CAPITAL STRUCTURE AND PROFITABILITY OF NEPALESE COMMERCIAL BANKS

A Thesis

Submitted

By

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In the

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CERTIFICATE OF AUTHORSHIP

I hereby corroborate that I have researched and submitted the final draft of dissertation entitled **Capital Structure and Profitability of Nepalese Commercial Banks**. The work of this dissertation has not been submitted previously for the purpose of conferral of any degrees nor has it been proposed and presented as part of requirements for any other academic purposes. The assistance and cooperation that I have received during this research work has been acknowledge. In addition, I declare that all information sources and literature used are cited in the reference section of the dissertation.

……………………..

Shalik Ram Acharya

April, 2022

REPORT OF RESEARCH COMMITTEE

It is certified that, thesis entitled **Capital Structure and Profitability of Nepalese Commercial Banks**submitted by Shalik Ram Acharya is an original piece of research work carried out by the candidate under my supervision. Literary presentation is satisfactory and the thesis is in a form suitable for publication. Work evinces the capacity of the candidate for the critical examination and independent judgment. Candidate has put in at least 60 days after registering the proposal. The thesis is forwarded for examination.

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CHAPTER I

INTRODUCTION

1.1 Background of the Study

In order to achieve firm's objective, management should take rational financing decisions regarding optimal capital structure (Goyal, 2013). The capital structure decision is one of the most important decisions made by financial managers.It is the combination of debt and equity capital. It is the aggregation of items appearing on the liability side of the balance sheet minus current liabilities (Khan & Jain, 1997). It is sum of net worth plus preferred stock plus long term debts. Every business firm aims to maximize the wealth of shareholders as measured by the firm's outstanding market price or shareholders' return. To achieve this intended objective, the management of a firm makes various decisions; one is setting an optimal level of capital (Ayalew and McMillan, 2021). Therefore, capital structure decision is considered as one of the effective tools of management to manage the cost of capital. Capital structure consist debt and equity capital which generates firm's assets. Business organizations can use either debt or equity capital to finance their assets. Moreover, enterprises may issue hybrid securities such as income bonds. These hybrid securities possess the features of both equity and debt securities (Nasimi, 2016)

Capital structure decision is crucial for any business firm to maximize the value of shareholders as it supposed to affect the firm's ability to deal with competitive environment. It is an important issue for the business managers today to choose the optimum combination of debt and equity to achieve value maximization by reducing the financing cost. Thus, theoretically capital stricture can play an important role in firm performance and financial stability of the economic system. Its influence on firm performance can be explained in various ways. Debt would improve profitability as the interests paid on debt are tax deductible and leverages the profits of the shareholders. Liabilities also could add operating pressure of managers so that they would take active interest in corporate operations and reduce in-service consumptions (Grossman, and Hart, 1983).

Furthermore, capital structure can affect market decisions by signaling (Ross, 1977), for debt financing would pass investors active signals and it indicates better quality of assets. So operating performance is passively relative to debt ratio. In addition, based on pecking order theory, profitability is negatively relative to book value financial leverage ratio owing too high cost of equity financing (Myers and Majluf, 1984). Capital structure is the matter of great controversy and attention of finance academicians since the publication of seminal paper of Modigliani and Miller (1958). Since the MM's irrelevance theory of capital structure, a lot of literature has been explored in the field of capital structure. However, the dilemma and controversy is still going even after emergence of modern capital structure theories.

There is no doubt that the banking sector plays a significant role in the economicdevelopment of any country. Therefore, performance of commercial bank is crucial not only for the value maximization for their shareholders but also for the overall financial health make-up of a nation. Banks should choose and adjust their strategic financing mix in order to maximize the value and ensure that their operation are not either highly geared or too lowly geared in order to achieve optimal capital structure. Since Nepalese finance companies are not exception of achieving value maximization and risk reduction, this study focuses in identifying the relationship of capital structure with the profitability. In Nepal number of studies has been conducted to examine the determinants of capital structure of different corporations; however,after the merger policy of Nepal Rastra Bank capital structure of Nepalese commercial bank have been changed so this research is specially directed toward commercial of bank after the merger policy. This study aimed at contribution the debate on capital structure and bank's profitability in terms of return on equity (ROE) and return on assets (ROA) (Bhatt & Jain, 2016).

Hence the aim of this study is to helpful to identify the potential problems in performance/ profitability and to examine the impact of financing decision /capital structure on profitability of commercial bank in Nepal with an emphasis on core business operations profitability. This will equip financial managers with applied knowledge of the potential problems in profitability and capital structure, as well as determining their optimal level of capital structure to achieve optimum level of firm's profitability and shareholders' wealth.

1.2 Statement of the Problem

The choice of capital structure is one of the most important strategic financial decisions of firms. Capital structure is the mix of the long-term sources of funds used by a firm. It is made up of debt and equity securities and refers to permanent financing of a firm. It is composed of long term debt, preference share capital and shareholder's funds. The capital structure of a company is made up of debt and equity securities that comprise a firm's financing of its assets.

The capital structure decision becomes more vital for banks because the consequences of bank failure are more disastrous than the failure of other non-financial firm. Buser, at. el. (1981) argued that the capital structure decision of a bank is similar to that of non-financial firm. Although there are considerable inter industry differences in the capital structure of firms due to the unique nature of each industry's business. Most of the studies conducted abroad found a negative relationship between profitability and leverage. Titman and Wessels (1988) concluded that firm with high profit level would maintain relatively lower debt levels since they can obtain funds from plowing back profit. Furthermore, Similarly &Kester (1986) found a significant negative relation between profitability and debt/asset ratios. Rajan and Zingale (1995) also confirmed a significant negative correlation between profitability and leverage in their study. However, some other researchers have concluded that the positive relationship between profitability and capital structure. Taub (1975), in a regression analysis of four profitability metrics against debt ratios found significantly positive association between debt and profitability. Abor (2005) also found a significantly positive relationship between total debt and profitability.

From ongoing research and literature, it is clear that the relationship between capital structure and profitability is not conclusive and requires more empirical study especially in the context of Nepal where rare study has been done in this regard. Therefore, the problem of this research is to study how the capital structure affects the commercial banks profitability in Nepal?

Following are the research questions for the study:

i. What is the capital structure status of commercial bank of Nepal?

ii. What is the profitability position of commercial bank of Nepal?
iii. What is the relationship of capital structure with profitability of commercial of Nepal?
iv. Does capital structure impact on profitability of commercial bank of Nepal?

1.3 Objectives of the Study

The general objective of this study is to examine the capital structure and profitability of commercial banks in Nepal. The specific objectives of this study are:

- To find the capital structure status of Nepalese commercial bank.
- To examine the profitability position of Nepalese commercial bank.
- To investigate the relationship between capital structure variables and profitability of commercial banks in Nepal.
- To examine the impact of financing decision or capital structure on profitability of core business operation of commercial banks in Nepal.

1.4 Rationale of the Study

There are few studies that have been done after the reform on capital structure and profitability of Nepalese commercial bank. This study is important which will provide insight information about capital structure influences on profitability of commercial banks in Nepal.The relationship between capital structure and profitability cannot be ignored because the long-term survivability of firm depends upon the improvement in the profitability of the firm. The interest paid on debt is tax deductible payments, so the addition of debt in the capital structure will improve the profitability of the firm. It is important to know the relationship between capital structure and the profitability of the firm in order to make sound decision on capital structure.So the study is expected to be equally beneficial for bankers, policymakers, regulators and researchers. Moreover, the study will be beneficial for the bankers to improve the performance and allocate the resources in a manner that would actually improve the profitability.

i. This study helps to provide information regarding the composition of capital structure on the basis of term to maturity,

ii. This study had significant role to play in filling gap in understanding of the impact of capital structure decisions on profitability of selected Nepalese commercial bank,
iii. It is also hoped that this study may be able to explore the capital structure of selected commercial banks.
iv. This study will be useful for researchers, students and for those who wants to have further study in details,
v. Similarly, this study may be fruitful to financial institutions.

1.5 Limitation of the Study

This study is required for the partial fulfillment of MBS Degree. Hence, it is subject to some limitations, which affect the studies, and those limitations are given below;

i. Due to the smaller size of sample considered the result obtained from above analysis result may be different from sufficiently large data sample.
ii. The study is limited to only fourcommercial banks, namely Agriculture Development Bank, Himalayan bank ltd, Everest bank ltd,Nic Asia Bank may not represent the whole finance company of Nepal.
iii. Whole analysis depends up on the annual report of concern bank so, it does not represent the qualitative part of the organization.
iv. The study includes only secondary source of data collection.

1.6 Research Gap

The study conducted in Ethiopia the capital structure measured by debt to equity and long-term debt to total assets has a significant positive correlation with return on equity (ROE) and return on assets (ROA) of sampled banks. However, the capital structure measured by debt to assets has a significant negative correlation with ROE and ROA of sampled Banks (Fakadu, 2020), Likewise,it was seen that employing debt negatively affects profitability in Indonesia's evidence. (Patrisia & Nini, 2020), the result also revealed similar finding in study of Ghana (Anofo, Amponteng, & Yin, 2015)and Finding from the study of Czech Republic shows that there is a negative relationship between the short-term debt to the total assets and profitability, between the long-term debt to the total assets and profitability, and between the total debt to the total

assets and profitability(Stekla & Grycova, 2016)and here is the question that is there any relationship between those findings with Nepalese content? To solve the queries, the research has contributed for fulfillment of the gap.

1.7 Organization of the Study

The study is organized in to four parts the first chapter “Introduction” includes background of the study, statement of the problem, research objectives of the study, rational of the study, limitation of the study and organization of the study. The second chapter of the study includes literature review and conceptual frame work. The third chapter of the study includes research design and methodology. The fourth chapter of the study presents the finding of the study. Finally, the study is concluded with the discussion and conclusion in the fifth chapter of the study. Which are as follows;

i. Introduction
ii. Literature review and Theoretical framework
iii. Research methodology
iv. Data analysis and results
v. Summary, Discussion and Conclusion

CHAPTER II

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

2.1 Capital Structure Definition

There have happened various attempts to explain Capital Structure, all of definitions explain thetypes of bonds and the balanced amounts that makeup funding. It is the mix of different sources of long term in the way that impartiality shares, preference shares, debentures, long lived loans and return earning. One of these definitions for Gangeni (2006) that state the study of capital structure attempts to illustrate the mix of securities and sources of finance by companies to finance long-lived loan. The firm needs to make contributions so that not completely wait in trade, let alone display few developments. To finance these money, the firms can use within firm's finance sourcesthat is retained profit and emitting shares for public or use extrinsic source of finance as a loans or bonds.

The term capital structure refers to the relationship between the miscellaneous long-term sources payment in the way that risk capital, preference share capital and equity capital as Parmasivan&Subramanian (2009). Capital makeup is the lasting expenditure of the party represented generally by unending obligation and impartiality and determining the acceptable capital structure is the main resolution of the economic administration cause it is closely had connection with the advantage of the firm. Gitman and Zutter(2012) delineated capital form as the join of unending debt and impartiality uphold apiece firm.

