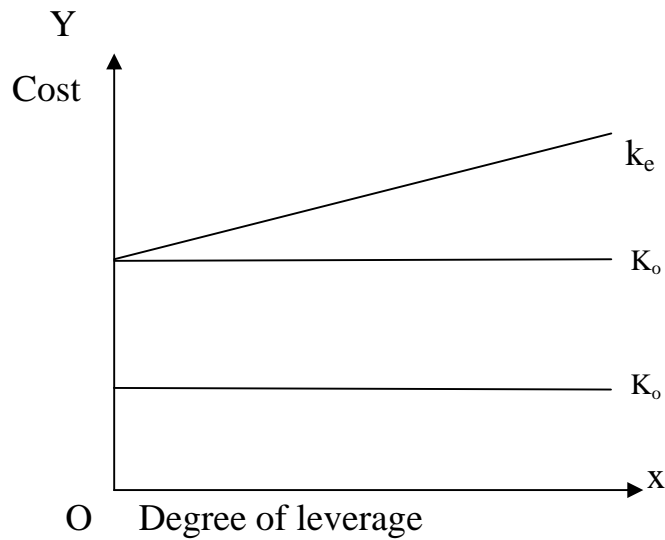


Figure 2.2

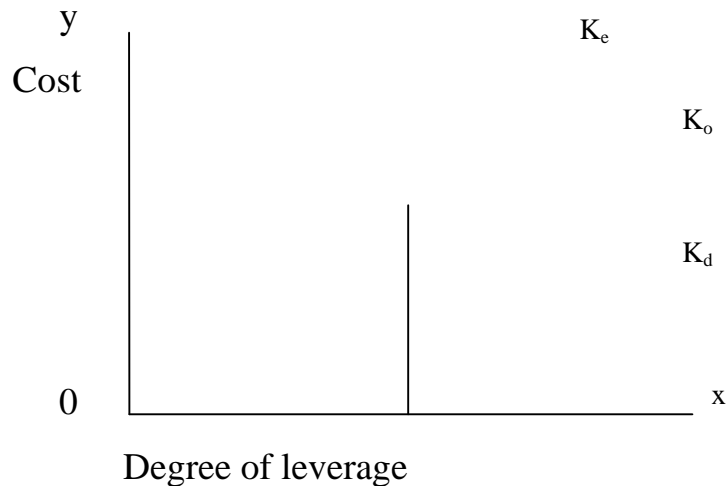
In above figure 2.2 degree of leverage is plotted along the horizontal axis and cost of capital figure on the vertical axis. It shows that  $k_d$  and  $k_e$  are constant and  $k_e$  increase with leverage continuously. As the average cost of capital is constant, this approach implies that there is not any unique optimal capital structure. (Rabindra Bhattarai; 2006: 345)

### 2.1.3.3 Traditional Approach

This approach assumes the capital structure as relevant matter for the value and cost of capital of the firm. It takes some features of both net income and net operating income approach. This approach strikes a balance between the two different approaches net income and net operating income. Therefore, it is also known as the intermediate approach. It resembles the net income approach in arguing that cost of the capital and total value of the firm are not independent of the capital structure. However, it does not subscribe to the view of approach that value of a firm necessary increase for all the degree of leverage. In one respect, it shares a feature with the NOI approach that beyond a certain degree of leverage, the overall cost increases leading to a decrease in the total value of the firm.

According to this approach, there is an optimal capital structure therefore the firm can increase the total value of the firm through the wise use of leverage. The firm initially can lower its overall its overall cost of capital through the use of cheapest cost debt

and raise its total value through the use of cheapest cost debt and raise its total value through leverage. But the increase in leverage increase in leverages the risk to the holders and the debt holders demand high interest rate as a result the overall cost of capital also increases.



At the overall cost of capital declines with increase is debt ratio because the rise in  $k_e$  does not entirely offset the use of cheaper debt funds. As a result, the weighted average cost of capital,  $k_o$ , decline with moderate use of leverage. After a point, however, the increase in  $k_e$  more than offsets the use of cheaper debt funds in the capital structure, and  $k_o$  begins to rise. The rise in  $k_o$  is supported further one  $k_d$  begin to rise. The optimal capital structure is the point at which  $k_o$  bottoms out. In the figure, this optimal capital structure is the point at which  $k_o$  bottoms out. In the figure, this optimal capital structure is point  $x$ . thus, the traditional position implies that the cost of capital is not independent of the capital structure of the firm and that there is an optimal capital structure. (Rabindra Bhattacharai; 2006:346).

#### 2.1.3.4 Modigliani- Millar Position

Capital structure without corporate tax (Rabindra Bhattacharai; 2006:347)

In 1958, two prominent financial researchers, Franco Modigliani and Merton Miler (MM), showed that, under certain assumptions, a firm's overall cost of capital, and therefore, its value, is independent of the capital structure. This approach assumed that:

- a. There is a perfect capital market.
- b. There are no transaction costs of buying and selling securities.

- c. A sufficient number of buyer and sellers exit in the market; so no single investor can have a significant influence on security prices.
- d. Relevant information is readily available to all investors and is cost-free to obtain.
- e. All investors can borrow or lend at the same rate.
- f. All investors are rational and have homogeneous expectations of a firm's earnings.
- g. All firms are homogeneous in riskiness.
- h. There are no personal or corporate taxes.
- i. All the cash flows are perpetuities, that is all firms expect zero growth.
- j. EBIT and bonds are perpetual.

In the no-tax MM case, the cost of debt and the overall cost of capital are constant regardless of a firm's financial leverage position, measured as the firm's debt to equity ratio. As a firm increases its relative debt level, the cost of equity capital increases; reflecting the higher return requirement of stockholders due to the increase in risk imposed by additional debt. The increase in the cost of equity capital exactly offsets the benefit of the lower cost of capital structure.

#### **2.1.4 Factor Affecting Capital Structure**

The following factors affect the capital structure.

- a. **Cost of capital:** The impact of financing decisions on the overall cost of capital should be evaluated and the criteria should be to minimize the overall cost of capital or to maximize the value of the firm.
- b. **Assets structure:** Firms whose assets are suitable as securities for loans tend to use debt heavily. Borrowed capital should not exceed a reasonable percentage of fixed assets.
- c. **Flexibility:** The Company's desire for flexibility in future financing decisions also affects the capital structure of the company. Therefore, the company should compare the benefits and cost of attaining the desired degree of flexibility and balance them properly.
- d. **Control:** If management has voting control over the company and is not in a position to buy any more stock, debt may be a choice for new financing. On the other hand, management groups that are not concerned about voting control may decide to use equity rather than debt.

- e. **Profitability:** The firms with very high rate of return on investment use relatively little debt. Their rate of return enables them to do most of their financing with retained earnings.
- f. **Taxes:** Interest is deductible expenses while dividend are not deductible. Hence the higher a firm's tax rate, the greater is the advantage is using debt.
- g. **Interest rate:** This affects the choice of securities to be offered to investors. High interest rate makes financing costly. When funds are obtained easily and cheaply. There is greater attitude for choice of types of security to be used.
- h. **Operating leverage:** The Company with a high level of earnings before interest and taxes can make a profitable use the high degree of leverage to increase return on the shareholder's equity.
- i. **Floatation costs:** Floatation cost is incurred only when the funds are raised. The cost of floating a debt is less than cost of floating and equity issue. This may encourage a company to use debt than issue equity shares.
- j. **Market condition:** conditions in the stock and bonds market undergo both long and short-term changes, which can have an important bearing on a firm's optimum capital structure.
- k. **Growth rate:** Faster growing firm's must rely more heavily on external capital. Other factors are stability of sales, cash flow ability of a company, nature of industry and capital requirements etc. (Pandey; 1999: 719)

### 2.1.5 Optimum Capital Structure

The overall cost of capital is minimized; theoretically at least. When the firm reaches its optimum capital structure. The optimum capital structure strikes a balance between the risk and returns and thus maximizes the price of the stock.

"Optimum capital structure can be properly defined as that combination of debt and equity that attains the stated managerial goals maximization of the firm's market value, and which minimizes the firm's cost of capital. As the existence of an optimum capital structure implies the simultaneous optimization of both the cost of capital and the firm's market value, occupies a central position in the theory of financial management." (Phillipatos; 1974: 237)

"An optimum capital structure would be obtained at the combination of debt and equity that maximizes the total value of the firm (value of shares plus value of debt) or minimizes the weighted average cost of capital." ((Panday; 1999: 277)



Some of important objectives of the optimal structure are as follows:

- a. To maximize return on equity capital
- b. To minimize cost of capital
- c. To minimize risk
- d. To increase flexibility
- e. To maintain control power
- f. To employ high grade security

### **2.1.6 Capital Structure Decision**

The determination of capital structure is not concerned only with value, return and cost but in practice, it involves additional considerations. Attitudes of managers with regard to financing decisions are quite often influenced by their desire; not to lose control; but to maintain operating flexibility and to have convenient and cheaper means of raising funds. The most important considerations are:

- Concern about dilution of control
- Desire to maintain operating flexibility
- Ease of marketing capital inexpensively
- Capacity for economics of scale, and
- Agency costs (Rabindra Bhattarai; 2006:4)

## **2.2 Review of Journals and Articles**

This section is devoted to review of important empirical works, concerning capital structure and cost of capital since 1958 till 2005. There are numerous studies in capital structure. So, it is out of the scope of this study to survey and review all the empirical work extensively and give here in detail. Therefore, some important studies and their findings are presented. In this section, review will be made on the foreign studies including Indian studies. The review is undertaken in four subsections. Section I focuses on the review of empirical works carried up to 1960s with their major findings. The second section deals with the review of studies during 1970s. Third section is devoted to review of studies during 1980s and finally fourth section deals with studies during 1990s respectively.

**(i) Review of Empirical Works (up to 1970s)**

**Modigliani and Miller (1958)** in their **first study**, they used the previous work of 'Allen and Smith' in support of their independence hypothesis. In the first part of their work, MM tested their proposition I the cost of capital is irrelevant to the firm's capital structure, by correlating after tax cost of capital, with leverage,  $B/V$ . They found that the correlation coefficient is statically in significant and position in sign. The regression line does not sauciest a curvilinear, 'u' shaped cost of capital key of traditional view, and then the data are shown in scatter diagram. In the second part of their study, they tested their proportion II, the expected yield on common shares, is a linear function of debt to equity ratio. The second part of their study is consistent with their views, i.e. if the cost of borrowed funds increases, the cost of equity will decline to offset this increase.

**Modigliani and Miller (1963)** were conducted the **second study** in 1963 with correcting their original hypothesis for corporate taxes and expected cost of capital to be affected by leverage for its tax advantages. They therefore wanted to test whether leverage had tax advantages or not. For this, they conducted the mathematical analysis regarding the effect of leverage and other variables only because of the tax advantage involved.

**Barge (1963)** tested the same hypothesis. For the study purpose, he utilized cross section data from three different industries-61 rail road industries, 63 departmental store companies and 34 cement industries. For the railroad industries, he performed both yield as well as the average cost of capital test. The average cost of capital was computed by dividing the three year average income by the average total market value. He uses the ratio of long term debt to permanent capital, at book value as the measure of financial structure. The result obtained from the study suggested that the average cost of capital first tends to decline and them tends to rise as the debt capital increase in the capital structure. In the department store study, he computed the leverage in the same manner as the rail road study. Result obtained from the support to the traditional view. Barges final test was on cement industry. In this study, variables were estimated in the same manner as in the case of departmental store are results obtained from this study again concluded that the traditional view has supported.

**Weston (1963)** the research work done by Weston is 'A Test of Cost of Capital Proposition'. He made some important improvement in the cost of capital model. He included firm size and growth as additional explanatory variables in his model.

He found the regression co-efficient of leverage to be positive and significant, when he used MM model. However, when the multiple regressions were run, he found that the correlation coefficient is significant and the regression coefficient is negative and significant. When the influence of growth is isolated, leverage is found to be negatively correlated with the cost of capital. He concluded that the apparent lack of influence of leverage on the overall cost of capital observed by MM was due to the negative correlation of leverage with earning growth. Weston also tested MM proposition II. When he used the MM model, his results were found to be consistent with their results i.e. cost of equity is the linear function of debt equity ratio.

**Wipper (1966)** Wiper study is related to test the empirical relationship between 'financial structure and value of the firm'. He tried to eliminate the principle problem of empirical study on the leverage and attempted to offer what were hoped to be more fruitful alternatives in determining the relationship between leverage and cost of capital. He found that shareholder's wealth can be enhanced by judicious use of debt financing.

**Sharma and Rao (1967)** tested the MM hypothesis that after allowing for the tax advantage from the interest paid on debt the value of a firm is independent its capital structure on the data of 30 engineering companies from Indian engineering industry. In this cross-sectional study for the year 1963, 1964 and 1965 they concluded that debt has non tax advantages and investors prefer corporate to personal leverage. So, it can be concluded that value of a firm rises up to leverage rate considered prudent. They found the co-efficient of debt variables to be more than the corporate income tax. They introduced debt as a separate independent variable. They used two stages least square as a method of arriving at the true expected future earnings.

**Peterson (1969)**, in his study of manufacture firms showed the evidences contrary to the traditional view, on the relation between risk measured by the coefficient of variation of rate of return of total capital over the period of 1947-56 and leverage measured by the ratio of senior to junior capital at book value, then the ratio of senior to junior capital at market value and finally by the ratio of fixed charges to earning power.

## **(ii) Review of Empirical Works (1970-1980s)**

**Rao and Lintzberges(1970)** were conducted the study of the effect of capital structure on the cost of capital in a less developed and less efficient capital market (India) and in a highly developed and efficient capital market (United States). They found that the results for the American utilities are consistent to the MM proposition that except for the advantages of debt financing, the cost of capital is independent of capital structure, and the results also supported that the MM hypothesis that investors are indifferent for the firm's dividend policy. In case of Indian utilities, the results are inconsistent to the MM approach and the traditional belief, the judicious use of financial leverage will lower the firm's cost of capital and investors have a preference for current dividends. In conclusion, they contended that the MM approach after allowing for the tax advantage of debt, the firm's cost of capital is independent of capital structure does not appear to be application in the case of developing economy.

**Davenport (1971)** in his study used the British data of three unrelated industries chemical, food and metal manufacturing industries. They had concluded that the results of his study did not support the MM contention, that the overall cost of capital is independent of the proportion of debt and preference share in the capital structure of the firm. They supported the traditional view of cost of capital and leverage because his result shows the u-shaped cost of capital schedule with respect to leverage.

**Hamada (1972)** provided the evidences that support of the MM hypothesis. Lev and Pekelman (1975) tested the validity of multi period adjusted model and concluded that the equity and debt effect on the current period of financial policy of the firms. Similarly, Kim et. al. (1979) suggested that weak evidence supports to the Clientele hypothesis of miller. Schwartz and Aronson (1966), Remmers et.al. (1974) showed that industrial influence is not a significant determinant of financial structure in the USA, Norway and Netherlands. Scott (1972) conversely provided the evidence in the support of significant industrial influence on capital structure and suggested that firm in different industries have different financial structure. Scott and Martin (1975) also came to the same type of conclusions. Remembers et. al. (1979) also bolstered evidence for the significant industrial influence on financial structure in the Japanese and French cases.

**Rao and Rao (1975)** found the negligible positive impact of corporate income tax on corporate debt policy of manufacturing sector in India. Mishra(1978) showed that the evidence in favor of the tax avoidance hypothesis for sugar, Tobacco, trading Industries and Aggregate Corporate Sector of India. Chakarborty (1975) examined the effect of firm's characteristics on capital structure and found that negative association of debt and equity ratio of leverage, retained earnings, profitability scaled by capital employed and corporate tax and positive association with size, profitability scaled by sales and capital intensiveness measured by gross fixed assets to sales. Rao (1979) found the adverse effect of profitability on debt equity ratio. Pandey (1979) observed the adverse relationship between capital structure and cost of equity.

**Pandey (1978)** has tried to test the MM approach in the developing economy with taking the sample from four different utilities cotton, chemicals, engineering and electricity from Indian marker. He made some improvement in the model derived by MM and used multiple regression equation for the year 1968, 1969and 1970 for the pooled data of the three cross-section years. The improvement was made on the measurement of leverage and added earning variability and liquidity as risk measure variable in the regression equation. He used two types of leverage, the debt to total capital ratio, and the debt to equity ratio the two ratios were measured with or without preference share capital in the debt portion. Both leverage were done on book value and included short term loan as part of leverage.

### **(iii) Review of Empirical Works (1980- 1990s)**

**Barnea, Haugen and Sanbet (1981)** identified three problems that occur because of debt financing. First is the stockholders incentive to accept sub-optimal and high-risk projects, which transfer wealth from bond holders. Second, the presence of debt in capital structure causes the firm to forgo any investment with positive net market value being lower than the debt value. The third is the bankruptcy costs where bankruptcy probability increases with company might not be able to generate profits to pay back the interest and the loans.

**Pandey's (1981)** study is concerned with the test of relationship between the cost of capital and leverage, effect of leverage, Cost equity and, effect of tax deductibility on cost of capital in Indian context. In the cross sectional analysis of 131 observations

drawn from Cotton, Chemical, Engineering and Electricity industries for the years 1986, 1969 and 1970, he found that the conclusion of MM independent hypothesis does not hold reliable conclusion specially in the context of India. Matta (1984) found the negative relationship between debt equity ratio and growth rate. Garg (1988) suggested that there existed the relationship between business risk and debt equity ratio. Pandey (1904) did the attitude survey of the practicing managers of 30 Indian companies and drew the conclusion that Indian practicing manager have the concept of optimal capital structure and it should be maintained by every company.

**Bawen et. al. (1982)**, Kester (1986) and Bradley et.al.(1989) studied in industrial influences on capital structure and found that the statistically significant industrial influences on financial structure. They have documented the leverage ratio of specific industries. Their results are on broad agreement and showed that drugs instruments, electronics and food industries have consistently low leverage paper, textile mill products, still, airlines and cement industries have consistently high leverage. Further, Bready et. al. (1984) concluded that regulated industries are most highly levered firms. Several studies under the framework of agency cost and asymmetric information modes are carried out on the specific characteristics of industries and firms that determine the leverage ratio and provide the guidelines in formulation of their financing policy. The result showed that the study of 1980s do not agree each other in respect to their findings except in the use of the relationship established between the fixed assets and leverage. Bradely et. al (1984) Kester(1986), Titman and Wessels(19880, Wedig (1988) Friend and Lang (1988) and friend and Hasbruck(1988) concluded that the increase impact of the volatility of earnings on leverage. Auebach (1985) and Kim Sorensen (1986) found that the positive relationship between the volatility and leverage ratio. In general, the results of the studies in regard to the relationship between the volatility and leverage are inconsistent with the agency cost theory. This theory contented that high variance firm has lower agency cost of debt and hence higher financial leverage.

**Mayer (1984)** pointed out that financial economists have not hesitated to give advice on capital structure, even though how firm actually chase their capital structure remains a puzzle as the theories developed did not seem to explain fully actual financing behavior. Mayer states that internal financing is preferred more than

external financing. This is due to the transaction (flotation) costs and the resulting agency costs of issuing new securities. When retained earnings are not sufficient, debt financing is the next choice before considering offering new stocks. The reason is that the flotation costs of debt issuing are lower than those of equity issuing.

**Auerbach (1985)** argues that leverage is inversely related to the growth rate because the tax deductibility of interest payments is less valuable to fast growing firms since they usually have more non-debt tax shields. **Monohar Krishna Shrestha (1985)** His study on "analysis of capital structure in selected public enterprises" argue that most of public enterprises have confusing capital structure since the corporation are not guided by any objectives based financial plan and policies. The corporations are using least combination of debt with equity to avoid financial burden as far as possible. According to Mr. Shrestha, the debt-equity ratio should neither be highly levered to create too much financial obligations that lie beyond capacity to meet not should be much lower low levered to infuse operational strategy to bypass responsibilities with out performance. He used ratio analysis as the tool of analysis and found the selected public enterprises. He further added that in many instances aphorism becomes the basis of capital structure and most of them want to eliminate debt if possible to relieve financial obligations.

#### **(iv) Review of Empirical Works (1990 to Early 2000s)**

**Mackin-Mason (1990)** studied the tax effect on corporate financing decisions. The study provided evidence of substantial tax effect on the choice between debt & equity. He concluded that changes in the marginal tax rate for any firm should affect financing decisions. when already exhausted ( with loss carry for wards) or with a high probability of facing a zero tax rate ,a firm with high tax shield is less likely to finance with debt .the reason is that tax shields lower the effective marginal tax rate on interest deduction.

**Harris and Ravi (1991)** pointed that numbers attempts to explain capital structure have proved to be in conclusive. The capital structure decision is ever more complicated when it is examined in an international context; particularly in developing countries where markets are characterized by controls and institutional constraints.

**Thies and Klock (1992)** found results that pertain to long term debt and common equity. The findings also refute claims that there is no cross sectional relationship between variability and capital structure and suggests that there are differences in the utilization of leverage across time and firms.

