

# **CHAPTER - I**

## **INTRODUCTION**

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

In the economic development of a country financial institution can be considered as a catalyst. The development process of a country involved the mobilization and development of resources. Development of trade, commerce and industry are the prime requisite for the attainment of the economic, political and social goals. To fulfill the purpose of planning, financial functions more often dominates the other functions.

“There is always lack of finance in underdeveloped economy because natural resources are either underutilized or unutilized in productive sectors or even other purposes i.e. social welfare and so on. Likewise, underdeveloped countries are not deficient in land, water, minerals, forest or power resources, though they may be untapped: constituting only potential resources.” And in the underdevelopment countries like Nepal there is always lack of financial resources not only because of its real absence but because of the available resources are not properly mobilized and are not fully utilized for the productive purpose. So, for the rapid economic development in the underdevelopment countries like Nepal there should be proper utilization of resources. Due to various difficulties or even ignorance of the people, such resources have not been properly utilized. Hoarding could be one of the reasons for this. So, financial institutions play a vital role in encouraging thrift and discouraging hoardings by mobilizing the resources and removing the habits of hoarding. They pursue rapid economic growth, developing the banking habit among the people, collecting the small-scattered resources in one bulk and utilizing them in further productive purposes and rendering other valuable services to the country. Thus, this gives the individuals an opportunity to borrow funds

against future income, which may improve the economic well-being of the borrowers. In this course the banks play the most important role in modern economic organization. Their business mainly consists of receiving deposits, giving loans and financing the trade of a country. Bank is a business organization where monetary transaction occurs. It creates funds from its client's savings and lends the same to needy person or business companies in terms of loans, advances and investment. So, proper financial decision making is more important in banking transaction for its efficiency and profitability. Most of the financial decisions of the bank are concerned with current assets and current liabilities. Capital structure is the liabilities part, therefore it is highly riskier and sensitive. Bank is the main financial institution, which plays an important role in the economic development of the nation. It is the backbone as well as the foundation for the development of the country. Its principal operations are concerned with the accumulation on the temporary idle money of the public for advancing others for expenditures. In other words, Bank is an institution that deals and makes loans and derives a profit from the difference in the interest rates paid and charged, respectively. Depositors may be either individuals or institutions. These deposits may be current, saving or fixed and the tenure depends upon the mutual agreements between the bank may be either an individual or institutions. The tenure of the loan may vary as per the demand, criteria and the usefulness of the loan. Some banks also have the power to create money.

The principal types of banking in the modern industrial world are commercial banking and central banking. A commercial banker is a dealer in money and in substitutes for money, such as cheques or bills of exchange. The bankers also provide a variety of other financial services. The basis of the banking business is borrowing from individuals, firms, and occasionally i.e., receiving "deposits" from them. With these resources and also with the bank's own capital, the banker makes loans or extends credit and also invests in securities. The banker makes profit by

borrowing at one rate of interest and lending at a higher rate and by charging commissions for services rendered. Commercial banks are the major financial institutions that occupy quite an important place in the framework in the economy development sectors as well as in saving and investment sectors. Commercial banks are suppliers of finance for trade and industry and play a vital role in the economic and financial life of the country. They also provide an opportunity in the development of individual industries, trade and business organization by investing savings and collected deposits. By investing the saving and collected deposits in the productive sectors, they help in the formation of capital. Besides they also render numerous services to its customers in a view of providing facilities to their economic and social life in the community.

### **1.1.1 An overview of Capital Structure**

#### **Introduction**

**Capital Structure** refers to the combination of long term sources of funds such as debentures, long term debt, preference share capital and equity share capital including reserve & surplus (Gautam and Thapa, 2061:1.2) Capital Structure is the composition of debt and equity securities that comprise a firm's financing of its assets. Both debt and equity securities are used in most large corporations. The choice of the amount of debt and equity is made after a comparison of certain characteristics of each kind of securities of internal factors related to the firm's operation and external factor that can affect the firm (Hampton, 1980:33). Capital Structure is the mix of long term debt and equity maintained by the firm (Gitman, 1988:22). Capital Structure is the mix (or proportion) of firm's permanent long term financing represented by debt, preferred stock and common stock equity (Van Horne and Wachowich, 1997:240).

A firm fulfills its financial needs using different sources of financing. These sources of financing may be long term, and short term. Short-term sources of

financing mature within one year or less whereas fund raised from long-term sources of financing can be used for several years. When a firm expands its business or activity, it needs capital. The term capital denotes the long-term funds of the firm. All of the items on the liabilities side of firm's balance sheet, excluding current liabilities, are sources of capital. The total capital can be divided into two components: debt capital and equity capital.

Capital Structure thus refers to the mix of sources from where the long-term funds required in a business may be raised. In other words, it refers to the proportion of debt capital and equity capital. Capital Structure represents the relationship among different kinds of long-term sources of capital and their amount.

### **1.1.2 Role of Capital Structure**

Capital plays an important role in the business. It requires from the promotional stage up to the end of a business. No business can be operated without capital. So, that capital is labeled as "Life Blood of Business". The capital can be collected from that various sources. The various sources are shares, debentures public deposits, bank loan etc. The financial manager has thus to make decision about the source or their combination to raise such funds. A firm employs substantial amount of debt capital because of tax deductibility of interest payment, flexibility, and lower effective cost. Capital Structure decision is one of the most important decisions that are taken by the financial manager. It is because the capital structure decision affects weighted average cost of capital (WACC), value of the firm and risk position of the firm. For maximization of profit and maximization of shareholders wealth, optimal capital structure should be maintained. Therefore, the role of optimal capital structure is more significant for every business organization irrespective to their nature.

### **1.1.3 Types of Capital**

The total capital can be divided into two components: Debt Capital and Share Capital.

The Capital Structure is made up of debt and equity securities, which comprises a firm's finance of its assets. It is the permanent source of financing represented by long term debt, plus preferred stock, plus net worth; the determination of the degree of liquidity of a firm is no simple task. In the long term run, liquidity may depend on the profitability of a firm but whether it services to achieve long **run profitability** depends to some extent on its capital structure. This term includes only long term debt and total stockholders' investment. It may be defined as one including both short term and long term fund (Western and Brigham, 2003:555).

#### **Debt Capital**

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

#### **Equity Capital**

Equity capital consists of the long-term fund provided by the firm's owners, the stockholders. In other words, equity capital includes common stock, paid in capital (share premium), reserve and surplus, and retained earnings (Gautam and Thapa, 2060).

#### **1.1.4 About the Institution under Study**

##### **Everest Bank Ltd (A Joint Venture with Punjab National Bank-PNB)**

Everest Bank Ltd started its operation in 1994 with a view and objectives of extending professionalized and efficient banking services to various segments of the society.

Everest Bank Ltd is a joint venture bank with Punjab National Bank (PNB-holding 20% equity in the bank).It is the largest nationalized bank in India having 113 years of banking history.PNB is a technology driven bank serving over 35 billion customers through a network of over 4500 branches spread all over the country with a total business of around INR 2178.74 billion. Everest Bank Ltd is the first Nepalese bank to open a representative office in Delhi, India.

The Local Nepalese Promoters hold 50% stake in the Bank's equity, while 20% of equity is contributed by joint venture partner PNB whereas 30% is held by the public.

Everest Bank is providing customer friendly service through a largest network of 34 branches (as on Bhadra 2066) among private sectors banks spread across Nepal and all connected with ABBS. It has a strong joint venture partner providing Technical Support.

Everest Bank Ltd was one of the first banks to introduce Any Branch Banking System (ABBS) in Nepal, which enables customers to do all their transactions from any branches other than where they have their account. Everest Bank is the first private commercial bank having largest network. The bank has been conferred with "Bank of the Year 2006, Nepal" by the banker, a publication of financial times, London. The bank was bestowed with the NICCI Excellence

award” by Nepal India chamber of commerce for its spectacular performance under finance sector.

The bank’s performance under all parameters has been outstanding during the fiscal year 2064-65 after providing for income tax and statutory provisions there was a disposal net profit of Rs.45.01 crore compared to Rs 29.64 crore last year-an increase of 51.86%.

Assets quality has improved by reduction of Non Performing Assets (NPA) to 0.64% from 0.91% in the previous year. This is one of the lowest NPA among the commercial banks in Nepal. The capital adequacy ratio of EBL is 12.04% which is above the requirement of 11.33% set by the central bank.

The corporate vision of EBL is to evolve and position the bank as a progressive, cost effective and customer friendly institution providing comprehensive financial and related services also integrating frontiers of technology and serving various segments of society. EBL is fully committed to excellence in serving the public and also excelling in corporate values.

The corporate mission of EBL is to provide excellent professional services and improve its position as a leader in the field of financial related service. It uses latest technology aided at customer satisfaction and act as an effective catalyst for socio-economic developments.

Everest Bank Ltd is playing a pivotal role in facilitating remittance to and from across globe. Being the first Nepalese bank to open a representative office in Delhi, India, the Nepalese in India can open account in Nepal from the designated branches of PNB and remit their saving economically through banking channel of Nepal. The Bank is also offering Cash Management System through HDFC Bank,

India for managing the funds of corporate exporting to India by collecting their fund from about 183 locations in India. Everest Bank is also providing 365 days banking facility to its customers (Website-[www.everestbanklimited.com](http://www.everestbanklimited.com)).

## **1.2 Statement of the Problems**

Banking industry is one of the fast growing businesses in Nepal. After the liberalization policy was adopted by government, this sector has been developed dramatically. Now, around more than two and half dozen banks are in operation.

Due to security problem and political instability, government could not be able to pay sufficient attention to business and industry sector. Regulation and monitoring by government has been weakened in the banking sector as like others and unfair competition is increasing. Customers and stakeholders are too much sad to hear the news that banks have tried to cartel in taking Treasury Bills time to time.

Other types of non-business practices might have been occurred in this industry. Surely such type of practices will hamper the whole sector. Ultimately the Capital Structure will be affected. The researchers have been watching this type of scenario where the capital structure is not so stagnant and continuous progress. Therefore, the researchers are interested to see the capital structure. Every trouble and problem is focused in capital structure of any company. So, the study is basically concentrated upon capital structure of Everest Bank Ltd.

The basic need of the study is partial fulfillment of the requirement for the degree of Master's of Business Studies (MBS) and apart from that Capital Structure decision is one of the most important decisions that are taken by finance managers. Capital Structure decision affects Weighted Average Cost of Capital (WACC), value of the firm and risk position of the firm. A firm, therefore, should try to find out the structure, which minimizes the WACC and risk and maximizes the value



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

- What is the significance of Capital Structure of Everest Bank Ltd?
- What factors affects the capital structure of the bank?
- What are the important features of capital structure management in Banks of Nepal?
- How does a optimal capital structure provides a stable earnings to its shareholders?
- How capital structure supports to achieve important objectives of the firm?

### **1.3 Focus of the Study**

Financial institutions assist in the economic development of the country. The concept of financial institutions in Nepal was introduced when the first commercial bank, the Nepal Bank Ltd was established on 30<sup>th</sup> Kartik 1994 B.S as a semi government organization. In the fiscal year 2039/040, new banking policy was introduced for the establishment of new banks by the joint investments of foreign nations. The establishment of joint venture banks gave a new horizon to the financial sector of the country. Commercial banks are the heart of the financial system, which plays significant role by collecting scattered surplus funds and deploying these funds in the productive sectors as an investment. They make

funds available through their lending and investing activities to borrowers, individuals, business firms and government establishments.

The main focus of the study is to know the liabilities part of Everest Bank Ltd as well to know the composition of debt and equity. How Everest Bank Ltd is getting highly success in the market? The main function of the manager is to determine the proportion of equity capital and debt capital. So this study is a reference regarding the capital structure of Everest Bank Ltd.

#### **1.4 Objective of the Study**

Each and every research study is conducted with a view of achieving some objectives and this study is of no exception. The main objectives of the study are to examine and analyze the capital structure of Everest Bank Ltd. The specific objectives of this study are as follows:

- To examine the existing financial position regarding the capital structure.
- To analyze the composition of Everest Bank Ltd of the mixture of debt and equity capital.
- To examine the different profitability ratios of Everest Bank Ltd.
- To suggest and recommend the financial position of Everest Bank Limited.

#### **1.5 Limitations of the Study**

None of the study can go beyond the boundary of some limitations and this study is also not an exception. Some limiting factors are unfavorable conditions, situations and other may be the objectives of the study. The scope of the present study has been limited in terms of period of study as well sources and nature of data. The following are the major limitations of the study,

- This study is basically based on secondary data collected from annual reports and financial statements.
- The study covers only five years period (i.e from FY60/61 to FY64/65).

- The study is concerned about Capital Structure of Everest Bank Ltd so; the conclusion drawn from the study may not be relevant for other commercial banks.
- Capital Structure is influenced by various factors, but this study excludes those factors.
- Due to limited time frame the study could not be able to analyze all sectors of the capital structure.
- The sources of input in this study are from limited area due to the researcher's convenience and completion.

### **1.6 Organization of the Study**

The entire study has been organized into five main chapters as:

The first chapter deals with background of the study, statement of problem, focus of the study, objectives of the study, and limitations of the study.

The second chapter is the brief review of literature related to this study. It includes a discussion on the conceptual framework and review of the major studies. It gives an overview of the related literature done in the past related to this study.

The third chapter deals with the research methodology which has been followed to achieve the purposes of the study. It consists of research design, the period covered, nature and sources of data, tools to be used, research variable etc.

The fourth chapter deals with presentation and analysis of data. It gives a clear picture of how the collected data has been presented on the study and how it has been analyzed.

And at last, the fifth chapter shows the summary of whole study, conclusion drawn and recommendations given. This ends the study paper.

Besides these chapters, bibliography and appendices are included in this research paper.

## **CHAPTER - II**

### **REVIEW OF LITERATURE**

#### **2.1 Introduction**

This Chapter highlights the literature related to the present study available from libraries, document collection centers and other information managing bureaus. To show the needs of the research work and justify this work, it is believed to be helpful. Besides these this chapter highlights the literature that is available in concerned subjects as to my knowledge, review of related reports to concerned banks, review of articles and relevant thesis.

#### **2.2 Definition of Bank**

It is very difficult to give a practice definition of a bank, because modern banks perform numbers of functions. So, various writers have defined the bank in different ways. Some of the important and common definitions of a bank are as follows.

A financial institution that is licensed to deal with money and its substitutes by accepting time and demand deposits, making loans, and investing in securities. The bank generates profits from the difference in the interest rates charged and paid.

An establishment for keeping money and valuables safely the money being paid out on the customer's order by mean of cheque.

A corporation empowered to deal with cash, domestic and foreign, and to receive the deposits of money and to loan those monies to third-parties.

A bank is an institution, usually incorporated with power to issue its promissory notes intended to circulate as money (known as bank notes); or to receive the

money of others on general deposit, to form a joint fund that shall be used by the institution, for its own benefit, for one or more of the purposes of making temporary loans and discounts; of dealing in notes, foreign and domestic bills of exchange, coin, bullion, credits, and the remission of money; or with both these powers, and with the privileges, in addition to these basic powers, of receiving special deposits and making collections for the holders of negotiable paper, if the institution sees fit to engage in such business.

A Commercial bank is a business profit seeking organization. So, the main objective of bank is profit maximization. Bank earns profit from the investment of the available resources. The existence of a bank depends upon the beliefs of the clients; people believe that bank deposit is liquid as the cash itself. People believe that bank is always able to meet their obligation. So, the bank must gain the confidence and trust of the people so as to create credits.

It is notable that the bankers are to be considered not only as dealers in money but also the leaders in development works. It is not just the store house of the country's wealth but a reservoir.

From above definition we can say that, commercial banking is the industrialized organization established for the purpose of gearing the economy with accepting the deposit from the public and disbursing the accumulated resources to the needed sectors.