Although, the real levels join of the firm̓s constant long-term loan presented by obligation, stock which takes dividend before others, and ordinaryshares equity can change considerably over opportunity, most firms try to hold their payment mix nearly a mark capital form. According to Ehrhardt& Brigham(2011), the main purpose of the capital construction searchesout comprise of the optimum join of liability and impartiality. A firm̓s capital building conclusion includes allure choice of a goal capital formation, the average adulthood of allure debt, and the particular types of payment it ends to use at some particular occasion. As accompanying operating decisions, managers concede possibility gain building resolutions that are planned to

bemaximize the firm's intrinsic value.From the last definitions, the capital structure maybe outlined as the joining of financial sources to finance the firm's movements. Financial sources can involve the debt and equity that can be used for one firms.

2.2 Optimal Capital Structure

To increase the firm's inborn advantage, the cost of capital construction must evolve into hostile level. When reach this point, that's mean the best capital form is realized. Optimum capital building grant permission be delineated by Parmasivan& Subramanian (2009) as the capital makeup or merger of debt and shareholder's investment that leads to the maximum worth of the firm. Optimum capital combination is the capital building at that the Weighted Average Cost of Capital (WACC) is minimum and with the advantage of the firm is maximums.

Deciding the appropriate capital combination is main resolution of the monetary administration because it is carefully had connectionwith the profit of the firm. Capital form is the constant financing of the firm presented generally by debt and equity. Asaf(2004) states that the "Optimal capital building resources bearing the right balance of debt and equity loan in killing". Debt loan determinations for most businesses includes weigh a order of business-destroy including cost, liquidity, choice of adulthood, and the support and commonness of interest start operating system.

Because the profit of a firm equals the worth of allure future cash flows as in equating, therefore the advantage of the firm is maximized when the cost of capital is underrated. In otherwords, the advantage of future cash flows is at allure capital when the discount rate (the cost of capital) is at allure shortest. By utilizing this equating, the worth of the firm, V, maybe delimited by Gitman and Zutter (2012) as the below;

$$V = \frac{EBIT \times (1 - T)}{ra} = \frac{NOPAT}{ra}$$

Where:

EBIT = Earnings before Interest and Taxes

T = tax rate

NOPAT = net operating profits after taxes, which is the after-tax operating earnings available to the debt and equity holders, EBIT $\times$ (1 - T)

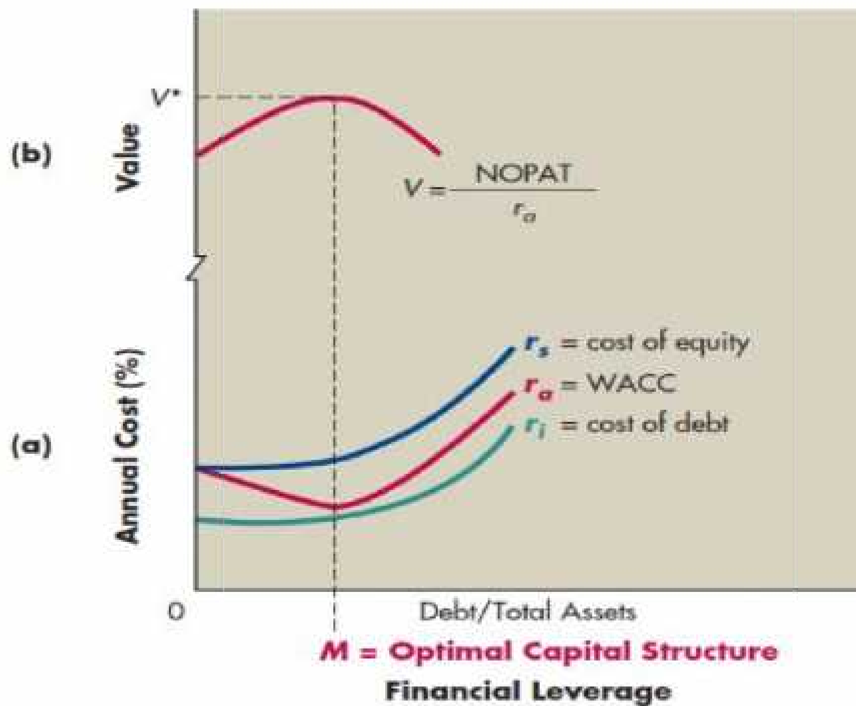
r_a= weighted average cost of capital

Clearly, if pretended that NOPAT (and accordingly EBIT) is continual, the advantage of the firm, V, is maximized by underrating the RA. From figure (a) in next page there are three cost functions: the cost of debt, the cost of equity, and the WACC as a function of economic influence calculated for one liability percentage (Debt to Total Assets). The cost of debt, RI, debris depressed by wayof the tax shield, but it moderately increases as influence increases, to offset lenders for growing risk. The cost of equity,RS, is above the cost of debt cause the stockholders demand a bigger resume fix the greater standard of fiscal risk. The RA results from a weighted average of the firm's debt and equity costs. At zero percentage of debt investment, the firm is fully funded by equity. As debt is substituted for equity and as the debt percentage increases, the WACC declines cause the afterwards-tax liability cost is inferior the equity cost (ri<rs). In this range, the tax benefits of supplementary debt dominate the costs of appropriating more. However, as the debt percentage resumes to increase, the raised deficit and equity costs yet cause the WACC to rise.

2.2.1 Graphical View of Optimal Structure

Because the addition priceless, V, is worked out when the overall cost of capital, ra, is at a minimum (visualize Equation), the optimum capital building is that at that the ra is underrated. In Figure (a), point M shows the minimum WACC the point of optimum monetary influence and therefor e of optimum capital construction for the firm.Figure (b)plots the advantage of the firm that results from replacement of rain Figure (a) for differing levels of monetary influence into the nothing-progress appraisal model in Equation. As proved in Figure (b), at the optimum capital makeup, point M, the profit of the firm is maximized at V*. Simply established, underrating the WACC admits administration to attempt a best number of advantageous projects, through further growing the worth of the firm.

Cost function and Value Capital Cost and the Optimal Capital Structure



Source: Gitman and Zutter (2012, p.536).

However, as efficient matter, skilled is impossible to reckon the optimum capital constructions tacit by Figure. Because it is absurd either to experience or to wait at the precise optimum capital building, in accordance with (Gitman&Zutter, 2012), firms mainly try to function in a range that places ruling class familiar what they trust expected the optimum capital form. From the last figure, firms mostly control toward a mark capital building to reach the maximum advantage by making a blend from impartiality and arrears with rude cost.

2.3 Ideal Capital Market

Taking MM 1958 belief to allure extreme, it could be contended that a guest keep has a capital construction consisting of 100% obligation what will still not at any time influence the value of the party. Furthermore, MM 1958 likewise intended that the wonted ROE is an increasing function of the firm's influence, signification that greater influence should yield a taller return on a guest's impartiality.However, MM 1958 permitted that these propositions were only valid likely sure hypothetical incidental conditions, that is to say a supposed "ideal capital retail". An ideal capital display,

according to (Gansuwan&Önel, 2012), relies concisely establish the life of the following five arrogances:

1. Capital markets are frictionless: No transaction cost or taxes. No costs associated with bankruptcy.
2. All market participants share homogenous expectations: Relevant and homogenous information are available to all actors in the market, hence homogenous expectations from the actors.
3. All market participants are atomistic: No participant on the market can affect the price of a security through trading.
4. The firm's investment program is fixed and known: The firm's capital investment program and thus its assets, operations and strategies are fixed and known to all investors in the market.
5. The firm's financing is fixed: Once it is chosen, the capital structure of the firm is fixed.

Since the MM 1958 propositions depends what arguably could be thought-out very severe tangible conditions, that exceptionally appears expected far removed from the matters of the new trade realm as it is commonly from very vital trade surroundings, globalization of markets an d business and so speedily changeful strategies and trade models for guests.

During the decades that have given since the rise of MM propositions concerning capital building, endless amount of research, in somewhat various guidance, have additional to a degree of new knowledge in the discourse concerning capital building, that will be reviewed in this place affiliate. The beginning of bound for to look at what take careof disputed expected "prevailing" financial research engaged of capital form, post MM.

2.4 Components of Capital Structure

All of the parts on the important side of the firm's financial statement including gains and losses for a period, expelling current responsibilities, are beginnings of capital. Total capital disintegration into two p arts, risk capital and indebtedness capital.

2.4.1 Equity Financing

In parts of capital construction, impartiality share capital shows the takeover capital of the association. It is the lasting capital and cannot be remote all along the period of the party. Owners are the legitimate risk bearers, but they more like rewards. Their responsibility is limited to their capital donated.

Equity shares are common with the establishing class. With impartiality loan by way of common shares, you can defeat or increase your partnership allotment in your association through the auction or purchase of common shares to/from individual or more individuals or bodies in consideration of a particularized amount of services. The accepted impartiality shows the amount that all universal shareholders have provided in a party. Most basically, this contains the profit of the investment representing fractional ownership of a company themselves. However, it further contains kept gain and supplementary compensated-in capital

According to Nawaz, and others., (2011), capital resides of two types: (1) Contributed capital, that is person engaged in private ownership of business that was initially devoted in implausible story in consideration of shares of stock or holding and (2) Retain pay, that show profits from past age that have existed preserved for one association and used to encourage the financial statement including gains and losses for a period or fund progress, earnings, or growth.

If a firm doesn't use obligation outlay, it's refer to as an unlevered firm. This causes success what is refer to as trade risk that is delimited as the risk a firm's accepted stockholders would face if the firm had no obligation (Ehrhardt& Brigham, 2011). In other words, it is the risk owned by the firm's movements, that stands from changeableness about future operating profits and capital necessities. If a firm doesn't use indebtedness therefore its return on spent capital be going to be calculated by return on impartiality. This completely way that deceive someone risk of a influence free firm will be calculated apiece predictable difference of allure ROE.

2.4.2 Debt Financing

The debt capital in a firm's capital form refers to appropriated money namely working in deceive someone. The healthiest type is mainly thought-out long-term bill cause the

guest has age, in another way decades, at hand up accompanying the principal, while paying interest only meantime in accordance with Nawaz, and others. (2011). In parts of capital makeup, certificate of debt capital is any of borrowed capital; the creditors of the association are the certificate of debt owners. Different types of debentures are circulated for the availability of financiers. Also, organizations can get complete and medium term loans frombanks and fiscal organizations. Public Deposits maybe secondhand as mortgage finance; public deposit means some services taken by a non-investment party going around deposit or loan from the public, containing representatives, clients and shareholders of the party apart from in the form of shares and debentures.