**Radhe S. Pradhan, (1994):** On his research financial management and practices in Nepal in 1992. The survey mainly dealt with financial function, sources and types of financing, financing decisions involving debt effect of change in taxes on capital structure, financial distress dealing with banks and dividend policy. The major findings of study connected with financial management are given as:

1. Banks and retained earnings are the two most widely used financing sources.
2. Generally, there is no definite time to borrow the issues stocks. That is majorities of respondents are unable to predict when interest rate will low or go up are unable to predict when the stock will go down or up.
3. The enterprises have a definite performance for bank loans at a lower level of debts.
4. Most enterprises do not borrow from one bank only and they do switch between banks which ever offer best interest rates.
5. Most enterprises find that banks are flexible in interest rate and convenience. To sum up it can be said that out of numerous studies on the capital market of Nepal. This study is established itself as a milestone and an outstanding one.

### **2.3 Review of Thesis**

Under this section, various thesis related to this study have been reviewed. There are as follows:

**Shanti Rai Parsai (1999):** In his MBA thesis "*A Study on Capital Structure of Nepal Bank limited*". in this research has some issues, to accept deposits with or without interest under saving and fixed other, deposits schemes, To provide loans taking the securities such as government securities, movable property, company shares or debenture, bill of exchange and promissory notes. This study's of specific objective are to analysis of debt and equity, trend of total assets and total liabilities, relationship



between deposit and investment. To analysis the return in ratio to capital employed, relationship between deposit and net profit. Describe the structure and trend of income and expenditure. He has use of various financial and statistical tools such as ratio analysis, percentage, index, trend analysis and coefficient of correlation.

This study found that the major contribution to the total liabilities is deposit, followed by net worth and borrowing from other banks. The major proportion of the total assets is: bills loans and advances followed by investment in share and debenture, cash and other bank balance and others assets. During this study total assets and liabilities is in increasing trend. It also increasing trend of total deposit and investment. Total deposit and total assets, net profit of other bank is highly fluctuating. Its EPS is increasing trend. There is significant relationship them total assets and net profit, total investment, total deposit and total investment but there is not significant relationship between net worth and net profit. Total income and total expenses are not under control of the bank. The increasing rate of total income and total expenditure are highly fluctuating. He has suggested total income and total expenditure, total deposit and total investment must be control by the bank. The bank needs to improve market price of the share reduce its expenses and control fluctuation in the earning per share.

**Kamal Bahadur Rajlawat (1999):** In his MBA thesis, paper that, "*A Study on Capital Structure of Necon Air Ltd.*" This specific objective are; growth and polices of NAL, to examine the financial position, review of various study relating topic and analysis of capital structure of the company. He has used some of financial and statistical tools such as: ratio analysis, correlation co-efficient. Time series, percentage, graph etc. From this study focus on debt and equity of the company and its result of debt and equity ratio is higher than needed. It means higher the debt cerates higher the risk. Which is dangerous the creditor point of view. On other hand higher debt capital is serious implication form the firm's point of view. In this condition the capital structure would lead to inflexibility in the operation of the firms as creditor would exercise pressure and interfere in management. Mrs Rajlawat suggest that Necon air Ltd. should decrease its debt capital drastically as possible as it can on the ratio of to 2:1 is the best ratio for optimal capital structure. That is why the company should reduce its heavy burden of interest payment.

**Shambhu Prasad Prajuli (2001):** In his master level thesis "*Capital Ownership Structure and its Impact on Profitability of Nepal Lever Ltd.*" The main objective of this study is to evaluate the capital structure and specific objective are: to study the relationship of debt and equity shareholder, EBIT and interest payment. To analyze the return on capital in relation to capital employed. He has used some of the statistical and financial tools such as ratio analysis, percentage, correlation coefficient, index etc. He found that its long -term debt seems very high at the time of establishment. The debt equity ratio in term of long-term debt and shareholder equity has been decreasing trend. His shows low degree of positive relationship between total debt and shareholder equity. There is not significant between debt and equity. The capital structure is not optimum. In order to optimum capital structure, there must be significant relationship between debt and equity. The debt to total capital ratio computed in term of shareholder equity to total assets shows the increasing trend, which means the company, has been increasing equity fund in raising the assets. The relationship between interest payment and EBIT is not significant. He suggest from the Du point analysis, it is seen that the assets use efficiency but profit margin and equity multiplies is in decreasing tend. Which caused continuous decrease in ROE? Now it appears that ROE could be levered up by increasing amount of debt in the firm. In this study shows that some of fiscal year, there is no long -term debt. He recommended the maintainers of a proper capital structure by including long -term debt.

**Nibedan Baidy (2004):** His MBA research on title of "*Capital Structure Management of Manufacturing Companies Listed in NEPSE*". Under this study, the main objective is to analyze, evaluate and interpret their capital structure employed by the selected organization but specific objective are: to examine the capital structure. To analyze cost of capital and return on capital in relation to the employed, debt servicing capacity of these company. He can be used financial and statistical tools are ratio and percentage. He found the average DOL is negative and positive. Negative shows the inefficient earning capacity of the firm which try to increase sales volume. The average ratio between shareholder equity and total assets for Arun vanaspati udhyog and Jyoti spinning mills is negative. It shows the negative value of shareholder equity. This indicates that all the assets have been produced out of debt capital, which is not good for any manufacturing company. In this study shows EPS, P/E ratio and Book

value per share of Nepal lever limited is higher than other company. The higher price ratio indicates the greater confidence of investors with its future. Book value per share is negative as companies have negative net worth in an average. Cost of equity is also higher of Nepal level Ltd. in these selected companies. The use of less costly debt fund increased the risk to the shareholders. This causes the equity capitalization rate to increase. At last, he suggests increase the equity proportion financing its assets to be a safe mode against liquidation. The debt amount is very huge and that is a need to reduce the debt capital. All the companies should try to streamline their sales. To earn high amount of profit from the sales revenue by increasing operating efficiency. Most of Nepalese manufacturing companies are losses. This reason is high operating cost of production, unskilled work force, over staffing, misuses of facilities etc. This causes should be indicate by the management.

**Susil Dev Subedi (2005):** In his MBA thesis "*A Study on Capital Structure of Nabil Bank Ltd.*" In this studies specific objective were analyze the capital of Nabil Bank Ltd. to show financial position, examine the different profitability ratio and show overall trend analysis. Under this study used various tools such as graph, percentage, diagram, mean, standard deviation and co-variance. He found and concluded that total liabilities and capital item, show the overall situation of bank in falling down. Deposit is the biggest amount in the balance sheet. Fixed deposit is taken as long-term debt in the banking business. It is key determent factor to capital structure. Debt and equity are properly mixed good capital structure is formed. Price earnings ratio reflects the price currently reported EPS. It measures investor's expectations and the market appraised of the performance of a firm. This study suggests, deposit is the major concern to the capital structure. It effects on investment policy. The more the fixed deposit increase, the more the long-term investment becomes possible. Bank becomes more successful and competent as per its capacity to collect the fixed deposit. So fixed deposit should be collected more as can as possible.

**Niraj Mishra (2005):** In his analytical, study "*A Study of Capital Structure Management of Selected Manufacturing Companies*". This study has specific objective are analyze cost of capital and return on capital in relation of the employed. To examine the capital structure and debt servicing capacity of the company; He used analytical tools ratio analysis, mean, standard deviation, coefficient of variance,

correlation coefficient. This study find average DOL is negative which shows the inefficient earning capacity of the firm. The average DFL is less than one. There is no any consistency in the DOL and DFL for the same types of manufacturing companies. Debt equity and interest coverage ratio for Jyoti spinning mills Ltd. is negative as the company has negative equity. Interest coverage ratio is negative, its show that the company's earnings are not sufficient even to repay their interest. Due to the use of lower amount of debt, the profit margin for the Jyoti spinning shows negative, which indicates that the company is suffering loss during almost all the study period. ROA for Jyoti spinning is negative which indicate that the assets of the company are not generating profit. The higher P/E ratio indicates greater confidence of investor with its future. Average overall cost of capital and cost of equity of Jyoti spinning is negative and other Nepal lever Ltd. and Bottlers Nepal are positive. Correlation coefficient of debt and shareholder's equity for Jyoti spinning negative correlation but Nepal level and Bottlers Nepal are positive correlation. Correlation coefficient between EBIT and net profit for Jyoti spinning mills and Nepal liver Ltd. are negative correlation but Bottlers Nepal Ltd. is positive correlation. Correlation between EBT and net profit for Jyoti spinning mills and Nepal liver Ltd is positive correlation and Bottlers Nepal Ltd shows negative correlation. He concluded that the company's policy to increase current liabilities by replacing long term loan is not according to the principle of capital structure management. The use of debt would save the tax if they would be earning but in reality of Jyoti spiriting mills. There is no earning so there is not saving. His recommendation was increase in current liabilities would affect the liquidity aspect of the company. Short-term borrowing is more risky because short-term interest rates are more little than longer rates. Therefore, there is maintaining proper capital structure be including long-term debt.

**Rima Pradhan** (2007): In her study “*A comparative analysis of capital structure management between Nepal Bangladesh Bank Ltd. and Himalayan Bank Ltd.*” The study covers only the latest six Fiscal Years from 1999/2000 to 2004/2005. She tries to explain competitive position and the situation of the selected banks. She analyzes the combination of capital with long and short term debt and equity capital. She uses different tools to analyze and compare these banks. She used different tools.

**Accounting Tools:** Different ratios have been used to measure the performance of the sampled banks.

**The statistical tools:** different statistical tools are applied in this study are, Expected rate of return, Standard Deviation, Coefficient of Variation, Karl Pearson's Coefficient of Correlation and Student's t-test. As this research is related to financial subject matter so statistical tools and formula are expressed in financial terms except correlation coefficient, coefficient of (multiple) determination ( $r^2$ ) and Student's t-test. Due to the most use of average and standard deviation in financial sector also the researcher has used the financial notation for these statistical tools.

Her findings can be summarized as follows:

- ) From the study bank are found to be highly levered. The banks are using higher amount of debt. The average debt equity ratio is large and she recommendation to reduces it as possible.
- ) The interest coverage ratio during the study period was positive for both bank and both banks are able to pay the interest on deposit. HBL is stronger than NBBL.
- ) In case of average ROA and ROE, EPS; HBL has higher ratio than NBBL.
- ) On average overall capitalization rate of HBL is higher than NBBL. The  $K_o$  of banks is in quite good position even though the rate of return in last 6 year.
- ) The correlation between overall capitalization rate and debt to equity ratio is - 0.98 and 0.99, which indicate NBBL is highly negative relationship and HBL is Positive relationship.
- ) The operating profits to joint venture bank have gone up, so have the provision for loan loss. In short, the banking sector in Nepal is somehow doing well even though it has to face a number of challenges during the past few years.

**Rajendra Dhakal (2008):** In his study "*A study on capital structure management of selected commercial banks (with special reference to Himalayan Bank, Nepal SBI Bank, Everest Bank And Nepal Investment Bank Ltd.)*" analysis the capital structure of different five year period. He tries to explain competitive position and the situation of the selected banks. He analyzes the combination of capital with long and short term debt and equity capital. He uses different tools to analyze different financial and statistical tools are used to analyze and compare these banks. He used different

financial tools such as: debt equity ratio, Debt Ratio, interest coverage ratio, price earning ratio, return on assets, return on shareholders' equity, and he find capitalization rate. He used different statistical tools such as: mean, standard deviation, correlation coefficient, probable of error of correlation, variance and regression analysis. He uses the different ratios and present different table and chart. His findings can be summarized as follows:

- ) From the study bank are found to be highly levered. The companies financial mix accounts a higher proportion of debt and it is increasing every year. Most of the banks cannot manage the current assets.
- ) The interest coverage ratio during the study period was positive for all selected bank.
- ) In case of ROA and ROE, EBL has higher ratio than any other banks. Which indicated the EBL best bank among the selected banks.
- ) The average EPS of EBL and HBL higher than other selected banks and EPS of EBL is fund to be in increasing trend and EPS of other banks are fluctuating during the study period.
- ) The cost of banks are increasing, the main cause of cost increase may unskilled manpower, overstaffing, unsystematic arranged of material, level of unnecessary and expenses is high and misuse of the facilities and resources.
- ) The correlation coefficient of the variable of selected bank for the statistical analysis is found positive to each other. The coefficients are all statistically significant in more than average banks. A positive correlation means both of the variables are moving toward the same direction.

## **2.4 Research Gap**

This study is different in the sense that the selected company is totally different from the above previous studies. This study done considering the data of five year (061/062to 065/066) of Siddhartha bank. This study tried to analyze and evaluate the relationship of capital structure with various variables on like, leverage ratio, profitability Ratio, market related ratio, and capitalization rate and so on.

## **CHAPTER III**

### **RESEARCH METHODOLOGY**

#### **3.1 Introduction**

Research refers to systematic and objective attempt. This is used to study a problem for the purpose of driving general principles. The invitation has been guide by previously collected information and aims to add to the body of knowledge on the subject "Research methodology is the way to solve systematically about the research problem." (Kothari 1990; 39) "The research for gaining the knowledge about method of goal methodology."(Joshi 2001; 12.13) This chapter includes research design, Nature and source of data, Population and sample, Data Collection & procedure and method of analyses. To accomplish the goal, this study is follows the research methodology described in this chapter.

#### **3.2 research Design**

Research design is the plan structure and strategy of investigations conceived so as to obtain answer to research equations and to control variance. "A research design is purely and simply the Framework or plan for a study that guides the collection and analysis of the data." (Goes; 1989:51) The main objective of this study is to analyze and evaluate the capital study of selected commercial Bank. This study follows the analytical and descriptive research design. To complete this study following design and format has been used. First of all information and data are collect. The important information and data are selected. Then data is arranged by using manner. After that data are analyzed by using approach financial and statistical tools. In analysis part interpretation and comments are also made where ever necessary. Result and conclusion are given after analyses of data recommendation and suggestion is also given. The design has been adopted from provirus research works.

As the study focused to evaluate capital structure of SBL. For the research work the analytical and descriptive research designs are applied

### **3.3 Nature and Source of Data**

For this study secondary data have been used and the sources of data are as follows.

- i. Annual reports of SBL
- ii. Bulletin and reports of NRB
- iii. Web site of NRB( [www.nrb.org.np](http://www.nrb.org.np))
- iv. Web site of SBL([www.siddharthabank.com](http://www.siddharthabank.com))
- v. Various information from "Nepal Stock Exchange Ltd."

Other reports and bulletins of the concerned organizations

### **3.4 Data Collection Procedure**

Study follows the following research methodology to achieve its basic objectives.

Various historical data are used for the study of capital structure of SBL. Nature, source of data, analysis & techniques used: The data are collected, analyzed and presented in the table from as per the requirement of the study

### **3.5 Population and Sample**

There are more than two dozen commercial banks in Nepal. For this research, those listed banks serve as population. Among them only single commercial bank: SIDDHARTHA BANK LIMITED has been taken into account for research proposes as samples in this research study. This is the best performing bank in Nepal. Their earning per share, percentage of dividend paid per equity capital, net profits are good among commercial banks. This is equipped with research and analysis team, proper MIS, sufficient capital and skilled manpower. They also have access to Global financial markets. These factors put it in the best position.

### **3.6 Method of Data Analysis**

Data collected from different sources are in raw form and in the initial stage. As judging independently does not help much thus the data analysis are done in the following ways.

- a) Data and information are collected and gathered to fulfill the research problem and objectives of the study.



- b) The collected data and information are identified, classified and arranged properly.
- c) Then the data and information are processed and analyzed.
- d) Interpretation, recommendation and suggestion are made after analysis.
- e) The data are analyzed by using different financial tools and techniques along with some statistical tools and also analyzes by diagrams wherever useful.

### 3.6.1 Financial Analysis

Financial tools are: Share capital to total liabilities ratio, Reserve and surplus to total liabilities ratio, Total deposit to total liabilities ratio, Current liabilities ratio, Borrowing to total liabilities ratio Net worth to total liabilities ratio. Financial tools are used to examine the financial performance i.e. strength and weakness of band. In this study, financial tools like ratio analysis and financial statement analysis have been used. The analysis of financial mix is performed by using ratio analysis. It's a powerful tool of financial analysis. It is used to interpret the financial statements so that the strengths and weaknesses of a firm as well as its historical performance and current financial condition can be determined. Capital structure ratio. The ratio indicates the proportion of debt and equity in financing the firm's assets. It is concerned with the long term solvency of a firm. Capital structure ratios are calculated to measure the financial risk and firm's ability of using the debt for the benefit of the shareholders.

#### (i) Debt to Equity ratio

This ratio is a measure of the relative amount provided by lenders and owners. It is also known as "External internal Equity Ratio." It is calculated according to the following Formula,

$$\text{Debt to Equity Ratio} = \frac{\text{Amount of Debt}}{\text{Amount of Equity}}$$

This ratio indicates the cushion of ownership funds available to debt holder. It gives on idea of the amount of capital supplied to a firm by internal funds or owners an average debt to equity ratio of 1:1 is acceptable.

## **(ii) Debt ratio**

The debt ratio is defined as total debt divided by total assets. It indicates to percentage of assets that are financed through debt. It is calculated as under

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

This ratio should be 1:2 or 0.5:1. A ratio above 1:2 or 0.5:1 implies that lenders and creditors were providing more finance than ordinary shareholders and that too without expectation of a share in any surplus as compensation to creditors in extending credit. A very low ratio can cause worry to shareholders as it means company is not using debt to best advantage.

## **(iii) Interest coverage Ratio**

The ratio is designed to relate the interest Charge of a firm to its ability to service them. It is simply ratio of earning before tax and taxes for a particular reporting period to the amount of interest charge for the period. The reporting period here is of one year. This ratio measures the extent to which earning can decline without resultant financial embarrassment to the firm because of inability to meet annual interest cost. It means, too high or low ratio as well is unfavorable to the firms. High ratio implies that the firm is very conservative in using debt and low ratio implies that the firm is using excessive debt and does not have the ability to offer assured payment of interest to the creditors.

Thus,

$$\text{Interest Coverage Ratio} = \frac{\text{EBIT}}{\text{Interest}}$$

## **(iv) Earning per share (EPS)**

A part from return the profitability of a firm from the point of view of the ordinary shareholders is earning per share. It measures the profit available to equity shareholder per share.

$$\text{EPS} = \frac{\text{Net profit after tax} - \text{Pref.Divident}}{\text{Total No. of Share}}$$

## **(v) Price Earning ratio (P/E Ratio)**

Price-Earning ratio indicates investor's expectation about the growth of the firm's earnings.

$$\text{P/E ratio} = \frac{\text{Market price per share}}{\text{Earning Per Share}}$$

**(vi) Return on Assets (ROA)**

This ratio measures the productivity of the assets. Higher ratio shows the higher return on the assets used in the business there by indicating effective use of the resources available and vice versa. The formula for computation of this ratio is as follows:

$$\text{ROA} = \frac{\text{Net Profit After Tax}}{\text{Total Assets}}$$

**(vii) Return on Share holder's fund or Equity (ROSE)**

This ratio is ascertained for measuring the efficiency of the investment made by the shareholders in the business on the basis of the relationship between shareholder's fund and net profit;

$$\text{ROSE} = \frac{\text{Net profit after tax}}{\text{Share holder fund}}$$

$$(\text{shareholders fun} = \text{Share capital} + \text{Reserve Fund} + \text{Profit \& loss})$$

**(viii) Net income Approach (overall capitalization Rate)**

The overall cost of capital is measured by dividing net operating income by the value of firm is the book value debt and market value of equity overall cost of capital ( $K_o$ ).

$$K_o = \frac{\text{Earning Before Interest and tax (EBIT)}}{\text{Total value of firm (V_o)}}$$

**(ix) Net operating income Approach (Equity Capitalization Rate)**

This approach argues that the value of the firm remains constant to the degree of leverage and equity capitalization rate tends to increase with the degree of leverage Equity capitalization Rate ( $K_e$ ).

$$K_e = \frac{\text{EBIT}-I}{S} \text{ OR } \frac{\text{EPS}}{\text{MVPS}}$$

### 3.6.2 Statistical Analysis

Statistical and Research cannot be separated whenever research work is carried on statistics is most to have output of the research .To achieve the objective of the study, some important statistical tools such as mean, standard deviation, coefficient of variance, of correlation, regression analysis of important variables has been used which are as follows:

#### a. Arithmetic mean ( $\bar{X}$ )

The most popular and widely used measure for representing the entire data by on value is called the mean. The value is obtained by adding together all the items and dividing this total by the no of items.

$$\bar{X} = \frac{X_1 + X_2 + \dots + X_n}{n} = \frac{\sum X}{n}$$

Where  $\sum X$  = Sum of all values of the variables

n = No. of observation years

#### b. Standard Deviation (S.D.)

The standard deviation measures the absolute dispersion or variability of a distribution the greater the amount of dispersion or variability the greater the standard deviation the greater will be magnitude of the deviations of the values from their mean and vice versa.

$$SD = \sqrt{\frac{\sum (X - \bar{X})^2}{n}}$$

#### c. Correlation Coefficient (r)

Correlation coefficient is calculated of relationship between the deferent variables. When change in the value of one variable is accompanied by the change in value of the other two variables are said to have correlation. The study used karl person's correlation coefficient. The correlation coefficient between two variables x and y usually denoted by  $r_{xy}$  is a numerical measure of linear relationship between them.

$$r = r_{xy} = \frac{\phi_{xy}}{\sqrt{\phi_x^2 \phi_y^2}}$$

#### d. Probable Error (P.E.)

The Probable error of the coefficient of correlation helps in interpreting its value. The probable error helps to determine reliability of computed correlation coefficient. So far, as it depends on the condition of random sampling. The probable error is defined by:

$$P. E = \frac{0.6745(1-r^2)}{\sqrt{n}}$$

It can be interpreted to know whether it calculated value of is significant or not in the following way.

