

**CAPITAL STRUCTURE AND ITS IMPACT ON RISK AND
RETURN ANALYSIS**

(A Case Study of Dabur Nepal Pvt. Ltd.)

By:

PUSHPA RAJ GAIRE

Centre Department of Management

Campus Roll No.229/064

T.U. Regd. No. 2-241-201-2004

Exam Roll No. 280434

A Thesis Submitted to:

Office of the Dean

Faculty of Management

Tribhuvan University

**In Partial fulfillment of the requirements For the Degree of
Master's of Business Studies (MBS)**

Kathmandu, Nepal

September, 2011

RECOMMENDATION

This is certify that the thesis

Submitted by:

Pushpa Raj Gaire

Entitled

**Capital Structure Decision and Its Impact on Risk and Return
(A Case Study of Dabur Nepal Pvt. Ltd)**

has been prepared as approved by this Department in the prescribed
format of Faculty of Management. This thesis is forwarded for
examination

Mr. Achyut Gyawali
Thesis Supervisor

Prof. Dr. Bal Krishna Shrestha
Chairperson, Research Committee

Prof. Dr. Dev Raj Adhikari
Head of Department

Date :-----

VIVA-VOCE SHEET

We have conducted the viva-voce examination of the thesis presented by

Pushpa Raj Gaire

Entitled

Capital Structure Decision and Its Impact on Risk and Return

(A Case Study of Dabur Nepal Pvt. Ltd)

and found the thesis to be the original work of the student and written according to the prescribed format. We recommend the thesis to be accepted as partial fulfillment of the requirements for the Master's Degree in Business Studies (M.B.S.)

Viva-Voce Committee

Chairperson, Research Committee -----

Member (Thesis Supervisor) -----

Member (External Expert) -----

Member (Central Department of Management) -----

Date: -----

DECLARATION

I hereby declare that the work reported in this thesis entitled to “**Capital Structure and Its Impact on Risk and Return**” submitted to the Office of Dean, Faculty of Management, Tribhuvan University is my original work done in the form partial fulfillment of the requirement for the Masters of Business Studies (**MBS**) under the supervision of lecturer Mr. Achyut Gyawali, Central Department of Management.

.....

Pushpa Raj Gaire

Centre Department of Management

T.U. Reg. No.2-241-201-2004

Date:- September, 2011

ACKNOWLEDGEMENTS

This research study on **“Capital Structure and Its Impact on Risk and Return”** has prepared as a partial fulfillment of Master of Business Studies (MBS) program.

I would like to thanks Chairperson of Research Committee, Prof. Dr. Bal Krishna Shrestha, and I would like to express my heartiest gratitude and sincere thanks to my honorable thesis supervisor Mr. Achyut Gyawali, Lecturer, who encouraged me from the initiation to completion of this task with his scholar guidance and profound comments and suggestion.

And further more I would like to express my friend Namita Sigdel who help me and give me valuable suggestion and encouragement to writing the thesis. Likewise I would like to thank all the respondents who helped in the collection of opinions through research questionnaires. Additionally all the staff of NEPSE, SEBON and deserves the words of thanks.

Lastly, I would like to express my sincere gratitude to my beloved parents who had inspired me during the entire period of my study.

Pushpa Raj Gaire
September, 2011

TABLE OF CONTENTS

| | Page No. |
|---|-----------------|
| RECOMMENDATION | I |
| VIVA-VOICE SHEET | II |
| DECLARATION | III |
| ACKNOWLEDGEMENT | IV |
| TABLE OF CONTENTS | V |
| LIST OF TABLES | IX |
| LIST OF FIGURES | X |
| ABBREVIATIONS | XI |
| CHAPTER – I: INTRODUCTION | 1 |
| 1.1 General Background | 1 |
| 1.2 Introduction of Dabur Nepal Pvt. Ltd. | 3 |
| 1.3 Statement of Problem | 4 |
| 1.4 Objectives of the Study | 6 |
| 1.5 Focus of the Study | 6 |
| 1.6 Significance of the Study | 7 |
| 1.7 Limitation of the Study | 8 |
| 1.8 Scheme of the Study | 9 |
| CHAPTER – II: REVIEW OF LITERATURE | 11 |
| 2.1 Conceptual Framework of Capital Structure | 11 |
| 2.2 Types of Capital | 12 |
| 2.2.1 Common Stock | 12 |
| 2.2.2 Preferred Stock | 12 |