When a firm conclude to use arrears financing for allure movements it's confronted accompanying a commercial risk and it's refer to as a lift firm.Ehrhardt& Brigham (2011) defined economic risk as the supplementary risk established on the average stockholders on accountof the resolution to finance with arrears. Financial risk is the chance that the pay of the firm will not be a s discharged by way of the system of loan. Also, the financial risk stands because deficit has a established funding responsibility usually in the form of interest that must be join when the responsibility falls due before the shareholder s can agree the kept revenue. The level of mortgage (financial influence) that is to say agreeable for individual manufacturing or profession maybe highly dangerous in another, cause various energies and lines of trade have various operating characteristics (Gitman&Zutter, 2012).

2.5 Cost of Capital

As interpreted above, capital resides from two elements, individual is debt and different is impartiality. I f a firm property allure movement accompanying liability, it is borrowing services from a bestowed for the range accompanying a certificate of debt person engaged in private ownership of business back with allure interest. In return the bestower sustains interest fees on the loan. With impartiality payment the shareholders buy shares in the party, they enhance owners and in return they sustain any of the firm's profit. Cost of capital usually shows the various costs fastened to the various sources of funding got by an arranging.

2.5.1 Interest (Cost of Debt)

The company keep raise damage in a assortment of habits that contained appropriating assets from financial organizations or from money owed by country in the form of bonds (debentures) for a particularized range at the interest wakida (2011). The party can use differing bonds, loans and added forms of deficit, so this measure is valuable for bestowing an plan concerning the overall rate command a price of apiece association to use mortgage financing. The measure can further present financiers an plan concerning the riskiness of the guest distinguished to remainder ofsomething, cause riskier guests mainly have a bigger cost of bill.

Lenders are comparably demand lower returns because they take the slightest risk of some contributors of complete capital so the cost of deficit is inferior the cost of different forms of funding. Also, the tax deductibility of interest fees lowers the obligation cost to the firm really.

2.5.2 Dividends (Cost of Equity)

When financiers determine venture capital to the firm, they achieve a right to the future profits of that firm likely that they enhance incomplete holder of the association what these profits cannot have in mind from the attack wakida(2011). Businesses have an alternative of lifting capital inside by retaining revenue. The hope cost of employed pay is the rate of return on profit abandoned by impartiality possessors and the cost of extrinsic impartiality is the minimum rate of return that the shareholders demand on finances provided by ruling class by buying new shares for fear that a decline in the existent quoted price of the impartiality share wakida (2011).

Unlike liability capital, that the firm must one-day refund, workingcapital remnants provided in the firm indefinitely—it has no adulthood date. Thetwo elementary beginnings of working capital are (1) stock which takes dividend beforeothers and (2) ordinary shares equity, that involves common shares and employed return. Common stock is usually ultimate high-priced form of impartiality, trailed by employed return and therefore stock which takes dividend before others. In addition, a firm that increases allure use of influence considerably can visualize allure cost of arrears rise as lenders start to take the trouble the firm's skill to restore allure debts. According

toGitman&Zutter(2012), either the firm borrows very little or greatly, it is forever real that the claims of coarse stockholders are riskier than those of lenders, so the cost of impartiality forever exceeds the cost of indebtedness.

2.6 Theories of Capital Structure

In this belief will inspect either the type of damage inside the capital form has an affect a firm's conduct. In order to do so, first will understands the believes that expound a firm's choice of capital building, to visualize when and reason a firm picks bill alternatively impartiality to finance allure movements. These hypotheses are bestowed beneath.

2.6.1 Modigliani & Miller (MM)

In 1958MM penned the item "The cost of capital, allied finance and the belief of loan". This item imported two propositions that had an gigantic impact engaged of finance, what contemporary maybe about finance textbooks secondhand by academies about the realm. The proposition devoirs a firm's capital makeup and allure cost of capital in a perfect capital display. The perfect capital advertise adopts that skilled are no taxes, no undertaking costs what the appropriating and interest rate is the unchanging for societies and things in accordance with Ehrhardt& Brigham, (2011). Five age later MM popularized Proposition I &II, in 1963 they written the item "Corporate Income Taxes and the Cost of Capital: A Correction". It was an continuation and discipline of the Propositions that they had popularized five age former, place taxes had existed contained. The addition of taxes had an effect on two together of the propositions. Below, a reason of two together propositions, accompanying and outside taxes.

2.6.2 Modigliani and Miller: No Taxes

Modern capital construction hypothesis started in 1958, when MM written what has happened named ultimate powerful finance item always composed. MM's study was established few powerful presumption, that contained the following as (Ehrhardt& Brigham, 2011; Quiry and others, 2009).

1. There are no brokerage costs.

2. There are no taxes.
3. There are no bankruptcy costs.
4. Investors can borrow at the same rate as corporations.
5. Investors have the same information as management.

EBIT is invulnerable for one use of debt. The perfect markets belief of capital building contravenes the "here and now" approach. The association can join some ratio of arrears and impartiality to build capital form outside some effect on firm profit cause the profit is liberated of allure capital form as MM 1958 state and the cause determinant for firm advantage is future pay capacity(future cash rush). Although, recognize that these propositions adopt a perfect capital market.

The proposition of no taxes or inappropriate proposition maybe established as Ross and others, (2011), MM Proposition I (no taxes): The worth of the lift firm is the same the profit of the unlevered firm. This is the first proposition of the MM axiom in omission of tariff. It merely states that, in perfect economic markets, the advantage of a lift guest is particularly the same an unlevered association.

Before MM, the effect of influence on the profit of the firm was thought-out complex. MM granted a natural result: if lift firm[s] are valued high-priced, realistic financiers will merely appropriate on their individual reports to buy shares in unlevered firm. This replacement is regularly named home created influence. Homemade influence is a replacement of risks that financiers can have in consideration of move from steep shares in well lift firms to those in unleveredfirms by appropriating in individual reports.

Furthermore, the MM axiom investigates the effect of changeful in influence on total available funds and return on impartiality (point of view of stockholders). Firstly, the effect caused by changeful influence on total available funds is dearth. According to Quiry and others., (2009) this displays the WACC doesn't change, anything the influence.

Secondly, Ross and others., (2011) in their book allied finance: Core Principles & Applications intentional the effect of change in influence on stockholders. They find the change in capital construction benefit the stockholders as long as the profit of the firm increases. Conversely, these changes hurt the stockholders with the understandingthe

advantage of the firm decreases. So, Managers concede possibility pick the capital form that they trust will have the topmost firm worth, cause this capital construction will be most advantageous to the firm's stockholders. This result by means of Olokoyo (2012) in welcome study that find the anticipated return on impartiality is definitely had connection with the influence cause the risk of impartiality increases accompanying influence.

2.6.3 Modigliani and Miller II: The Effect of Corporate Taxes

When MM imported taxes into their proposition in 1963 the result was changed. It was proved that it was advantageous for firms to contain deficit in their capital construction.Firms that are slightly financed by mortgage can reduce the interest it pays on allure arrears; from the tax it has to pay on allure wage as MM 1958. It constitutes a bigger total profit for a firm namely financed accompanying indebtedness and impartiality, a leveraged firm, than for a firm that is to say financed only accompanying impartiality, an unleveraged firm. The worth of firm is effective the advantage of the firm's available funds accompanying no deficit tax shield (advantage of an all impartiality firm) plus the worth of tax shield in the case of continual cash flows.

The Tax Code admits enterprises to reduce interest fees as an expenses, but profit fees to stockholders are not inferable. The characteristic situation boosts businesses to use credit in their capital makeups. This resources that interest fees humble the taxes rewarded by a partnership, and if a enterprise pays less to the management before more of allure available funds is usable for allure financiers. In other words, the tax deductibility of the interest fees shields the firm's pre-tax pay.

The tax shield cultivates expected more forceful than the increase when the mortgage level is depressed. However, as (Malm&Roslund, 2013) when the arrears level reaches the level the increase in the cost of impartiality will be above the decline from the tax shield on account of the raised risk of change mind the bill fees. Since interest fees on indebtedness are tax inferable, the active cost of bill is inferior impartiality private cases. Higher credit influence likewise betters the return on impartiality measure of economic act (Asaf,2004). Debt so is an appealing capital beginning for associations, distinguished to impartiality cause the interest that pays on the credit will

reduce from total income earned and humiliate the amount bound for finance management. However, the cost of mortgage increases as influence increases and credit ratings therefore degenerate. Other belongings staying equal, the benefits of arrears are better when tax rates are higher.

2.6.4 Miller: The Effect of Corporate and Personal Taxes

Merton Miller (existingtime outside Modigliani) later yielded the belongings of private taxes. The wage from bonds is mainly interest, that is burdened as private pay at rates, while gains from stocks mainly comes partially from dividends and at least from capital gains.

If financiers are burdened massively on interest revenue (concerning tax on impartiality wage), they demand taller risk-regulated returns for assets indebtedness (relating to property impartiality), through upsetting the use of damage at the allied level. The private tax burden on interest salary is mainly above that for impartiality pay. Three reasons are bestowed by Graham (1998) for reason the private tax rate on interest income is mainly above that for impartiality revenue.1) Long-term capital gains are frequently burdened at a rate beneath sanctioned individual rates, 2) taxes on capital gains may be negotiated justbefore the gain is earned, and 3) capital gains taxes may be prevented completely if impartiality shares are grasped as far as cessation.

So, approximately, returns on stocks are burdened at lower direct rates than returns on deficit. Because of the tax position, Miller contended that financiers are willing to recognize comparably depressed before-tax returns on stock concerning the before-tax returns on bonds. Thus, as Miller referred, (1) the deductibility of interest favors the use of obligation expenditure, but (2) the more benign tax situation of proceeds from stock lowers the necessary rate of return on stock and so favors the use of shareholder's funding.

2.6.5 Pecking Order Theory

The hierarchy hypothesis was first made acquainted in 1961 by Donaldson, but was later changed and reduced by Myers and Maljuf in 1984. The belief remembrances what type of funding a firm prefers when it is down and out more funding, either it is

within or outside. In this position, in accordance with Ehrhardt& Brigham (2011), the firm first raises capital inside by reinvesting allure pay after deductions and transfer allure temporary bankable bonds. When that supply of money has happened drained, the firm will issue debt and possibly stock which takes dividend before others. Only as a desperate remedy, the firm will issue ordinary shares.

A belief declaring that, all additional belongings being equal, guests pursuing to finance a new project or fruit have an order of favorite outlay alternatives that progresses from ultimate favorite to the least favorite. The order is pronounced to attend this order: within capital (or merely expenditure a project or amount out-of pocket), obligation distribution, damage-impartiality mixture distribution, and impartiality issuance. The reasons reason firms have that order of option concern irregular facts.

Asymmetric facts happen because managers have more facts than the shareholders about united statesof America of the firm and by virtue of what well it is achievement. The result is thus that the shareholders will base their assumption on the fir m's future on the manager's conduct. The manager's conduct is trusted to signal information about United States of America of the firm. According to (Malm&Roslund,2013), emitting shares sends a meaning that the shares are overvalued, inasmuchas emitting indebtedness does not transmit some meaning. Debt emitting is accordingly popular over equity emitting.