- If  $r < PE$  There is no evidence of correlation i.e.  $r$  is not at all significant.
- If  $r > 6 P.E.$  The existence of correlation is practically certain i.e.  $r$  is significant.
- The P.E. of correlation may be used to determine the limits with in which the population correlation coefficient lies. The limit of the population correlation is  $r + P.E.$

## CHAPTER - IV DATA PRESENTATION AND ANALYSIS

### 4.1 Introduction

This chapter constitutes the most crucial part of the study. It provides mechanism for meeting the basic objectives stated earlier in the first chapter of this research. The research has followed the, methodology described in this third chapter in order to attain the objectives. Thus, application of the major variables taken into account for the purpose study are total Debt and Total Assets, , Net Profit after tax and share holder's Equity, EBIT and Interests, Net Income and Net Operating Income approach, Coefficient of Correlation analysis of different variables of selected banks. The firm should maintain a sound capital structure to run its business operation in this competitive world. Both excessive as well as inadequate capital positions are dangerous from the firm's point of view. So, an enlightened management should, therefore, maintain right capital structure to meet its objectives. In the Section capital structure are presented for the last five years.

### 4.2 Analysis of Capital Structure and Ownership

This analysis is describe the capital structure position; on the basis of the ownership and proportion of ownership of share capital.

#### 4.2.1 Analysis of Capital Structure position

Table No: 4.2.1

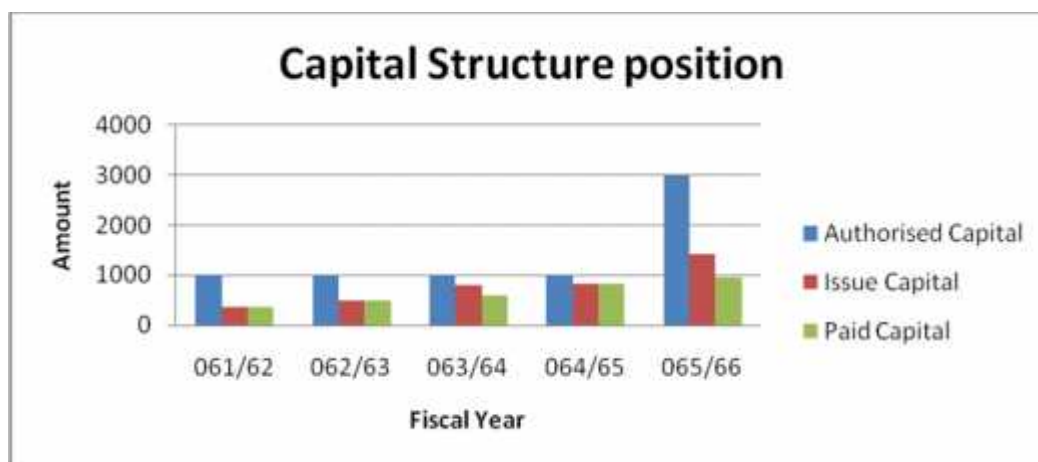
Capital Structure position

Amount in million

Capital	061/62	062/63	063/64	064/65	065/66	'A' banks Total
Authorized Capital	1000	1000	1000	1000	3000	-
Issue Capital	350	500	800	828	1428.3	-
Paid Capital	350	500	600	828	952.2	38902.060

*Source: Annual Report of SBL*

Figure No: 4.2.1  
Capital Structure position



The bank commence at 2059/060 as a commercial bank. The bank has authorized capital of Rs 1000 million and its issue capital and paid up capital is Rs. 350 million. In FY 060/061 and FY 061/062 the bank is continue at same capital formation. In FY 062/063 the bank has authorized capital is Rs 1000 million and issue capital and paid up capital is Rs 500 million, in FY 063/064 the authorized capital is Rs 1000 million and issue capital is Rs 800 Million and paid up capital is Rs 600 million, in FY 064/065 the authorized capital is Rs 1000 million and issue capital is Rs 828 Million and paid up capital is Rs 828 million, in FY 065/066 the authorized capital is Rs 3000 million and issue capital is Rs 1428.3 Million and paid up capital is Rs 952.2 million. Total 'A' class commercial total paid up capital is Rs 38902.060.

#### 4.2.2 Analysis of Share Capital Ownership

Table No: 4.2.2.1

##### Share Capital Ownership

Owners	061/62	062/63	063/64	064/65	065/66
Promoter	350	350	420	579.6	485.62
General	–	150	30	248.4	466.58
<b>Total</b>	<b>350</b>	<b>500</b>	<b>600</b>	<b>828</b>	<b>952.2</b>

Source: Annual Report of SBL

Figure No: 4.2.2.1  
Share Capital Ownership

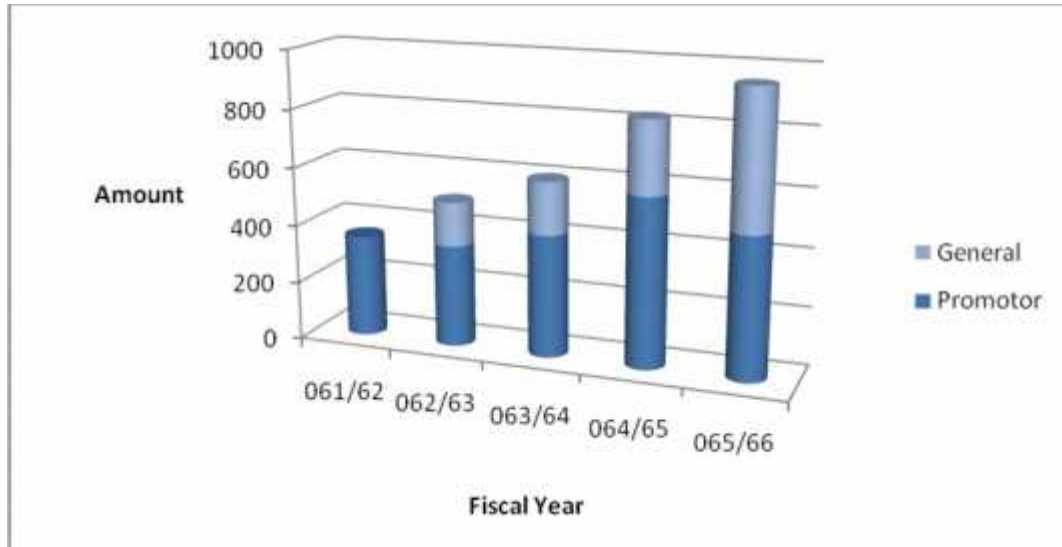
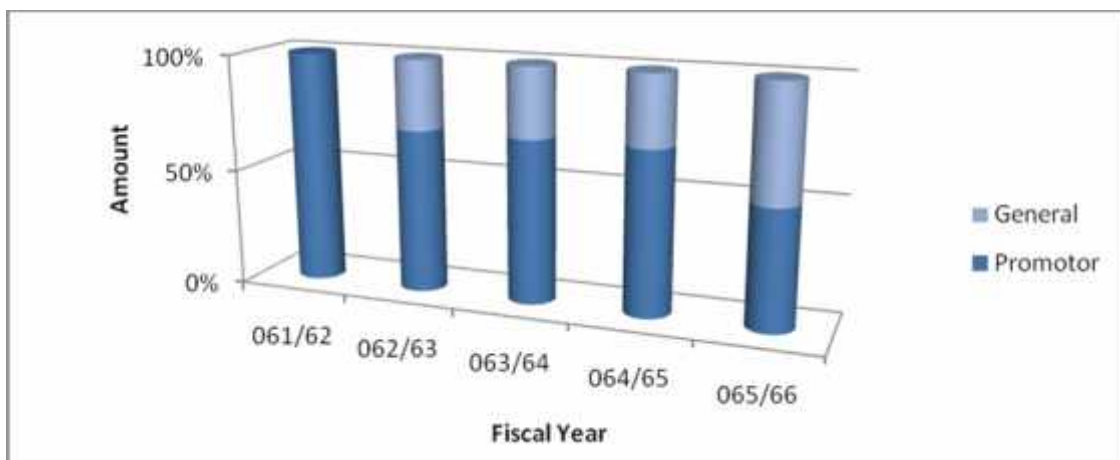


Table No: 4.2.2.2  
Proportion of Ownership

Owners	061/62	062/63	063/64	064/65	065/66
Promoters	100 %	70 %	70 %	70 %	51 %
General	-	30 %	30 %	30 %	49 %
<b>Total</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>

Figure No: 4.2.2.2  
Proportion of Ownership





The bank uses the majorities of share from promoter .The bank has only promoter share capital of 350 million in FY 061/62. The bank issue public sharers 150 million in 062/63. Then the proportion of promoter and ordinary share is 7:3. In FY 063/64 the bank issue right share and increase the share capital to Rs 600 million. The bank maintains the same proportion. In FY 064/065 the bank increase the share capital to Rs 828 million. In FY 065/66 bank increase capital to 9522 million. The proportion of promoter share and general share capital is 51 % and 49%.

#### 4.2.3 Analysis of Sources of Capital

Siddhartha Bank has the following different sources of fund.

Table no: 4.2.3.1

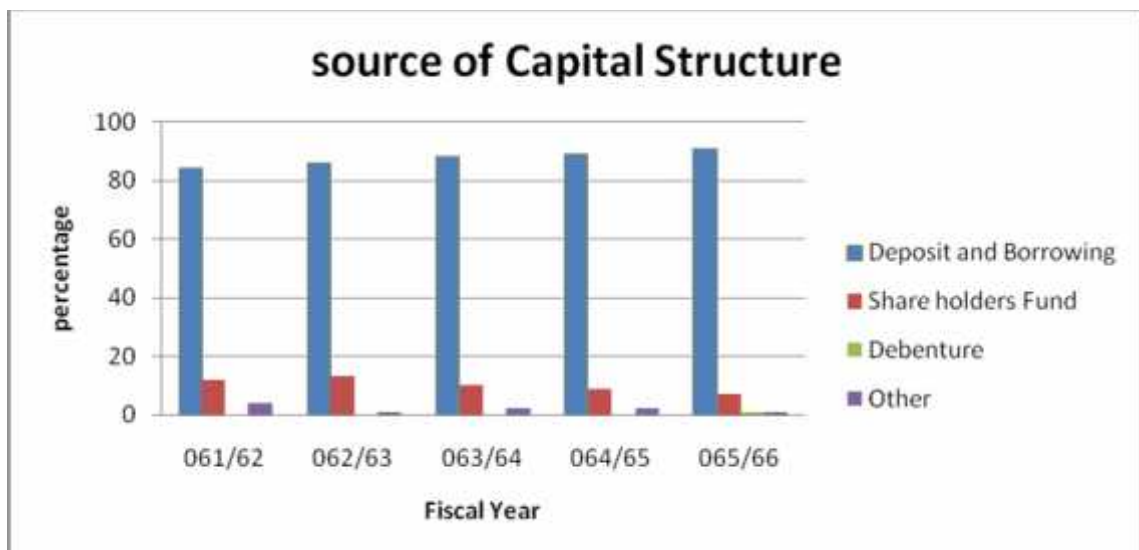
##### Sources of Capital Structure

Sources of Fund	061/62	062/63	063/64	064/65	065/66
Deposit and Borrowing	84 %	86 %	88 %	89 %	91 %
Share holders Fund	12 %	13 %	10 %	9 %	7 %
Debenture	-	-	-	-	1 %
Other	4 %	1 %	2 %	2 %	1 %
<b>Total</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>	<b>100 %</b>

Source: Annual Report of SBL

Figure No: 4.2.3.1

##### Sources of Capital structure



The bank manages the fund from different sources. They are deposit and borrowing, shareholders equity, debenture and other sources. In FY 061/062, the bank uses the 84

% of deposit and borrowing, 12 % of Shareholders equity, and 4 % of other sources of fund of total capital. In FY 062/63 the bank uses the 86% of Deposit and borrowings, 13 % of shareholders equity, and 1 % of other sources. In FY 063/064 the bank uses the 88% of Deposit and borrowings, 10 % of shareholders equity, and 2 % of other sources. In FY 064/65 the bank uses the 89% of Deposit and borrowings, 9 % of shareholders equity, and 2 % of other sources. In FY 065/66 the bank uses the 91% of Deposit and borrowings, 7 % of shareholders equity, and 1 % of debenture and 1 % from other sources.

**Sources of fund of all commercial bank as on Mid- July 2009**

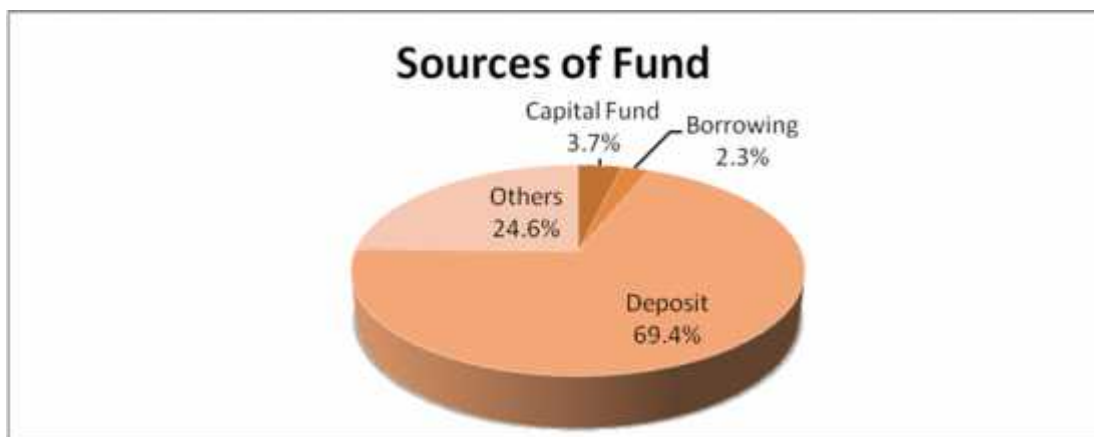
Table No: 4.2.3.2

Sources of fund of all commercial banks

sources of Fund	Percent
Capital Fund	3.7
Borrowing	2.3
Deposit	69.4
Others	24.6
Total	100

Figure No: 4.2.3.2

Sources of fund of all commercial banks.



The composition of liabilities of total commercial banks shows that, the deposit has occupied the dominant share of 69.40 percent followed by capital fund 3.74 percent

and borrowings 2.26 percent in the Mid - July 2009. The respective shares of deposit, capital fund and borrowings in the previous year were 75.18 percent, 1.76 percent and 2.54 percent respectively.

#### 4.2.4 Analysis of Share Capital

Total capital and liabilities are all items included in liabilities side of balance sheet. The commercial banks has to manage the liabilities very carefully to minimize risk and achieve desirable Profit. Commercial banks have to consider various components of liabilities in details regarding how to manage them properly. The total liabilities of commercial banks consist of their liabilities to depositor, Shareholder, lenders, and the central Bank being the lender of the last lender. The various item included in the liabilities of commercial banks are equity, reserve, borrowings, deposits, new accounts, money market liabilities, deposit account , wholesale and retail certificate of deposits , negotiable instruments. Brokered deposits, Euro dollar deposits, Interest paying liabilities, shot-term loan loans, bills payable, and other outstanding expenses. The following table shows the position of total equity Share capital of SBL.

Table 4.2.4  
Share Capital

*Amount in Million*

<b>FY</b>	<b>Amount</b>	<b>Change Rate</b>	<b>Prop<sup>n</sup> of TL%</b>
061/62	350	0	11.29
062/63	500	42.86	10.51
063/64	600	20	13.26
064/65	828	38	7.09
065/066	952.2	15	5.325
<b>Average</b>	<b>646.04</b>	<b>23.172</b>	<b>9.495</b>

*Source: Annual Report of SBL*

Figure 4.2.4  
Share Capital



The value of share capital in FY 061/062 is 350 million which increase in 500 million in FY 062/63, in FY 063/064 is 600 million, in FY 064/065 is 828 million and in FY 065/066 is 952.2 million. The average change rate is 23.172 percent. Share capital proportion among the total liabilities and capital are 18.84 in FY 061/062, 10.51 in FY 062/63, 13.26 in FY 063/64, 7.09 in 064/065 and FY 065/066 is 5.325. The average proportion is 9.495.

#### 4.2.5 Reserve and Surplus

Table 4.2.5

#### Reserve and Surplus

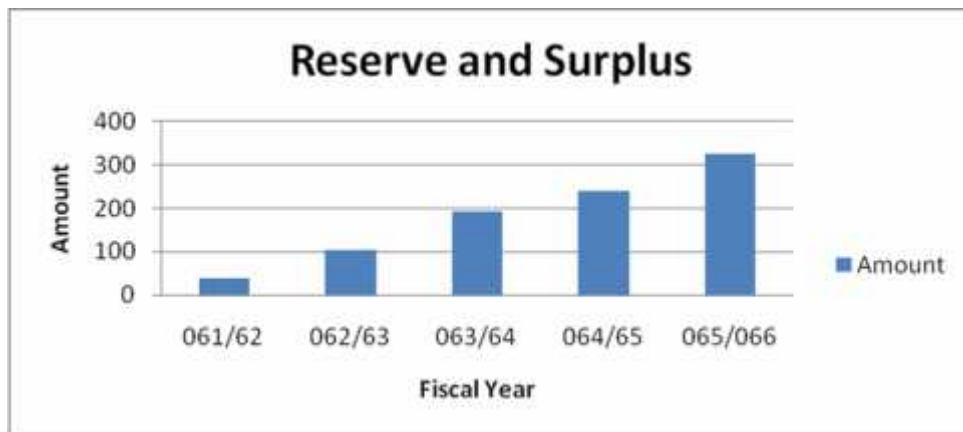
*Amount in Million*

F.Y.	Amount	Change Rate	Prop <sup>n</sup> of TL%	'A'banks Total
061/62	37.888	0	1.22	-
062/63	103.141	172.23	2.17	-
063/64	193.709	87.81	2.44	-
064/65	240.346	24.075	2.06	-
065/066	326.545	86.199	1.83	14632.25
<b>Average</b>	<b>180.326</b>	<b>92.579</b>	<b>1.944</b>	<b>585.29</b>

Source: Annual Report of SBL

Figure 4.2.5

#### Reserve and Surplus



The value of Reserve and Surplus is Rs 37.88 million in FY 061/62, in FY 062/063 is Rs 103.141 million, in FY 063/064 is Rs 193.709 million, in FY 064/065 is Rs 240.346 million and in FY 065/066 is Rs 326.545 million. The average change rate is 92.579 percent. Reserve and Surplus proportion among the total liabilities are 1.22 in

FY 061/062, 2.17 in FY 062/63, 2.44 in FY 063/64, 2.06 in 064/65 and 1.83 in FY 065/066. The average proportion is 1.944. The total commercial banks reserve and surplus is Rs 14632.2544 and average reserve and surplus is Rs 585.29. SBL reserve and surplus is less than average.

#### 4.2.6 Analysis of Deposit Position

The bank uses different types of deposit schemes to collect money from customer. They are fixed deposit, called deposit, saving deposit, and other non-interest bearing deposits. The bank introduced various types of schemes on saving accounts with different interest rate.