A bank business is basically to buy and selling credits, credit instrument are its stock in trade. Also on the basis of its own credit a bank creates money transferred by credit instrument (Klise, 1972:108).

**In United Dominions (1966), Lord Denning deferred to these words to define a bank:**

"An establishment for the custody of money received from, or on behalf of, its customers. Its essential duty is to pay their drafts on it: its profits arise from the use of money left unemployed by them.

**In Canada, Justice Richards of the Manitoba Court of Appeal (1949) tried his hand at listing the business of a bank as being:**

Receiving money on deposit from its customers;

Paying a customer's cheques or drafts on it to the amount on deposit by such customers, and holding Dominion Government and bank notes and coin for such purpose;

- Paying interest by agreement on deposits.
- Discounting commercial paper for its customers.
- Dealing in exchange and in gold and silver coin and bullion.
- Collecting notes and drafts deposited.
- Arranging credits for itself with banks in other towns, cities and countries.
- Selling its drafts or cheques on other banks and banking correspondents.
- Issuing letters of credit.

Lending money to its customers on the customers' notes, by way of overdraft (or) on bonds, shares and other securities:

Ordinary banking business consists of changing cash for bank deposit for cash. Transforming bank deposits from one person or corporation (one depositor's) to other, giving bank deposit in exchange for bills of exchange government bonds security or unsecured promises of businessmen to repay.

### **2.3 Development of Banking in Nepal**

The word 'bank' may be new and very common but the banking business in Nepal is very old. Since Lichchhavi era, we have record to be in existence of such business. There was a cast Tankadhari in Malla era whose sole job was to collect money and lend them to people.

Shankhadhara Sakhkwa related myth also proves that this business is too old. He made all payments of loan holders in Kantipur City.

In Nepal, 'Tejarath Adda' functioned like bank. It was established during the tenure of Prime Minister Ranodeep Singh (B.S.1933). It was the 1<sup>st</sup> step towards the institution as development of Banking in Nepal. Its main function was to grant loan to government employees at the 5% interest rate. The loan used to be given from government treasury. It was beneficial for the government employees only, not for general public. It did not collect deposits from the general public.

Later in 1933 B.S, in initiation of Sardar Gunjman Singha Sumsher Rana Nepal Bank limited was established. It was a developed and advanced form of Tejarath Adda. It was semi-government organization. It became a unanimous leader in banking industry for about two decades. It played a vital role in expanding banking habit among people. After issuance of Nepali notes in 2002B.S. it played an important role of making people habit transact in Nepali notes.

Nepal Rastra Bank (NRB), the Central Bank of Nepal, was established in 1956 under the Nepal Rastra Bank Act, 1955, to discharge the central banking responsibilities including guiding the development of the embryonic domestic financial sector. Since inception, there has been a significant growth in both the number and the activities of the domestic financial institutions. The Bank is eminently aware that, for the achievement of the above objectives in the present



dynamic environment, sustained progress and continued reform of the financial sector is of utmost importance. Continuously aware of this great responsibility, NRB is seriously pursuing various policies, strategies and actions, all of which are conveyed in the annual report on monetary policy.

Industry and Commerce sectors are the backbone of our country. This sector needs long term loans. Nepal Industrial Development Corporation (NIDC) bank was established to give facilities for industries in 1016 B.S. It provides long term and sometimes midterm loans for industrial sector.

Rastriya Banijya Bank (RBB) is the fully government owned, and is the largest commercial bank in Nepal. RBB was established on January 23, 1966 (2022 Magh 10 BS) under the RBB Act. RBB provides various banking services to a wide range of customers including banks, insurance companies, industrial trading houses, airlines, hotels, and many other sectors. RBB has Nepal's most extensive banking network with over 123 branches. Through its branch network, RBB has been contributing to Nepal's economic development by providing banking services throughout the country.

Agricultural Development Bank, Nepal was established in 1968 under the ADBN Act 1967, as successor to the cooperative Bank. Agricultural Development Bank Limited (ADBL) is an autonomous organization largely owned by Government of Nepal. The bank has been working as a premier rural credit institution since the last three decades, contributing a more than 67 percent of institutional credit supply in the country. Hence, rural finance is the principal operational area of ADBL. Besides, it has also been executing Small Farmer Development Program (SFDP), the major poverty alleviation program launched in the country. Furthermore, the bank has also been involved in commercial banking operations since 1984.

Nepali customers were enjoying the facility of only two commercial banks and Agriculture bank. Government adopted liberal economic policy and allowed to establish banks from private sector and jointly with foreign or local partner. In 2041 B.S Nepal Arab bank limited was established. It was a milestone in the banking history. Because it was first joint venture bank in Nepal. The foreign partner of this bank was Dubai Bank Limited (U.A.E), Nepali partner were Rastriya Bema Sansthan and Security exchange limited. After about one decade Dubai bank limited withdraw its share and now its all shareholders are Nepali persons and institutions. Nepali banking sector has been competitive now. Modern banking techniques have been introduced. They have a great role of setting up banking culture among Nepali People.

Government has replaced the Commercial Bank act 2031 by financial institution ordinance 2060. In these sixty eight years of banking history, it has crossed economic conditions and situation. Due to change in not only the external environment but also the change in situation, now this industry has been backbone of the country. Without banking industry Nepalese economy cannot be imagined now.

## **2.4 Meaning of Capital Structure**

**Capital Structure** refers to the way a **corporation** finances its **assets** through some combination of **equity**, **debt**, or **hybrid securities**. A firm's capital structure is then the composition or 'structure' of its liabilities. For example, a firm that sells Rs. 20 billion in equity and Rs 80 billion in debt is said to be 20% equity-financed and 80% debt-financed. The firm's ratio of debt to total financing, 80% in this example is referred to as the firm's **leverage**. In reality, capital structure may be highly complex and include tens of sources. Gearing Ratio is the proportion of the capital employed of the firm which come from outside of the business finance, e.g. by taking a long term loan etc.

**Capital Structure** refers to the combination of long term sources of funds such as debentures, long term debt, preferences share capital and equity share capital including reserve and surplus (Gautam and Thapa, 2061:1.2). Capital Structure is the composition of debt and equity securities that comprise a firm's financing of its assets. Both debt and equity securities are used in most large corporations. The choice of the amount of debt and equity is made after a comparison of certain characteristics of each kind of securities of internal factors related to the firm's operation and external factor that can affect the firm (Hampton, 1980:33). Capital Structure is the mix of long term debt and equity maintained by the firm (Gitman, 1988:22). Capital Structure is the mix(or proportion) of firm' permanent long term financing represent by debt, preferred stock and common stock equity (Van Horne & Wachowich,1997:240).

The optimum capital Structure may be defined as that capital structure or combination of debt and equity that leads to the maximum value of the firm (Khan & Jain, 1997:8).

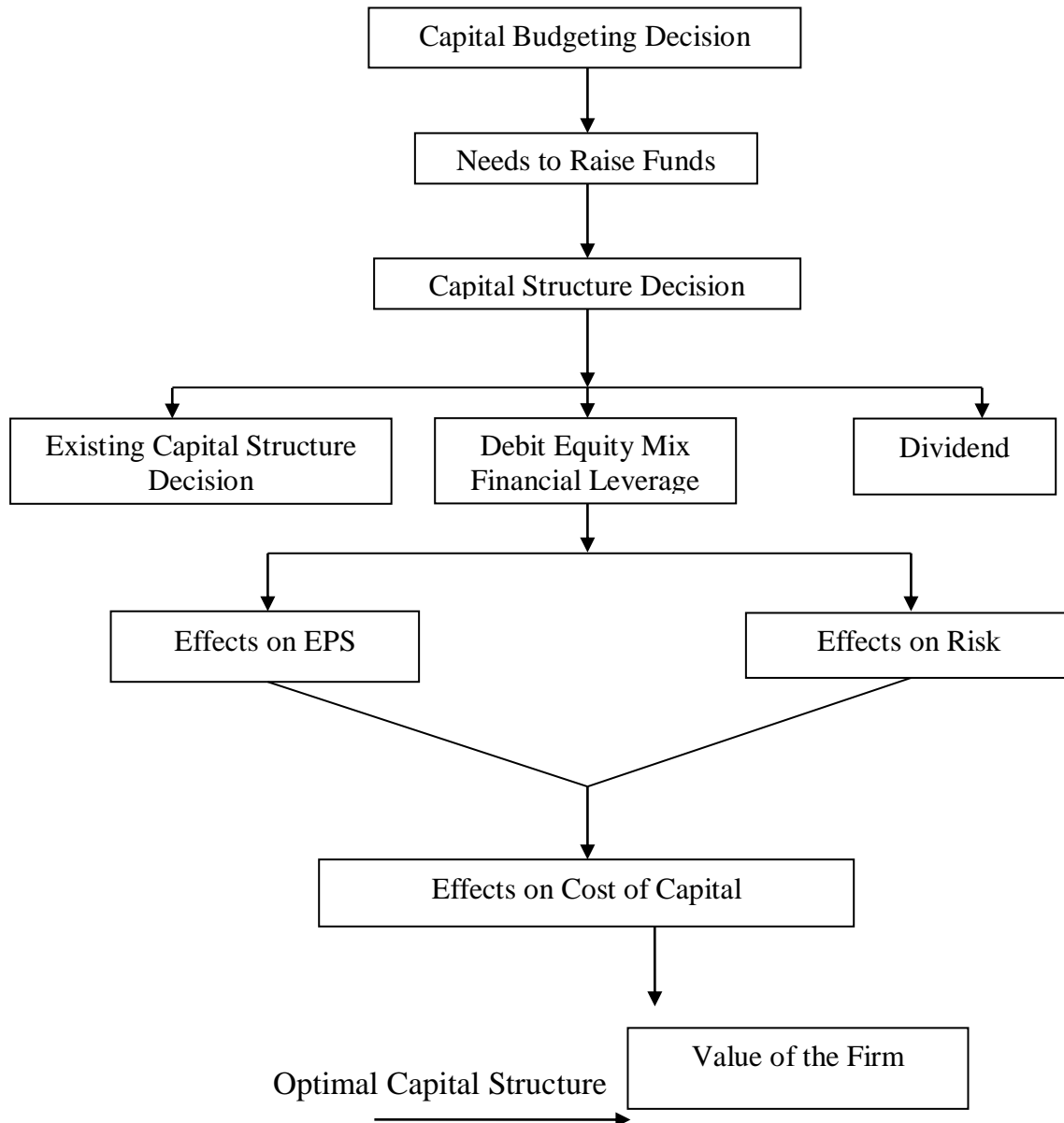
The Capital Structure is made up of debt and equity securities, which comprises a firm's finance of its assets. It is the permanent source of financing represented by long term debt, plus preferred stock, plus net worth; the determination of the degree of liquidity of a firm is no simple task. In the long term run, liquidity may depend on the profitability of a firm but whether it services to achieve long **run profitability** depends to some extent on its capital structure. This term includes only long term debt and total stockholders' investment. It may be defined as one including both short term and long term fund (Western and Brigham, 2003:555).

The main function of manager is to determine the proportion of equity and debt capital. If a company can increase its total valuation by carrying its capital structure, an optimal financing mix would be in existence (Van Horne, 1997:8).

The use of debt capital affects the return and risk of stakeholders and the return on equity as well as risk will increase. A proper balance will have to be struck between return is maximized with minimum risk. The market value per share will be maximized and firm's capital structure would be optimum. Once the financial manager is able to determine the best combination of debt and equity, he must raise the appropriate amount through best available resources. So, the financial manager is concerned with determining the best financial mix or capital structure, the optimal financing mix would exist in which market price per share could be maximized (Pandey, 1980:203).

As earlier stated, the financing or capital structure decision is a significant managerial decision as it influences the shareholders return and risk. Consequently, whenever funds are raised initially at the time of its promotion and subsequently, whenever funds have to be raised to finance investment a capital structure decision is involved (Van Horne, 1997:10).

A process of capital structure decision is shown in figure below.



According to the above capital structure decision chart, demand for funds generates a new capital structure. Since a decision has to be made as to the quality and forms of functioning, the decision will involve an analysis of the existing capital structure and the factor which will govern the decision at the present. The dividend decision bearing on the capital structure may effect its debt equity mix.

The debt equity mix has implication for the shareholders earning and risk which in turn will affect the cost of capital and the market value of the firm.

There may be many components of capital structure the important categories are,

- Common Stock
- Debenture
- Retained Earning

## **2.5 Theories of Capital Structure**

There are many theories proposed by scholars regarding the capital structure.

The major four theories are:

- Net Income Approach
- Net Operating Income Approach
- Traditional Approach, and
- The Modigliani-Miller Approach

In order to have better understanding of capital structure theory, assumptions and definitions are given below.

### **Assumptions**

- Two types of Capital is employed, one is long term debt and another is shareholders equity.
- The firm's total assets remain constant only degree of leverage can be changed by selling debt to repurchase stocks or selling shares to entire debt.
- The net operating income(NOI or EBIT) is not expected to grow.
- All earnings of the firm are paid out in the form of cash dividends or dividend payout rate is 100 percent.
- There is no personal and corporate income tax.
- The firm is expected to continue indefinitely.

In addition to above assumption, the following symbols are employed.

S = Total market value of equity

D = Total market value of debt.

V = Total market value of the firm (V=S+D)

NOI = X = Expected net operating income, i.e earning before interest and ,  
Tax (EBIT)

I = Interest charge (i.e Ke/D)

NI = Y = Net income available to shareholders (EBIT-I), when corporate tax  
does not exist given this assumption, we shall also make use of some  
basic

**Definition,**

1. Cost of debt (Kd) =  $\frac{I}{D}$

So, value of debt (D) =  $\frac{I}{Kd}$

2. Cost of equity (Ke) =  $\frac{Div1}{Po+g}$

$\frac{Div1}{Po+0}$

EPS1/Po (when Div=EPS, then g=0)

So, Ks = (NOI-I)/S

Where,

Div1 = Dividend per share

EPS = Earning per share o next year

Po = Correct market price per share

G = Growth rate

3. Overall cost of capital or weighted average cost of capital

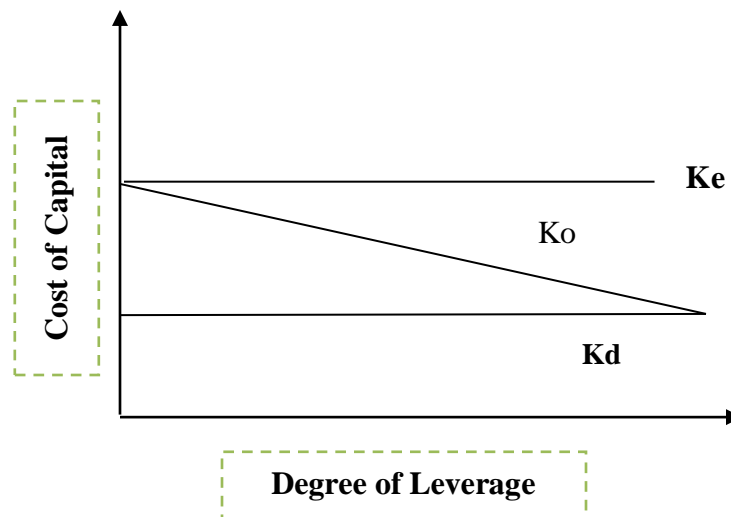
$$K_o = K_e (S/V + K_d (D/V)) = X/V = (NOI)/V$$

4. Total value of the firm (V) = total market value of the common stock + Total market value of the debt.

$$\text{Or, } V = S + d = X/K_o + (NOI)/K_o$$

### 2.5.1 Net Income Approach

The main theme of the Net Income approach, the cost of debt capital and the equity capital remains unchanged when leverage ratio varies.