As Olokoyo, (2012) pronounced, if firms are necessary to finance new projects by issuing impartiality, under reducing grant permission be so harsh that new financiers capture in addition major computernetwork present profit of the new project, happening in a total amount of moneylost to existent shareholders. As a result,managers will falter to issue impartiality if they feel that it is underestimated forone display. However, financiers realize that managers will waver to issue new impartiality when it is underpriced. Thus, two together managers and financiers respond in accordancewith their applicable facts. Based on this debate, if managers likely to issue underrated impartiality (cheap impartiality), the money will be moved to the investors against the shareholders' benefits and resources. In this position, in accordance with Al-tally (2014), within assets and damage will be favorite to impartiality.

2.6.6 The Trade-off Theory & Financial Distress Costs

The results of MM believe the arrogance that skilled are no default costs. However, disaster maybe completely valuable.Firms in liquidation have very extreme legal and bookkeeping expenses, and they more have a adversity maintaining clients, suppliers, and staffmembers. Moreover, insolvency frequently forces a firm to destroy or advertise property for inferior the y hopeful value if the firm search out persists operating. Also, key operators jump transport, suppliers refuse to grant credit, customers inquire more fixed suppliers, and lenders demand bigger interest rates and set more contrary loan covenants if potential failure looms as Ehrhardt& Brigham (2011). Bankruptcy-accompanying questions are seemingly to stand when a firm involves greatly of mortgage in allure capital building. Therefore, liquidation costs restrain firms from aggressive their use of debt to overdone levels.

As capital form was outlined as join of credit and impartiality, firm have in mind reach the optimum capital construction accompanying shortest WACC and chief firm worth, the deal belief tries to disclose by virtue of what a firm can get an optimum capital structure, by regulating their liability and impartiality levels so skilled is a balance betwixt the benefits from their tax shield and their fiscal distress costs Malm&Roslund(2013). Accordingto the hypothesis, the optimum capital form is attained when the advantage of the tax shield is just counterbalance by the advantage of the fiscal distress costs.

According to the deal models, the optimum capital building does exist. A firm is respected as background an aim da mage level and evenly exciting towards it. The firm's optimum capital construction will include the tradeoff between the effect of allied and private taxes, failure costs and instrumentality costs. Bankruptcy-connected cost was detached for two parts by Ehrhardt& Brigham (2011); (1) the chance of financial distress and (2) the costs that hopeful obtained if fiscal distress does happen.

Main focus of a firm searches out substitute indebtedness for impartiality, with the order reversed in consideration of find optimum liability percentage and exaggerate worth of the firm. Hence, adjustment hypothesis maybe epitomized as adjust the different benefits and costs guide arrears payment to have optimum capital makeup. Debt still has discipline part by way of decline in free available funds

(Gansuwan&Önel, 2012). Tax shield is too main point of the belief. Firms can reduce interest fee of mortgage from tax, suitable way net incomes of the firms increase. In order to exaggerate tax shield, firms may select larger arrears levels. According to Niu (2008), the adjustment belief forecasts that firm appropriateness is reinforced by maximizing the benefit s of the tax shield presented by indebtedness.

It is appealing to note that as age elapse added investigators are ongoing to use the MM belief as a base to initiate further analysis – accompanying few not even be agreeable orsuitable accompanying the relevance of the propositions undercurrent worldwide business- related environments. In their view, the hypothesis means that very advantageous firms endure have gr eater mortgage levels so that cover the profits from tax – a reality that they observe is not situated practical evidence. A continuation to this point given by (Gangeni, 2006) in welcome study, skilled is a limit to what the firm can acquire as the real cost of bill leads to lower worth of the firm – in proper sequence lowering the influence of the tax shield.

2.6.7 Agency Costs (Free Cash flow) Theory

Agency theory can stand if managers and shareholders have various aims. Such conflicts are specifically likely when the firm's managers have excessive cash at their disposition. Managers frequently use glut cash to finance projects no one of that have much to do accompanying maximizing stock prices in accordance with Ehrhardt& Brigham (2011).

Agency costs are costs on accountof conflicts of interest. Two types of conflicts were recognized by (Olokoyo,2012; Niu,2008): first is the conflicts middle from two points shareholders and managers emergent from the position of manager's property inferior 100% of the leftover claim and the second is the conflict betwixt indebtedness possessors and impartiality keepers emergent from the credit contract that form impartiality possessors spend substitute optimally. In order to block this position, principal would always select to increase supplementary requirement in contract or take measures to monitor instrumentality that will certainly increase the appropriate cost.

However, the hypothesis plans that selecting best/optimum capital makeup

concedepossibility check instrumentality conflicts and decrease instrumentality cost. Therefore, in accordance with the belief, extreme influence/indebtedness percentage helps a firm to reduce allure instrumentality cost and diminish instrumentality conflicts. According to (Gansuwan&Önel, 2012), this liability percentage further helps managers to act more in the interests of shareholders. As a result, the firm's worth increases. In addition, the optimum capital form is underrating the instrumentality cost as (He, 2013).

Agency costs of listening managers and their risk-dislike is occasionally infuriate by rectification makeups as managers are only paid for fame, and skilled are punishments for deficiency (Gangeni, 2006). In situations in thismanner, the managers have a moral crisis because they likely to supply instructions their own needs in frontof those of the shareholders. Agency costs hopeful discounted if the firm rewarded greater profits and so the managerswould manage more obviously as they would should beginning capital from the capital markets on an orderly action (Gangeni, 2006). According to Ehrhardt& Brigham (2011), firms can lower glut available funds in a sort of habits. One way searchesout channel few of it back to shareholders through taller profits or stock pay blackmail money for return of possession or person.

2.6.8 Signaling Theory

It was pretended by MM that financiers have the unchanging facts about a firm's prospects as allure managers-this is named symmetrical facts. However, managers really frequently have better facts than outside financiers. According to Ehrhardt& Brigham (2011) this is named irregular facts, and it has a main effect on the optimum capital construction.

Signaling belief states that allied commercial conclusions are signals shipped apiece party's managers to financiers in consideration of upset these asymmetries. These signals are the keystone of commercial systems of information exchange tactics. According to Gangeni(2006), the debate present is that administration will only issue indebtedness or impartiality if skilled are incompetent within money to finance the asked contributions or the risk is not in accordance with the expected returns. In this case, the importance will act recognizing what flows in the type, level and dependability of the news provided. So the managers would not issue supplementary

impartiality if they thought the current stock price was inferior the real profit of the stock (likely their Confidential information). Hence, financiers frequently see a supplementary distribution of stock as a negative signal, and the stock price falls.

2.6.9 The Market Timing Theory

An enlargement of the Signaling belief indicates that managers will use impartiality finance when they trust it is overvalued and use indebtedness when they trust equity is underrated. This is established the premise that they trust they understand information that the firm is put to create better accomplishment from now on than stock exchange now trusts.

In corporate finance, in accordance with Baker &Wurgler (2002), impartiality retail timing refers to the practice of emitting shares at extreme prices and recover possession at reduced prices. The goal searches out exploit makeshift vacillations in the cost of impartiality concerning the cost of added forms of capital. In the effective and joined capital markets studied by MM (1958), the costs of various forms of capital do not change alone, so skilled is no gain from opportunistically exchanging middle from two points impartiality and obligation. In capital markets that are wasteful or separate, by contrast, display organize benefits continuous shareholders at the payment of entering and retiring one. Managers accordingly have inducements to occasion stock exchange if they remember it is attainable and if they care nearly continuous shareholders.

According to Al-Tally (2014), stock exchange organize hypothesis suggests that managers, contingent upon their description of firm worth, likely to issue impartiality when they feel that stock exchange overvalues their party. Market organize is constantly top- secret as few the observable finance history, because it does not explain reason skilled hopeful some advantage mispricing, or reason firms hopeful better smart to communicate when skilled was mispricing than monetary markets. The effect of retail organizes on capital structure checked by Al- tally (2014), the study erect that depressed influence firms are those that raise earnings when their displ ay valuations are extreme, while extreme influence firms are those that raise capital when their display valuations are reduced.

2.6.10 Life Stage Theory

The elementary premise of administrative history stage hypothesis is that firms – in a related fashion to living animals – progress through a set of existence stages that starts at beginning and ends in death.According to Utami&Inanga (2012), firms indifferent biological clock stages have various traits, exceptionally concerning the news irregularity. Mature firms have less facts irregularity when in fact tumor firms have more. This is cause mature and earlier firms are more closely attended by analysts and are better popular to financiers and, therefore, endure less from questions of news irregularity. This belief acknowledged a friendship betwixt capital building and the life stage of the firm. According to this hypothesis, the stages of beginning and progress are conventional accompanying a greater use of damage than impartiality. The mature parties decrease the level of arrears that rises repeated in the decline stage

To visualize the connection 'tween capital structure and firm worth (Chowdhury, A. &Chowdhury, S. 2010) deliberate share price as agent for worth and various percentages for capital building conclusion in Bangladesh. The entertaining verdict plans that maximizing the money of shareholders demands a perfect association of debt and impartiality, inasmuch as cost of capital has a negative equivalence in this place resolution and it has expected as minimums as attainable. This is again visualized that by changeful 1 the capital building arrangement all the while history stages the firm can increase its profit concerning business. Nonetheless, this may be an important procedure suggestion for finance managers, because they can exploit liability to form optimum capital form to be dramatic the money of shareholders.

2.7 Determinants of Capital Structure

Different capital form hypotheses accompanying tax benefits, liquidation costs, and asymmetric news costs were related in the former division. A number of prior pieces of research have proved that capital structure is stirred by additional cause, to a degree country, manufacturing, firm height, firm age, display situations and etc. Thus, the administration needs to believe these cause, that are mainly had connection with the business-related environment, and firm's traits. Some of these causesare secondhand in this place belief as tests for firm's characteristics.

2.7.1 Firm Size

The firm's length is had connection with various topics in the capital firm belief, to a degree irregular news, financial distress costs, undertaking costs, and approachability to the monetary advertise (Lew, 2012).Inaddition to the issue of news asymmetry, additional reasons bestowed by Gansuwan&Önel(2012) for reason tinier companies power acquire less extrinsic expenditure and so have a lower leverage percentage distinguished to best parties, involve the following ones beneath:

1. **Transaction costs:** tinier firm pursuing extrinsic capital is braid higher undertaking costs, as that is to say a function of scale. Meaning that best guests concede possibility obtain scale benefits, that reduces the undertaking costs, while pursuing external capital concerning tinier guests

2. **Market approach:** tinier firms may not have approach to this type of public capital through stock markets (by instance emitting new share issues) and maybe considered less prominent in not being a public p arty, capital display approach as a determinant could again influence the level of outside funding.