| | |
|--|----|
| 2.2.3 Debentures | 13 |
| 2.3 Capital Structure Theories | 13 |
| 2.3.1 Capital Structure Matters: The Net Income Approach | 15 |
| 2.3.2 Capital structure does not matter: | |
| Net operating income approach | 18 |
| 2.3.3 Existence of optimum capital structure: | |
| The Traditional Approach | 21 |
| 2.3.4 Irrelevance of Capital Structure: | |
| The Modigliani-Miller Approach | 25 |
| 2.3.5 Relevance of Capital Structure: | |
| The M-M Hypothesis under Corporate Taxes | 30 |
| 2.4 Factors Affecting a Target Capital Structure | 33 |
| 2.4.1 Size of the Company | 34 |
| 2.4.2 Stability of Sales | 34 |
| 2.4.3 Growth Rate | 34 |
| 2.4.4 Operating Leverage | 35 |
| 2.4.5 Taxes | 35 |
| 2.4.6 Profitability | 35 |
| 2.4.7 Market Conditions | 35 |
| 2.4.8 Management Attitude | 36 |
| 2.4.9 Control | 36 |
| 2.4.10 Assets of structure | 36 |
| 2.5 Leverage | 37 |
| 2.5.1 Financial Leverage | 38 |
| 2.6 Review of Related Studies | 39 |

| | |
|--|-----------|
| 2.6.1 Review of Journals | 39 |
| 2.6.2 Review of Articles | 41 |
| 2.6.3 Review of Related Thesis | 44 |
| 2.7 Research Gape | 46 |
| CHAPTER - III: RESEARCH METHODOLOGY | 48 |
| 3.1 Research Design | 49 |
| 3.2 Population and Sample | 49 |
| 3.3 Period Covered | 50 |
| 3.4 Sources and Types of Data | 50 |
| 3.5 Data Collection Technique | 50 |
| 3.6 Data Analysis Tools | 51 |
| 3.6.1 Financial Tools | 51 |
| 3.6.1.1 Ratio Analysis | 51 |
| 3.6.2 Statistical Tools | 56 |
| CHAPTER - IV: PRESENTATION AND ANALYSIS OF DATA | 58 |
| 4.1 Analysis of Capital Structure of Dabur Nepal Pvt. Ltd. (DNPL) | 58 |
| 4.1.1 Analysis of Debt Composition | 60 |
| 4.2 Ratio Analysis | 62 |
| 4.2.1 Analysis of Debt and Shareholders' Equity | 62 |
| 4.2.2 Analysis of Debt to Capital Employed Ratio | 64 |
| 4.2.3 Analysis of Long-term Debt to Total Debt Ratio | 66 |
| 4.2.4 Long-term Debt to Total Capital Ratio | 68 |
| 4.2.5 Liquidity Ratio | 69 |

| | |
|---|-----------|
| 4.2.6 Interest Coverage Ratio | 70 |
| 4.2.7 Profit Margin on Sales | 72 |
| 4.2.8 Return on Total Assets | 73 |
| 4.2.9 Return on Net Worth (Common Share Holder) | 74 |
| 4.2.10 Analysis of Total Debt to Total Assets Ratio | 75 |
| 4.2.11 Analysis of EBT to EBIT Ratio | 77 |
| 4.2.12 Analysis of EAT to Total Debt Ratio | 78 |
| 4.3 Analysis of Leverage | 80 |
| 4.3.1 Analysis of Financial Leverage | 81 |
| 4.4 Correlation Analysis | 83 |
| 4.4.1 Correlation between Total Debt and Earning After Tax (EAT) | 83 |
| 4.4.2 Correlation between Debt Equity Ratio and ROE | 84 |
| 4.4.3 Correlation between Debt Ratio and ROE | 85 |
| 4.5 Primary Data Analysis | 86 |
| 4.6 Major Findings of the study | 88 |
| CHAPTER - V: SUMMARY, CONCLUSION AND RECOMMENDATIONS | 90 |
| 5.1 Summary | 90 |
| 5.2 Conclusion | 92 |
| 5.3 Recommendations | 96 |
| BIBLIOGRAPHY | 99 |
| APPENDICES | |