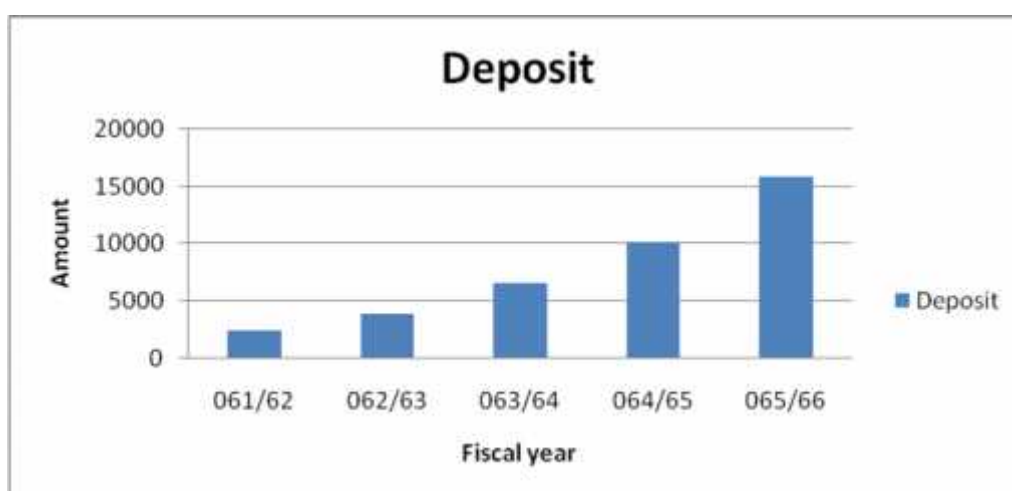
Table 4.2.6  
Total Deposit Position

*Amount in Million*

FY	Deposit	Yearly Change	Prop of Total Liabilities	'A' Banks Total
061/62	2461.922	0	79.44	-
062/63	3918.076	59.15	82.36	-
063/64	6625.078	69.09	83.28	-
064/65	10191.441	53.83	87.34	-
065/66	15855	56	88.66	555145.2795
<b>Average</b>	<b>7810.3034</b>	<b>47.525</b>	<b>84.216</b>	<b>22205.81118</b>
<b>Standard Deviation</b>		<b>5374.62409</b>		

*Source: Annual Report of SBL*

Figure 4.2.6.1  
Total Deposit Position



The amount of deposit are Rs (Million) 2461.922, 3918.076, 6625.078, 10191.441 and 15855 for the FY 061/62, 062/63, 063/64, 064/65 and 065/066 respectively. The amount is in increasing trend. The proportion of total deposit among total liabilities and capital are 79.44, 82.36, 83.28, 87.34 and 88.66 respectively for the FY 061/62, 062/63, 063/64, 064/65 and 065/066. The average proportion change rate is 47.525 and standard deviation is 5374. Total deposit of all commercial banks is Rs 555145279500 and average deposit is Rs 22205.81118. Total deposit of Siddhartha bank is less than average of all commercial banks deposit.

Figure 4.2.6.2  
Total Deposit Trend



The value of Deposit is Rs. 2461.922 million in FY 061/62. The average change rate is 54.54 percent. Deposit proportion among the total liabilities are 69.52 in FY 060/61, 79.44 in FY 061/062, 82.37 in FY 062/63, 83.33 in FY 063/64, 87.34 in 064/65. The average proportion is 80.40. SBL increases its deposit by 56 percent from previous year. The aggregate growth rate of "A" class commercial bank is 32.55 percent from previous year. The SBL growth rate is higher than aggregate of 'A' class commercial banks.

## 4.2.7 Analysis of Deposit Mixed

Table No: 4.2.7.1

Deposit mixed analysis

Amount in million

Deposits	061/62	062/63	063/64	064/65	065/66
Fixed Deposit	1197	1632	3023	4562	7158
Call Deposit	621	1030	1493	2722	4841
Saving	525	1128	1881	2622	3446
Non- interest bearing	119	128	227	248	409
<b>Total</b>	<b>2464</b>	<b>3918</b>	<b>6625</b>	<b>10191</b>	<b>15855</b>

Source: Annual Report of SBL

Figure No: 4.2.7.1

Deposit mixed analysis

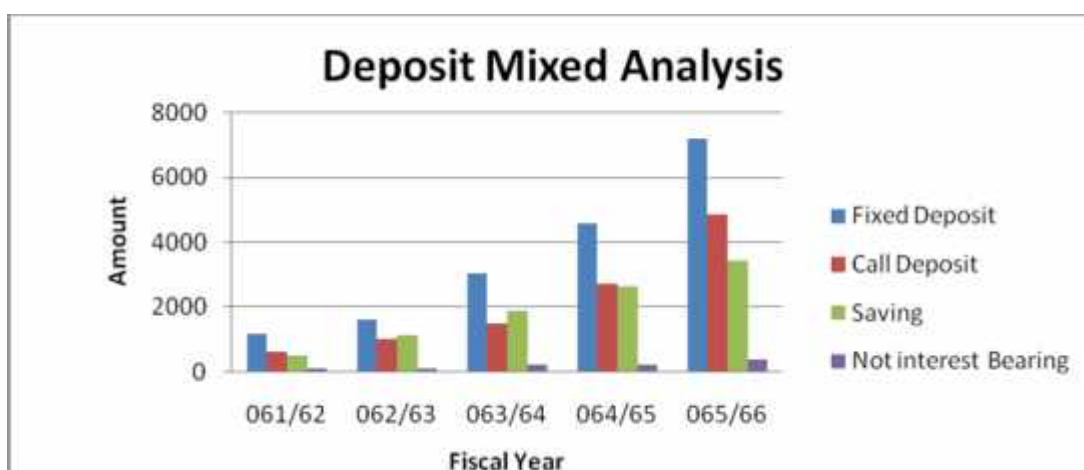


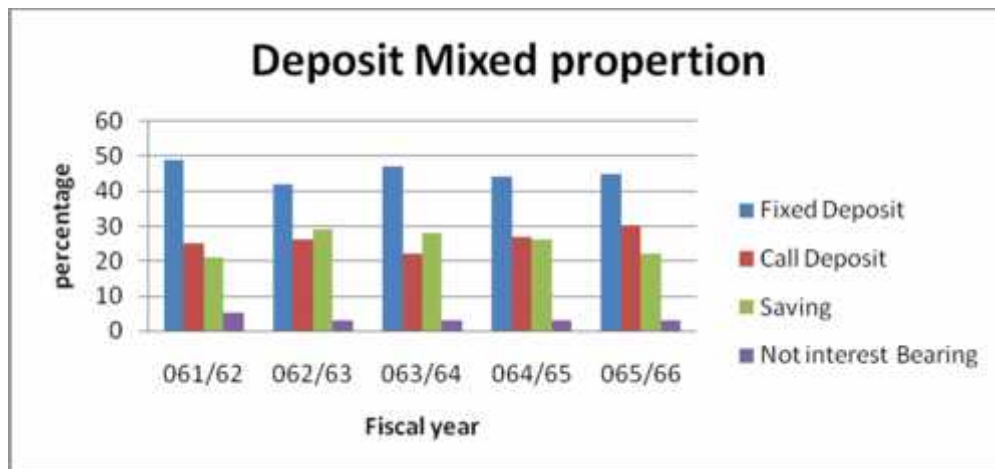
Table No: 4.2.7.2

Proportion of Deposit Mix

Deposits	061/62	062/63	063/64	064/65	065/66
Fixed Deposit	49%	42%	47%	44%	45%
Call Deposit	25%	26%	22%	27%	30%
Saving	21%	29%	28%	26%	22%
Not interest Bearing	5%	3%	3%	3%	3%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Figure No: 4.2.7.2

Deposit mixed proportion



The bank introduces different types of saving deposit scheme. But in general the bank has the following deposit sources: Fixed deposit, Called deposit, Saving deposit, and non interest bearing accounts.

In FY 061/062 the bank has RS 1197 (49 %) million of fixed deposit, Rs 621 (25 %) of Call deposit, Rs 525 (21 %) of saving deposit and 119 (5%) million of non-interest bearing deposits.

In FY 062/063 the bank has RS 1632 (42%) million of Fixed deposit, Rs 1030 (26 %) of Call deposit, Rs 1128 (29 %) of saving deposit and 128 (3 %) million of non-interest bearing deposits.

In FY 063/064 the bank has RS 3023 (47 %) million of fixed deposit, Rs 1493 (22 %) of Call deposit, Rs 1881 (28 %) of saving deposit and 227 (3%) million of non-interest bearing deposits.

In FY 064/065 the bank has RS 4562 (44 %) million of fixed deposit, Rs 2722 (27 %) of Call deposit, Rs 2622 (26 %) of saving deposit and 248 (3%) million of non-interest bearing deposits.

In FY 065/066 the bank has RS 7158 (45 %) million of fixed deposit, Rs 4841 (30 %) of Call deposit, Rs 3446 (22 %) of saving deposit and 409 (3%) million of non-interest bearing deposits.



## 4.2.8 Borrowings

Table 4.2.8

### Borrowings

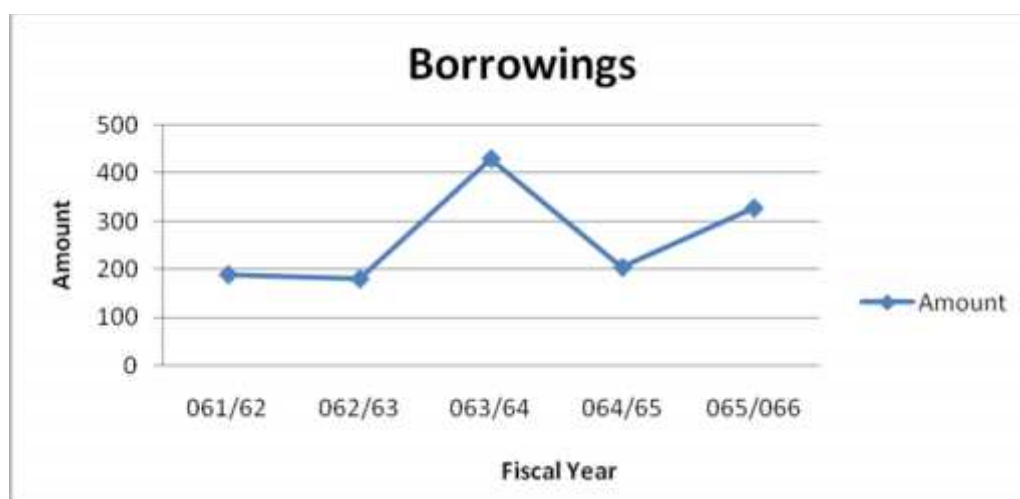
*Amount in Million*

F.Y.	Amount	Change Rate	Prop <sup>n</sup> of TL%	'A' Bank Av.
061/62	190	13.64	6.13	-
062/63	181.15	4.66	3.81	-
063/64	430.00	137.37	5.41	-
064/65	205.132	52.29	1.76	-
065/066	327.6	59.70	1.83	-
<b>Average</b>	<b>266.776</b>	<b>53.532</b>	<b>3.788</b>	<b>704.62</b>

*Source: Annual Report of SBL*

Figure 4.2.8

### Borrowings



The value of Borrowing is Rs. 190 million in FY 061/62, in FY 062/63 is Rs 181.15 million, in FY 063/64 is Rs 430 million, in FY 064/65 is Rs 205.132, and in FY 065/66 is Rs 327.6 million. The average borrowing of all 'A' class bank is Rs 704.62 million. SBL last year borrowing is less than all 'A' class commercial bank. In The average change rate is 53.532 percent. Borrowing proportion among the total liabilities are 6.13 in FY 061/062, 3.81 in FY 062/63, 5.41 in FY 063/64, 1.76 in 064/65 and in FY 065/66 is 1.83 .The average proportion is 3.788 . The aggregate growth rate of all 'A' class commercial bank is 12.73 percent from previous year. SBL last year growth rate is 59.70, which is higher than the aggregate growth rate of all 'A' class commercial bank.

## 4.2.9 Bills Payable

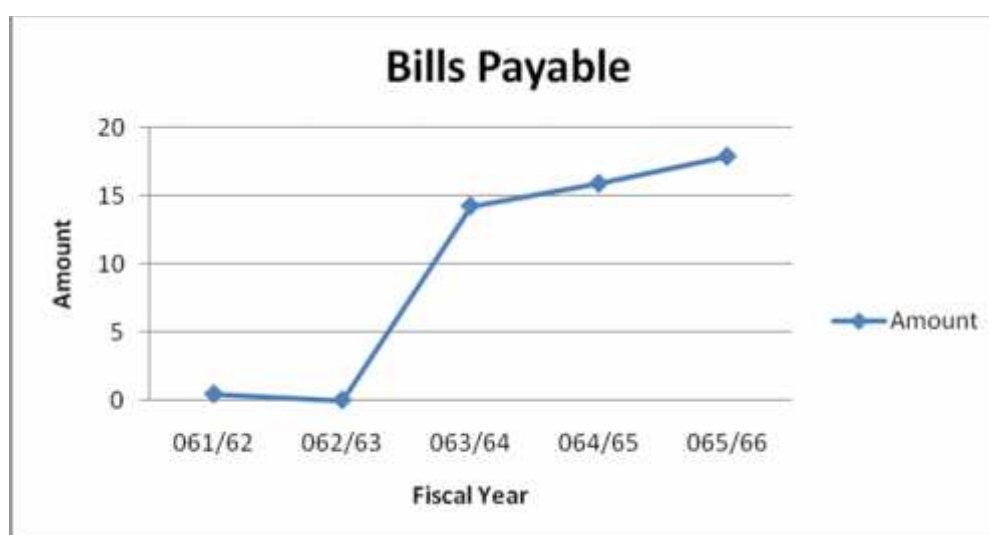
Table 4.2.9  
Bills Payable

*Amount in Million*

F.Y.	Amount	Change Rate	Prop <sup>n</sup> of TL%	'A' Banks Av.
061/62	0.4292	55.38	0.014	-
062/63	-	100	0	-
063/64	14.2397	100	0.179	-
064/65	15.8842	11.54	0.136	-
065/66	17.877	12.55	.10	-
<b>Average</b>	<b>9.68602</b>	<b>55.89</b>	<b>0.0858</b>	<b>66.87</b>

*Source: Annual Report of SBL*

Figure 4.2.9  
Bills Payable



The value of Bills Payable is Rs, 0.4292 million in FY 061/62. In FY 063/64 is Rs 14.2397 million, in FY 064/65 Rs 15.8842 million, and in FY 065/66 is Rs 17.877 million. The aggregate of all 'A' class bank is Rs 1738.50 million and the average is Rs 66.87 million. The average change rate is 55.89 percent. Bill Payable proportion among the total liabilities is 0.014 in FY 061/062, 0 in FY 062/63, 0.179 in FY 063/64, 0.136 in 064/65 and .10 in FY 065/66. The average proportion is 0.0858. The aggregate growth rate of all 'A' class commercial bank is 78.20 percent .SBL last year growth is less than aggregate growth rate of 'A' class commercial banks.

#### 4.2.10 Analysis of Debenture Analysis

Table No 4.2.10

##### Debenture

FY	Amount	% Change	Prop <sup>n</sup> on TL	'A' Banks Total
061/62	-	-	-	-
062/63	-	-	-	-
063/64	-	-	-	-
064/65	-	-	-	-
065/66	22,77,70,000	-	1.27	3727770000

Source: Annual Report of SBL

The bank issue SBL debenture 2072 at 8.5% p.a at par 1000. This debenture is matured at 2072. The total amount collected from issue of debenture is Rs 227770,000. Total debenture issue by all commercial bank is Rs 3727770000.

#### 4.2.11 Analysis of Total Capital and Liabilities

Table 4.2.11

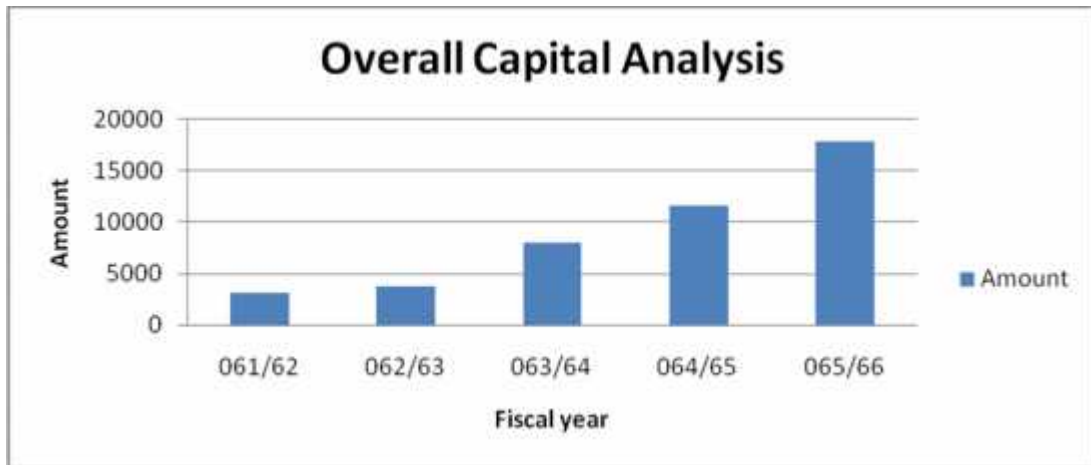
##### Overall Capital Analysis

Amount in Million

F.Y.	Amount	Change Rate	Prop <sup>n</sup> of TL%	'A' Banks Total
061/62	3099	66.8	100	-
062/63	4757	53.49	100	-
063/64	7955	67.22	100	-
064/65	11669	46.68	100	-
065/66	17882	53.24	100	663856.44
Average	9072.4	48.15	100	26554.26
Standard Deviation	5914.05426			

Source: Annual Report of SBL

Figure 4.2.11  
Overall Capital Analysis



The value of Total Capital and Liabilities is Rs. 3098.966 million in FY 061/62, 4756.935 million in FY 062/63, 7954.664 million in 063/64, 11668.355 million in FY 064/65 and in FY 065/66 is Rs 17882 million. The average change rate is 48.15 percent. Borrowing proportion among the total liabilities are 100 in all FY. Standard deviation is 5914.05426. Total capital and liabilities of all commercial banks is Rs 663856.4403 and average capital and liabilities Rs 26554.26. SBL total capital and liabilities is less than average. The aggregate growth rate of all 'A' class banks is 104.36 percent. SBL last year growth rate is 53.25 percent.

#### 4.2.12 Analysis of Capital Structure Adequacy on Risk Weighted assets Analysis

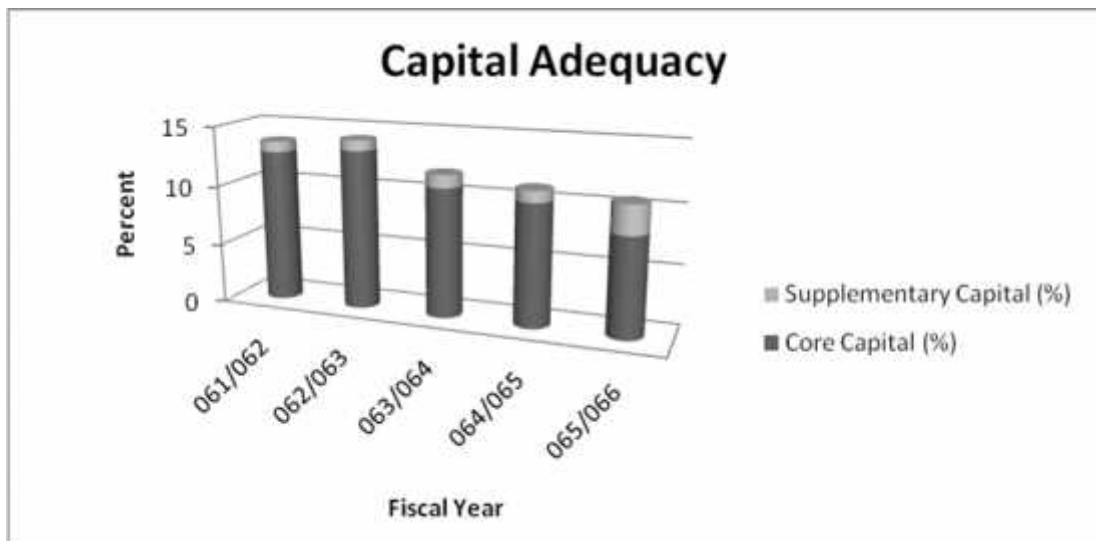
Qualifying capital consists of Tier 1 (core) capital and Tier 2 (supplementary) capital elements, net of required deductions from capital. Thus, for the purpose of calculation of regulatory capital, banks are required to classify their capital into two parts: Core Capital and Supplementary Capital.

Table No: 4.2.12  
Capital structure adequacy

Year	Core Capital (%)	Supplementary Capital (%)	Total Capital	% Change
061/062	12.77	.87	13.64	
062/063	13.29	.87	14.16	3.81
063/064	10.78	1.05	11.84	16.38
064/065	10.19	.95	11.14	5.91
065/066	8.26	2.42	10.69	4.04
Average	11.058	1.232	12.294	7.535
Standard deviation	2.03545	0.6822	1.53332	
Correlation of coefficient			-0.819	
PE ( r )			.099314	

Source: Annual Report of SBL

Figure No: 4.2.12  
Capital structure adequacy



The composition of total capital is made by core capital and supplementary capital. Adequacy of capital fund on weighted assets in FY 061/062, adequacy of the capital fund on weighted assets is 13.64 which is above than the NRB standard , In FY 062/063 is 14.16, in FY 063/064 , 064/065 and in FY 065/066 are 11.84 percent , 11.14 and 10.69 percent respectively. All the period the standard adequacy under NRB rule is sufficient.

### 4.3 Financial Analysis

The ratios of a firm by themselves do not reveal anything. For meaningful interpretation, the ratios of a firm should be compared with the ratios of similar firms and the international and national standard and industry norms. Such comparisons will reveal whether the firm is significantly out of line with its competitors. If it significantly out of line, the firm should undertake a detailed analysis to spot out the troubled areas. The study is conducted using each of the bank's financial statement for the last six fiscal years. Hence, various as well as statistical tools to analyze the compatibility of the banks.

#### 4.3.1 Leverage Ratio Analysis

Leverage ratio reflects the extent to which the banks depend on debt capital structure. Financial leverage is magnification of risk and return introduced through the use of fixed cost financing such as debt and preferred stock. In order to know the long-term financial position, leverage ratios are calculated. These ratios are also called 'capital structure ratios'. These ratios will indicate the proportion of debt equity in the capital structure of a bank.