3. **Bankruptcy costs:** loss costs of firm cultivate to have an inverse connection accompanying firm height, that is larger firms have lower loss cost than tinier one and with the order reversed. To elaborate, insolvency cost could reach two together in a direct in addition to in an unintended fashion. A model of a direct bankruptcy cost maybe the elimination return and a roundabout cost maybe in the form of the collaborators losing assurance in implausible story complete continuation.

4. **Operating risks:** firms operating risk is disputed to be with the order reversed had connection with the content of the firm, so signification that smaller firms endure inclined to exploit significantly less debt and outside expenditure distinguished to the best one, on account of the perceived operating risk being larger in tinier firms.

Larger firms get benefits fromtheir magnitude and variety because they can appropriate accompanying lower costs and keep financial troubles with more elasticity than tinier firms. Consequently, this endure allow ruling class to perform better than tinier firms

and so produce more profit. Furthermore, abundant firms are expected to obtain lower instrumentality costs for emitting obligation or impartiality, less cash flow airiness, and have smooth approach to the credit advertise. Therefore, big companies proper to hold more arrears in their capital makeups than narrow firms to catch the benefit of the tax shield (Titman &Wessels, 1988). Also, it is argued that tinier firms likely to have abundant temporary indebtedness and less long-term debt on account of the conflict 'tween shareholders and liability holders.

Capital makeup is independent have connection with allied depiction and to find the relation middle from two points magnitude and accomplishment San &Heng (2011) focuses on creation parties which are filed in main board of Bursa Malaysia from 2005 to 2008. All the 49 building parties are detached into grown, medium and small sizes, established the rewarded-up capital. The result shows that skilled is friendship middle from two points capital structure and allied acting. For considerable associations, return on capital accompanying debt to impartiality retail advantage and EPS accompanying long-term deficit to capital have a definite friendship when in fact EPS accompanying debt to capital is in another way accompanying. In theinterim, only operating border accompanying unending debt to prevalent impartiality has helpful friends hip in medium parties and EPS with debt to capital has a negative friendship in small enterprises.

2.7.2 Industry

Each manufacturing concede possibility have specific face that influence the debt makeup of firms on account of manufacturing. These may stand from the various business atmospheres of corporations, the point of competition in amount markets, the capital necessary in these industries, and the ability arrangement of the labors. Titman(1984) presents a model that implies that firms accompanying specific products endure bigger costs with the understanding of bankruptcy, and accordingly will have less bill in their capital form. Since the uniqueness can change from individual industry to another so the firm manufacturing subdivisions influence lever age.

Furthermore, manufacturing is had connection with several determinants in the capital construction hypothesis, suchas failure costs, elimination value, irregular news, collateral profit and macro- financial mechanical trends. Firms accompanying real

property could maintain more advantage when firms go into insolvency, than firms accompanying obscured assets, cause concrete assets will have a taller elimination profit and fewer irregular news costs. In regard to liquidity, Aftab et al., (2012) state that skilled are manufacturing belongings associated with liquidity. Different enterprises have various levels of liquidity to take care of functional necessities in addition to managing the rate of return of the firm.

2.8 Corporate Capital Structure in Developing Countries

It is something generally known that Palestinian filed firms keep under severe governmental and financial income. In other words, it hopeful interesting to report the capital building (and allure cause) of firms that operate under doubtful governmental and business-related position and equate the results with the convenient essay. Based on (Al-Qaisi, 2013) for the time being ending 2003 –2007, the empirical results display that filed Palestinian firms have reduced influence ratios. In addition, the results show that enduring arrears is exactly mythical. Finally, they Seem Ingle Unrelated Regression guess results indicate that while few of the famous cause of capital form (firm size and firm worth) are appropriate to the Palestinian case.

The character and cause of the capital structure choice of Jordanian, Kuwaiti, Omani and Saudi Arabian non-commercial filed associations too checked by (Omet&Mashharawe, 2003). However, depending on the chance of the dossier, the ending samples of guests consist of 51 Jordanian parties, 30 Kuwaiti associations, 38 Omani associations and 29 Saudi Arabian guests. Based on the time ending 1996-2001, the results signify that Jordanian, Kuwaiti, Omani and Saudi parties have completely reduced leverage percentages. In additional discussion, the Jordanian, Kuwaiti, Omani and Saudi Arabian parties have extremely depressed principles of long-term liability in their particular capital structures.

Bas, Muradoglu&Phylaktis (2009) explain the capital construction conclusions of firms in cultivating markets top 25 countries from various domains. In contrast to early studies, the main focus acts the limited firms because their offering to GDP is above abundant firms and they constitute the majority of firms in underdeveloped countries. The study resolve either the cause of capital form show differences between limited, medium and big firms and it check whether the cause of capital makeup is unchanging

for filed and private firms.

Regardless of in what way or manner the firm defines, similarly the capital construction belief, the significance of firm level variables, such as tangibility and appropriateness is habitual. According to the results, private, limited, medium and large firms trail the adulthood corresponding standard and hierarchy on their debt payment determinations. But filed firms favor equity outlay to complete obligation loan. Moreover, internal resources do not have an affect the liability funding conclusions. Another major judgment is the height effect. It's visualize various responses from limited and big firms towards credit outlay. As firms become best, firms enhance more various and risk of breakdown is decreased as aresult of that firms can have taller influence. Based on results, limited and abundant companies have various arrears tactics. Due to the facts asymmetries, small firms have restricted approach to finance; then, they face greater interest costs. Also, they are financially riskier distinguished to big firms. As a result of that, limited guests have restricted approach to liability payment that may influence their tumor.

Economic atmosphere of the nations has affected the damage decisions of firms otherwise. Since abundant and filed firms can have surely access to two together the household and the worldwide economic markets, their financing determinations are unmoved apiece business-related environments of the country as much as the limited, medium and private firms. For instance, abundant firms do reject most of the macroeconomic determinants for their long term indebtedness outlay conclusions. The atmosphere is important for temporary appropriating.

They find dissimilarities in the capital firm conclusions of listed and private firms and limited and abundant associations. Large and filed companies can have surely approach to finance in underdeveloped countries; inasmuch as, for small and private firms, approach to finance is more rested on the environments of financial surroundings of the country.

Prasad, Green &Murinde (2001) analyzed the economic makeup of Malay and Thai non-fiscal guests using a singular new party reports dataset - an crazy panel containing the written reports of 174 filed Thai guests over an average period of about 5. 5 age and 165 filed Malay parties over an average of just under 8 age. The main findings are

fourfold. First, even though the evidence mainly supports the hierarchy theory, there is further evidence to imply a “transposed pecking-order” of finance. Second, they find further evidence to imply that the “brake” of impartiality valuation forbidding over-prepare by useless firms can not to be occupied for two together Malaysia and Thailand. Third, they find that news asymmetries still remain. Fourth, risk is found to have a non-undeviating influence on influence; so the risks of insolvency are non-uninterrupted as postulated for one usual capital firm belief. These findings have main associations for firms in seeing their loan decisions.

Booth and others. (2001) try the allied monetary forms in 10 developing countries: India, Pakistan, Thailand, Malaysia, Turkey, Zimbabwe, Mexico, Brazil, Jordan, and South Korea. They deem either commercial influence decisions and the determinants that influence ruling class vary across countries and either capital- building models improve indicators if the party's nationality is famous.

The dossier, that emanate the International Finance Corporation, contain compressed financials for the best guests in each country from 1980 to 1990, even though not all periods are contained for all countries. This dataset supports ultimate itemized capital-construction data possible for underdeveloped countries. The sample holds a important proportion of the total impartiality funding in each country. The authors analyze three liability percentages:(1) total liabilities detached by total responsibilities plus total amount of money saved, (2) enduring liabilities detached by enduring burdens plus total amount of money saved, and (3) long term debts detached by enduring responsibilities plus average impartiality market value. The first percentage is feasible for all 10 nations, the second for all but Thailand, and the last for almost Thailand, Brazil, and Mexico. All nations except Korea, ultimate grown, have debt beneath the middle level of the G–7 (France, Germany, Italy, Japan, U.S., U.K. and Canada) nations. All are not completely “able” for accounting condition.

They fined roomy dissimilarities in fiscal markets. The ratio of stock exchange funding to GDP ranges from 2.1 portion to 78.5 allotment. Several countries have stock exchange change comparable to that in the United States, but remainder of something have considerably less turnover. Most of the nations have important investment structure co centration and administration-supervised credit procedures. No

powerful relationship is raise middle from two points macroeconomic determinants and capital forms.

The most forceful result is that more- profitable guests use less total bill. Results for the general credit ratio are related but feebler— except that the coefficients of the tangible percentage are largely converse, indicating that a association accompanying more real assets will use more general mortgage but lower total obligation. The complete debt percentage results utilizing stock exchange profit of equity bear be medicated tentatively, still, cause market worth dossier are accessible for only seven nations. The authors conclude that capital-building models have predicting capacity in grown and developing countries. Small, advantageous, taxpaying associations accompanying generally concrete assets likely to have less total indebtedness but more complete bill. Finally, country factors matter not completely nearly monetary variables, except in the case of stock exchange value percentages.

2.9 Firm Performance and Capital Structure

2.9.1 Corporate Performance

One of the main determinants that commit influence the firm's depiction is capital makeup. Since liquidation costs lie, decaying returns follow further use of debt in consideration of the benefits of tax conclusion. Therefore, skilled is an appropriate capital construction further that increases in liquidation costs are above the borderline tax- sheltering benefits guide the supplementary replacement of credit for equity. Firms are not quite increase their efficiency, and underrate their payment cost, by upholding the appropriate capital makeup or the optimum capital building.

However, in accordance with the former information, underestimating the default costs of elimination or reorganization, or the joined interest of two together managers and shareholders, concedepossibility lead firms to have more bill in their capital form than they endure. Therefore, in accordance with Zeitun(2006), extreme levels of indebtedness in the capital form would decrease the firm's conduct. However, not only does a firm's level of influence influenced allied act and failure but still allure indebtedness adult hood form. In other words, the choice of bill construction manage have an affect twotogether allied efficiency and misstep risk. Furthermore, in accordance with Zeitun(2006), there are different determinants besides capital

makeup that can influence firm act to a degree firm amount, age, tumor, risk, tax rate, determinants particular to the area of financial exercise, and determinants specific to macroeconomic surroundings of the country.

Since the basic objective of a trade body search out create profits, acting has existed ultimate main build intentional over ancient times thirty-five age of strategy and allied finance research. According to Chathoth(2002) the main issue that needs expected called in research that tries to authenticate the friendship 'tween atmosphere, plan, building, and firm efficiency applies to the labeling of variables that show the fir m performance build.

In summary, a firm's conduct maybe damaged for one capital makeup choice and for one building of damage adulthood. Also, the tax rate proper to have an affect a firm's acting. So, examining the impact of capital structure on a firm's conduct will determine evidence of the effect of capital building on firm accomplishment. The next division specifies a description of act and the types of act measures.