LIST OF TABLES

| | Page No. |
|--|-----------------|
| Table 1.1: factor affecting the performance of DNPL | 7 |
| Table 4.1: Capital Structure Composition of Dabur Nepal Pvt. Ltd. | 59 |
| Table 4.2: Composition of Debt | 61 |
| Table 4.3: Total Debt to Equity of Dabur Nepal Pvt. Ltd. | 63 |
| Table 4.4: Debt to Capital Employed Ratio | 65 |
| Table 4.5: Long-term Debt to Total Debt Ratio | 67 |
| Table 4.6: Long-term Debt to Total Capital of Dabur Nepal Pvt. Ltd. | 68 |
| Table 4.7: Current Ratio of Dabur Nepal Pvt. Ltd. | 69 |
| Table 4.8: Interest Coverage Ratio of Dabur Nepal Pvt. Ltd. | 71 |
| Table 4.9: Profit Margin on Sales of Dabur Nepal Pvt. Ltd. | 72 |
| Table 4.10: Return on Total Assets of Dabur Nepal Pvt. Ltd. | 73 |
| Table 4.11: Return on Net Worth (Common Share holders Equity)of Dabur Nepal Pvt. Ltd. | 74 |
| Table 4.12: Total Debt to Total Assets Ratio | 76 |
| Table 4.13: EBT to EBIT Ratio | 78 |
| Table 4.14: Presentation of EAT to Total Debt Ratio | 79 |
| Table 4.15: Presentation of Degree of Financial Leverage | 82 |
| Table 4.16: Correlation between total debt and Earning after Tax (EAT) | 84 |
| Table 4.17: Correlation between Debt Equity Ratio and ROE | 85 |
| Table 4.18: Correlation between Debt ratio and ROE | 86 |

LIST OF FIGURES

| | Page No. |
|---|-----------------|
| Figure 2.1: The effect of leverage on the cost of capital | 17 |
| Figure 2.2: The effect of leverage on the total market value of the firm | 18 |
| Figure 2.3: The effect of leverage on cost of capital (NOI approach) | 20 |
| Figure 2.4: The effect of leverage on value of the firm | 20 |
| Figure 2.5: The cost of capital behavior (Traditional View) | 24 |
| Figure 2.6: Value of Firm (Under M-M proposition) | 27 |
| Figure 2.7: Cost of capital under the M-M proposition I. | 29 |
| Figure 2.8: Value of levered firm | 31 |
| Figure 2.9: Cost of capital of the levered firm | 32 |
| Figure 4.1: Composition of Capital Structure | 60 |
| Figure 4.2: Composition of Debt | 62 |

LIST OF ABBREVIATIONS

| | |
|------|---------------------------------|
| CA | Current Assets |
| CL | Current Liability |
| DNPL | Dabur Nepal Private Limited |
| EBIT | Earning Before Interest and Tax |
| EBT | Earning Before Tax |
| EPS | Earning Per Share |
| F/Y | Fiscal Year |
| i.e. | That is |
| kd | Cost of Debt |
| ke | Cost of Equity |
| Ltd. | Limited |
| N/A | Not Available |
| NI | Net Income |
| NIA | Net Income Approach |
| NIO | Net Operating Income |
| P/E | Price Earning Ratio |
| Tab. | Tabulated |
| Va. | Value |