From the above figure, the degree of financial leverage is plotted along the horizontal axis and the cost of capital figures on the vertical axis. It can be noticed that under NI approach,  $K_e$  and  $K_e$  are assumed not to change with leverage. As the proportion of debt is increased in the capital structure, being less costly, it causes weighted average cost of debt. The optimum capital structure would occur at the point where the value of the firm is maximum and overall cost of capital is minimum. Under NI approach, the firm will have the maximum value of the firm is maximum and overall cost of capital is minimum value and the lowest cost of capital when it is almost debt financed (Pandey,1999:680).



### 2.5.2 Net Operating Income Approach

Another theory of capital structure, suggested by Durand, is the net operating income (NOI) approach. This approach is dramatically opposite to the net income approach. The essence of this approach is that the leverage/capital structure decision of the firm is irrelevant. Any change in leverage will not lead to any leverage in the total value of the firm and the market price of shares, as the overall cost of capital is:

The market value of the firm (V) is determined by  $V = (D+S)$

$$\begin{aligned} &= \frac{\text{NOI}}{K_o} \\ &= \frac{X}{K_o} \end{aligned}$$

Where,

$K_o$  is overall cost of capitalization rate and it depends on the business risk of the firm. It is independent of financial mix. If NOI and  $K_o$  are independent of financial mix, V will be constant and independent of capital structure change.

The capital assumptions of the NOI approach are:

- The market capitalization the value of the firm as a whole. Thus the split between debt and equity is not important.
- The market uses an overall capitalization rate,  $K_o$  to capitalize risk if the business risk is assumed to remain unchanged,  $K_o$  is constant.
- The use of less costly debt fund increase the risk a shareholders. This causes the equity capitalization rate to increase. Thus the advantage of debt is offset exactly. By the increase in the equity capitalization rate,  $K_e$ .
- The debt capitalization rate,  $K_d$  is constant.
- The corporate income tax does not exist.

As stated above, under NOI approach, the total value of the firm ( $V$ ) =  $\frac{NOI}{K_0}$

$$= \frac{BIT}{K_0}$$

Where,

$$V=S+D$$

$$\text{So, } S= V-D$$

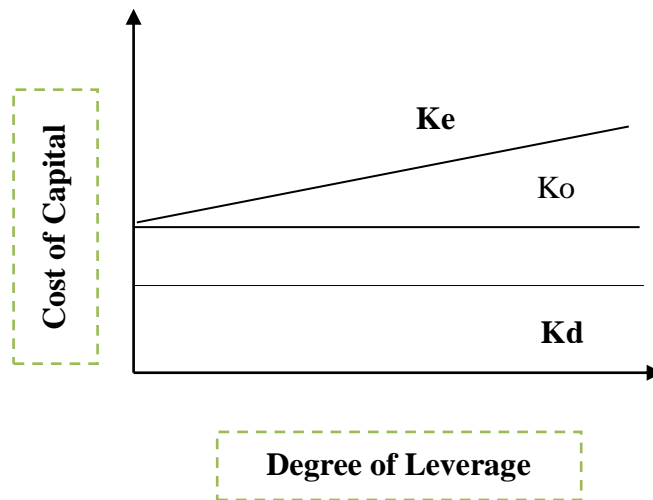
$$\text{The cost of equity [Ke]} = \frac{NOI-I}{V-D} = \frac{NI}{S}$$

Alternatively,

$$K_e = K_0 + \frac{K_0 - K_d}{D/S}$$

Where,

If  $K_0$  and  $K_d$  were constant,  $K_e$  would increase Linearly with debt-equity ratio  $D/S$ .



From above figure, it shows that  $K_0$  and  $K_d$  are constant and  $K_e$  increase with leverage continuously. As the average and the cost of capital,  $K$  is constant; this approach implies that there is not only any unique optimum capital structure. In

other words, as the cost of capital is the same at all capital structure, every capital structure is optimum (Pandey, 1999:683).

### **2.5.3 Conceptual Views**

The traditional view, which is also known as an intermediate approach, is a compromise between the net income approach and the net operating approach. According to this view, the value of the firm can be increase or a judicious mix of debt and equity capital can reduce the cost of capital. This approach very clearly implies that the cost of capital decreases with the reasonable limit of debt and then increase with leverage. Thus, an optimum capital structure exists, and it occurs when the cost of capital is minimum or the value of the firm is maximum (Bares, 1983:44).

The NI and NOI approach hold extreme views on the relationship between the leverage, cost of capital and the value of the firm. In practical situation, both these approaches seem to be unrealistic. The traditional approach takes a compromising view between the two and incorporates the basic philosophy of both. It takes a midway between the NI approach (that the value of the firm can be increased by increasing the leverage) and the NOI approach (that the value of the firm is constant irrespective of the degree of financial leverage).

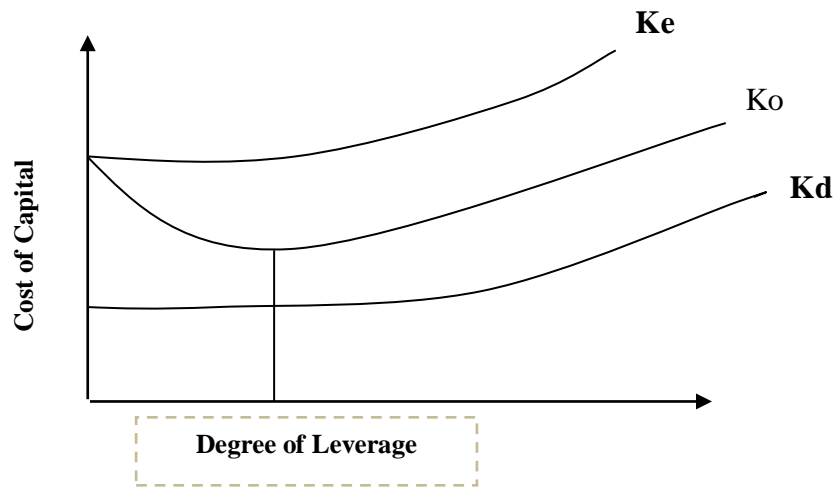
As per the traditional approach,, a firm should make a judicial use of both the debt and equity to achieve a capital structure which may be called the optimal capital structure. At this capital structure, the overall cost of capital, WACC, of the firm will be minimum and the value of the firm maximum. The traditional view point states that the value of the firm increases with increase in financial leverage but up to a certain limit only. Beyond this limit, the increase in financial leverage will increase its WACC also and hence the value of the firm will decline.

Under the traditional approach, the cost of debt  $K_d$ , is assumed to be less than the cost of equity  $K_e$ . In case of 100% equity firm,  $K_o$  is equal to  $K_e$  but when (cheaper) debt is introduced in the capital structure and the financial leverage increases, the  $K_e$  remains same as the equity investors expect a minimum leverage in every firm. The  $K_e$  does not increase with the increase in leverage. The argument for  $K_e$  remaining unchanged may be that up to a particular degree of leverage, the interest charge may not be large enough to pose a real threat to the dividend payable to the shareholders. This constant  $K_e$  and  $K_d$  makes the  $K_o$  to fall initially. Thus, it shows that the benefits of cheaper debts are available to the firm. But this position does not continue when leverage is further increased.

The increase in leverage beyond a limit increases the risk of the equity investors also and as a result the  $K_e$  also starts increasing. However, the benefits of the use of debt may be so large that even after offsetting the effects of increase in  $K_e$ , the  $K_o$  may still go down or may become constant for some degree of leverages.

However, if the firm increases the leverage further, then the risk of debt investors may also increase and consequently the  $K_d$  also start increasing. The already increasing  $K_e$  and the now increasing  $K_d$ , makes  $K_o$  to increase. Therefore, the use of leverage beyond a point will have the effect of increase in the overall cost of capital of the firm and thus results in the decrease in value of the firm.

Thus, there is a level of financial leverage in any firm, up to which it favorably affects the value of the firm but thereafter if the leverage is increased further, then the effect may be adverse and the value of the firm may decrease.



Thus, as per the traditional approach, a firm can be benefitted from a moderate level of leverage when the advantages of using debt (having lower cost) outweigh the disadvantages of increasing  $K_e$  (as a result of higher financial risk). The overall cost of capital  $K_o$ , therefore is a function of the financial leverage. The value of the firm can be affected therefore, by judicious use of debt and equity in the capital structure.

#### 2.5.4 The Modigliani Miller Approach

Modigliani and Miller supplied rigorous challenges to the traditional model. According to them, the cost of capital and so also the value of firm remains unaffected by leverage employed by the firm. Thus MM agreed that any regional choice of debt and equity would result in the same cost of capital under their assumptions and there is no optimal mix of debt and equity financing. The independence of capital arguments based on the hypothesis that regardless of the effect of leverage on interest rates, The equity capitalization rate will rise by and amount sufficient cost debt. The content that cost of capital is equal to capitalization rate of pure equity stream if income class and the market value is ascertained by capitalizing its expected income at the appropriate discount rate for its risk class. So long as the business risk remains the same the capitalization (cost

of capital) will remain constant remaining constant the capitalization rate (cost of equity capital) will raise just enough to offset the gains resulting from application of low cost debt (Srivastav,1984: 88).

### **Assumptions**

The MM hypothesis can be best explained in terms of their proposition (i) and (ii) should however, be noticed that there proposition are based on certain assumption. The assumption a described below, particularly related to the tax environment.

- 1) Perfect capital markets: Securities (share and debt instrument) are traded in the perfect capital market situation. This specifically means that.
  - Investors are free to buy or sell securities.
  - They can borrow without restriction at some term as the firm do.
  - They behave rationally, it is also implied that the transaction costs, i.e. the cost of buying and selling securities, do not exist.
- 2) Homogenous risk classes; Firms can be grouped into homogenous risk classes. Firms would be considered to belong to a homogenous risk class if there expected earning has identical risk characteristics.
- 3) Risk: The risk of investors is defined in terms of the variability of the net operating income (NOI). The risk of investors depends on both the random fluctuation of the expended NOI and the possibility that the actual value of the variable may turn out to be different then their best estimate.
- 4) No Taxes: MM assumes that nom corporate income tax exists.
- 5) Full Pay Out: Firms distributed as net earnings to the shareholders, which means a 100% pay out.

**Proposition-1**

Given the above stated assumption, MM argue that, for firms in the same risk class, the total market value is independent of the debt-equity mix and given by capitalizing the expected net operating income by the rate appropriate to the risk class (Modigliani and Miller, 1985:266).

This is proposition (1) and can be expressed as follows:

$$V = (S+D) = X/K_o = \text{NOI}/K_o \dots \dots \dots (i)$$

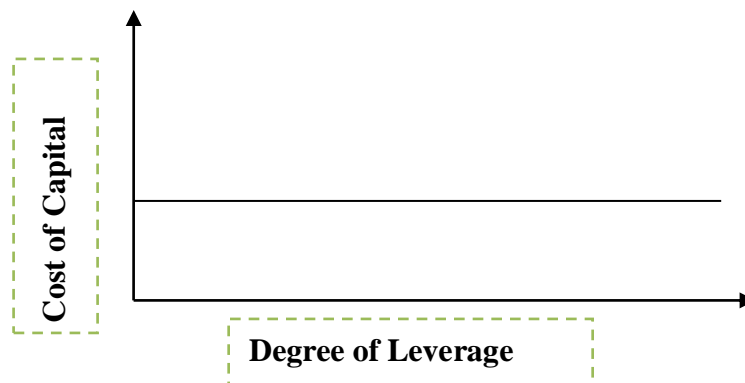
Where,

- V = The market value of the firm.
- S = The market value of the firm’s common shares.
- D = The market value of the debt.
- X = The expected net operating income (EBIT).
- K<sub>o</sub> = The capitalization rate appropriate to the risk class of the firm from equation (i)

$$K_o = \frac{\text{NOI}}{V}$$

$$\text{So, } K_e(S/S+D) + K_d(D/S+D)$$

The cost of capital function as hypothesized by MM through proposition (i) is shown in figure below. It is evident from the figure that the average cost of capital is constant and is not affected by leverage cost of capital.



**Arbitrage Process**

The simple principle of proposition (i) is that firms identical in all respects except for their capital structures cannot command different market values or have different cost of capital. MM does not accept the NI approach as valid. There option is that if two identical firms, except for the degree of leverage, have market values arbitrage (or switching) will take the place to enable investors to engage in personal or homemade leverage as against the corporate to restore equilibrium in the market (Pandey, 1999:688).

The essence of the arbitrage process is the purchased securities or assets whose prices are lower (under valued securities) and, sale of securities whose prices are higher, in related markets which are temporarily out of equilibrium. The arbitrage process is essentially a balancing operation implies that a securities cannot sale at different prices.

**Proposition-2**

MM's proposition's, which defines the cost of equity, follows from their proposition 1. The cost of equity formula can be derived from MM's definition of the average cost of capital. The expected yield or equity or the cost of equity is defined as follows,

$$K_e = \frac{X - K_d}{S} \dots\dots\dots (ii)$$

Since, we know that,

$$K_o = \frac{X}{V} \dots\dots\dots (iii)$$

and,

$K_o$  and  $V$  are constant by definitions, then we obtain the following equation.



$$X=K_oV=K_o(S+D)\dots\dots\dots(iv),(V=S+D)$$

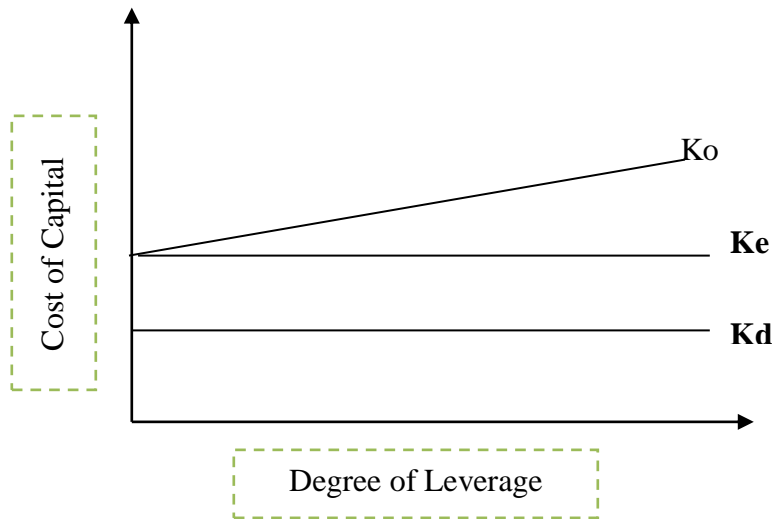
Substituting equation (iv), into(ii)

We have,

$$\begin{aligned} K_e &= (K_o(S+D)-K_d)S \\ &= (K_oS+ K_oD-K_dD)/S \\ &= K_o + (K_o-K_d)D/S\dots\dots\dots(v) \end{aligned}$$

Equation(v) state that, for any firm is a given risk class, the cost of equity,  $K_e$  is equal to the constant average cost of capital,  $K_o$  ,plus premium for the financial risk, which is equal to debt equity ratio times spread between the constant average cost of capital and cost of debt  $(K_o-K_d)D/S$ . The cost of equity,  $K_e$  is a linear function of leverage measured by the market value share to shareholders equity, but always increased cost of equity, The benefit of leverage is exactly taken of the increase cost of equity, also consequently the firms marketing value will remain unaffected. It should however be noticed that the functional relationship.

$K_e=K_o+(K_o-K_d)D/S$  is valid irrespective of particular valuation theory.



From the above given figure, MM insists that the arbitrage process will work and that increase with debt  $K_e$  will become less sensitive to further borrowing. The reason for this is the debt holders, in the extreme situation, own the firm's assets and bear some of the firm's business risk since the risk of shareholders is transferred to debt holders,  $K_e$  declines (Pandey, 1999:692).