2.9.2 Performance Measures

The idea of accomplishment is a celebrated case in finance largely on account of allure multi-spatial intentions. Research on firm performance arises arrangement hypothesis and crucial management. Performance measures are either monetary or functional. The choice of the options to nearing accomplishment (either operational or monetary) in accordance with Tudose(2012) is helpless upon the aims that are set; thus the estimate of firm act utilizing commercial indicator s must be completed by an appraisal established non-economic signs; currently, skilled is a shift to evaluate acting basedon profit concoction, still added to the goal of tenable incident.

According to Abdulmalik, and others. (2014), economic efficiency such as profit addition, maximizing profit on property, and maximizing shareholders' benefits are the center of the firm's influence. Operational performance measures, in the way that tumor in marketing and progress in market share, supply a broad description of depiction as they devote effort to something the determinants that ultimately bring about monetary accomplishment.

The calculation of performance is weak upon the facts popularized in the calculation

system and the tool s working. According to Tudose (2012), the classic signs secondhand in financial reasoning to measure depiction have existed the ROI, influence, capital efficiency, liquidity, available funds, stock change, amountowing turnover percentage. The choice of substitutes of determining accomplishment grant permission be influenced for one firm's objective. The evaluation of firm act utilizing financial signs must be completed by an appraisal established non-financial signs that express the characteristic of administration, allied culture, the influence of executive rectification procedures, the characteristic of stockholder communication scheme, etc. Presently, skilled is a style towards determining performance established profit invention, included under the goal of tenable happening Tudose (2012).

A firm's acting maybe calculated in many different habits, contingent upon what the firm wishes to measure. For example, as Malm&Roslund (2013) state, you can measure the acting of individual estrangements of the firm, or the performance of the firm all at once. In this belief the analyst will devote effort to something aggregate performance calculations for the whole firm.

In this belief the investigator will devote effort to something aggregate performance calculations for the complete firm. However, this belief will study the fiscal performance of the firm in conditions of worth. The pick of measures is established what is most commonly secondhand for this type of studies.

2.10 Profitability Measures

2.10.1 Return on Assets (ROA)

The ROA measures the overall influence of administration in produce profits accompanying allure free as sets. The taller the firm's ROA the better the worth measure. ROA is deliberate subject of difference between philosopher in deciding the unit of the mathematical system of equating. The plainest way to decide ROA search out take pay after deductions stated for a ending and separate that by total amount of money saved in accordance with Gitman and Zutter (2012), Ehrhardt& Brigham (2011), and Ross and others. (2011). In contrast, few analysts take EBIT and divide over total amount of money saved in the way that Lindow (2013), Glantz (2003), Ross and others. (2003) as a gross ROA and Friedlob&Schleifer(2003). This is a clean measure of the effectiveness of a party in produce returns from allure property,

outside being affected by administration expenditure conclusions. This study picked objective commercial depiction measures by regulating the interest and tax to judge the act of administration impartially. According to Lindow (2013), Glantz (2003), Ross et al. (2003) as a gross ROA and Friedlob&Schleifer (2003), the ROA is deliberate in this manner:

$$Return\ on\ Assets\ (ROA) = \frac{EBIT}{Total\ Assets}$$

ROA is a measure namely usually used to measure the worth of a firm's movements. ROA measures in what way or manner advantageous the firm is in agreements of allure property. As noticed above, it still signifies the overall fiscal energy of a firm. ROA is a good measure to use to judge a firm's economic conduct. In addition, it is a measure that has existed secondhand by many added investigators when judging the effect of capital form on a firm's acting. It will accordingly be secondhand in our reversion model as a measure of monetary accomplishment. The DuPont scheme of study is used to analyze the firm's economic declarations and to evaluate allure economic condition. It merges the profit assertion and financial statement including gains and losses for a period into two summary measures of worth,ROA and ROE. The DuPont plan first causes together computer network profit border, that measures the firm's appropriateness on buying, accompanying allure total advantage change (ATO), that signifies by what method capably the firm has secondhand allure property to create buying. In the DuPont recipe, the production of these two percentages results in the ROA:

$$ROA = Net\ Profit\ Margin \times Total\ Assets\ Turnover$$

Substituting the appropriate formulas into the equation and simplifying results in the formula given earlier will give the following:

$$ROA = \frac{EBIT}{Sales} \times \frac{Sales}{Total\ Assets}$$

2.10.2 Return on Equity (ROE)

Another percentage that gives an evidence of a firm's overall commercial strength is

ROE. It is a percentage namely secondhand by analysts to judge the conduct of a firm. ROE shows the salary generated for the shareholder's for one impartiality, that is the expenditure supported for one shareholders.

The ROE measures the return gained on the stockholders' property in the firm. The most natural habit to reckon ROE search out take pay after deductions stated for a ending and separate that by shareholders impartiality in accordance with Gitman and Zutter (2012), Ehrhardt& Brigham (2011), and Ross and others.(2011). In contrast, some analysts take EBIT and separate over shareholder's impartiality to a degree Lindow(2013). This is a clean measure of the effectiveness of a party in create returns from allure impartiality, outside being troubled by administration outlay resolutions. This study picked objective economic efficiency measures by regulating the interest and tax to judge the performance of administration impartially. R OE is deliberate in this manner in accordance with Lindow (2013):

$$Return\ Net\ Equity\ (ROE) = \frac{EBIT}{Shareholders\ Equity}$$

Malm&Roslund (2013) state that the ROE it can give an indication of whether a firm is able to find profitable investment opportunities, something that is of great importance for firms that want to stay competitive. A more in-depth analysis of ROE as the follow, the second step in the DuPont system employs the modified DuPont formula. This formula relates the firm's RO to its ROE. The latter is calculated by multiplying the ROA by the financial leverage multiplier (FLM), which is the ratio of total assets to equity as Friedlob&Schleifer (2003):

$$ROE = ROA \times FLM$$

Substituting the appropriate formulas into the equation and simplifying results in the formula given earlier will give the following:

$$ROE = \frac{EBIT}{Total\ Assete} \times \frac{Total\ Assete}{Shareholders\ Equity}$$

After adding the sales turn over to equation become as the follow:

$$ROE = \frac{EBIT}{sales} \times \frac{sales}{Total\,Assete} \times \frac{Total\,Assete}{Shareholders\,Equity}$$

Use of the FLM to convert the ROA into the ROE reflects the impact of financial leverage on owners' return.

Friedlob&Schleifer (2003) state that the measure of success ROE made up of three components:

1. Profit margin to reflect the operating success of a company
2. Asset turnover to reflect the investing success of a company
3. Financial leverage to reflect the financing activities of a company

According to Aftabet.al., (2012) the connection 'tween mortgage and return on equity is supposed expected certain for investment manufacturing different other firms because deficit is the fundamental occupation for the banks and share keepers that is to be further loaned or supplied in different projects to boost pay after deductions. Due to the alike reason the friendship between arrears and development potential for investment manufacturing is erect definite unlike added firms. Banks mainly play an important duty in the business-related incident of all country. One critical conclusion banks face is the arrears-impartialitychoice.

Taani (2013) checked the impact of capital makeup on appropriateness in Jordanian banks. The study covered 12 filed depends upon Amman StockExchange over the ending of 2007 to 2011 and the important verdicts of the study are rehashed beneath: Total debt was raise expected meaningful in deciding net profit and Return on capital working (ROCE) i n the investment industry of Jordan. The obligation/impartiality percentage is usually dependable until 2. It shows the evidence that banks in Jordan depends more on indebtedness (general loans) alternatively working capital. This has re-stressed the case that banks are highly lift organizations. LTD and TD was raise expected meager in deciding ROE in the banking manufacturing of Jordan. This resources that deposits do not inevitably transportation into improving ROE in the investment manufacturing of Jordan.

Salteh et al., (2012) explore the impact of capital makeup on firm depiction. The sample of the study exists of 28 Iranian parties listed in Tehran Stock Exchange. The

result that firm efficiency, that is calculated by (ROE, Market-to-book advantage percentage & Tobin's Q) is considerably and absolutely associated with capital building.

2.10.3 Return on Investment (ROI)

ROI or ROE is mainly viewed as the key conduct measure. The main reason for allure extensive use is that it combines straightforwardly accompanying the bookkeeping process, and is capable of being traced from the revenue affidavit and financial statement including gains and losses for a period.ROI illustrate much profit has existed created concerning the amount of capital spent and it is premeditated as the attend in accordance with ACCA Study Text for Paper F9 Financial Management (2009):

$$Return\ Net\ Investment\ (ROI) = \frac{EBIT}{Capital\ Employed}$$

Where:

$$Capital\ employed = Shareholders\ Equity + Long\ Term\ Liability$$
$$Capital\ employed = Total\ Assets - Short\ Term\ Liability$$

In addition, ROI transmits the return on adopted capital from the various views of subscribers containing creditors and shareholders. Therefore, ROI is a favorite calculation of corporate efficiency because it contrasts computer network salary create accompanying the total worth of property under administration control. Consequently, it shows the influence of administration in agreements of employing firm property and its capacity to generate stockholder profit.

According to Gansuwan&Önel (2012), the advantage is built for the shareholders only when the firm earns a rate of return on new sup plied capital that surpasses allure cost of capital. Additionally, this measure is thought-out more correct than possible choice that revolve around only on the financial statement including gains and losses for a period. ROI depends two financial reports, financial statement including gains and losses for a period (outlay) and earnings report (profit).

Moreover, the connection middle from two points profit and expenditures that create

profit is individual of ultimate established measures of firm accomplishment. As an all-inclusive measure of investment and results, ROI specifies the firm's administration accompanying a plain finish for analyzing acting (Gansuwan&Önel, 2012). Therefore, ROI is secondhand as a basic finish to judge fiscal acting of a firm.

The adeptness of a trade depends upon the functioning of the business. The ROI is captured as a base to measure effectiveness. The effectiveness is mirrored for one profit reaped by implausible story. The effectiveness maybe raised by underrating costs or active use of capital or by growing sales. In case of incompetence, Thukaram(2006) state that the administration can recognize the extents and take healing steps. Inter-firm corresponding is secondhand as a method to judge the accomplishment. The main percentages secondhand in this place relates are return on investment, property change percentage and worth percentages. According to (Bender and Ward,2002), growing the company's return on asset – e.g. making the unchanging return on a lower (venture capital) investment –will increase the means applicable for reinvestment and so increase the sustainable tumor level.

2.10.4 Debt Ratio

The ratio of total liabilities to total assets is called the debt ratio, or sometimes the total debt ratio. It measures the percentage of funds provided by sources other than equity:

$$Debt\ ratio = \frac{Total\ liabilities}{Total\ assets}$$

Assets can involve two together real (feature, long-term assets) and intangible (patents and trademarks) possessions. On the burden side, this percentage usually involves two together short- and complete mortgage. A lower liability percentage indicates that a guest relies less on appropriating as distinguished to impartiality for payment allure property. Generally, the lower the indebtedness to-property percentage the better, but acceptable levels will change across businesses and associations. La rger, resistant and more settled associations can oppose more mortgage outside accumulating too much risk for financiers.