##### 4.3.1.1 Total Debt to Total Assets Ratio

Debt ratio measures relationship between total debts and total assets. Debt to total asset ratio measure the proportion of total assets financed by the debt. This ratio is calculated as follow:

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Table No: 4.3.1.1  
Debt to total assets

Amount in Million

Year	Total Assets	Total Debt	Ratio	% change
061/062	3099	2641	.85	-
062/063	4757	4089	.86	1.18
063/064	7955	7066	.89	3.49
064/065	11669	10458	.90	1.12
065/66	17882	16385	.9163	1.81
Average	9072.4	8127.8	0.88	
Standard deviation	5914.05426	5503.53257	0.02768	
Correlation coefficient ( r )				1.00
PE ( r )				-

Source: Annual Report of SBL

High ratio shows bank's success in exploiting debt to be more profitable as well as it also indicates its riskier capital structure and vice versa.

Figure No: 4.3.1.1

Debt Ratio

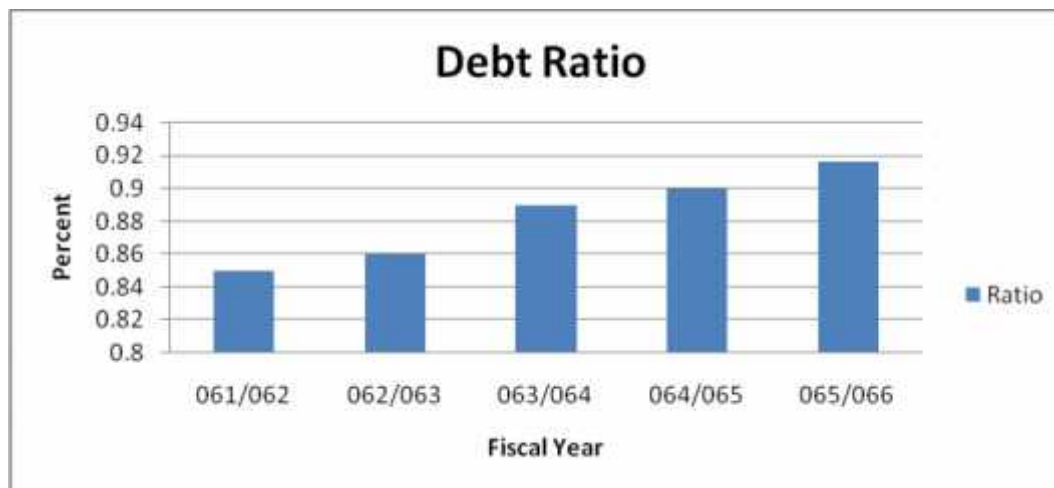
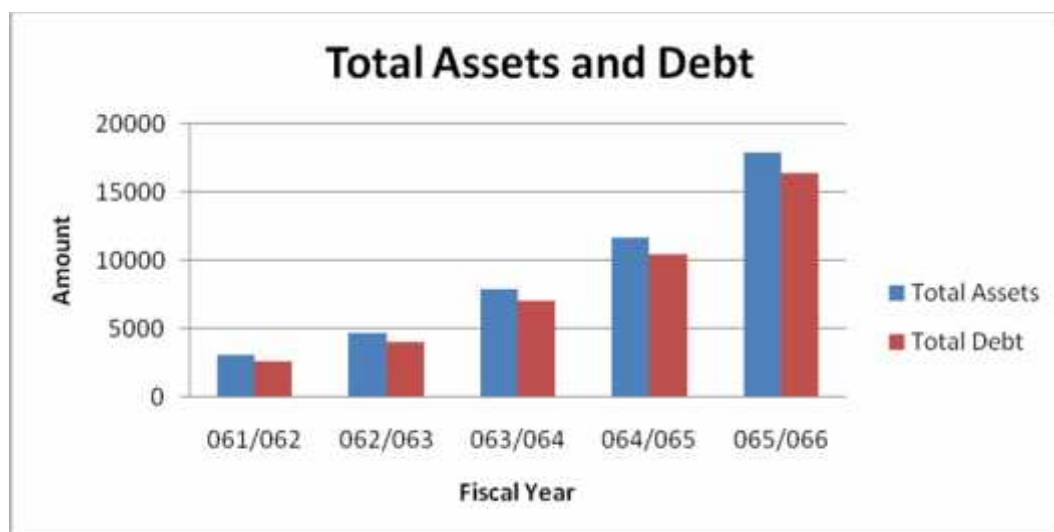


Figure no 4.3.1.1.2

Total Assets and Debt



The debt to total assets ratio in FY 061/62 is 0.85, in FY 062/63 is 0.86, in FY 063/64 is 0.89, in FY 064/65 is 0.90 and in FY 065/66 is 0.91. The average ratio is 0.88 and standard deviation is 0.02768. The correlation coefficient is 1.00.

The assets and debt are increase every year. The assets and debt in FY 061/62 is Rs 3099 and Rs 2641 Million, in FY 062/63 is Rs 4757 and Rs 4089 Million, in FY 063/64 is Rs 7955 and 7066 Million, in FY 064/65 is Rs 11669 and 10458 Million and in FY 065/66 is Rs 17882 and 16385 Million. The average is Rs 9072.4 and 8127.8 Million. The standard deviation is 5914.05426 and 5503.53257.

### 4.3.1.2 Total Credit to Deposit Ratio

This ratio explains how much credit is creation through the investment of fund collecting from the customer. The banks received deposit from one customer, invest it to other customer, and create credit. This ratio indicates the efficiency of the investment. The formula is:

$$\text{Credit to Deposit Ratio} = \frac{\text{Total Credit}}{\text{Total Deposit}}$$

Table No: 4.3.1.2

Total credit to deposit ratio

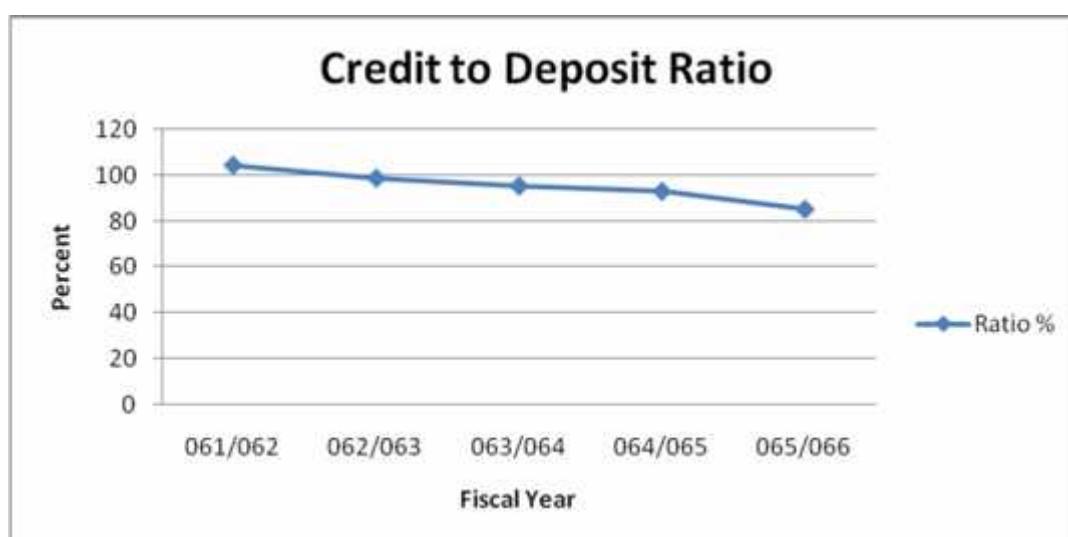
Amount in Million

Year	Ratio %	% change	'A' Bank Average
061/062	104.42	-	-
062/063	98.75	5.43	-
063/064	95.39	3.40	67.84
064/065	93.03	2.47	71.09
065/066	85.18	8.44	70.64
Standard Deviation	7.11754		

Source: annual report of SBL

Figure no: 4.3.1.2

Credit to deposit Ratio



The credit to deposit analysis in FY 061/062 is 104.42 percent, in FY 062/063 is 98.75 percent which is decrease by 5.43 percent, in FY 063/064 is 95.39 percent which is decrease by 3.40 percent, in FY 064/065 is 93.03 percent which is decrease



by 2.47 percent and in FY 065/66 is 85.18 percent which is decrease by 8.44 percent. In addition, average credit to deposit analysis is 95.354 percent and average changing rate is 4.935 percent. The standard deviation is 7.11754 percent. The average credit to deposit ratio of all commercial in last year is 70.64 percent. SBL last year C/D ratio is 85.18 percent, which is higher than average of average of all commercial banks average and also higher than NRB standard.

#### 4.3.1.3 Total debt to equity ratio Analysis

The debt-equity ratio shows the relationship between banks debt and equity financing. It measures the relative interest of creditors and owners. Debt equity ratio, an important tool of financial analysis, depicts an arithmetical relation between debt funds and owners' funds. The total debt includes current accounts, saving accounts, calls and short deposits, overdraft fixed deposit, loan and advances and borrowing from other banks. Shareholder's equity or net worth includes paid-up capital, reserve and surplus.

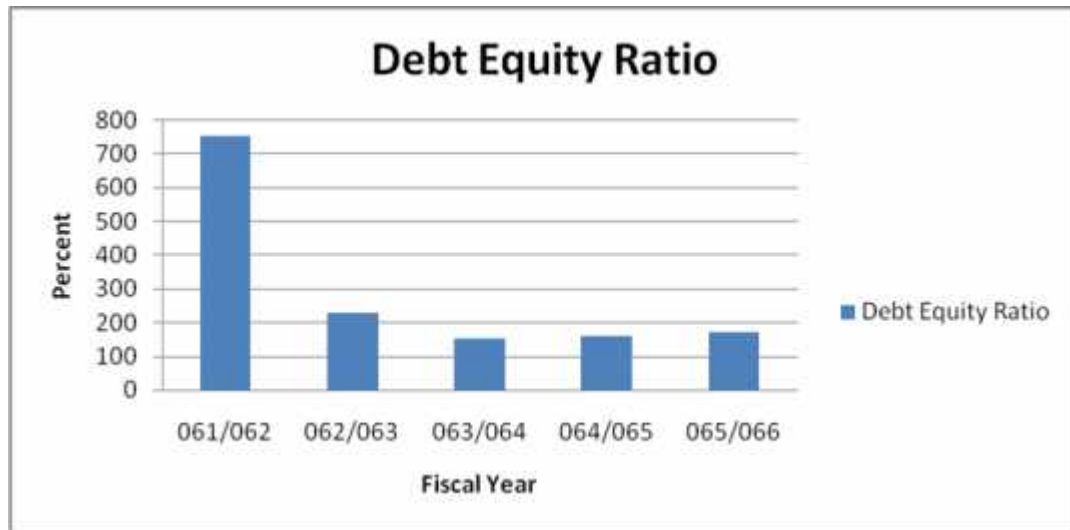
Table No 4.3.1.3  
Debt Equity Ratio

Amount in Million

Fiscal Year	Equity Capital	Debt Capital	Debt Ratio(%)	% Change
061/062	350	2641	754.57	-
062/063	1800	4089	227.17	69.89
063/064	4668	7066	151.37	33.37
064/065	9025	10458	158.88	4.96
065/66	9522	16385	172.1	8.32
Average	5073	8127. 80	292.8180	29.135
Standard Deviation	4141.11060	5503.533	259.82895	
Correlation coefficient			0.938	
PE ( r )			0.0362	

Source: Annual Report of SBL

Figure No 4.3.1.3  
Debt Equity Ratio



The debt ratio of fiscal year 061/62 is 755 percent, in 062/063, is 227.17 percent, in 063/064, is 151.37 percent, and in 064/065 is 158.88 percent and in the fiscal year 065/66 is 172.1 percent. The average D/E ratio is 292.818 percent and the standard deviation of debt equity ratio is 259.82895 and correlation coefficient between total debt and share capital is 0.938, which is significance. The Probable Error of correlation coefficient is 0.0362

#### 4.3.1.4 Equity Multiplier

It measures rupees amount of assets for rupees of equity. The equity multiplier ratio is amount of assets for each amount of equity. It is the relationship between total assets and equity. This ratio is calculated as follows.

$$\text{Equity Multiplier} = \frac{\text{Total Assets}}{\text{Total Equity}}$$

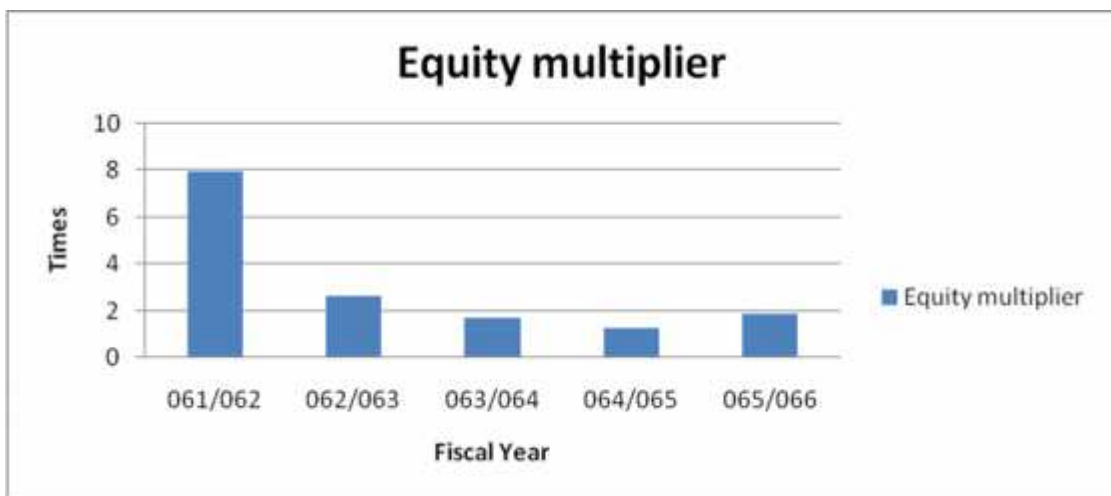
Table no: 4.3.1.4  
Equity Multiplier

Rs In Million

Year	Total Assets	Total Equity	Ratio	% Change
061/062	3099	350	7.99	-
062/063	4757	1800	2.64	67
063/064	7955	4668	1.70	35.61
064/065	11669	9025	1.29	24.12
065/066	17882	9522	1.88	45.74
Average	5867	5073	3.1	43.12
Standard Deviation			2.77706	
Correlation of Coefficient			.942	
PE (r )			0.0340	

Source: Annual Report of SBL

Figure no 4.3.1.4  
Equity Multiplier Ratio



The equity multiplier in fiscal year in 061/062 is 7.99 times, in FY 062/063 is 2.64 times and it is decrease by 67 percent, in FY 063/064 is 1.70 times, it is decreased by 35.61 percent , in FY 064/065 is 1.29 times, and decrease by 24.12 percent, in FY 065/066 is 1.88 times. The average equity multiplier is 3.10 times. The standard deviation is 2.77706, correlation of coefficient is 0.942 and probable of error on correlation is 0.0340.

#### 4.3.1.5 Interest Coverage Ratio.

This ratio is also known as time interest earned (TIE) ratio which measures the debt servicing capacity of a firm in so far as the fixed interest on the total loan is concerned. Higher the ratio indicates higher capacity to bear the high volume of interest charge and vice versa.

Table No: 4.3.1.5

#### Interest coverage Ratio

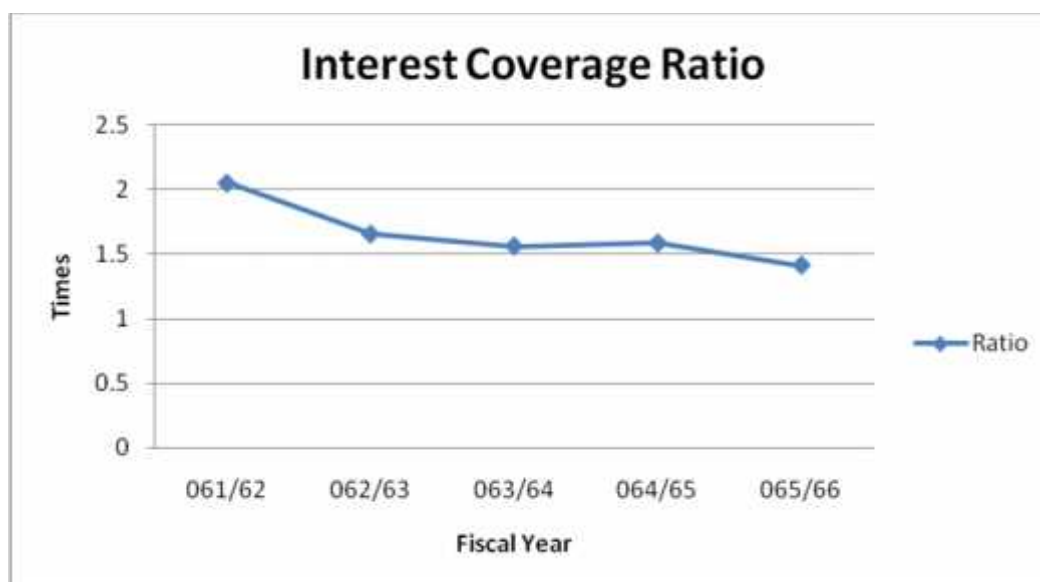
Amount in Million

FY	EBIT	Interest	Ratio
061/62	189	92	2.054
062/63	255	154	1.656
063/64	425	272	1.5625
064/65	627	408	1.586
065/66	1150	814	1.4128
Average	533.2	348	1.6543
Standard Deviation			0.2404

Source: Annual Report of SBL

Figure No: 4.3.1.5

#### Interest coverage Ratio



Interest coverage ratios of FY 061/62, 062/63, 063/64, 064/65, 065/66 are 2.054, 1.656, 1.563, 1.586, 1.4128 times. Average interest coverage ratio is 1.6543 times. The Standard deviation is 0.2404. The interest coverage ratio is sufficient to pay interest to creditors.

### 4.3.2 Profitability Ratios

Profitability is important measure of a company's operating success. There are two areas for judging profitability (1) relationships in the income statement that indicate a company's ability to recover the costs and expenses, (2) relationship of income to various balance sheet measures that indicate the company's relative ability to earn interest from the assets employed. The first measure is the profit margin and the second one is the return on investment.

#### 4.3.2.1 Net Profit Margin

Profit margin measure the relationship of net income and operating income.

Table No: 4.3.2.1

Net profit margin

Amount in Million

Year	Net Income	Operating Income	Ratio %	% Change
061/062	70	129	54.26	-
062/063	65	187	34.76	34.35
063/064	95	263	36.12	3.91
064/065	143	402	35.57	1.52
065/066	218	570	38.25	7.53
Average	118.2	310.2	39.79	11.83
Standard deviation	63.7708	177.60	8.1904	
Correlation			0.984	
PE ( r )			0.00958	

Source: Annual Report of SBL

Figure No: 4.3.2.1

Net Profit Margin



Net profit margin in FY 061/062 is 54.26 percent; in FY 062/063 is 34.76 percent, this is decrease by 34.35 percent. In FY 063/064 is 36.12 percent, which is increase by 3.91 percent. in FY 064/065 is 35.57 percent , this is decrease by 1.52 percent and in FY 065/066 the profit margin is 38.25 percent this is increase by 7.53 percent. The average profit margin is 39.79 percent and average changing rate is 11.83 percent. The standard deviation is 8.1904. The correlation of coefficient is 0.984 and probable of error on correlation coefficient is 0.00958.

#### 4.3.2.2 Return on Total Assets

Return on total assets ratio measures the profitability of bank that explains a firm to earn satisfactory return on all financial resources invested in the bank's assets; otherwise its survivable is threatened. The ratio explains net income for each unit of assets. Higher ratio indicates efficiency in utilizing its overall resources and vice-versa. Rate return on total assets is major tool to judge the operational efficiency of a bank. The return on total assets of selected banks is as follows: Total capital and liabilities are all items included in liabilities side of balance sheet. The following table shows the position of total capital and liabilities of SBL.

Table No: 4.3.2.2  
Return on Total Assets

Fiscal Year	Ratio	Change
061/62	2.27	-
062/63	1.37	39.64
063/64	1.20	12.40
064/65	1.23	2.5
065/066	1.22	0.813
Average	1.458	13.84
Standard deviation	0.4589	

*Source: Annual Report of SBL*

Figure No: 4.3.2.2  
Return on Total Assets



The ratio of Return on Total Assets is 2.27 percent, 1.37 percent, 1.20 percent, 1.23 percent and 1.22 percent in the FY 061/62, 062/63, 063/64, 064/65 and 065/066 respectively. The smallest ration is in fiscal year 063/64 i.e. 1.20 percent and the largest is in 061/62 i.e. 2.27 percent. The average return on assets is 1.458 percent. The standard deviation is 0.4589

#### 4.3.2.3 Return on Shareholder's Equity

A return on shareholder's equity is the measure of productivity of shareholder's funds. It carries the relationship of return on shareholder's equity. The shareholder's equity includes common share capital, preference share capital, reserve, and surplus. Management's objective is to generate the maximum return on shareholder's investment in the firm. ROE is therefore the best single measure of the company's success in fulfilling its goal. Thus, this ratio is of great interest and value to the present as well as the perspective shareholders and also the great concern to management, which has the responsibility of maximizing the owner's welfare. The ratio equals the net profit after taxes divided by the common stockholder's equity.