The arbitrage process may fail to bring equilibrium in the capital market, for the following reasons. The assumption that firms and individual can borrow and lend at the same rate interest doesn't hold well in practice. It is incorrect to assume that Personal (home made) leverage is a perfect situation. The existence of transaction cost also interface with the working of arbitrage. Institutional restriction also impedes the working of arbitrage. The incorporation of the corporate income taxes will also frustrate MM's conclusion (Pandey, 1999:260).

The capital structure theories try to explain the nature and composition but not seem to be enough to explain for all structure. It should be noted that sound capital structure should enhance profitability while maintaining flexibility and solvency and enabling to control this situations. It should also be conservative to ensure not relevance on debt excessively.

## **2.6 Determinants of the Capital Structure**

### **2.6.1 Earning Per Share**

The use of fixed cost sources capital to finance, such as debt and Preference share capital to the finance, the assets of the company is known as financial leverage of trading of equity.

The leverage effect of EPS is more important consideration in any capital structure planning of the firm. Leverage is to increase shareholders equity.

EPS is calculated as follows:

$$\text{EPS} = \frac{\text{Net Profit After Taxes} - \text{Preference Dividend}}{\text{No of Common Shares Outstanding}}$$

Earnings Per share are one of the most used measures of the firm's performance. It has positive and negative considerations. For example, when a firm has to maximize EPS, the plant will choose the highest level of debt. In most cases, EPS criterion will favor debt. It may be that if the firm's cost after tax borrowing is less than its return of EPS (Earning Price) ratio, then it's the content EBIT, EPS will always increase with an increased leverage. On the other hand, after tax borrowing is greater than earning price ratio.

### **2.6.2 Cost of Capital**

The cost of sources of finance is the minimum return expected by its suppliers. The expected return depends on the degree of risk assumed by investors. A high degree of risk is assumed by shareholders than debt-holder. Therefore, debt is a cheaper source of funds than equity. This is generally the case even when taxes are not considered. If the tax deductibility of interest changes further reduces the cost of debt.

Similarly, preference share capital is also cheaper than equity but not cheap as debt. Therefore using a specific cost of capital criteria for financing decision, a firm would always like to employ debt entire issue. It ignores risk and the impact of financing decision. The overall cost of capital should be evaluated and the criterion should be to minimize the overall cost of capital or to maximize the value of the firm.

It should however, be realized that company cannot continuously overall cost of capital by employing debt. A point or range is reached beyond which debt becomes more expensive because of increases, the risk of creditors increase and they demand of higher interest rate and don't grant loan to the company at all once

its debt has reached a particular level. Furthermore, the excessive amount of debt makes the shareholders position very risky. This has the effect of increasing the cost of equity.

### **2.6.3 Cash Flowability**

Conservation is a major feature of sound capital structure. It doesn't mean employing no debt or small amount of debt. It is related to the fixed charges created by the use of debt or preference capital in the capital structure and the firms ability to generate cash to meet these fixed charges.

The fixed charges of a company include payment of interest, preference dividends and principal. Thus the fixed charges depend on both the amount of securities and the terms of debt of preference capital with short term maturity. Whenever a company thinks of raising additional debt, it should analyze its expected future cash flows to meet the fixed charges.

If a company is not able to generate enough cash to meet its fixed obligation, it may have to face financial insolvency. The firms expecting large and stable cash, employ a large amount of debt in their capital structure, it is quite risky to employ fixed charged sources of finance by those firms whose cash flows are not stable.

### **2.6.4 Control**

Control is another main determination of the capital structure for designing capital structure, something existing management control over there. The control factor is important in closely held companies then in widely held companies.

Since debt having voting rights, a company should use debt to avoid the loss of the control. However, when a company uses large amount of debt, lot of restrictions are put by the debt holders on company to protect their interest. These restrictions

control the freedom of the management to run the business. A very excessive amount of debt can also cause bankruptcy which means a complete loss of control.

### **2.6.5 Flexibility**

It is another important consideration in setting up the capital structure. It means the firm's ability to adopt its capital structure to the needs of changing conditions. The capital structure of a firm is feasible if it has no difficulty in changing its capitalization or source of funds. The company should be able to raise funds without undue delay and cost whenever warranted by the future conditions. The financial plan of the company should be flexible enough to change the composition of the capital structure.

### **2.6.6 Floatation Cost**

Floatation Cost is not a major influence of the capital structure of a company. The costs are incurred only when the new shares are issued, which has certain cost of the underwriting commission or brokerage fees for the raised funds. Generally, cost of floatation of a debt is less than cost of floatation of equity. Floatation costs are not a significant consideration.

Floatation as a percentage of funds will decline. Therefore, it can be an important consideration in deciding the size of a security issue. The company will save in terms of floatation cost if it raises funds through large issue of securities. But a large issue can curtail company's financial flexibility.

### **2.6.7 Marketability**

Marketability means the readiness of investors to purchase particular types of security in a given period of time.

It is an important consideration for the time of security issue. General market consideration plays a vital role for any type of share issue like debt, equity etc. Because, capital markets aren't constant at all. During buoyancy, shares are depended more while in depression debts are depended.

### **2.6.8 Size of the Company**

It greatly influences for the availability of funds from different sources. If it will be available, interest. Rate may be high. These types of company's capital structure are very inflexible and cannot run freely. On the other hand large company has greater degree of flexibility in designing its required capital structure. The larger company's can easily make long term loan available and they can easily sell common shares, debentures etc. Therefore, size of the company is an important consideration in making the appropriate capital structure which leads the long term service of the company.

## **2.7 Deposit Analysis**

Deposit is one of the most important most liabilities of bank. They are collected and invested properly. Income from investment is the profit of the bank. Deposits have to be given interest but not for current account. Now a day's some banks have started to give interest on current deposit.

### **2.7.1 Fixed Deposit Analysis**

Fixed deposit of bank is considered as long term debit collected from the customer. Which a bank accepts for more than year. A fixed deposit is only long term debt of Everest Bank Limited.

### **2.7.2 Analysis of Shareholder's Equity**

The shareholders of share holders equity of the bank include paid up capital, reserve and surplus, other reserve and undistributed profit. This is called net worth too.

### **2.7.3 Analysis of Debt to Equity Ratio**

Debt to equity ratio shows the relationship between borrowed funds and owners capital. The ratio reflects the relative claims of creditors and shareholder's against the assets of the firm. It is widely popular measure of the long term financial structure of the firm. The higher debt to equity ratio shows a large share of the financing by the creditors, relatively to the owners. Therefore, there is a large claim against the assets of the firm. The higher debt to equity ratio shows a large share of financing by the creditors, relatively to the owners. Therefore, there is a large riskier to the creditors. A high production of debt in the financial structure would lead to inflexibility in the operations of the firm because firm is legally liable to pay the interest even if the firm is having loss. Where, a smaller ratio shows smaller claim of creditors, relatively high stake of the owner implies sufficient safety margin and substantial protection against shrinkage in (DER) = Fixed Deposit/Net worth.

### **2.7.4 Debt to Total Capital Ratio (DCR) Analysis**

The relationship between creditor's funds and owners, capital can also be shown by debt to total capital ratio. These types of capital structure ratio are deviated from the debt equity ratio. Here, it states that the outsider's liabilities are related to the total capitalization to the firm and not only to the shareholders equity.

$$\text{Fixed deposit to total employed ratio (DCR)} = \frac{\text{FD}}{\text{CE}}$$

Where capital employed includes net worth and fixed deposits.

### **2.7.5 Analysis of Capital Adequacy**

It is used in case of bank to assess the strength of the capital structure, the adequacy ratio of the capital. Appropriate capital adequacy ratio has always been a

controversial issue for the commercial banks, however, extremely higher or lower capital adequacy ratio is considered to be unfavorable in terms of lowered return of lowered slovenly respectively.

### **2.7.6 Analysis of Debt Capacity of Everest Bank Limited**

The interest coverage ratio is calculated to analyze the debt capacity of the bank or to indicate firm's ability to meet interest obligations. Interest coverage ratio is one of the most conventional coverage ratios which measure the relationship between what is normally available from operation of the form and the claims of the outsiders; it is used to test firm's debt servicing capacity. It is determined by dividing operating profit by the fixed interest charges on debt.

$$\text{Thus Interest Coverage Ratio (ICR)} = \frac{\text{EBIT}}{\text{Interest}}$$

### **2.7.7 Capital Structure Position Analysis**

When debt and equity are properly mixed, minimizes the cost of capital and maximizes the value. In order to analyze the value of the bank fixed deposit and equity share capital are taken into consideration. Net income approach is considered to find out the overall capitalization and net operating income approach is considered to find out the equity capitalization rate of the bank.

### **2.7.8 Overall Capitalization Rate Analysis**

The overall capitalization rate is calculated under net income approach which measures the degree of leverage of the firm. This approach assumes that the cost of debt is less than the cost of equity. So, the degree of financial leverage is increased the weighted average cost of capital will decline as a result value of the firm will increases. The higher use of cheaper debt lowers the cost and consequently increases the value.

$$\text{Overall Capitalization Rate (Ko)} = \frac{\text{EBIT}}{\text{Value of Firm}}$$



### **2.7.9 Equity Capitalization Rate Analysis**

The net operating income is considered to find out and analyze the equity capitalization rate of Everest Bank Limited. The net operating income approach implies that the total valuation of the bank is unaffected by its capital structure. In this approach the equity capitalization rate has to be analyzed.

Equity capitalization rate (Ke) is calculated as below,

$$K_e = \frac{EPS}{MVPS}$$

Where

EPS = Earnings Per Share

MVPS=Market value per share

### **2.7.10 Interest Margin Analysis**

Interest margin show the percentage of bank earns as interest for each unit of investment made in loans and advanced and HMG's security. This ratio is examined to measures the profitability of this earning assets. A high margin reflects the better efficiency in utilizing the resources in interest margin generating sector and vice-versa.

Interest margin can be calculated as below,

Interest Margin = (Interest Income- Interest expenses)/Loans & Advances+ HMG'S Securities)

### **2.7.11 Return Total Deposits Analysis**

One of the major financial sources of a bank is deposit collections and deposit is mobilized for loans and advanced and in other investment to earn profit. This return ratio helps to find out the profit earned using total deposit. Its assists to

identify the bank's overall performance as well as its success in generating profit. The ratio, here, is calculated in order to diagnose whether the banks are well efficient or not in mobilizing its total deposits. So, corrective action could be forwarded to the bank.

Return on deposits ratio can be formulated as below.

$$\text{ROD} = \frac{\text{Net Income}}{\text{Total Deposit}}$$

Higher ratio signifies better mobilization and utilization of deposits and vice versa.

### **2.7.12 Return on Total Assets (ROA) Analysis**

Return on total assets ratio measures the profitability of bank that explains a firm to earn satisfactory return on all financial resources invested in the bank's assets otherwise its survivable is threatened. The ratio explains net income for each unit of assets.

Higher ratio indicates efficiency in utilizing its overall resources and vice versa. From the point of view of judging operational efficiency, rate of return on total assets is more useful measure.

The return on total assets ratio is calculated using formula as below.

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Asset}}$$

### **2.7.13 Return on Capital Employed (ROCE) Analysis**

Return on capital employment ratio is another ratio related to the profitability of long term funds. The ratio provides us a test of profitability related to the source of long term sufficient insight into efficiently the long term funds of owners and creditors are being used.

It explains net income for each unit of long term funds. The higher the ratio the more efficient the use of capital employed. From the point of view of judging operational efficiency, ROCE is more useful measure.

The ratio is formulated as below,

$$\text{ROCE} = \frac{\text{Net Income}}{\text{Fixed Deposit} + \text{Net Worth}}$$

#### **2.7.14 Return on Equity (ROE) Analysis**

This ratio carries the relationship of return to the sources of funds. This shows whether the banks have earned a satisfactory return from its internal sources or not. ROCE had expressed, previously, the profitability of the banks in relation to the funds supplied by the creditors and owners together but this ratio is used to measure exclusively the return the owner's funds. Hence, this ratio reveals how profitably the owner's fund have been utilized by the bank and indicates whether a bank complete for private sources of capital in the economy.

Higher the ratio, higher will be the investment which the shareholders will undertake.

Return on equity can be formulated as below,

$$\text{ROE} = \frac{\text{Net Income}}{\text{Net Worth/Per share}}$$

#### **2.7.15 Earning Per Share (EPS) Analysis**

The profitability of a bank from the point of view of the ordinary shareholders is earning per share. The ratio explains net income for each unit of share. Earning per share of an organization gives the strength of the share in the market. As EPS does neither reveal how much dividend paid to the owners nor how much dividend paid to the owners nor how much of the earning retained by an organization. Thus, it

only shows how much of the earning retained by an organization. Thus, it only shows how much theoretically belongs to the ordinary shareholders.

### **2.7.16 Dividend Per Share Analysis**

Dividend per share is evaluated to know the share of dividend that the shareholders receive in relation to the paid up value of the share. A large number of percent and potential investors may be interested in the dividend per share rather than the earning per share. Therefore, an institution offering a high dividend per share is regarded as an efficient in fulfilling shareholders expectation which will also enable to increase the value of an institution.

Dividend per share is the earning distributed to ordinary shareholders divided by the number of ordinary shares outstanding i.e.

$$\text{DPS} = \frac{\text{Earning Paid to Shareholders Dividend}}{\text{No of Ordinary Shares}}$$

### **2.7.17 Dividend Payout Ratio Analysis**

The ratio represents the percentage of the profit distributed as dividend and the percentage retained as revenue and surplus for the growth of the bank. Usually higher ratio is preferred by the shareholder of dividend and retained earnings. Importance of DPR lies in its ability to state the dividend policy of the concerned banks more obviously which influences the market of the share

DPR of Everest Bank Limited is formulated as below,

$$\text{DPR} = \frac{\text{Dividend per share}}{\text{Earning per share}}$$

### **2.7.18 Market Value Per Share (MVPS) Analysis**

Market value per share is the average market value of Everest Bank limited.

### **2.7.19 Price Earning (P/E) Rate Analysis**

Price earnings ratio reflects the price currently being paid by the market for each rupee currently reported EPS. In other words, it measure investors, expectations and market appraisal of the performance of a firm. It is an indication of the way investors think that the banks would perform better in the future.

Higher market price suggested that investors expect earnings to grow and this gives a high P/E but low P/E implies that investors feel that earning are not likely to rise.

Price earnings ratio is calculated as below,

$$\text{P/E Ratio} = \frac{\text{Market Price of Share}}{\text{Earning Per Share}}$$

### **2.8 Review of Journals and Articles**

Under this heading, an effort has been made to examine and review of some related articles published in different economic journals, magazines and newspaper.

**Weston, Besly & Brigham (1996)**, Capital Structure has been developed along with two main line (i) Tax benefit[bankruptcy cost of trade off theory and (ii) Signaling Theory, they said that cash firm has an optimal capital structure defined as that mix of debt, preferred stock & common equity which minimize its weighted average cost of capital.

**Pandey (1998)**, the professor of Indian Institute of management had also studied about Capital Structure. According to him, under favourable economic condition the earning per share increases with leverage, but leverage also increases the financial risk of the shareholders. As a result, it cannot be stated definitely whether

or not the value of the firm will increase with leverage. Further he has said if the value of the firm can be affected by capital structure which maximizes the market value of the firm. Pandey further added there exists conflicting theories on the relationship between capital structure and the value of the firm. On the context of capital structure, Pandey has argued that the capital structure decision of the firm can be characterized as a choice of that combination of debt and equity which maximize the market value of the firm. He has supported to traditional approach, the cost of equity declines with leverage at a acceptable range of debt and then starts to increase with increasing debt of capital.