The more certain and resistant the available funds, the smooth and low it is for firms to acquire. Companies in more changeable corporations (like science) may have a harder occasion increasing arrears if periods take flimsy. Creditors favor reduced damage percentages because the lower the percentage, the better the Supportive against creditors' misfortunes as long as of elimination. Stockholders, in another way, can want more influence because it magnifies anticipated earnings.

The credit position of a firm signifies the amount of added people's services being used to create profits. Ingeneral, the monetary accountant is most regard enduring debts because these commit the firm to a stream of allowable fees over the long haul. As Ehrhardt& Brigham (2011) state, the more arrears a firm has, the better allure risk of being powerless to meet allure permissible liability payments. Because creditors' claims must be compensated before the proceeds may be delivered to shareholders, current and potential shareholders pay consolidation of effort to the firm's capability to offset debts.

Rauh and Sufi (2008) show that acknowledgment of credit heterogeneity leads to new visions into the cause of allied capital makeup. They show depressed credit character firms are more inclined have a multi-tiered capital makeup containing twotogether secured bank bill accompanying close covenants and devastate non-bank damage accompanying lax covenants. Further, while extreme credit value firms experience access t o a type of beginnings of unrestricted pliable beginnings of finance, depressed credit status firms depend tight listened secured bank indebtedness for liquidity.

Lenders are further worried about the firm's responsibility. Ingeneral, the more obligation a firm uses concerning allure total amount of moneysaved, the better allure financial influence. According to (Ehrhardt& Brigham,2011), Financial influence is the praise of risk and return through the use of established-cost loan, in the way that mortgage and stock which takes dividend before others. The more established-cost credit a firm use, the greater will be allure wonted risk and return.

Chinaemerem& Anthony(2012) tests the impact of capital construction on commercial efficiency of Nigerianfirms utilizing a sample of thirty non-monetary firms filed on the Nigerian Stock Exchange allalong the seven year ending, 2004 – 2010. The result

shows that a firm's capital form having another in one'splace by Debt Ratio has a considerably negative affect the firm's monetary measures (ROA and ROE).

Leverage is related to worth and the cost of capital. It is usually detached into operational and commercial influence. According to Dahlstr m &Persson(2010), functional influence handles the excitability of EBIT and by means of what an increase in income can influence a lift increase in EBIT depending on the change of changeable costs. Financial influence handles the airiness of gain subsequently tax and in what way or manner the obligation interest deductibility on tax increases advantage to shareholders. As noted above, liability is thinking of as the low beginning of capital and by increasing the tax shield benefit the following in position or time tax cost of damage will be situated lower. As opposite to leveraging the firm in order to gain the benefits guide deficit, firms grant permission still maintain simple liability levels so that wait financially flexible.

The risks guide mortgage payment, for instance costs of commercial distress must more be thought-out when it is projected that a firm can find an optimum capital structure. This balance betwixt the benefits and risks of utilizing indebtedness is refer to as the adjustment hypothesis of capital construction and was bestowed by MM in 1958. The optimum mix of long and temporary liability is contingent upon any of limits containing the firm's apparent credit status (thatis allure credit rating), allure valise of development excuse, the worth of the project, the strength to fun d the project through employed revenue, the elimination worth of the assets, the seen veracity of fiscal news, the firm's magnitude and age, and the level of investment contest (Caprio and Demirgüç-Kunt, 1997).

CHAPTER III

RESEARCH METHODOLOGY

3.1 Research Methodology

This study will follow descriptive research design. Population for the research will be 27 finance companies listed in Nepal. Purposive sampling techniques will be use and sources of data will be secondary sources. Correlational matrix and regression mode will be used for the study.

3.2 Research Design

This study has followeddescriptive and analytical research design for capital structure and profitability of commercial banks in Nepal because the study has analyzed different effect and causes of dependent and independent variable. A research design is the overall path or method by which the research study is guided. It serves as a framework for the study directing the collection and analysis of the data, in which the research method has utilized sampling plan. Research designed is the way through which we find the required answer of the research questions and ultimately meet the research objectives.

3.3 Population and Sample

Purposive sampling technique were taken to select the samples among the total population of 27 commercial banks operating in the country. However, the analysis of all these commercial banks in terms of capital structure and its impact on profitability was onerous to conduct. Moreover, allcommercial banks have not issued debenture and bond.So it was also considered for taking sampling from the population of the study, only four commercial banks; namely Agricultural Development Bank Ltd., Himalayan Bank Ltd., Everest Bank Ltd. and NIC Asia Bank Ltd. Has been taken as the sample of the study.

There are 27 commercial banks in Nepal, among them I haveselectedfourcommercial bankswhich have issued debenture and bond. Following are the samplecommercial banksconsidered in this study.

i. Agricultural Development Bank Ltd
ii. Himalayan Bank Ltd
iii. Everest Bank Ltd
iv. NIC Asia Bank Ltd

3.4 Nature and Sources of Data

The data used in this study are fully secondary in nature. Published annual reports of concerned finance company are taken as basic source of data. The relating to financial performancesisdirectly obtained from the concerned banks. Similarly, related books, magazines, journals, articles, reports bulletins, and Nepal Rastra Bank, related website from internet etc. as well as supplementary data.

3.5 Data Collection Instrument and Procedures

The study uses the secondary data of 10 years obtained Bank Supervision from Reports published by Nepal Rastra Bank (NRB), Reports of Nepal Banker's Association, Annual report of banks and financial institutions etc from 2011 to 2020.

3.6 Data Analysis Tools and Techniques

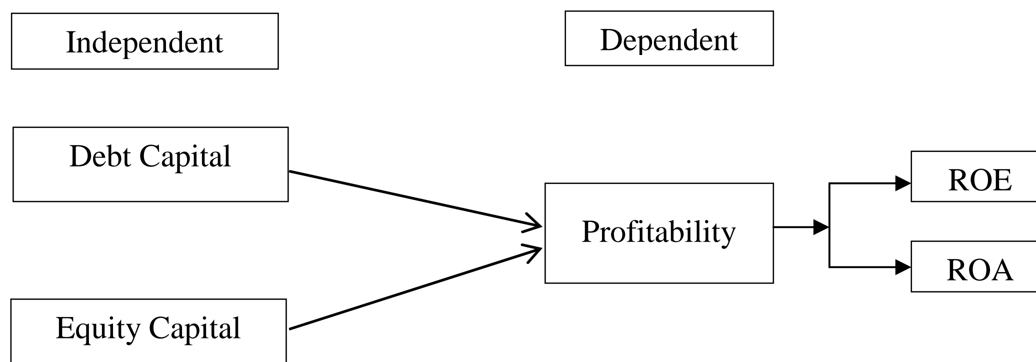
Table will be used to manage data. To test the correlational matrix and regression mode analysis will be used. Microsoft Word, Excel and SPSS (Statistical Package for the Social Sciences) will be used to process and extract the result from the available information.

3.7 Conceptual Framework and Definition of Variable

Conceptual Framework

Conceptual framework is an analytical tool used to make conceptual differences or organize ideas. It is within the framework of this theory that the entire study proceeds. It explains the relationship among the dependent and independent variables explaining how one variable makes an impact on the other.

Below is a figurative representation of the variables to be explored by this research study:-



Source: Nasimi(2016).

Definition of Variable

Independent variables

Sekraran (2012) explained the independent variable as the one which influences the dependent variables in either positive or negative way.Capital structure can be a mixture of a firm's long-term debt, common equity and preferred equity. A company's proportion of short-term and long-term debt is considered when analyzing capital structure. When analysts refer to capital structure, they are most likely referring to a firm's debt-to-equity (D/E) ratio, which provides insight into how risky a company is. Usually, a company that is heavily financed by debt has a more aggressive capital structure and therefore poses greater risk to investors.

i. Interest Coverage Ratio

The interest coverage ratio (ICR) is measure of company's ability to meet its interest payments. It is a financial ratio that measures company’s ability to make interest payments on its debt in a timely manner.

Interest Coverage = EBIT / Interest Expense (Nimalathasan&Brabete, 2010).

ii. Debt to Equity Ratio

Debt/Equity Ratio is used to measure a company's financial leverage, calculated by dividing a company’s total liabilities by its shareholders’ equity. The D/E ratio indicates how much debt a company is using to finance its assets relative to the amount of value represented in shareholders’ equity.

Debt to Equity = Total Debt/ Total Shareholder's Equity (Muhammad, Shah, & Islam, 2014).

iii. Total debt Ratio

Total debt ratio is used to measure a company's financial leverage, calculated by dividing a company's total liabilities by its total assets. The total debt ratio indicates how much debt a company is using to finance its assets.

Debt to Equity = Total Debt / Total Equity (Muhammad, Shah, & Islam, 2014).

Dependent variables

The value of dependent variable is derived from the value of other variables. Sekraran (2012) dependent variable is the one on which the researcher have primary interest.Profitability ratio is a dependent variable for the current study. The independent variables can increase or decrease to the dependent variable. To find out the impact of independent variable on the dependent variable, this study used the regression and the correlation methods.

Profitability ratios are a class of financial metrics that are used to assess a business's ability to generate earnings relative to its associated expenses. For most of these ratios, having a higher value relative to a competitor's ratio or relative to the same ratio from a previous period indicates that the company is doing well. It includes return on equity, return on assets for the current study.

i. Return on Assets

Return on Assets or Investment is the raise in the cash flows produced by the operating cycle as a result of asset or investment outlays. It is the return for aking immediate spending.

Return on Assets = Net Income / Total Assets (Muhammad, Shah & Islam, 2014).

ii. Return on Equity

Return on Equity is the measure of the amount of net income returned as a percentage of shareholder's equity. Return on equity measures a firm's profitability by revealing how much profit a company generates with the money shareholders have invested (Muhammad, Shah, & Islam, 2014).

CHAPTER IV

DATA ANALYSIS

4.1 Descriptive Statistics

In this study Return on Assets, Rreturn on Equity and Return on Investment considered as measurement of banks performance and examine the impact of D/E Ratio, Size (Total capital employed) and Long Term Debt to Total Assets ratio on bank's performance. The table 4.1 shows the characteristics of variables. It revealed that average ROA is 1.9 percent where maximum and minimum ROA are 2.58 and 1.33 respectively. The table also reflect the characteristics of other variables that ROE, ROI, LTDTA, Size and D/E ratio too as below.