Table No: 4.3.2.3  
Return on Shareholder's Equity

Amount in Million

Fiscal Year	Shareholder' Equity	Net Income	Ratio	% Change
061/062	458	70	15.28	-
062/063	668	65	9.73	46
063/064	889	95	10.69	33
064/065	1211	143	11.81	35
065/066	1496.755	218	14.565	23.33
Average	944.55	118.2	12.4150	34.33
Standard Deviation			2.41773	
Correlation Coefficient			0.953	
PE ( r )			0.0277	

Source: Annual Report of SBL

Figure No: 4.3.2.3.1  
Shareholder's Equity

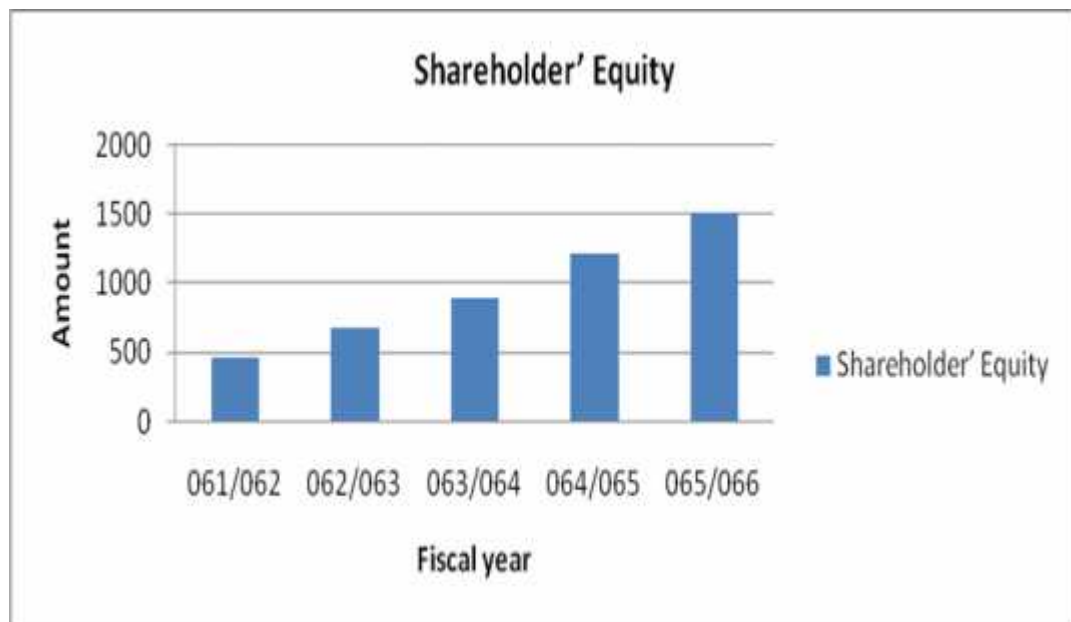
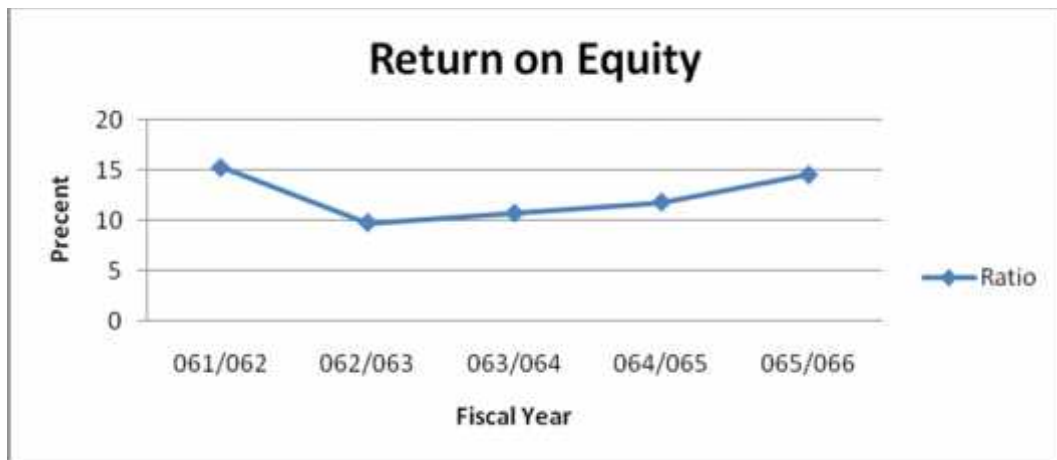




Figure No: 4.3.2.3.2

Return on Shareholder's Equity



The shareholder's equity is Rs (in Millions) 287, 458, 668, 889, 1211 and 1496.755 in fiscal year 061/062, 062/063, 063/064, 064/065 and 065/066 respectively. The average shareholders' equity in such five year is Rs (in Millions) 944.55. The average change rate is 34.33 percent.

The return on shareholder's ratio in fiscal year 061/062 is percent 15.28 in 062/063 is 9.73 percent, in 063/064 is percent 10.69 and in 064/065 is 11.81 percent and in FY 065/066 is 14.565 percent. The average return on shareholder's equity is 12.4150, and standard deviation is 2.41773. The correlation coefficient on net income and return on equity is 0.953 and probable of error on correlation coefficient is 0.0277

**4.3.2.4 Return on Total Deposit**

Table No: 4.3.2.4

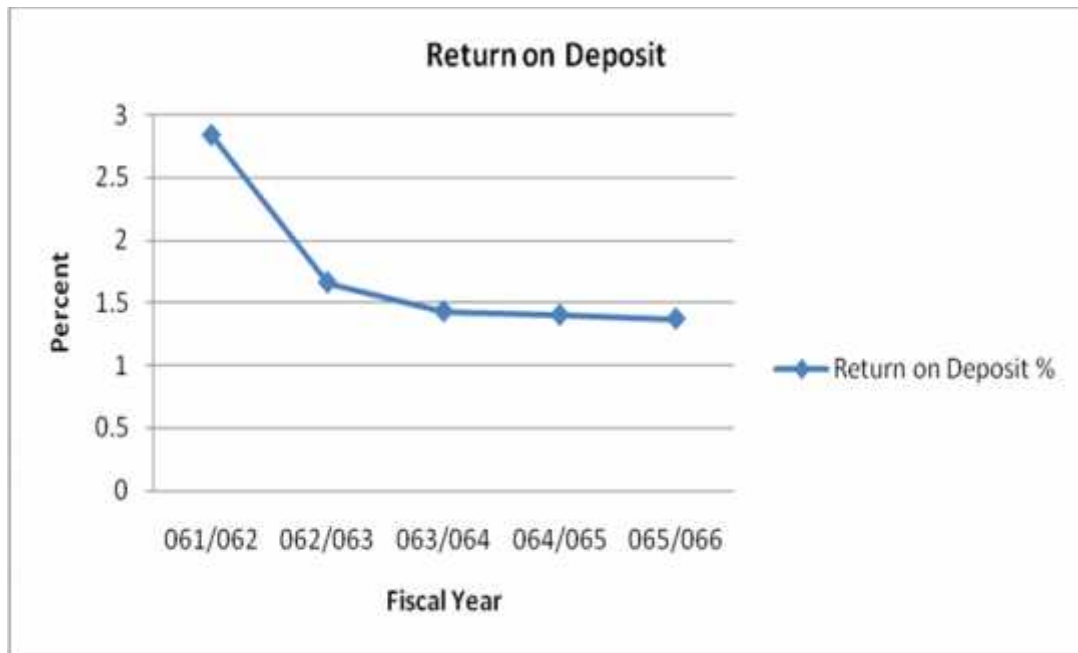
Return on Total Deposit

Amount in Million

Year	Net Income	Total Deposit	Ratio (%)	% Change
061/062	70	2462	2.84	-
062/063	65	3918	1.66	41.55
063/064	95	6625	1.43	1.39
064/065	143	10191	1.40	2.10
065/066	218	15855	1.37	2.14
Average	118.2	7810.2	1.74	9.436
Standard deviation			0.6255	
Correlation Coefficient			0.988	
PE ( r )			0.0072	

Source: Annual Report of SBL

Figure No: 4.3.2.4  
Return on Total Deposit



The return on Deposit at fiscal year 061/062 is 2.84 percent, in 062/063 is 1.66 percent; it is decrease by 44.55 percent. In FY 063/064 is 1.43 percent, which is decrease by 1.39 percent and in 064/065 is 1.40 percent which is decrease by 2.10 percent and in FY 065/066 is 1.37 percent, which is decrease by 2.14 percent. The return is decrease every year because the deposit is increase highly than return. Average return on deposit is 1.74 percent .The standard deviation is 0.6255. The correlation coefficient is 0.988 and probable of error is 0.0072

#### 4.3.2.5 Interest Margin Analysis

Net interest margin measure the profitability of commercial bank. It is another most popular tool of profitability measurement. It is calculated as follows:

$$\text{Net interest Margin} = \frac{\text{Net Interest Income}}{\text{Interest Earning Assets}}$$

(Interest Earning Assets= Loans+ Investment)

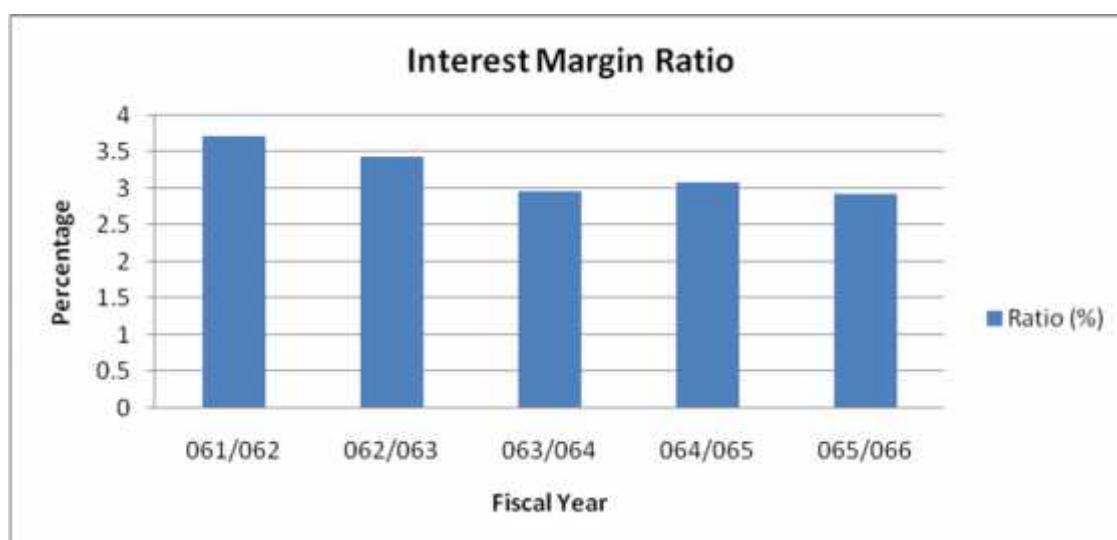
Table No: 4.3.2.5  
Interest Margin Analysis

Amount is Million

Year	Net Int. Earning	Int. Earning Assets	Ratio (%)	% Change
061/062	106	2858	3.70	-
062/063	152	4440	3.42	3.57
063/064	210	7088	2.96	13.45
064/065	322	10486	3.07	3.72
065/066	452	15505	2.92	4.89
Average	248.4	8075.4	3.2140	6.41
Standard Deviation	139.56647	5060.19523	0.33553	
Correlation			0.999	
PE ( r )			0.00062	

Source: Annual Report of SBL

Figure No: 4.3.2.5  
Interest margin Ratio



Interest margin ratio in FY 061/062 is 3.70 percent. In FY 062/063 it is 3.42 percent, which is decreased by 3.57 percent. In FY 063/064 is 2.96 percent which is decrease by 13.45 percent. In FY 064/065 it is 3.07 which is increase by 3.72 percent and in FY 065/066 it is 2.92 percent and it is increase by 6.41 percent. The average interest margin ratio is 3.21 percent. The standard deviation is 0.335553. The correlation of coefficient is 0.999 and probable of error is 0.00062.

### 4.3.3 Market Related Ratios

These ratios show the banks performance in summary. By analysis these ratios we can easily know the banks position and compare the various banks each other. So that we can make buying and selling decision of the banks share.

Table no: 4.3.3

#### Common share information

Particulars	061/062	062/063	063/064	064/065	065/065
EPS (Rs)	20.08	13.05	15.88	17.29	22.89
Return on Equity %	18.12	10.82	12	13.4	17.04
No of Share Outstanding (Thousand)	3500	5000	6000	8280	9522
Market Capitalization (Rs. Million)	3500	1800	4668	9025	9522

Source: Annual Report of SBL

#### 4.3.3.1 Earning per Share (EPS)

Earning per share shows the profitability of the firm on a per share basis; it does not reflect how much is paid as dividend and how much is retained in the business. EPS is one of the most widely used measures of the bank's performance. It is an important index of the bank's performance and the investors rely heavily on it for their investment decisions. In order to see the strength of the share in the share in the market, EPS of selected banks are calculated as below:

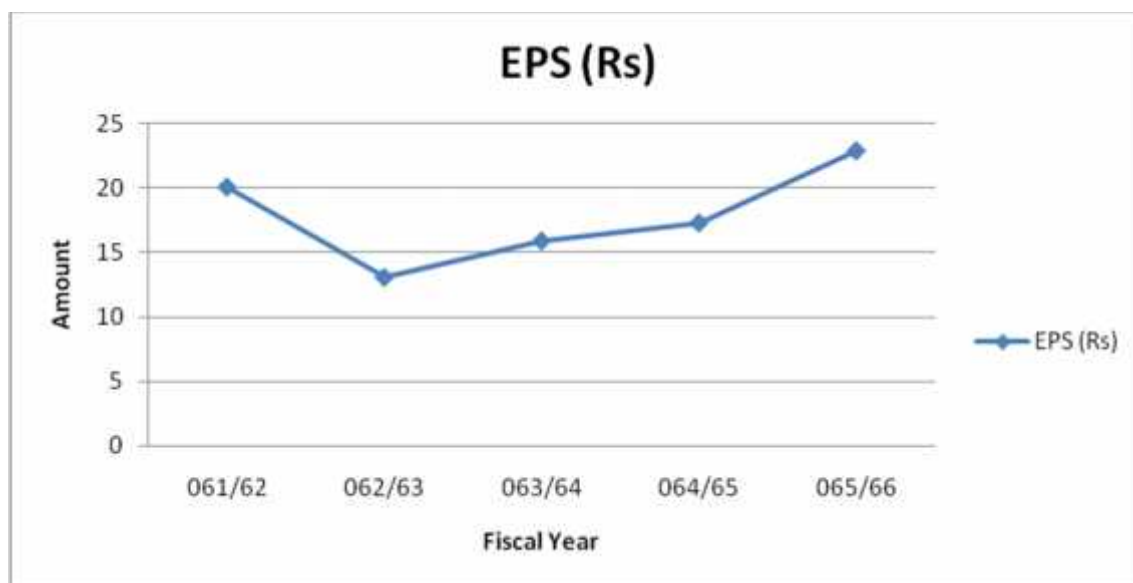
Table 4.3.3.1

#### Earning Per Share

Fiscal Year	EPS (Rs)	Change %
061/62	20.08	-
062/63	13.05	35.00
063/64	15.88	21.68
064/65	17.29	8.88
065/66	22.89	32.39
Average	17.8380	24.49
Standard Deviation	3.79501	

Source: Annual Report of SBL

Figure 4.3.3.1  
Earning Per Share



Earning per share is one of the market related ratio to see market performance of the bank, market related ratios are computed. The EPS of SBL is RS 20.08, Rs 13.05, Rs 15.88, Rs 17.29 and Rs 22.89 in the FY 061/62, 062/63, 063/64, 064/65 and Rs 065/66 respectively. The average EPS is Rs. 17.8380. The standard deviation is 3.79501. The annual change rate of EPS is decrease by 35 percent, from 061/62 to 062/63, increase by 21.68 percent, from 062/63 to 063/64 and increase by 8.88 percent, from 063/64 to 064/65 and EPS is increase by 32.39 percent from previous year. The average change rate is 24.49 percent.

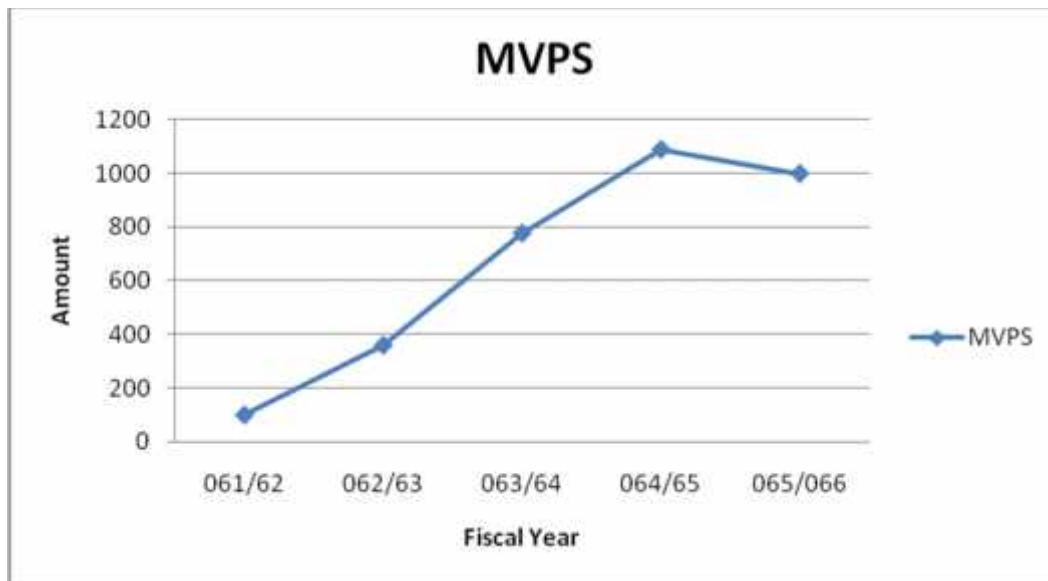
#### 4.3.3.2 Market Value per Share (MVPS)

Table 4.3.3.2  
Market Value per Share

Fiscal Year	MVPS	Amount in Million
		Change%
061/62	100	-
062/63	360	260
063/64	778	116.11
064/65	1090	40.10
065/066	1000	8.26
Average	665.6	106.1175
Standard Deviation	378.91086	

Source: Annual Report of SBL

Figure 4.3.3.2  
Market Value per Share



The market value of SBL is Rs 100 Rs. 360, Rs. 778, Rs. 1090 and Rs 1000 for FY 061/062, 062/63, 063/64, 064/65 and 065/66 respectively. The average MVPS is Rs. 665.6 The market value change by 260 percent from 061/062, 116.11 percent from 062/063 to 063/64, and 40.10 percent, from 063/64 to 064/65 and 8.26 percent in FY 065/66 from previous year. The average change rate is 106.1175 percent. The standard deviation is 378.91086.