**Khatri (1998)**, conducted the empirical study of M-M Proposition in the Nepalese contest. Khatri took 12 random selections and various enterprise of two different sectors out of 75 listed companies in Nepal stock Exchange using secondary data from 1980-1996. He used simple and multiple regression models & found that regression coefficient positive for banking and insurance sectors while negative for manufacturing and trading sectors. Making overall 28 observations for all given descriptive statistics of the variables, average cost of capital is found to be negatively correlated with leverage, size, growth, dividend payout ratio in case of manufacturing and trading sectors. This indicates that negative sign of correlation coefficient between average cost of capital with use of leverage. However in case of banking and insurance sector, cost of capital is found to be positively correlated with leverage employing that cost of debt financing is greater than cost of internal sources of fund. As such there is negative relationship with size, liquidity and payout ratio and positive with growth and earning variability.

**Poudyal (2002)** in his article, "*Capital Structure, it's impact on Value of Firm*" concentrated his study to examine the interrelationship between the objective of achieving an optimal capital structure and to provide conceptual framework for the determination of the optimal capital structure. For this a hypothetical firm is

constructed and different assumptions are laid down to analyze the effect of capital structure. Various statistical and financial tools like ratio analysis are used to extract reasonable figures for the hypothetical firm. It is observed that the minimum weighted cost of capital, maximum value of the firm and price per share are attained at the debt ratio of 30%.

Further more, if there is flexibility to select capital structure in any proportion, optimal capital structure ranges from 30 % to 40%. An optimal capital structure would fulfill the intent of shareholder's and financing requirement of a company as well as other groups concerned.

## **2.9 Review of Related Thesis**

**Pathak (1999)**, entitled "*A comparative study between Nepal Indoswz Bank and Nepal Grindlays Bank Ltd*". The capital structure of both banks are highly levered, so is difficult for them to pay interest and principal that may ultimately lead them to liquidity or bankruptcy. There is no significant relationship between debt and equity ratio in terms of fixed deposit to net worth and overall capitalization rates of the banks. The ROE fluctuation was influenced by the dividend payout ratio and interest margin in EBL Ltd. Both banks vary in the case of total assets, number of bank branches, which may ultimately affect the bank's performance and increase the profitability more than ever.

**Prasai (1999)**, on the topic of "*Capital Structure of Nepal Bank Ltd*". The basic objective of the study is to analyze the interrelationship and trends among some of the component parts of capital and assets structures. To analyze facts in the study, he used some of the statistical tools, such as ratio percentage, average and coefficient of correlation. From the study it is known that the bank is the composition of loan and advances, cash investment and other assets. Between these all components loan and advances are the major position. During the study,

total assets and capitals are in increasing trend. But increasing rate of components is different. So the interrelationship of the components is fluctuating. The average growth rate of total deposits and other liabilities is higher than the average growth rate of net profit, and higher than the growth rate of total expenses. The total income and total expenses are not under control to the bank. And the net profits only 40.64% the total income He has concluded that the bank showed total income as well as expenditure and suggested that the bank must control total deposit and the bank must control investment. The bank needs to reduce its expenses and control fluctuation in the earnings per share to improve its market price per share.

**Rajlawat (1999)**, on the topic of “*Capital Structure of Necon Air Limited*” by in his study, he has found that Necon Air Ltd has debt equity ratio higher than its necessity. This higher debt capital is a serious implication from the firm’s point of view. In this condition, the capital structure will lead to inflexibility in the operation of the firm as creditors would exercise pressure and interferes with management. Necon Air has taken debt from different commercial banks as well as owners and has to pay heavy portion of profit as interest. According to the annual report, it has close relationships with Nepal Arab Bank Ltd. In borrowing loan in different ways but higher portion of the long term debt has been borrowed from Clever Aviation U.K. So the payment of the interest will be hazardous when profit is declining. So, Rajlawat suggest that Necon Air Ltd should decrease its debt capital drastically as far as practicable. He has added that the ratio of 2:1 is the best ratio for optimal capital structure. He recommended the company should reduce heavy burden of interest payment, the interference of creditors with management and also pressure for cheaper source of fund for investment.

**Sapkota(2000)**, Again another study is related to “*Capital Structure of Nabil Bank Ltd*”. The main objective of his study was to examine the existing financial position regarding capital structure, relationship between deposit and capital,



analyze the composition as well as mixture of debt and equity and various profitability ratios. He has found in his study that deposit (fixed), a major concern to capital structure is in decreasing trend which effects on investment policy. For this he suggested to operate different programs to attract people to save money in the bank. He found high debt equity ratio of Nabil Bank Ltd. Higher debt capital creates risk which is dangerous signal from creditors point of view. Hence, it is advised to reduce the debt capital and to maximize the profit at any cost to manage this condition. He has analyzed capital composition trend to be slowing. So, the bank should be in problem and should adopt the corrective measures to strengthen the financial position.

**Shah (2004)** in her Unpublished Masters Degree Thesis “*A study on the capital structure of selected Manufacturing Companies (Nepal Lever Ltd, Bottlers Nepal Ltd, Sriram Sugar Mills, Jyoti Spinning Mills, Arun Vanaspati Udhyog)*” has studied with a purpose to access the debt serving capacity of the mentioned manufacturing companies, examine the relation between Return on Equity and Total Debt, Return on Equity and Debt Ratio, Earning after tax and Total Debt and interest and Earnings Before Interest and tax.

The methodology used in the study included both financial as well as statistical tools. The financial tools used were ratio analysis and statistical tools used were correlation and regression analysis.

The study revealed that Nepal Lever Ltd, has not been using Long term debt and it was fully equity based. The Bottlers Nepal Ltd, is also free of Long term debt because of improved cash flows and effective management. The Sriram Sugar mills 66.33% of assets financed with debt and hence there is less flexibility to the owners. The degree of financial leverage analysis of Jyoti Spinning Mills shows the failure of the company to gain expected profits. And the Arun Vanaspati

Udhyog has a fluctuating Debt Equity Ratio. Its long term debt is decreasing and only creditors make a small share of finance.

**Bajracharya (2006)** in her Unpublished Masters Degree Thesis “*A study on the Capital Structure of Commercial Banks*” has stated the main objective of the study is to evaluate the analyze the relationship of capital structure ratios of the commercial banks under study, analyze the relationship of capital structure with variables such as earning per share, dividend per share and net worth and also to analyze the effect of capital structure on the value of the companies.

The methodology used in the study includes both financial as well as statistical tools. The financial tools used were Ratio analysis and statistical tools used were Standard Deviation, Correlation Coefficient and Probable Error.

The study has found that the average debt equity ratio of Bank of Kathmandu shows that claim of owners is higher than the creditors, where as Himalayan Bank Limited has lower claims. Similarly Nepal Investment Bank has a fluctuating trend. All the sample banks have negligible long term debt in comparison to their assets. All the sample banks have fluctuating trend of long term debt to total debt ratio. BOK is able to pay interest amount with interest coverage ratio of 1.38% where HBL has increasing trend. Similarly NIB too has fluctuating trend of interest coverage ratio with the highest interest coverage ratio among the three sample banks. The return earned by the equity shareholder's of NIB is least and the return of HBL is highest among three sample banks. NIB seems to have the highest return of 1.32 as compared to 1.02 of BOK and 1.16 of HBL. Correlation Coefficient and Probable Error relationship between Long term Debt and Earning per share is not significant.

## **2.10 Research Gap**

After study the above thesis, I found that the researcher highly focused only the relationship between deposit and investment as well as return in ratio to capital employed but in study of capital structure there must be analyzed total liabilities not only deposit. Deposit is the part of total liabilities. And the above researches are studied in five years ago. That's why in the present scenario also it is not sufficient and Everest Bank Limited is the leading bank in the Nepalese economy that's why it's capital structure must be different than other manufacturing industries, trading industries and other banks.

## **CHAPTER - III**

### **RESEARCH METHODOLOGY**

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

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

#### **3.1 Research Design**

Selection of appropriate research design is necessary to meet the study objectives of any research, “Research design is a plan structure and strategy of investigation conceived so as to obtain answer to research questions and to control variances”.

The study aims to portraying accurately on the capital structure and it’s Impact on overall financial position of Everest Bank Ltd. It is based on recent five years data from F/Y 2060/61 to F/Y 64/65.

The method and definite technique which guide to study and give ways to perform research work is known as research design. It is the most necessary thing to complete the research and fulfill the objective of the research.

The main objective of research work is to evaluate the capital structure of Everest Bank Ltd. To complete this study following design and format will be adopted.

First of all, information and data will be collected. The important information and data will be selected. Then data will be arranged in useful manner. After that, data will be analyzed by using appropriate financial and statistical tools. In analysis part, interpretation and comment will also be made wherever necessary.

Result and conclusion will be drawn/ given after analysis of data, recommendation and suggestion will also be given. Previous thesis styles and formats will be followed along with my full knowledge and ideas.

### **3.2 Nature and Sources of Data**

This study is mainly based on secondary data provided by Everest Bank Ltd. Data and information have been extracted from the annual reports of the bank collected from the concerned bank and downloaded from official websites. The supplementary data and information have been acquired from various sources like newspaper, magazines, brochures, booklets, periodicals and bulletins, published and unpublished reports, related documents and journals available in library of Shanker Dev Campus, and other organization like Nepal Stock Exchange and Nepal Rastra Bank.

### **3.3 Data Processing Procedure**

Methods of analysis are applied as simple as possible. The obtained data are presented in various tables, diagrams and charts with supporting interpretations. Among various tools of data analysis, financial tools and statistical tools are used for research under study.

### **Financial Tools**

Financial Tools are used for expressing the mutual relation of different accounts consisting in the financial statement. To make the datas of financial statement

more clear, it is to be expressed in referring to other figures. With the help of various financial tools, it can be made short, simple and understandable. Following are some important financial tools used for research work of Capital Structure of Everest Bank Limited.

- **Shareholder's Equity**

Shareholder's fund include equity share capital, Preference Share Capital, Reserves and Surplus, Reserve Fund, General Reserve, Other Reserves, Undistributed Profit. It is calculated as,

$$= \text{Paid up Capital} + \text{R\&S} + \text{Other reserves} + \text{Undistributed Profit} = \text{Net Worth}$$

- **Debt to Equity(D/E) Ratio**

It is a popular measure of the long term financial solvency of a firm. It is calculated as follows,

$$= \frac{\text{Fixed Deposit}}{\text{Net Worth}}$$

- **Debt to Total Capital (DCR) Ratio**

Total Capital includes shareholders equity as well as long term debt. It shows the relationship between the long term debt and total capital. It is calculated as,

$$= \frac{\text{Fixed Deposit}}{\text{Capital Employed}}$$

Where,

$$\text{Capital Employed} = \text{Fixed Deposit} + \text{Net Worth}$$

- **Capital Adequacy Ratio(CAR) Ratio**

- **Debt Capacity Ratio**

How much a firm is capable to pay interest charges on it' borrowed capital is calculated by using Debt Capacity Ratio.

It is calculated as,

$$= \frac{\text{NPBIT}}{\text{Interest}}$$

The higher the coverage, the greater the ability of the firm to make the payment of interest.

- **Overall Capitalization Rate(Ko)**

It measures the degree of leverage of the firm. It can be calculated as below,  
NPBIT/Value of the firm

Where,

Value of the firm= Fixed Deposit+ Equity Share

- **Equity Capitalization Rate (Ke)**

Net operating income is considered to find out and analyze the equity capitalization rate of Everest bank Limited. It is calculated as follows,

$$= \frac{\text{EPS}}{\text{MVPS}}$$

- **Interest Margin**

What percentage a bank earns as interest for each unit of investment made in loans and advances is shown by interest margin rate which is calculated as follows,  
=Interest Income/ Loans and Advances

- **Return on Total Deposits**

Whether banks are well efficient or not in mobilizing it's total deposit is calculated by using following ratio,

$$= \frac{\text{Net Profit}}{\text{Total Deposits}}$$

- **Return on Total Assets(ROA) Analysis**

This ratio measures the profitability of all financial resources invested in the firm's assets. Hence, the higher ratio implies that the available source and tools are employed efficiently. It is calculated as follows,

$$= \frac{\text{Net Profit}}{\text{Total Assets}}$$

- **Return on Capital Employed(ROCE)**

Whether total Capital of the firm is efficiently utilized or not is calculated by using following ratio,

$$= \frac{\text{Net Profit}}{\text{Fixed Deposits+ Net Worth}}$$

Where,

Fixed Deposit + Net Worth = Capital Employed

- **Return on Equity(ROE)**

How well the firm has used the resources contributed by the owners is calculated by using ROE Ratio. It is good for firm to have a return of high investment. It is calculated as follows,

$$= \frac{\text{Net Profit}}{\text{Shareholders Equity}}$$

- **Earnings Per Share(EPS)**

EPS of an organization gives the strength of the share in the market. The Profitability of a bank is earning per share which is calculated as follows,

$$= \frac{\text{Net Profit}}{\text{No of Shares}}$$



- **Dividend Per Share(DPS)**

It is calculated to know the share of dividend that the shareholders receive in relation to the paid up value of share. DPS is the earning distributed to ordinary shareholders divided by the no. of ordinary shares outstanding.

$$= \frac{\text{Earnings Paid to Equity Shareholders}}{\text{No of Shares}}$$

- **Dividend Payout Ratio**

What percentage of profit is distributed as dividend and the percentage retained as revenue and surplus for the growth of the bank is calculated by DPR and it is calculated as follows,

$$= \frac{\text{DPS}}{\text{EPS}}$$

- **Market Value Per Share(MVPS)**

Earnings Per Share expressed in terms of average market value is MVPS. It is calculated as,

$$= \text{P/E Ratio} \times \text{EPS}$$

- **Price Earning Ratio(P/E)**

P/E ratio reflects the price currently being paid by the market for each rupee of currently reported EPS. It is calculated as,

$$= \frac{\text{MVPS}}{\text{EPS}}$$

### **Statistical Tools**

In this method of data analysis we have used only Standard Deviation and, Coefficient of Variation for data analysis. It has a wide application in statistics.

### **Standard Deviation**

It is very rigidly defined, based on all the observations, least affected by fluctuation and suitable for mathematical treatment. It is calculated as follows,

$$SD = \frac{1}{N} \sum (x - \bar{x})^2$$

Where,

N = No. of Observations

$\bar{x}$  = Observations

X = Mean of the given observations

### **Coefficient of Variation**

CV is defined by 100 times the coefficient of standard Deviation. CV is independent of unit, hence two units can be betterly compared for their variability.

$$C.V. = \frac{SD}{\text{Mean}} \times 100$$

Where,

SD= Standard Deviation

### **3.4 Method of Data Analysis**

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

- Data and information are collected and gathered to fulfill the research problem and objectives of the study.
- The collected data and information are identified, classified and arranged properly.
- Then the data and information are processed and analyzed.
- Interpretation, recommendation and suggestion are made after analysis.

## CHAPTER - IV

### DATA PRESENTATION ANALYSIS

#### Capital and Liabilities Analysis

The first objective of this study is to examine the financial position regarding Capital Structure of Everest Bank Limited. The way to show off the success of the company is a balance sheet. By analyzing the balance sheet, investors creditors and others can assess the ability to meet short-term obligations and solvency as well as its ability to pay all current and long-term debts as they come due. The balance sheet also shows the composition of assets and liabilities, the relative proportions of debt and equity financing and the amount of earnings that it has had to retain. Total Capital and Liabilities are items included in Liabilities side of balance sheet. Balance sheet presents a clear picture of financial position of any business firm. The following table shows the position of Share Capital of Everest Bank Limited.