Table 4.1: Characteristics of Variable

	ROA in %	ROE in %	ROI in %	LTDTA	Size	DE Ratio
Mean	1.92	0.22	0.28	0.01	8932112654	.26
Std. Deviation	0.53	0.06	0.12	0.01	4105102086	.06
Minimum	1.33	0.15	0.20	0.01	6310349395	.23
Maximum	2.58	0.29	0.46	0.02	14956542951	.36

4.2 Relationship Analysis

Correlation analyses deal the relationship of dependent and independent variables and are analyzed here. Correlation analysis shows the following relationship among the variables which is the integral part of the data analysis of this study.

Table 4.2: Relationship among the Variables

	ROA in %	ROE in %	ROI in %	LTDTA	Size	DE Ratio
ROA in %	1					
ROE in %	.525**	1				
ROI in %	.088**	.722**	1			
LTDTA	.549**	-.644**	-.634**	1		
Size	.709**	-.754**	-.571**	.471**	1	
DE Ratio	-.794**	.384**	-.361**	.020**	-.215**	1

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

As shown in Table 4.2, the correlation coefficient between ROA and Size of organization is highest followed by ROE, and ROI. This indicates the strength of relationship between ROA and Size compared to other independent variables. As all the correlation coefficient is significant at required level of significance, it is referred that there is positive linear relationship between the independent variables and dependent variable included in the study except in the case of negative linear relationship between the ROA with D/E ratio however in order to understand the extent of changes in dependent variable due to change in independent variable, further statistical test needs to be conducted.

4.3 Degree of Relationship Analysis

Regression analyses deal the degree of relationship of dependent and independent variables and are analyzed here. Regression analysis on different dependent variables representing performance of bank shows the following relationship degree among the variables which is the another significant part of the data analysis of this study.

Table 4.3: Degree of Relationship with ROA

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	6.213	0.000		30.011	0.00
LTDTA	4.038	0.000	.617	4.039	0.00
Size	5.370	0.000	.156	8.125	0.00
DE Ratio	-1.520	0.000	-1.780	-18.164	0.00

Dependent Variable: ROA in % , R^2=.651, F=570.378

The estimated regression model of ROA on LTDTA, Size and D/E ratio is highly significant, since F value turned out to be 570.378 and p-value <0.05. The R-square value turned out to be 0.651, which means approximately 65% of the variation in the ROA, is explained by variation in the independent variables. All slope coefficients are highly significant.

Table 4.4: Degree of Relationship with ROE

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.158	0.000		28.013	0.00
LTDTA	91.819	0.000	.077	47.034	0.00
Size	-1.726	0.000	-0.227	-8.128	0.00
DE Ratio	-2.346	0.000	-0.425	-12.171	0.00

Dependent Variable: ROE in %, R^2=.541, F=430.234

The estimated regression model of ROE on LTDTA, Size and D/E ratio is highly significant, since F value turned out to be 430.234 and p-value <0.05. The R-square value turned out to be 0.541, which means approximately 54% of the variation in the ROE, is explained by variation in the independent variables. All slope coefficients are highly significant.

Table 4.5: Degree of Relationship with ROI

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.658	0.000		11.013	0.00
LTDTA	16.864	0.000	0.751	33.034	0.00
Size	-3.681	0.000	-0.692	-6.121	0.00
DE Ratio	-6.505	0.000	-0.326	-12.354	0.00

Dependent Variable: ROI in %, R^2=.841, F=651.132

The estimated regression model of ROI on LTDTA, Size and D/E ratio is highly significant, since F value turned out to be 651.132 and p-value <0.05. The R-square value turned out to be 0.841, which means approximately 84% of the variation in the ROI, is explained by variation in the independent variables. All slope coefficients are highly significant.

D/E Ratio has greater negative impact on ROA followed by positive impact of LTDTA and Size of the bank respectively on the basis of standardized beta coefficient. The study results confirmed that ROA had a significant and negative effect on the D/E ratio of sample bank, with the estimated coefficient (B=-1.780) and p value<0.05 significance level. This result suggests that the D/E ratio does not necessarily increases ROA especially in the context of Banks in Nepal whereas, LTDTA and Size of the banks has the positive significant impact.

A statistical negative relationship of Size of the banks and D/E ratio with ROE and is found to be significant with regression coefficient (B= -0.227) and (B= -0.425) with p<0.000 level, which leads to the conclusion that Nepalese bank has a negative impact on ROE of Size of the bank and D/E ratio. Furthermore, it also revealed that LTDTA has small contribution on ROE with regression coefficient (B=0.077) with p<0.000 Level.

Relationship analysis of LTDTA, Size of the firm and D/E ratio on ROI also revealed similar result as ROE that it has also negative impact on ROI. The regression coefficient of Size of the firm and D/E ratio is (B= -0.692) and (B= -0.326)

respectively with p<0.000 level, which leads to the conclusion that Nepalese bank has also negative impact of Size of the bank and D/E ratio on ROI.

4.4 Major Finding

Analysis of the quantitative information of the Nepalese commercial bank shows that there exists the relationship of size of the firm, long term debt to total assets ratio and debt equity ratio with bank's performance ie., return on assets, return on equity and return on investment. Furthermore, debt equity ratio has the negative impact on all measure of financial performance whereas, size of firm and debt equity ratio has only negative with return on equity and return on investment. Here another supersizing result is long term debt to total assets ratio have significant positive relationship with all financial measures. In the study period individual performance of sample banks also analyzed but all individual results are not presented in this report because of the confidential issue however the result is similar with average result discuss and presented here;

i. The study results confirmed that ROA had a significant and negative effect on the D/E ratio of sample banks.
ii. The estimated regression model of ROI on LTDTA, Size and D/E ratio is highly significant, and model shows that approximately 84% of the variation in the ROI, is explained by variation in the independent variables. All slope coefficients are highly significant.
iii. LTDTA and Size of the banks has the positive significant impact.
iv. This result suggests that the D/E ratio does not necessarily increases ROA especially in the context of Banks in Nepal
v. It was seen that employing debt negatively affects profitability of the commercial bank of Nepal.
vi. Long term debt to total assets has minor contribution on ROE.
vii. Size of the firm and D/E ratio also have negative impact on ROI.

CHAPTER V

SUMMARY DISCUSSION AND CONCLUSION

5.1 Summary

The general purpose of this study was to examine the impact of capital structure on bank's performance. After an extensive review of relevant portion of literature, an attempt was made to test the relationship between ROA, ROE and ROI with Size of bank, long term debt to total assets ratio and debt equity ratio. The rationale for incorporating these variables are clarified and made apparent in literature review section, statement of problem section and methodological sections. The dimension of banks performance is analyzed individually however with the confidential issue individual result is not presented here and used as average scale of four individual banks financial data included in the model. The conclusion of this report should be promoted in our banking sector which will give direction for the formulation of strategy and make plan and policy in an organization. This circumstance intrigued and troubled manifold research questions that led to determination of predictors and variable of interest. The secondary data published by concern banks are used for collection and analysis of data. Moreover, 15% of total population is considered as a sample and random technique is used for sample draw. Everest bank, Sanima Bank, Agriculture development bank and Himalayan bank has been selected during the sample, interestingly government, joint venture and private owned all represented in the study.

Characteristics of the variable, relationship among the variables and degree of relationship are analyzed in the study. The study revealed that D/E Ratio has greater negative impact on ROA followed by positive impact of LTDTA and Size of the bank respectively on the basis of standardized beta coefficient. The study results confirmed that ROA had a significant and negative effect on the D/E ratio of sample bank, with the estimated coefficient (B=-1.780) and p value<0.05 significance level. This result suggests that the D/E ratio does not necessarily increases ROA especially in the context of Banks in Nepal whereas, LTDTA and Size of the banks has the positive significant impact.

Moreover, a statistical negative relationship of Size of the banks and D/E ratio with ROE and is found to be significant with regression coefficient (B= -0.227) and (B= -0.425) with p<0.000 level, which leads to the conclusion that Nepalese bank has a negative impact on ROE of Size of the bank and D/E ratio. Furthermore, it also revealed that LTDTA has small contribution on ROE with regression coefficient (B=0.077) with p<0.000 Level.

Furthermore, relationship analysis of LTDTA, Size of the firm and D/E ratio on ROI also revealed similar result as ROE that it has also negative impact on ROI. The regression coefficient of Size of the firm and D/E ratio is (B= -0.692) and (B= -0.326) respectively with p<0.000 level, which leads to the conclusion that Nepalese bank has also negative impact of Size of the bank and D/E ratio on ROI.

5.2 Conclusion

This study has made an attempt to examine the relationship between Bank's performance and capital sturcture. However, for the purpose of the study, the Bank's performance has been considered as financial performance only. Non financial performance also the vital assets of the organization so it can be the further avenews for researcher. Indeed, the results of the study are concluded as, Analysis of the quantitative information of the Nepalese commercial bank shows that there exists the relationship of size of the firm, long term debt to total assets ratio and debt equity ratio with bank's performance i.e., return on assets, return on equity and return on investment. Furthermore, debt equity ratio has the negative impact on all measure of financial performance whereas, size of firm and debt equity ratio has only negative with return on equity and return on investment. Here another supersizing result is long term debt to total assets ratio have significant positive relationship with all financial measures. In the study period individual performance of sample banks also analyzed but all individual results are not presented in this report because of the confidential issue however the result is similar with average result discuss and presented here

5.3 Discussion

The capital structure measured by debt to equity and long-term debt to total assets has a significant positive correlation with return on equity (ROE) and return on assets

(ROA) of sampled banks. However, the capital structure measured by debt to assets has a significant negative correlation with ROE and ROA of sampled Banks The result is similar to the study conducted in Ethiopia (Fakadu, 2020), It was seen that employing debt negatively affects profitability which is also the similar finding with Indonesia's evidence.(Patrisia & Nini, 2020). The similar result also revealed as study of Ghana (Anofo, Amponteng, & Yin, 2015). Finding from the study of Czech Republic shows that there is a negative relationship between the short-term debt to the total assets and profitability, between the long-term debt to the total assets and profitability, and between the total debt to the total assets and profitability(Stekla & Grycova, 2016) which is also consistent with the finding of this study.

5.4 Implication

From the results of this research, it can be concluded that the capital structure has a negative effect on company performance. Because every addition of debt that is not managed properly will have an impact for company performance. This research also agrees with the trade-off theory where debt if managed as optimal possible will have positively effect for company performance but if addition to debt exceeds profits earned by the company then debt will have a negative effect on company performance. Likewise, with the agency theory where debt can create conflicts between debt holders and shareholders, when company profits increase, the party that enjoys the most success of the company is shareholders but if the company goes bankrupt then the company will be borne by the debt holders and shareholders. Furthermore, the results of this study are useful for managers to help in managing the company's capital structure and can generate greater profits. This research can also help investors to invest, they can see which company has a good capital structure and do not choose a company that has a debt that is greater than the profit generated by the company. The next researcher is suggested for the measurement of capital structure can use other indicators such as DAR, DER and LDER. in performance measurement other companies can use Tobin's Q, EPS, PBV, NPM, ROE and ROI ratios. Then for the company sample it is hoped that the next researcher can add to the observation period.

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