#### 4.3.3.3 Equity Market Capitalization Analysis

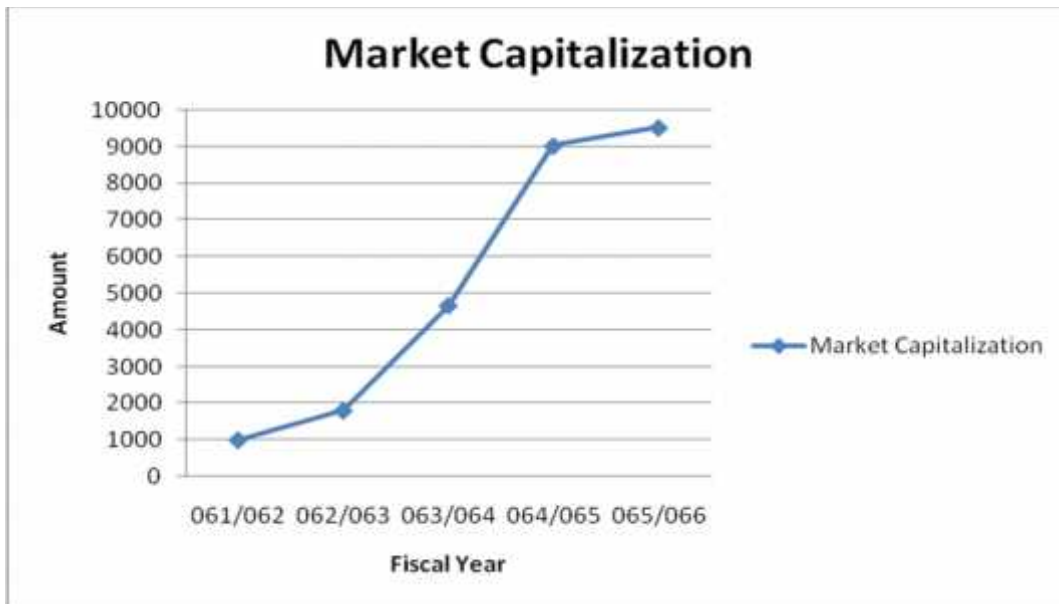
Table No: 4.3.3.3  
Equity Market Capitalization Analysis

Amount in Million

Year	Market Capitalization	% Changes
061/062	1000	-
062/063	1800	80
063/064	4668	159.333
064/065	9025	93.34
065/066	9522	5.507
Average	5203	84.544
Standard deviation	6383.8285	

Source: Annual Report of SBL

Figure No: 4.3.3.3  
Market Capitalization



The share is listed after the established of third year of the company. The equity market capitalization in year 062/063 is Rs 1800 Million, in FY 063/064 is Rs 4668 million which is increased by 62.76 percent and in FY 064/065 is Rs 9025 which is increased by 93.34 percent. The overall equity market capitalization of all 'A' class commercial banks is Rs 270098 million as on 15-Jul-2009. The average equity market capitalization of all 'A' class commercial bank is 10388.38. The average market capitalization of SBL is Rs 6353.75. SBL equity market capitalization is less than average of all 'A' class commercial banks and its standard deviation is 6383.8285

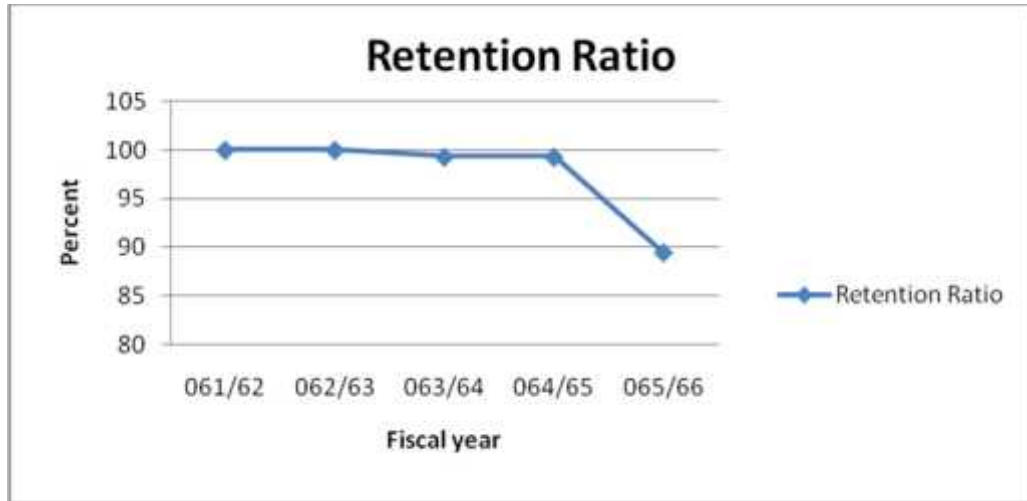
#### 4.3.3.4 Retention Ratio (1 - DPR)

Table 4.3.3.4  
Retention Ratio

F.Y.	Retention Ratio	Change
061/62	100	-
062/63	100	-
063/64	99.29	0.71
064/65	99.29	-
065/66	89.47	9.89

Source: Annual Report of SBL

Figure 4.3.3.4  
Retention Ratio



The Retention ratio of SBL is 100 percent, 100 percent and 99.29 percent 99.29 percent and 89.47 percent in the FY 061/62, in FY 062 /63, in FY 063/64, in FY 064/65 and in FY 065/66 respectively.

#### 4.3.3.5 Price Earning Ratio

Price earning ratio reflects the price currently being paid by the market for the each rupees of currently reported EPS. In other words, it measures investor expectations and the market appraisal of the performance of a firm. It is an indication of the way investors think that the banks would perform better in the future. Higher market price suggest that investor expect earning to grow and this gives a high P/E implies that investor feel that earning are not likely to rise. Price earning ratio is calculated as below:

$$\text{Price earning ratio} = \frac{\text{Market price per share}}{\text{Earning per share}}$$

Table 4.3.3.5  
Price Earning Ratio

F.Y.	Ratio	Change(Rs)
061/62	-	-
062/63	27.59	-
063/64	48.98	77.53
064/65	63.04	28.70
065/66	43.7	30.68
Average	45.8275	45.63
Standard Deviation	14.64401	

Source: Annual Report of SBL

Figure 4.3.3.5



## Piece Earning Ratio



The Price Earning Ratio is 27.59 time, 48.98 time, 63.04 time and 43.7 times in FY 062/63, FY 063/64, FY 064/65 and FY 065/66 respectively. The average P/E ratio is 45.8275 time. The P/E ration is in decreasing trained. It changed by 77.53 percent in 063/64, 28.70 percent in year 064/65 and 30.68 percent in FY 065/66. The average change rate is 45.64 percent. Standard deviation is 14.64401.

### 4.3.4 Analysis of Capital Structure

The analysis of capital structure is a concept of vital importance for this study. Here, capital structure adequacy on risk weighted assets and both NI and NOI approach are considered to analyze the capital structure of the overall capitalization.

#### 4.3.4.1 Net Income Approach (overall Capitalization Rate- $K_0$ )

The total market value of firm is simply obtained by adding the market value of debt to the market value of equity.

$$K_0 = \frac{EBIT}{V}$$

(Value of Firm  $V$  = Market Value of Debt + Market Value of Equity)

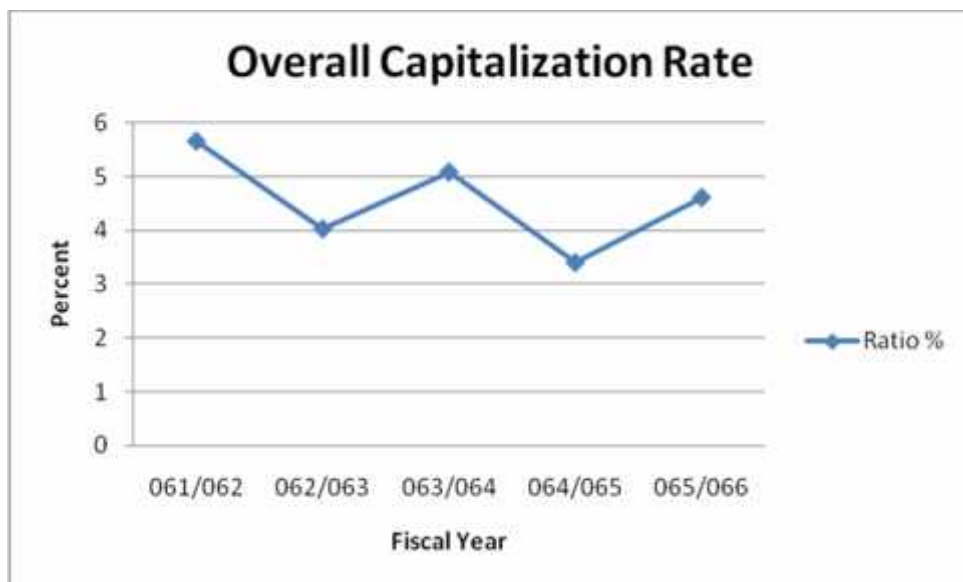
Table No: 4.3.4.1

## Overall Capitalization

Amount in Million

Year	Value of Firm	EBIT	Ratio %	'A' Banks AV
061/062	3343	189	5.65	-
062/063	5590	255	4.03	-
063/064	8360	425	5.08	-
064/065	18968	647	3.41	-
065/066	24968	1150	4.61	-
<b>Average</b>	<b>8381.2</b>	<b>306.2</b>	<b>4.556</b>	<b>3.62</b>
<b>Standard deviation</b>			<b>0.8752</b>	

Figure No: 4.3.4.1  
Overall Capitalization Rate



According to the net income approach the overall capitalization rate  $k_o$  in FY 061/062  $k_o$  is 5.65 percent, in FY 062/063  $k_o$  is 4.03 percent, in FY 063/064  $k_o$  is 5.08 percent, in FY 064/065  $k_o$  is 3.41 percent, in FY 065/066  $k_o$  is 4.61 percent. The average capitalization rate  $k_o$  in net income approach is 4.556 percent. Standard deviation of overall capitalization rate is 0.8752. The average overall capitalization rate of all 'A' class commercial banks is 3.62 percent. The EBIT is Rs 37806.3797 and total market value of all commercial bank is Rs 1044888 as on 15-July 2009. SBL overall capitalization rate is higher than all 'A' class commercial bank.

### 4.3.4.2 Net Operating Income (NOI) Approach (Equity Capitalization Rate – $K_e$ )

The net operating income approach focus on the equity capitalization rate and appears as irrelevancy theory of capital structure, as already explained in detail in chapter II. According to this approach, overall capitalization rate,  $K_o$  as well as the debt capitalization rate,  $K_d$ , is independent of degree of leverage. However, the equity capitalization rate,  $K_e$ , increase linearly with financial leverage. Equity capitalization rate is obtained simply dividing the earning before tax by market value of the equity. Thus, under net operating income approach, the equity capitalization is computed as follows:

$$K_e = \frac{\text{Earning before tax}}{\text{Market Value of equity}}$$

Table No: 4.3.4.2

Equity Capitalization Rate

Amount in Figure

Year	MV Equity	EBT	Ratio	'A' banks Av.
061/062	1000	87	8.7	-
062/063	1800	92	5.11	-
063/064	4668	139	2.98	-
064/065	9025	217	2.40	-
065/066	9255	310	3.26	-
<b>Average</b>	3238.6	100.8	4.49	7.38
<b>Standard deviation</b>			2.56269	

Figure No: 4.3.4.2

Equity Capitalization Rate



According to the net operating income approach the equity capitalization rate at in FY 061/062 is 8.7 percent, in FY 062/063  $k_e$  is 5.11 percent, in FY 063/064  $k_e$  is 2.98 percent, in FY 064/065 is 2.40 percent, and in FY 065/066 is 3.26 percent. The average capitalization rate  $k_e$  in net operating income approach is 4.49 percent. The standard deviation of capitalization rate is 2.5627. The average equity capitalization rate is 7.38 percent in FY 065/66. SBL equity capitalization rate is less than average of all 'A' class commercial banks equity capitalization rate.

## 4.4 Statistical Analysis

### 4.4.1 Correlation coefficient analysis

Two variables are said to have “correlation” when they are so related that the change in the value of once variable is accomplished by the change in the value of the other. The measure of correlation is called correlation coefficient summarized in one figure, the degree and direction of movement. But the important things that is to be noted here is that correlation analysis only help s in determining the extent to which the two variables are considered but does not tell us about cause and effect relationship. Though, there is a high degree of correlation between two variable one cannot say which one is the cause and which one the effect.

Table no: 4.4.1

Correlation coefficient

SN	Particulars	r	r <sup>2</sup>	PE ( r )	6xPE	Level of significant
1	D/E Ratio & ROE	0.623	0.3881	0.274	1.642	In Significant
2	Total Assets & Equity	0.942	0.8874	0.034	0.204	significant
3	Net Income & Operating Income	0.984	0.968	0.00958	0.05748	Significant
4	NI & Shareholders' Equity	0.953	0.908	0.0277	0.1662	Significant
5	Net Income & Total Deposit	0.988	0.976	0.0072	0.0432	Significant
6	ROE & ROA	0.594	0.353	0.289	1.73	Insignificant
7	D/E Ratio & ROA	0.999	0.998	0.0009	0.0054	Significant
8	ROE & Cr to Deposit	0.247	0.610	0.4199	2.520	Insignificant
9	Cr. To dep. & ROA	0.921	0.848	0.0687	0.407	Significant
10	EBIT & Int. Expenses	0.983	0.966	0.151	0.0905	Significant
11	Overall Capitalization rate & D/E ratio	0.673	0.453	0.245	1.468	Insignificant

#### **4.4.1.1 Coefficient of Correlation between Debt equity Ratio & ROE**

The correlation coefficient between Debt equity Ratio & ROE is 0.623. Coefficient of correlation determinations ( $r^2$ ) is 0.3881. Which PE is 0.274 and 6 x PE is 1.642.  $r < 6$  PE, so its level of significant is negative. Or it is insignificant.

#### **4.4.1.2 Coefficient of Correlation between Total assets and Total equity**

The correlation coefficient between Total assets and equity is 0.942. Coefficient of correlation determinations ( $r^2$ ) is 0.8874, whose PE is 0.0340 and 6 x PE is 0.214  $r > 6$  PE, so its level of significant is positive. Or it is significant. When the bank increases the equity the total assets will be increases, and vice versa.

#### **4.4.1.3 Coefficient Of Correlation between Net Income and Operating Income.**

The correlation coefficient between equity share capital and total liabilities is 0.984. Coefficient of correlation determinations ( $r^2$ ) is 0.968, which PE is 0.00968 and 6 x PE is 0.05748.  $r > 6$  PE, so its level of significant is positive. Or it is significant. When the operating income is increase the net income is increases and vice versa.

#### **4.4.1.4 Coefficient of Correlation between net income and share holders equity.**

Coefficient of Correlation between net income and share holders equity is 0.953. Coefficient of correlation determinations ( $r^2$ ) is 0.908, which PE is 0.0277 and 6 x PE is 0.1662.  $r > 6$  PE, so its level of significant is positive. Or it is significant. When the bank increases the shareholders equity, the net income will increases and vice versa.

#### **4.4.1.5 Coefficient of Correlation between net income and total deposit**

Coefficient of Correlation between net income and share holders equity is 0.988. Coefficient of correlation determinations ( $r^2$ ) is 0.976, which PE is 0.0072 and 6 x PE is 0.0432.  $r > 6$  PE, so its level of significant is positive. Or it is significant. When the deposit is the net income is increases.

#### **4.4.1.6 Coefficient of Correlation between ROE and ROA**

Coefficient of Correlation between ROE and ROA is 0.594. Coefficient of correlation determinations ( $r^2$ ) is 0.353, which PE is 0.289 and 6 x PE is 1.73.  $r > 6$  PE, so its level of significant is positive. Or it is significant.

#### **4.4.1.7 Coefficient of Correlation between D/E Ratio and ROA**

Coefficient of Correlation between net income and share holders equity is 0.999. Coefficient of correlation determinations ( $r^2$ ) is 0.998, which PE is 0.0009 and 6 x PE is 0.0054.  $r > 6$  PE, so its level of significant is positive. Or it is significant.

#### **4.4.1.8 Coefficient of Correlation between ROE and Cr. To Deposit**

Coefficient of Correlation between net income and share holders equity is 0.247. Coefficient of correlation determinations ( $r^2$ ) is 0.610, which PE is 0.4199 and 6 x PE is 2.520.  $r < 6$  PE, so its level of significant is negative. Or it is significant.

#### **4.4.1.9 Coefficient of Correlation between ROA and Cr. To Deposit**

Coefficient of Correlation between net income and share holders equity is 0.921. Coefficient of correlation determinations ( $r^2$ ) is 0.848, which PE is 0.0687 and 6 x PE is 0.407.  $r > 6$  PE, so its level of significant is positive. Or it is significant.

#### **4.4.1.10 Coefficient of Correlation between EBIT and Interest Expenses**

Coefficient of Correlation between net income and share holder's equity is 0.983. Coefficient of correlation determinations ( $r^2$ ) is 0.966, which PE is 0.151 and 6 x PE is 0.0905.  $r > 6$  PE, so its level of significant is positive. Or it is significant.

#### **4.4.1.11 Coefficient of Correlation between Overall Capital Rate and D/E**

Coefficient of Correlation between net income and share holders equity is 0.673. Coefficient of correlation determinations ( $r^2$ ) is 0.453, which PE is 0.245 and 6 x PE is 0.1468.  $r > 6$  PE, so its level of significant is positive. Or it is significant.

### **4.5 Major Finding Of the study**

- The bank increased authorized capital from 1000 million to 3000 million in FY 065/66, and increases its issue capital. The bank has a paid capital of Rs 952.2 million.

- On total paid up capital the bank maintain 7:3 up to FY 064/65 from public issue and in FY 065/66 ,the bank maintain 51: 49 between promoters and public share holders.
- The bank collects capital from different sources. Deposit and borrowing, shareholders equity, debenture and other sources. The bank collect maximum fund from deposit and borrowings. The bank issue debenture in FY 065/66.
- The bank is able to collect the highest amount of deposit in the year 2065/66. The proportion over total liabilities and capital is 84.216 % in average.
- The bank has various schemes on deposit: Fixed, Called, Saving, and Non-interest bearing deposit. The bank uses the maximum fund from Fixed, called, saving and non-interest bearing deposit respectively.
- The banks total deposit in FY 065/66 is less than the average of all 'A' class commercial bank. But bank increase its deposit by 56 percent from previous year.
- Total liabilities and capital among the five study years, the maximum is in 2065/66. The proportion of share capital to liabilities is in increasing & decreasing trend. The average of share capital to total liabilities is 23.172. SBL total capital and liability in FY 065/66 is less than the average of all 'A' class commercial bank. But bank increase its Capital and liabilities by 53.24 percent from previous year.
- The reserve and surplus is in increasing trend. Its proportion with the total liabilities is also increasing. The average proportion of reserve and surplus is 1.944 percent. The highest Reserve and Surplus is in FY 065/66.
- The Borrowing is in increasing trend. Its proportion with the total liabilities is also increasing. The average proportion of Borrowing is 3.708 percent. The highest borrowing is in FY 065/66.
- The Bills Payable is in increasing trend. Its proportion with the total liabilities is also increasing. The average proportion of Bills Payable is 1.944 percent. The highest Bills Payable is in FY 065/66.
- The bank issue SBL debenture 2072 at 8.5% p.a at par 1000. This debenture is matured at 2072. The total amount collected from issue of debenture is Rs 22, 77, 70,000.

- The average debt ratio is 88 percent, which indicate the ratio of debt on assets. Debt to equity ratio measure the ratio of debt on equity. The average debt to equity ratio is 292.18 percent.
- Credit to deposit ratio is important ratio. Credit to debt ratio measure the efficiency of credit creation through the investment of fund received by the customer. The average ratio of credit to debt ratio is 95.354 percent. This ratio is good for the company. The ratio is decrease every year because the deposit is increased. The average credit to deposit ratio of all commercial in last year is 70.64 percent. SBL last year C/D ratio is 85.18 percent, which is higher than average of average of all commercial banks average and also higher than NRB standard.
- The net income of SBL in FY 065/66 is Rs 218 million. Total net income of all 'A' class commercial bank is Rs 14142.6922 as on 15-Jul-2009. Average return of all 'A' class commercial bank is Rs 565.72 million. SBL net income is less than all 'A' class commercial banks.
- The equity multiplier ratio is amount of assets for each amount of equity. It is the relationship between total assets and equity. The average equity multiplier is 3.1 times. This ratio is increase every year
- Profit margin measure the relationship of net income and operating income. The average profit margin is 39.79 percent. This margin rate is decrease every year but the ratio during the five year is good.
- The average return on assets is 1.458 percent, average return on equity is 12.4150 percent, and average interest margin ratio is 3.2140 percent. Return on deposit describe in the return on total deposit analysis. The profit is sufficient or not and what strategy to be implemented for profit is described by this ratio. The ratio is in decreasing trend. The average ratio is 1.458 percent.
- Theoretical how much earning per share is calculated by earning per share formula. The average EPS is Rs 17.8380. The maximum EPS is in FY 065/66, which is Rs 22.89. This is help to maximize the shareholders wealth.
- The Retention ratio of SBL is 100 percent, 100 percent and 99.29 percent 99.29 percent and 89.47 percent in the FY 061/62, in FY 062 /63, in FY 063/64, in FY 064/65 and in FY 065/66 respectively.



- Market value per share is in increasing trend. The average change rate is 106.118 percent and average value of market per share is Rs 665.60.
- The equity market capitalization in year 062/063 is Rs 1800 Million, in FY 063/064 is Rs 4668 million which is increased by 62.76 percent and in FY 064/065 is Rs 9025 which is increased by 93.34 percent. The overall equity market capitalization of all 'A' class commercial banks is Rs 270098 million as on 15-Jul-2009. The average equity market capitalization is 10388.38. SBL equity market capitalization is less than average of all 'A' class commercial banks.
- Price earning ratio reflects the price currently being paid by the market for each rupee of currently reported EPS. The trend is increasing. The average P/E ratio is 45.8275 times and average change rate is 45.63 percent. . Overall trend of price earning ratio shows the fluctuating trend.
- The interest margin measures the profitability of the bank. It differentiates between interest earning and interest expenses. The average ratio is 3.2140 percent and the highest ratio is 4.46 percent at FY 060/61. Average changing rate is 6.41 percent.
- The correlation coefficient between Debt equity Ratio & ROE, total assets and Total Equity, net income and operating income and net income and shareholders equity's level of significant is positive. or the have positive relation.
- Net income and total deposit, D/E ratio and ROA, Cr. to deposit and ROA's level of significant is also positive. They have positive relation.
- The correlation coefficient between EBIT and Interest expenses is also positive. It means the bank is able to pay its interest to its depositors.
- The correlation coefficient between ROE & ROA, ROE & Cr. to Deposit and Overall Capital and D/E ratio are insignificant. They have not any significant relation between them.
- The composition of total capital is made by core capital and supplementary capital. Adequacy of capital fund on weighted assets in FY 061/062, adequacy of the capital fund on weighted assets is 13.64 which is above than the NRB standard , In FY 062/063 is 14.16, in FY 063/064 , 064/065 and in

FY 065/066 are 11.84 percent , 11.14 and 10.69 percent respectively. All the period the standard adequacy under NRB rule is sufficient.