#### 4.1 Share Capital

**Table 4.1**  
**Share Capital**

(Amount in crores)

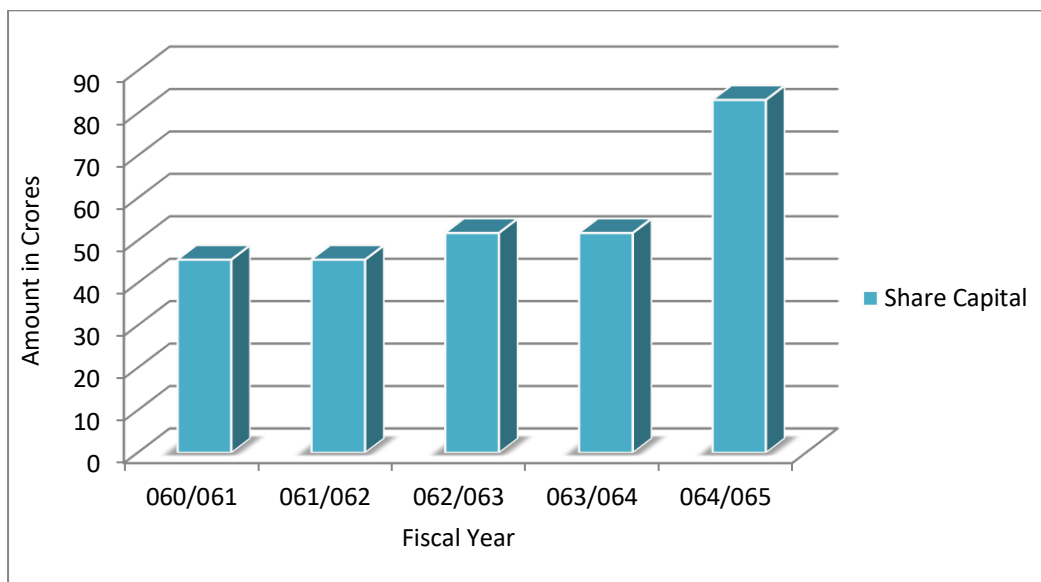
<b>Fiscal Year</b>	<b>Amount</b>	<b>Change Rate(%)</b>	<b>Proportion of TL %</b>
060/061	45.5	-	4.73
061/062	45.5	-	3.88
062/063	51.8	13.84	3.24
063/064	51.8	-	2.41
064/065	83.14	60.50	3.06
<b>Average</b>		<b>14.868</b>	<b>3.464</b>

*Source: Annual Report of Everest Bank Limited.*

The value of share capital is Rs 45.5 crores in F/Y 061/062 which increased to Rs 51.8 crores in F/Y 062/063 by 13.84%. Further in F/Y 064/065 it increased to Rs

83.14 crores by 60.50% The average change rate is therefore,14.87%. Share Capital Proportion among the total liabilities and capital is 4.73%, 3.88%, 3.24%, 2.41%, and 3.06% in F/Y 060/061, f/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The trend of proportion of share capital to total liabilities are decreasing except in F/Y 064/065. And the average proportion of Total Liabilities is 3.46%.

**Figure 4.1**  
**Share Capital Position**



## 4.2 Investments

**Table 4.2**  
**Investment**

(Amount in Crores)

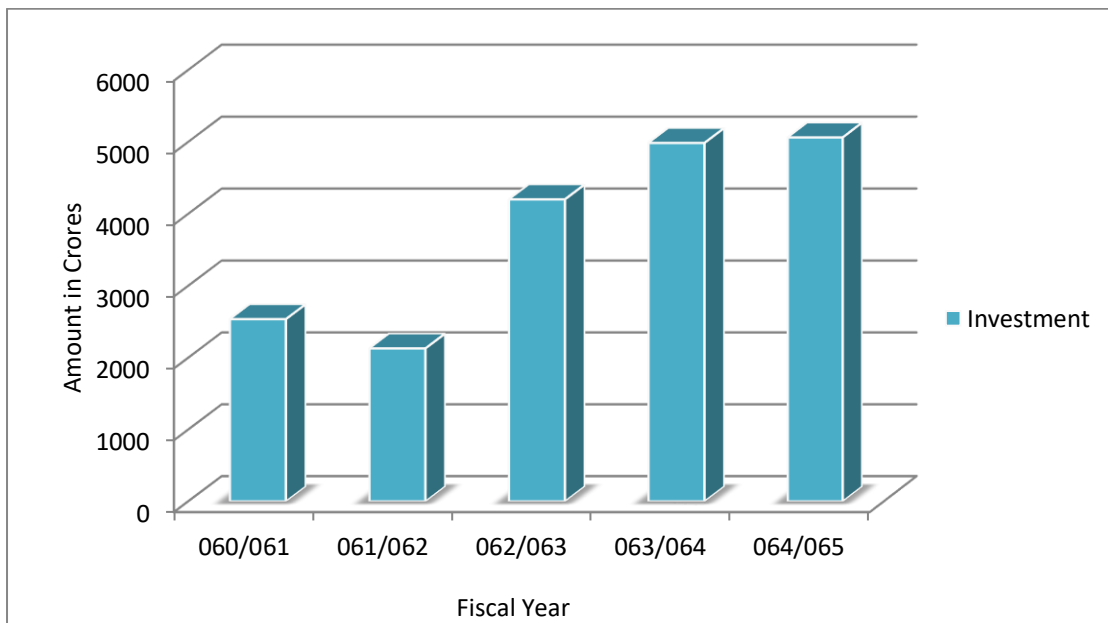
Fiscal Year	Amount(Invested)	Change Rate%
060/061	2536	-
061/062	2129	-16.04
062/063	4201	97.32
063/064	4985	18.66
064/065	5061	1.52
<b>Average</b>	<b>3782.4</b>	<b>25.365</b>

Source: Annual Report of Everest Bank Limited

Investments of Everest Bank Limited for F/Y 060/061 was Rs 2536 crore, for F/Y 061/062 Rs 2129 crore, for F/Y 062/063 Rs 4201 crore, for F/Y 063/064 Rs 4985 crore and for F/Y 064/065 Rs 5061 crore. The amount is continuously increasing except in F/Y 061/062. The change rate inclined to 97.32% in F/Y 062/063 from -16.04% change rate in F/Y 061/062. Then after change rate continuously goes on decreasing. The average change rate is 25.37%.

The bank has managed to wisely invest in highly yielding portfolio and hence increase the income this fiscal year.

**Figure 4.2**  
**Investment Position**



### 4.3 Deposits

**Table 4.3**  
**Deposits**

(Amount in Crores)

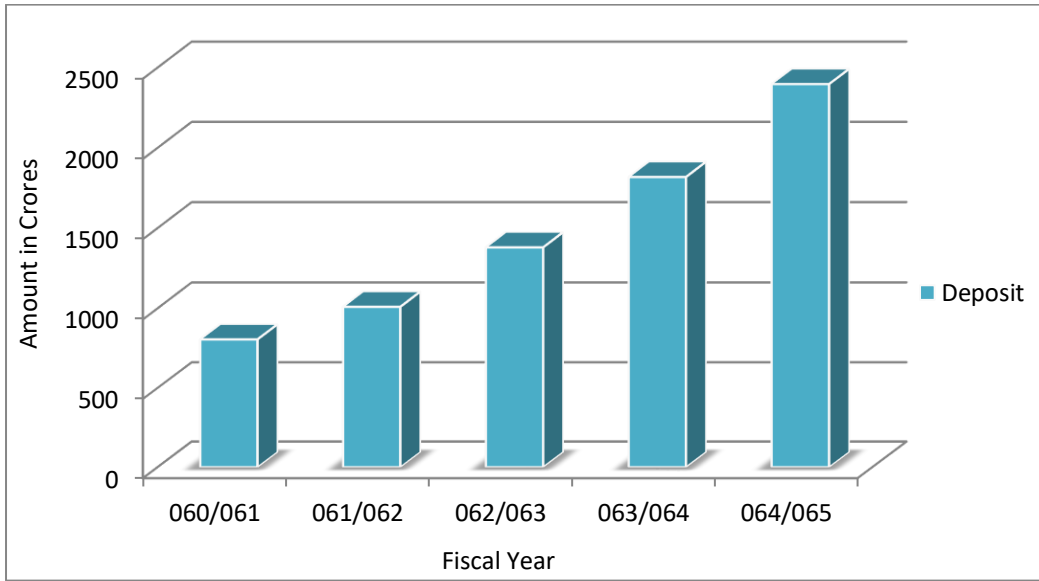
<b>Fiscal Year</b>	<b>Amount</b>	<b>Change Rate%</b>	<b>Proportion of TL%</b>
060/061	806.4	-	83.92
061/062	1009.77	25.21	86.06
062/063	1380.24	36.69	86.48
063/064	1818.62	31.76	84.85
064/065	2397.63	31.83	88.31
<b>Average</b>		<b>31.37</b>	<b>85.92</b>

*Source: Annual Report of Everest Bank Limited*

The amount of deposits are Rs 806.4 crore, Rs 1009.77 crore, Rs 1380.24 crore, 1818.62 crore and Rs 2397.63 crore in F/Y 060/061, f/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The amount of deposit is increasing continuously. It has an increasing trend. The proportion deposit over the total capital and liabilities are 83.92%, 86.06%, 86.48%, 84.85%, and 88.31% in F/Y 060/061, f/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. It shows that the proportion of deposit is increasing but fell down in F/Y 063/064. It indicates the low collection of deposit is occurred in the second last year. The deposit is directly related to investment policy. The average proportion is 85.92 %.

The annual change rate of deposit is in increasing and decreasing trend. It changes to 25.21% from F/Y 060/061 to F/Y 061/062, 36.69% from F/Y 061/062 to F/Y 062/063, 31.76% from F/Y 062/063 to F/Y 063/064, 31.83% from F/Y 063/064 to 064/065. The average yearly change rate is 31.37%.

**Figure 4.3**  
**Deposit Position**



#### 4.4 Deposit Analysis

**Table 4.4**  
**Total Deposit Position**

(Amount in Crores)

<b>Fiscal Year</b>	<b>Deposit Amount</b>	<b>Index Trend</b>	<b>Change Rate%</b>	<b>Proportion of TL%</b>
060/061	806.4	100	-	83.92
061/062	1009.77	125.21	25.21	86.07
062/063	1380.24	171.14	36.69	86.49
063/064	1818.62	225.49	31.76	84.86
064/065	2397.63	297.27	31.83	88.31
<b>Average</b>			<b>31.37</b>	<b>85.93</b>
<b>SD</b>			<b>4.08</b>	<b>1.49</b>
<b>CV</b>			<b>13.00</b>	<b>1.74</b>

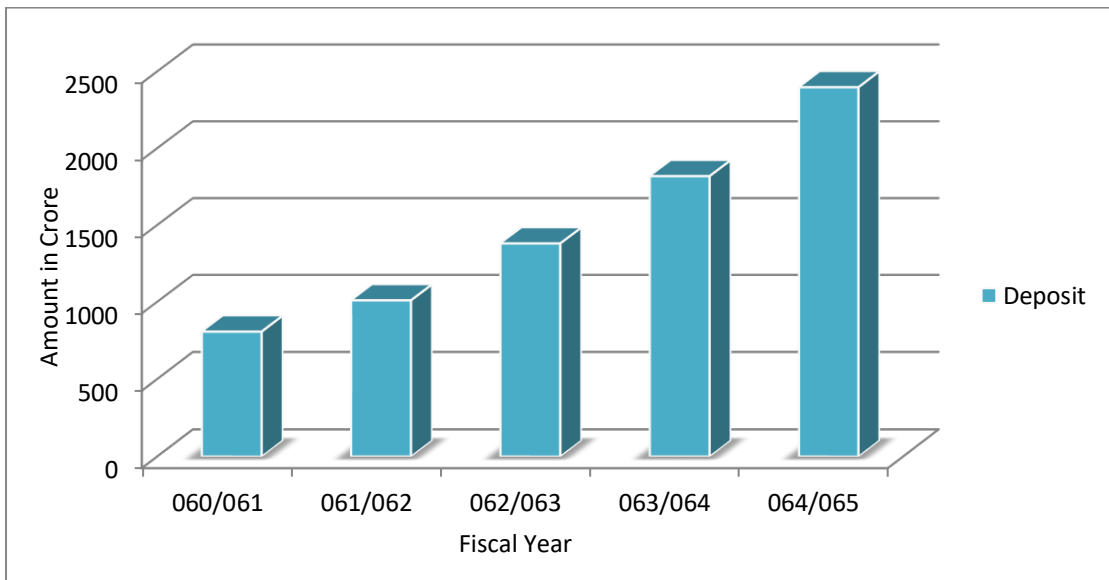
*Source: Annual Reports of Everest Bank Limited*

The amount of deposits are Rs 806.4 crore in F/Y 060/061, Rs 1009.77 crore in F/Y 061/062, Rs 1380.24 crore in F/Y 062/063, Rs 1818.62 crore in F/Y 063/064 and Rs 2397.63 crore in F/Y 064/065. The deposit amount is continuously increasing but the trend is not consistent. The proportion of total deposit among

total liabilities and capital tells the role of deposit in the whole capital structure. The proportion of total deposit on TL are 83.92%, 86.07%, 86.49%, 84.86%, and 88.31% in F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The average proportion rate is 85.93%. The Standard Deviation and Coefficient of variation are 1.49 and 1.74 respectively.

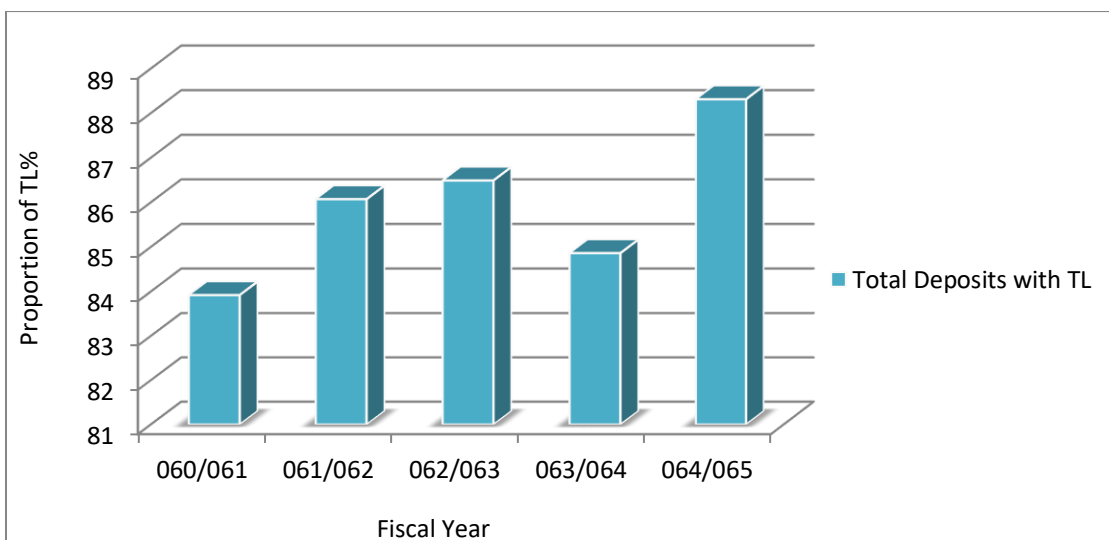
**Figure 4.4**

**Bar Diagram of Total Deposit**



**Figure 4.5**

**Bar Diagram of Total Deposits with Total Liabilities**

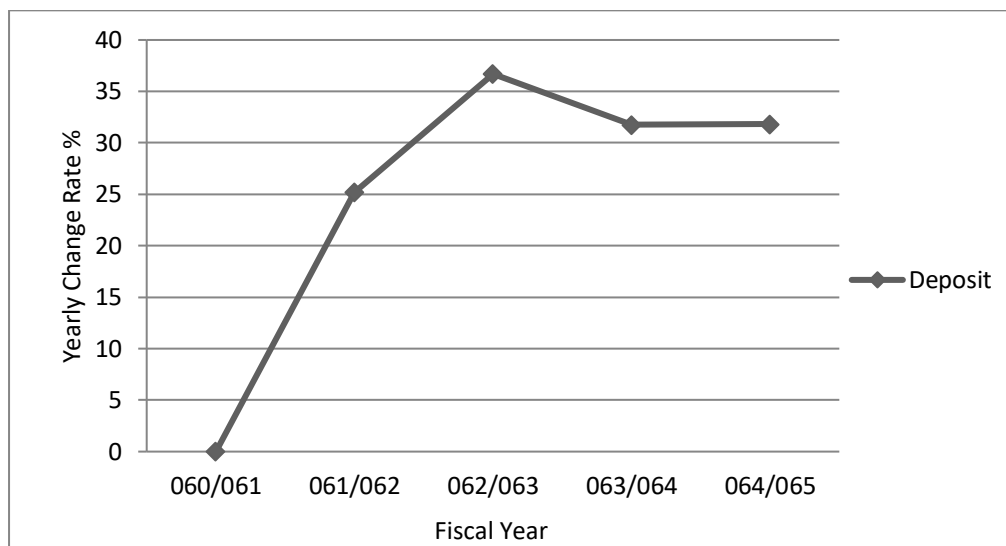




The Deposit changes by 25.21 %, 36.69%, 31.76%, 31.83% in F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The deposit increment is average. The change trend shows that the role of deposit among the whole capital is growing. In brief, we can say that the company is able to collect good deposit amount by making proper investment of its available resources.