- According to the net income approach the average overall capitalization rate  $k_o$  in net income approach is 4.556 percent. The average change in capitalization rate is 30.70 percent. The standard deviation is 0.8752. The average overall capitalization rate of all 'A' class commercial banks is 3.62 percent. SBL overall capitalization rate is higher than all 'A' class commercial bank.
- According to the net operating income approach the average equity capitalization rate  $k_e$  in net operating income approach is 4.49 percent. The standard deviation of capitalization rate is 2.5627. The average capitalization rate  $k_e$  in net operating income approach is 4.49 percent. The standard deviation of capitalization rate is 2.5627. The average equity capitalization rate is 7.38 percent in FY 065/66. SBL equity capitalization rate is less than average of all 'A' class commercial banks equity capitalization rate.

## **CHAPTER V**

### **SUMMARY, CONCLUSION AND RECOMMENDATION**

This chapter focuses on finding and recommendation, which are derived from the analysis of capital structure of SBL.

#### **5.1 Summary**

Capital structure represents the combination of long sources of capital. It is the left hand side part of the balance sheet. So it is also called liabilities part. Nepal is developing country financially it has been highly poor. The main concept of the study is to show the banking industry in Nepal and the role of SBL and the capital structure part of the SBL.

The main objectives are to examine the existing financial position regarding capital structure, describe the relationship between deposit capitalizations of SBL, to analyze the composition as well as the mixture of debt and equity, and to examine the different profitability ratio.

This study covers only five years data. This study is based on secondary collected from annual report, financial statements etc. The study is concern about the capital structure of SBL. Capital structure is influenced by various factors, but this study excludes those factors. For our convenience, annual data been taken which becomes easy for us to perform the study.

#### **5.2 Conclusion**

The growth and increasing integration of the world's economy has been parallel by expansion of global banking activities. Nepal though a developing country, couldn't identify the fact that commercial banking which is responded by extending loan and developing new highly innovative financial techniques that laid the foundation for totally new approaches to the provision of banking services on the basis of entire research study, the analysis of capital structure is very significant in project appraisal of shift competition. Most of the banks cannot manage the current assets. Because of the inefficient current management company cannot fulfill the organizational objective, i.e. to earn maximum profit and maximizing the share holder equity.

The banks performance can be seen by various ways. Different analysis gives different recommendation and suggestion to the bank. On the basis of above analysis and description the recommendation has been made for -

- The capital and liabilities analysis says that the overall condition and position of capital and liabilities is better.
- Capital structure position analysis says that the proportion of debt and equity is in normal position as like others. Equity capitalization and overall capitalization both analysis demand the higher profit of the firm.
- Return on total deposit seems better. But in case of fixed deposit, because of other deposits have been properly mobilized but fixed deposit is not mobilized in that manner. Study demands for the investment / mobilization of fixed deposit also.
- The bank has been able to show satisfactory ratio of return on total assets, return on equity ratio is also better. Earning per share should be in increasing trend. Continuous progress in EPS will prosper the firm in share market. I think dividend per share is also optimum as compared, because in crises condition more reserve are needed than in past. Market value of the firm is not satisfactory.
- From the study of the bank is found to be highly levered. The company's financial mix accounts a higher proportion of debt and it is increasing every year.
- The correlation coefficients of the variable of selected bank for the statistical analysis are found positive to each other. The coefficients are all statistically significant in more than average banks. A positive correlation means both of the variables are moving toward the same direction.
- The bank major indicator such as: Total deposit, total capital and liabilities, equity capitalization and net profit are less than average of all 'A' class commercial banks but the bank is increases these all variables than previous year.
- Credit to deposit ratio and overall capitalization ratio is better than average of all 'A' class commercial banks.
- In brief, we can conclude that the bank is performing well. The bank is performing well among all commercial banks. SBL should open all the

doors to make it more competent. Especially it should invest properly and profit should be generated more than in past. The study's main demand is to invest in well manner and increase profit than two times.

Studies “A study on capital structure of Siddhartha bank ltd.” specifies the specific objective were analyze the capital of Siddhartha bank ltd. To show the financial position, examine the different tools such as graph, percentage, diagram, mean, standard deviation and PE of correlation. We found that the total capital and liabilities is increase. Deposit is the highest, amount of the bank. Among the various deposits: fixed deposit is the highest contribution in deposit, than called deposit, saving deposit and non-interest paying deposit respectively. This suggests the deposit is the main concern to the capital structure: it affects an investment policy. If the bank can increase more fixed deposit as a long term debt investment became more possible and bank becomes more successful and competent as per its capacity to collect the fixed deposit. So, fixed deposit should be collected more as can as possible.

The bank issue SBL debenture 2072 at 8.5% p.a at par Rs 1000. This debenture is matured at 2072. The total amount collected from issue of debenture is Rs 22, 77, 70,000. Debt and equity are properly mixed. The bank has a sound capital increase policy under the NRB rule. The bank is willing to offer the bonus share and right share offering to their existing shareholder to fulfill the requirement.

Even though, there is cut throat competition in this industry and the country's whole economy is down streaming, this bank is rated as a successful bank and running well among more than two dozen competitors. It does not need other square of fund. It is satisfactory symbol for all the stakeholders of the bank.

### **5.3 Recommendation**

Giving Recommendations to such huge organizations at this age and with experience just few weeks old itself is amazing. However as per the requirements of the report, there are some recommendation to the Bank and expect that the Bank would take these comments positively. If these comments are taken positively, it is sure that they would contribute something in achieving the very objectives and mission of the Bank. On the basis of above observation and field work study some recommendation are implemented which may be helpful for further progress of SBL

- Firstly, the Bank needs to become more selective in its idea of cost consciousness. No doubts, the idea of cost consciousness is instrumental for the success of any organization but it should be implemented on a selective basis that it does not harm the other needful aspects. It is believed that if organizations become too much cost conscious, they might become unconscious. In longer terms, overly cost conscious organizations destroy the creative skills of its members as they will become reluctant to present their ideas due to the fear of being turned down.
- The Bank seems to be only slightly interested in maintaining a formal information system regarding its competitors. The importance of Competitor Information System is immense in present context to make one self proactive to the deeds of the competitors, and becoming proactive serves in more than one ways than being reactive.
- The bank should also arrange the frequent training program to the employee for professional development that makes them to provide quality services to the customers, which increase efficiency.
- The Bank should design new deposit products to improve its deposit position by targeting those segments of markets that have not been previously targeted. Such target groups may be aged people, rural people, working class, etc. These areas may be good source of low cost funds.
- SBL is still fighting with its old banking software. The software seems to be outdated due to the introduction of advanced one.

Finally, it can be said that the study of a capital structure cannot be neglected by selected commercial banks. Otherwise it can seriously ride their financial viability. Thus, managers should understand the factors determining capital structure. Some of the Nepalese joint venture banks are suffering from the huge losses due to their administrative negligence in day to day operation and lack of specific Analysis of capital structure policy.

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## ANNEX - 1

### Balance sheet and Profit and Loss account

Amount in Millions

Particulars	Fiscal Year				
	061/62	062/63	063/64	064/65	065/66
Paid Up Capital	350	500	600	828	952.2
Reserve and Surplus	38	103	194	240	327
Debenture and Bond	-	-	-	-	227.77
Borrowings	190	181	430	205	328
Deposit	2462	3918	6625	10191	15855
Other Liabilities	59	55	106	204	192.03
<b>Total Capital and Liabilities</b>	<b>3099</b>	<b>4757</b>	<b>7955</b>	<b>11669</b>	<b>17882</b>
Cash and Bank Balance	131	116	517	437	271
Money at Short notice	22	100	229	585	485
Investment	287	651	865	1150	2176
Loan and Advances	2571	3789	6223	9336	13329
Fixed Deposit	30	40	47	72	172
Other Assets	58	61	73	89	172
<b>Total Assets</b>	<b>3099</b>	<b>4757</b>	<b>7955</b>	<b>11669</b>	<b>17882</b>
<b>profit and Loss Account</b>					
Interest Income	198	306	482	730	1265
Interest Expenses	92	154	272	408	814
A. Net Interest Income	106	152	210	322	451
Fees, Commission and Discount	8	14	20	21	73
Other Income	8	10	19	36	6
Foreign Exchange Gain/ Loss	7	12	14	27	39
B. Total Operating Income	129	187	263	407	659
Staff Expenses	20	26	34	48	79
Other Operating Expenses	31	44	56	71	113
C. Operating Profit Before provision	78	117	174	287	376
Provision for Possible Losses (Net)	-19	16	21	48	28
D. Operating Profit	97	101	153	239	348
Provision for Bonus	10	9	14	22	31
Provision For Taxes	17	26	44	74	92
E. net Profit / Loss	70	65	95	143	216

## ANNEX - 2

### Principal Financial Indicators for Five Year Period

S N	Particulars	Indicator s	Fiscal Year				
			061/62	062/63	063/64	064/65	065/66
1	Percent of net profit/Gross Income	Percent	29.25	19.13	17.83	17.67	15.75
2	Earning Per Share	Rs	20.08	13.05	15.88	17.29	22.89
3	Market Value Per Share	Rs	-	360	778	1090	1000
4	Price Earning Ratio	Ratio	-	27.59	48.98	63.04	43.7
5	Dividend on Share Capital (Including Bonus )	Percent	-	-	15.79	15.79	10.53
6	Cash Dividend on Share Capital	Percent	-	-	0.79	0.79	10.53
7	Interest Income/Loan and Advances	Percent	7.49	7.37	6.37	6.96	8.41
8	Staff Expenses/Total Operating Expenses	Percent	14.18	11.65	9.31	9.14	7.88
9	Interest Expenses/Total Deposit & Borrowing	Percent	3.47	3.75	3.85	3.93	6.12
10	Exchange Gain/Total income	Percent	2.98	3.53	2.66	3.39	2.8
11	Staff Bonus/Total Staff Expenses	Percent	47.49	35.09	41.38	44.97	38.42
12	Net Profit/Loan and Advance	Percent	2.73	1.72	1.53	1.53	1.63
13	Net Profit/Total Assets	Percent	2.27	1.37	1.2	1.23	1.22
14	Total Credit/Deposit	Percent	104.42	98.75	95.39	93.03	85.18
15	Total Operating Expenses/Total Assets	Percent	4.62	4.71	4.54	4.52	5.64
16	Adequacy of Capital Fund on Risk Weighted Assets						
a	Core Capital	Percent	12.77	13.29	10.78	10.27	8.26
b	Supplementary Capital	Percent	0.87	0.87	1.05	0.97	2.42
c	Total Capital Fund	Percent	13.64	14.16	11.84	11.24	10.69
17	Liquidity (CRR )	Percent	5.31	5.03	5.07	5.11	6.63
18	Non-performing Credit/Total credit	Percent	2.58	0.87	0.34	0.69	0.45
19	Weighted Average Interest Rate Spread	Percent	4.46	4.07	3.57	3.71	3.45
20	Book Net-Worth	Rs	38788900	60314145	79370993	107965995	127874452
21	Total Share	NOS	350000	500000	600000	8280000	9522000
22	Total Staff	NOS	56	72	79	116	168

## ANNEX- 3

### Correlation Coefficient

Ratios	Total capital	deposit	cr.to deposit	assets	Debt Ratio	Equity	debt eqty	ROA	roe	total deposit	cap and debt
Total capital	1	1.000 <sup>**</sup>	-0.982	1.000 <sup>**</sup>	0.948	.997 <sup>*</sup>	-0.792	-0.743	1.000 <sup>**</sup>	.999 <sup>*</sup>	-0.942
deposit	1.000 <sup>**</sup>	1	-0.983	1.000 <sup>**</sup>	0.95	0.997	-0.795	-0.747	1.000 <sup>**</sup>	.999 <sup>*</sup>	-0.943
cr.to deposit	-0.982	-0.983	1	-0.982	-0.991	-0.965	0.893	0.856	-0.982	-0.975	0.988
assets	1.000 <sup>**</sup>	1.000 <sup>**</sup>	-0.982	1	0.948	.997 <sup>*</sup>	-0.792	-0.743	1.000 <sup>**</sup>	.999 <sup>*</sup>	-0.942

Debt Ratio	0.948	0.95	-0.991	0.948	1	0.921	-0.945	-0.918	0.948	0.936	-1.000*
mrk value	0.659	0.664	-0.789	0.659	0.865	0.601	-0.981	-0.993	0.658	0.632	-0.874
mrk capitalization	0.89	0.892	-0.96	0.89	0.989	0.853	-0.983	-0.967	0.889	0.873	-0.992
Equity	.997*	0.997	-0.965	.997*	0.921	1	-0.744	-0.691	.997*	.999*	-0.914
debt eqty	-0.792	-0.795	0.893	-0.792	-0.945	-0.744	1	.997*	-0.791	-0.77	0.951
ROA	-0.743	-0.747	0.856	-0.743	-0.918	-0.691	.997*	1	-0.742	-0.719	0.925
roe	1.000**	1.000**	-0.982	1.000**	0.948	.997*	-0.791	-0.742	1	.999*	-0.941
total deposit	.999*	.999*	-0.975	.999*	0.936	.999*	-0.77	-0.719	.999*	1	-0.929
cap. and debt	-0.942	-0.943	0.988	-0.942	-1.000*	-0.914	0.951	0.925	-0.941	-0.929	1

**Note:**

\*\* Correlation is significant at the 0.01 level (2- tailed)

\* Correlation is significant at the 0.05 level (2- tailed)

## ANNEX - 4

### Capital Adequacy Table for Five Year Periods

*Amount in Thousands*

	Particular	Fiscal Year				
		061/62	062/63	063/64	064/65	065/66
<b>1.1</b>	<b>Risk Weighted Exposure</b>					
a	Risk Weighted Exposure for Credit Risk	-	-	-	10629677	14581786
b	Risk Weighted Exposure for Operational Risk	-	-	-	434021	622293
c	Risk Weighted Exposure For Market Risk	-	-	-	17675	6482
	<b>Total Risk Weighted Exposure for Market Risk</b>				<b>11081376</b>	<b>15210560</b>
<b>1.2</b>	<b>CAPITAL</b>					
	<b>Core Capital ( tire 1)</b>	<b>379038</b>	<b>539244</b>	<b>786859</b>	<b>1049680</b>	<b>1257070</b>
a	Paid Up Equity Share Capital	350000	500000	600000	828000	952200
b	Irredeemable Non- cumulative Preference Share	-	-	-	-	-
c	Share Premium	-	-	-	-	-
d	Propose Bonus Equity Share	-	-	-	124200	142830
e	Statutory General Reserves	14056	27107	46168	74802	118385
f	Retain Earning	-	-	-	1112	18167
g	Un-audited current Year cumulative profit	-	-	-	-	--
h	Capital Redemption Reserve	-	-	-	-	-
I	Capital Adjustment Reserve	23560	74872	146191	36555	7949
J	Debenture Redemption Reserve	-	-	-	-	32539
j	Dividend Equalization Reserves	-	-	-	-	-

k	Other Free Reserve	-	-	-	-	-
l	Less : Goodwill	-	-	-	-	-
m	Less : Miscellaneous Expenditure not written off	-	-	-	-	-
n	Less: Investment in equity in licensed Financial Institutions	-	-	-	-	-
o	Less: Investment in equity of intuitions with Financial interest	-	-	-	15000	15000
p	Less: Investment in equity of intuitions in excess of limit	-	-	-	-	-
q	Less: Investments arising out of understanding commitments	-	-	-	-	-
r	Less : Reciprocal crossholdings	-	-	-	-	-
s	Less: Other deductions	-	-	-	-	-
<b>Supplementary Capital ( Tire 2 )</b>						
		<b>25809</b>	<b>39035</b>	<b>76961</b>	<b>98055</b>	<b>368385</b>
a	Cumulative and/or Redeemable Preference share	-	-	-	-	-
b	Subordinated Term Debt	-	-	-	-	227770
c	Hybrid Capital Instruments	-	-	-	-	-
d	General loan loss provision	255536	37872	75610	94389	133941
e	Exchange Equalization Reserve	273	1163	1352	3666	6674
f	Investment Adjustment Reserve	-	-	-	-	-
g	Assets Revaluation Reserve	-	-	-	-	-
h	Other Reserves	-	-	-	-	-
	<b>Total Capital Fund</b>	<b>404847</b>	<b>632279</b>	<b>863820</b>	<b>1147734</b>	<b>1625465</b>
<b>1.3</b>	<b>CAPITAL ADEQUACY RATIOS</b>					
a	Tier 1 Capital to Total Risk Weighted Exposures	12.77	13.29	10.78	10.27	8.26
b	Tier 1 and Tier 2 to Capital to Total Risk Weighted Exposures	16.76	14.16	11.84	11.25	10.69

*Sources: Annual Report of SBL*

**ANNEX- 5**

**List of Shareholders' holding more than 0.5 % Share Capital**

SN	S. N. Name No. of shares Paid Amount Rs. %	No of Share	Paid Up	Proportion
1	Prudential Investment Co. Pvt. Ltd.	547620	54762000	5.75
2	Narendra Kumar Agrawal	466577	46657700	4.90
3	Chiranji Lal Agrawal	380878	38087800	4.00
4	Hira Lal Kedia	316130	31613000	3.32
5	Ratan Lal Kedia	314223	31422300	3.30
6	Pawan Kumar Agrawal	285659	28565900	3.00
7	Mahabir Investment Pvt. Ltd.	285659	28565900	3.00
8	Puspanjali International Pvt. Ltd.	285659	28565900	3.00
9	Narpat Singh Jain	278184	27818400	3.00
10	Subodh Todi	239953	23995300	3.00
11	Poonam Chand Agrawal	209483	20948300	2.92
12	Gomati Devi Kedia	209483	20948300	2.52
13	Dina Nath Kedia	205674	20567400	2.20
14	Rabindra Nath Sharma	199952	19995200	2.20
15	Ashok Kumar Baheti	190439	19043900	2.16
16	Ram Awatar Kedia	175203	17520300	2.10
17	Madan Lal Kedia	175203	17520300	2.00
18	Suresh Kumar Roongata	104062	10406200	1.84
19	Santosh Rathi	104062	10406200	1.84
20	Binod Kumar Agrawal	97123	9712300	1.09
21	Suresh Chandra Agrawal	97123	9712300	1.02
22	Krishna Murari Agrawal	69374	6937400	1.02
23	Binay Kumar Shah Madwari	69374	6937400	0.73
24	Raj Kumar Tibrewala	69374	6937400	0.73
25	Rajendra Agrawal	69374	6937400	0.73
26	Kabindra Bahadur Shrestha	69374	6937400	0.73
27	Bishwa Nath Shah	69374	6937400	0.73
28	Birendra Kumar Shah	69374	6937400	0.73
29	Jaskaran Sharada	69374	6937400	0.73
30	Nirmal Pradhan	63793	6379300	0.67
31	Damodar P Gautam/Satish Gautam	62436	6243600	0.66
32	Shyam Sunder Agrawal	55500	5550000	0.58
33	Jagadish Kumar Agrawal	48562	4856200	0.51

## Interview schedule

) What is the capital structure of the bank?

Promoter	:	51%
General Public	:	49%
Total Share Capital	:	Rs 95 Crores 22 Lakhs

) Why do you think this capital structure is suitable for the bank?

Yes. Being majority, 51% Promoter has sufficient hold in the Board, which helps to run the Bank as per its principal objectives.

) Do you think the bank has been able to satisfy its shareholders so far?

No, Siddhartha Bank has not been able to provide cash return till date.

However, the Bank has provided stock dividend as follows:

Two times 15% Bonus shares and two times 20% right shares.

As per prudent investment policy, the organization should be able to provide cash dividend at least to the inflation level. In Nepalese context, distribution of Stock dividend can only be beneficial to the general shareholders as they can easily cash the same.

) Is the bank planning to issue any preferred share capital in the near future?

No. Preferred share capital has certain fixed cost, which is not beneficial to the organization in view of uncertainty of profit. Further IPO may be better option if we are planning to increase capital base from outside investment.

) How do you mitigate the financial risk of the bank?

Bank has developed own financial policy guidelines to mitigate financial risk factors, which provides expenses authority to a certain level of the employee. Further to this, there are guidelines issued from Nepal Rastra Bank, Accounting Policies issued by Nepal Account Board, Rules of Income Tax etc. Bank has to follow all these policies / guidelines while doing all financial transactions. Bank follows double entry book keeping system, therefore, there are very few chances to hide any financial irregularities for a long time in the Bank.