**Figure 4.6**

**The Line Diagram of Yearly Change Rate of Deposits**



#### 4.5 Advances

**Table 4.5**

**Loans and Advances of Everest Bank Limited**

(Amount in Crores)

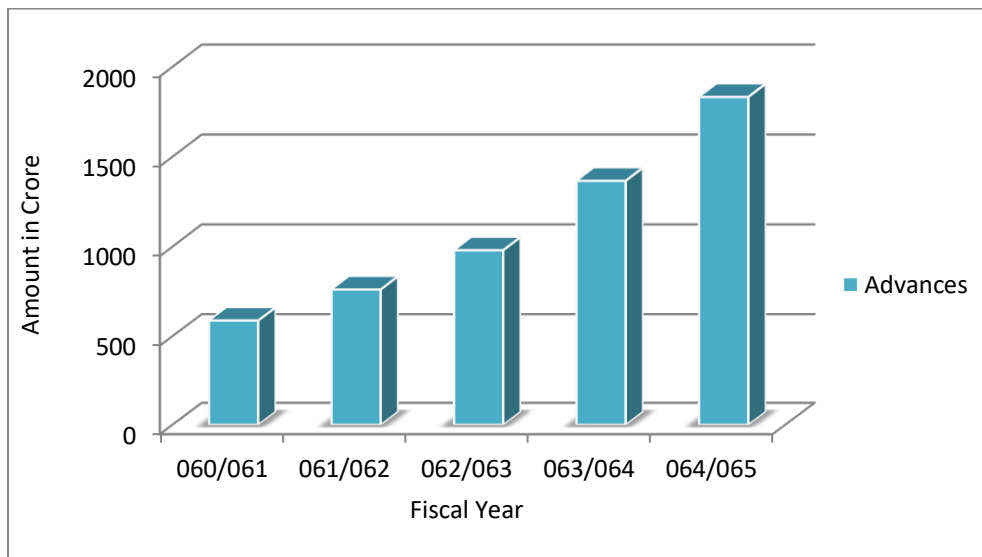
Fiscal Year	Amount	Change Rate%	Proportion of TL
060/061	588.41	-	61.23
061/062	761.86	29.48	64.93
062/063	980.13	28.64	61.41
063/064	1366.4	39.41	63.76
064/065	1833.0	34.21	67.54
<b>Average</b>		<b>32.93</b>	<b>63.78</b>
<b>SD</b>		<b>4.29</b>	<b>2.34</b>
<b>C.V</b>		<b>13.06</b>	<b>3.69</b>

*Source: Annual Report of Everest Bank Limited*

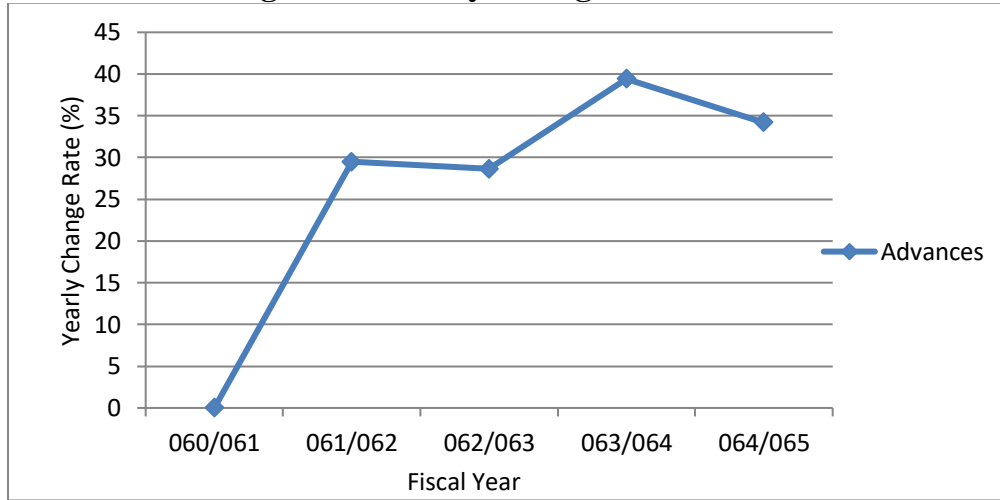
The growth in lending has been well managed through proper risk management and appraisal process. The bank has a major focus on wholesalers and retailers in commercial segment and in the housing loan in terms of retail segment where majority of the growth took place. Everest bank has been pioneers of retail lending products. The advance amounts were Rs 588.41 crore, Rs 761.86 crore, Rs 980.13 crore, Rs 1366.40 crore, and Rs 1833.0 crores in F/Y 060/061, f/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. As on mid July 2008(F/Y 064/065), it grew by 34.21% to Rs 1883.64 crore from Rs 1366.40 crore. It has a continuous increasing trend.

**Figure 4.7**

**Bar Diagram of Advance Position of Everest Bank Limited**



**Figure 4.8**  
**Line Diagram of Yearly Change Rate of Advances**



#### 4.6 Reserves and Surplus

**Table 4.6**  
**Reserve and Surplus**

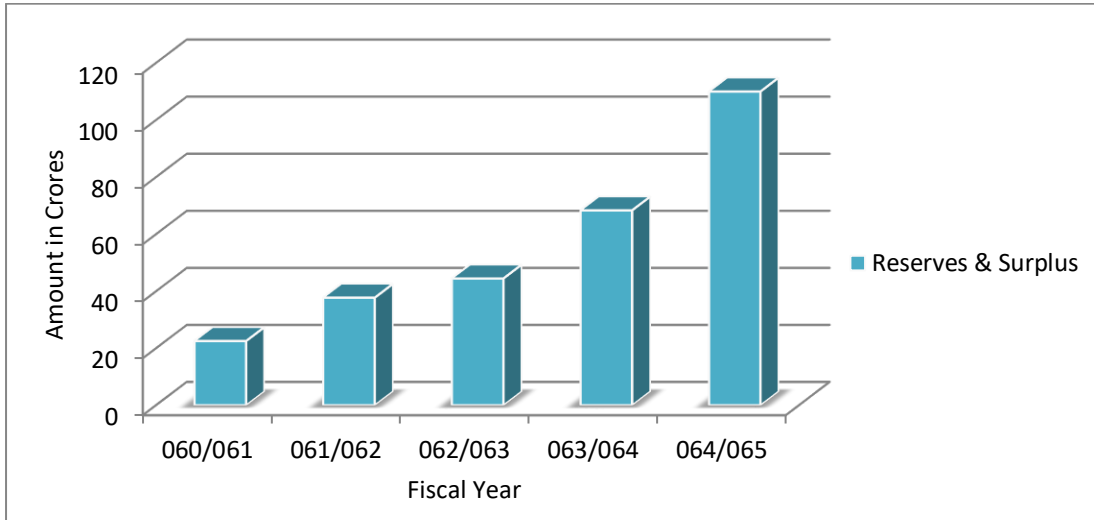
(Amount in Crores)

<b>Fiscal Year</b>	<b>Amount</b>	<b>Change Rate%</b>	<b>Proportion of TL</b>
060/061	22.53	-	2.34
061/062	37.76	67.59	3.21
062/063	44.48	17.79	2.79
063/064	68.35	53.66	3.19
064/065	109.98	59.44	4.01
<b>Average</b>		<b>49.62</b>	<b>3.108</b>

*Source: Annual Report of Everest Bank Limited*

Reserves and Surplus is Rs 22.53 Crore, Rs 37.76 crore, Rs 44.48 crore, Rs 68.35 crore and Rs 108.98 crore in F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The amount is regularly increasing but the increasing trend is not consistent. The increasing trend is fluctuating. From F/Y 060/061 to 061/062 it has changed by 67.59% but from F/Y 061/062 to 062/063 it has changed by 17.79%. Again the changed rate increased to 53.66% in F/Y 063/064 from F/Y 062/063. Finally it changed by 59.44% from F/Y 063/064 to 064/065. The average change rate is 49.62%.

**Figure 4.9**  
**Reserves and Surplus Position**



#### 4.7 Bills Payable

**Table 4.7**  
**Bills Payable Position**

(Amount in crore)

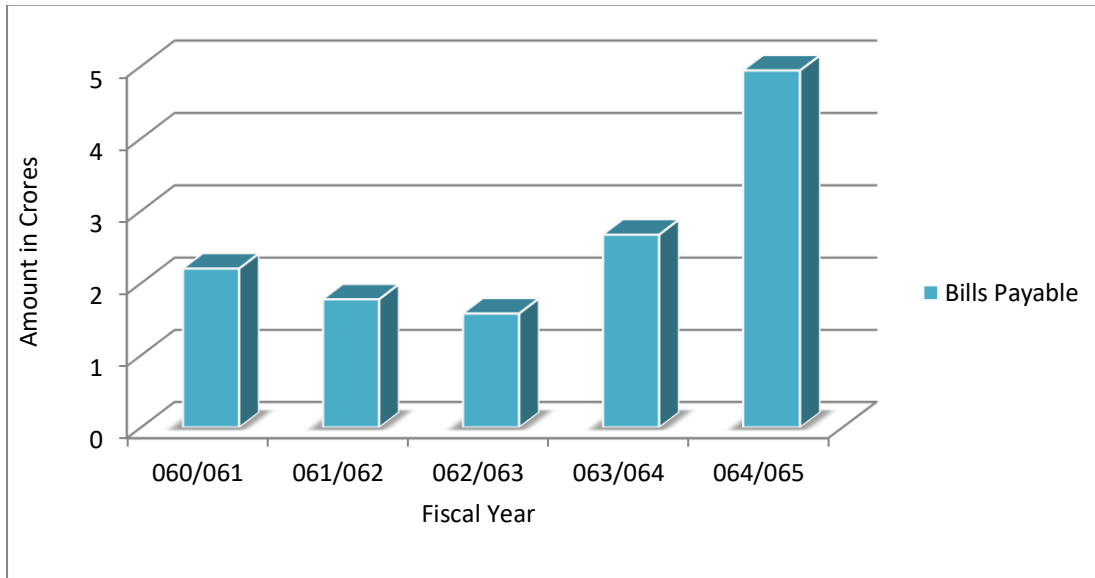
Fiscal Year	Amount	Change Rate%	Proportion of TL%
060/061	2.202	-	0.22
061/062	1.777	-19.3	0.15
062/063	1.580	-11.09	0.09
063/064	2.670	68.98	0.12
064/065	4.940	85.02	0.18
Average		30.9	0.15

*Source: Annual Report of Everest Bank Limited*

Bills Payable are those liabilities which should be paid within a shorter period of time as it is a short term liability. Rs 2.20 crore, Rs 1.78 crore, Rs 1.58 crore, Rs 2.67 crore and Rs 4.94 crore amount of bills payable are there in F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The amount is in fluctuating trend . The proportion of the bills payable among the whole capital and liabilities are 0.22% , 0.15%, 0.09%, 0.12%, and 0.18% in F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The proportion also fluctuates. The average proportion is 0.15%.

The yearly change rate of the bills payable is in highly fluctuating trend. It has changed by -19.30%, -11.086%, 68.98%, 85.01% for F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The average change rate is 30.90%.

**Figure 4.10**  
**Bar Diagram of Bills Payable Position**



#### 4.8 Total Capital and Liabilities

**Table 4.8**  
**Total Capital & Liabilities Position**

(Amount in Crores)

Fiscal Year	Amount	Change Rate%	Proportion of TL%
060/061	960.85	-	100
061/062	1173.25	22.1	100
062/063	1595.92	36.02	100
063/064	2143.26	34.29	100
064/065	2714.93	26.67	100

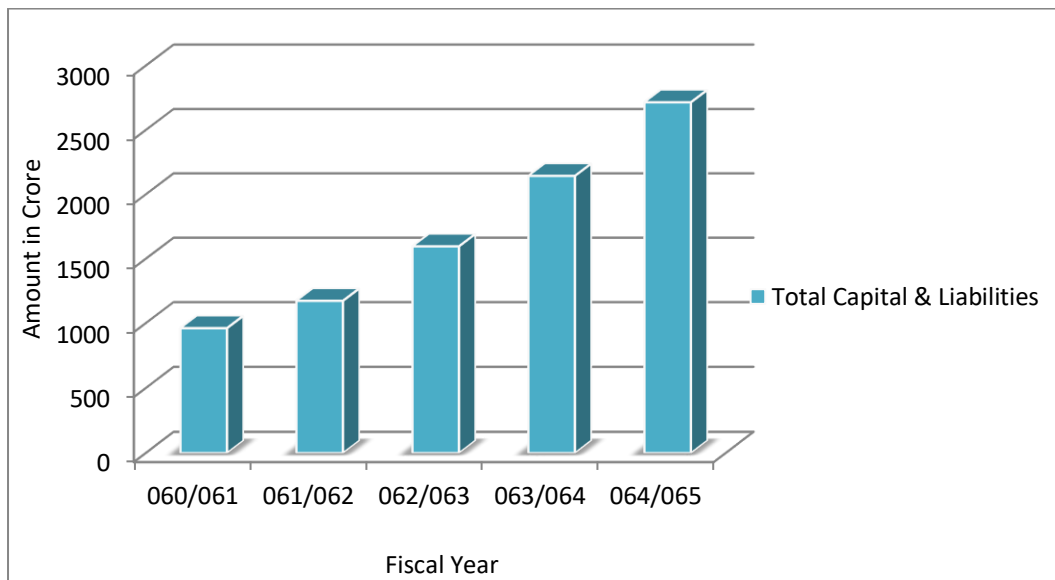
Source: Annual Report of Everest Bank Limited

Total Capital and Liabilities comprises of all the items of the left hand side of balance sheet. The total amount of the capital and liabilities of Everest Bank

Limited is continuously increasing. It has a increasing trend. It is Rs 960.85 crore in F/Y 060/061, Rs 1173.25 crore in F/Y 061/062, Rs 1595.92 crore in F/Y 062/063, Rs 2143.26 crore in F/Y 063/064 and Rs 2714.93 in F/Y 064/065. As like deposit it is also increasing every year. The whole liabilities trend highly depends on deposit. The economic position of country also affects it heavily. The annual change rate of total capital and liabilities is fluctuating. The rates are 22.10%, 36.02%, 34.29%, 26.67% for fiscal year 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The average change rate is 29.77% .The Capital and Liabilities position trend are depend on numerous internal and external factors.

**Figure 4.11**

**Bar Diagram of Total Capital & Liabilities Position**



The Second objectives of this research under study is to analyze the composition of the mixture of debt and equity capital of Everest Bank Limited. A strong balance sheet is an important consideration for investing in a company’s stock. The strength of a company’s balance sheet can be evaluated by three broad categories of investment quality measurements, working capital adequacy, assets performance and capital structure. In this research under study we are looking at

evaluating balance sheet strength based on the competition of a company's capital structure. A company's capitalization describes the composition of a company's permanent or long term capital which consists of a combination of debt and equity. A healthy proportion of equity capital is an indication of financial fitness. A company considered too highly levered may find its freedom of action restricted by its creditors and/or may have its profitability hurt as a result of paying high interest costs. There is no magic proportion of debt that a company can take on. The debt equity relationship varies according to industries involved, a companies line of business and it's stage of development. However, business investors are better off putting their money into companies with strong balance sheets. In gist we can say that companies should have lower debt and higher equity levels. In this context, we have calculated various capital ratios and indicators to evaluate the composition and mixture of debt and equity capital of Everest Bank limited In general we have used following ratios to assess the financial strength of the bank's capitalization structure. They are shareholder's equity, debt to equity ratio, debt to total capital ratio, equity capitalization of EBL, debt capacity of Everest bank limited, return on capital employed and return on equity. In order to analyze the Capital Structure management of the banks, the following components has been discussed and presented in table and figure

#### 4.9 Analysis of Shareholder's Equity

**Table 4.9**

**Composition of Shareholder's Equity of Everest Bank Ltd**

(Amount in Crores)

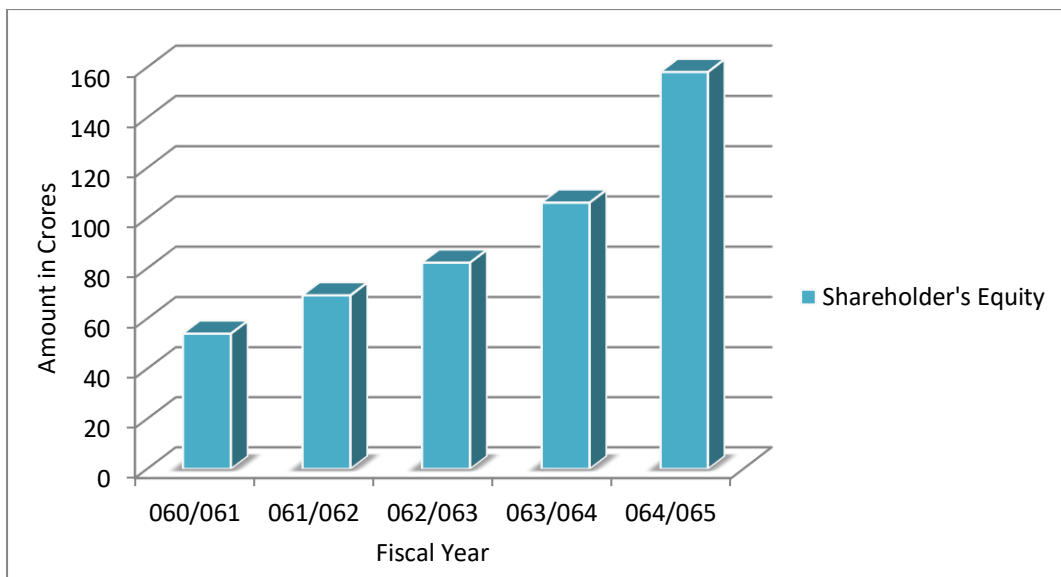
<b>Particular</b>	<b>060/061</b>	<b>061/062</b>	<b>062/063</b>	<b>063/064</b>	<b>064/065</b>
Paid up Capital	31.5	31.5	37.8	37.8	49.14
Reserves & Surplus	22.53	37.76	44.48	68.35	108.98
Total Shareholder's equity	54.03	69.26	82.28	106.15	158.12
No. of Share	3150000	3150000	3780000	3780000	4914000
Net Worth Per Share	171.52	219.87	217.67	280.82	321.77

*Source: Annual Report of Everest Bank Limited*

Paid up Capital of EBL is Rs 31.5 crore, Rs 31.5 crore, Rs 37.8 crore, Rs 37.8 crore and Rs 49.14 crore for F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. Reserves and Surplus were Rs 22.53 crore, Rs 37.76 crore, Rs 44.48 crore, Rs 68.35 crore and Rs 108.98 crore for F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. We consider actual no .of shares present those fiscal years. Thus, total sum of paid up capital and reserves and surplus is considered as shareholders equity which is also the net worth of the bank. Now net worth per share is calculated by dividing total shareholder’s equity by no of shares outstanding. Net worth per share of EBL is Rs 171.52 crore, Rs 219.87 crore, Rs 217.67 crore, Rs 280.82 crore and Rs 321.77 crore in F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. It is continuously increasing and it has a increasing trend. The shareholders equity(net worth) increases due to several causes like decreasing equity capitalization rate, bigger reserve funds etc. Reserves and Surplus are more than paid up capital every fiscal year. Hence we conclude that net worth highly depends in reserve and surplus. The position of net worth is shown in the following diagram.

**Figure 4.12**

**The Bar Diagram of Shareholder’s Equity**





**Table 4.10**

**The Net Worth Position and Index Table**

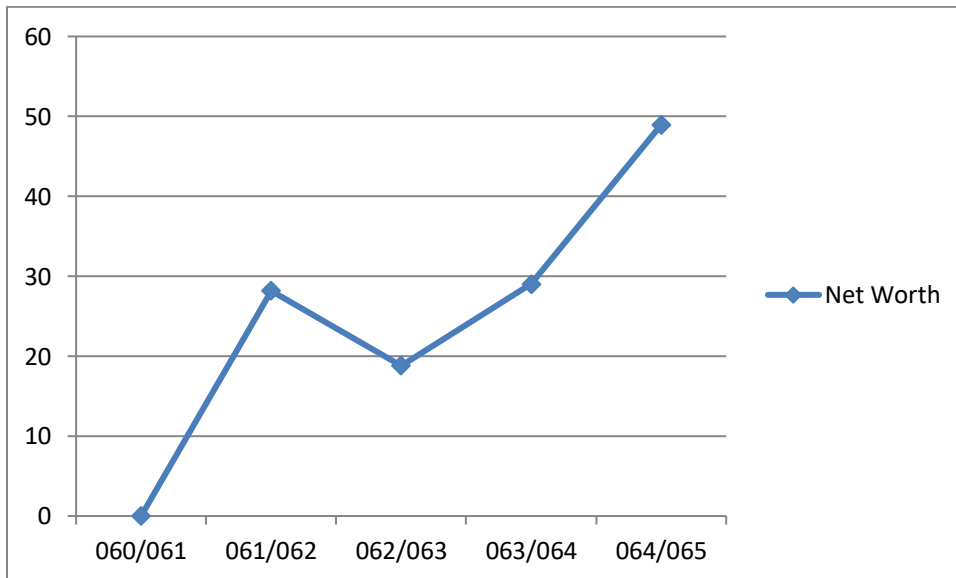
(Amount in Crores)

<b>Fiscal Year</b>	<b>Net Worth</b>	<b>Index</b>	<b>Yearly Change%</b>	<b>Proportion in TL%</b>
060/061	54.03	100	-	5.62
061/062	69.26	128.18	28.19	5.90
062/063	82.28	152.28	18.80	5.16
063/064	106.15	171.92	29.01	4.95
064/065	158.12	197.52	48.95	5.82
<b>Average</b>			<b>31.23</b>	<b>5.49</b>
<b>SD</b>			<b>10.99</b>	<b>0.37</b>
<b>C.V.</b>			<b>35.18</b>	<b>6.79</b>

The above figure tells the net worth of Everest Bank is changing in positive ratio. The annual change rate of net worth is 28.18% from F/Y 060/061 to 061/062, 18.78% from F/Y 061/062 to F/Y 062/063, 29.01% from 062/063 to 063/064, 48.95% from F/Y 063/064 to 064/065. The overall trend of annual change is increasing. Following figure deals about the trend.

**Figure 4.13**

**The line diagram of annual change rate of Shareholder's Equity**



The amount of shareholder's equity itself is increasing regularly but the change rate is not consistent, although its direction is towards overall increment at large. The Standard Deviation of annual change rate of shareholder's equity is 10.99 and Coefficient of Variation is 35.18. The average annual change rate is 31.23%.

The proportion of shareholders equity on total capital and liabilities is 5.62%, 5.90%, 5.16%, 4.95%, and 5.82% for F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The average proportion is 5.49% where it's standard deviation is 0.37 and C.V is 6.79.

#### 4.10 Analysis of Debt to Equity Ratio

The following table is presented to describe the Debt to Equity Ratio of Everest Bank Limited.

**Table 4.11**  
**Debt to Equity Ratio Position**

<b>Fiscal Year</b>	<b>Debt to Equity Ratio</b>	<b>Change %</b>
060/061	5.36	--
061/062	4.91	-8.39
062/063	5.16	5.09
063/064	5.30	2.71
064/065	4.08	-23.09
<b>Average</b>	<b>4.96</b>	<b>-5.92</b>
<b>SD</b>	<b>0.47</b>	<b>11.14</b>
<b>C.V.</b>	<b>9.42</b>	<b>-188.21</b>

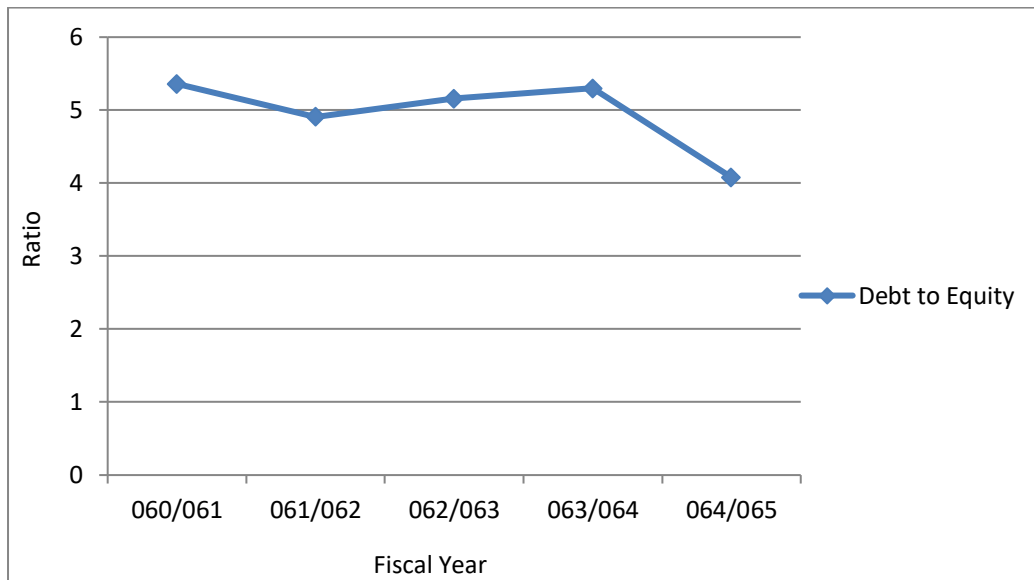
*Source: Annual Report of Everest Bank Limited*

The ratio is more significant to determine whether fixed deposit financing is adequate to strengthen the profitability of bank. It shows the relationship between borrowed fund and owner's capital. The higher debt to equity ratio shows a large share of financing by the creditors relatively to the owners. The Debt to Equity ratios are 5.36%, 4.91%, 5.16%, 5.30%, 4.08% in F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. In all the fiscal years DER is

greater than 2 % it means greater claims of creditors. The SD and C.V. are 0.47 and 9.42 respectively. DER has changed by -8.39%, 5.09%, 2.71%, -23.09 % in F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The SD and C.V. are 11.14% and -188.21% respectively, where average change rate is -5.92%.

**Figure 4.14**

**The Line Diagram of Fixed Deposit to Net Worth**



#### 4.11 Debt to Total Capital (DCR) Ratio Analysis

Following table shows the position of DCR.

**Table 4.12**

**Debt to Total Capital Ratio (DCR) Position**

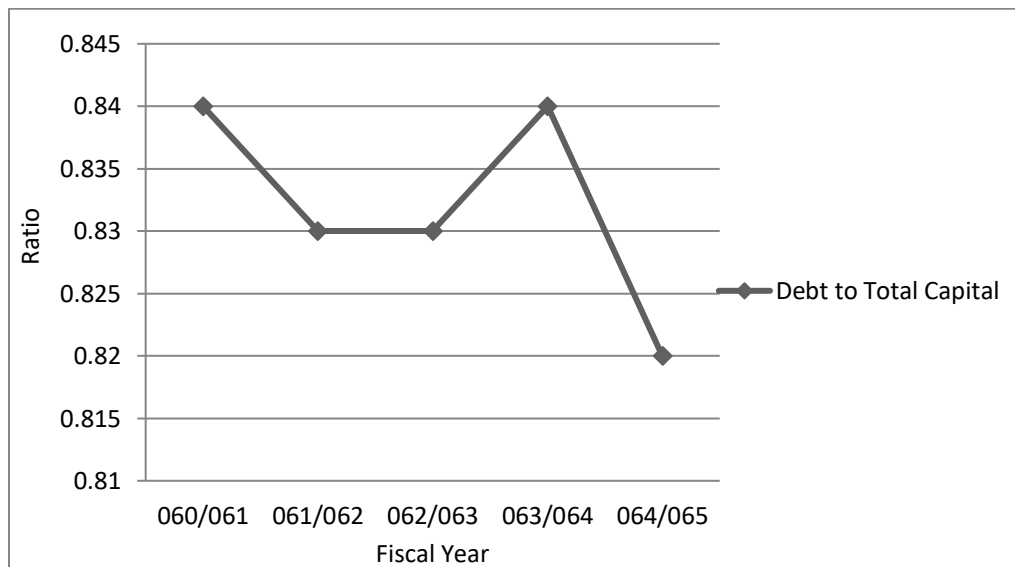
<b>Fiscal Year</b>	<b>DCR Ratio</b>	<b>Change Rate%</b>
060/061	0.84	-
061/062	0.83	-1.19
062/063	0.83	-
063/064	0.84	1.2
064/065	0.82	-2.38
<b>Average</b>	<b>0.83</b>	<b>-0.59</b>
<b>SD</b>	<b>0.007</b>	<b>1.49</b>
<b>C.V.</b>	<b>0.90</b>	<b>-252.31</b>

*Source: Annual Report of Everest Bank Limited*

The Debt to Total Capital ratio is 0.84%, 0.83%, 0.83%, 0.84%, and 0.82 % for F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. .The ratio is decreasing except in F/Y 063/064, it increase to 0.84%. The average DCR is 0.83%. SD and C.V. are 0.0074 and 0.90 respectively. The yearly change rate is -1.19%, 1.20%, -2.38% for F/Y 061/062, F/Y 063/064, and F/Y 064/065 respectively. SD and C.V are 1.49 and -252.31 respectively. The annual change rates are all negative except in F/Y 063/064 where DCR rate was higher. It implies that there is a secure environment to creditors in extending credit and vice versa.

**Figure 4.15**

**Line Diagram of Debt to Total Capital Ratio**



#### 4.12 Analysis of Debt Capacity of Everest Bank Limited

**Table 4.13**

##### **Interest Coverage Ratio (ICR) Position**

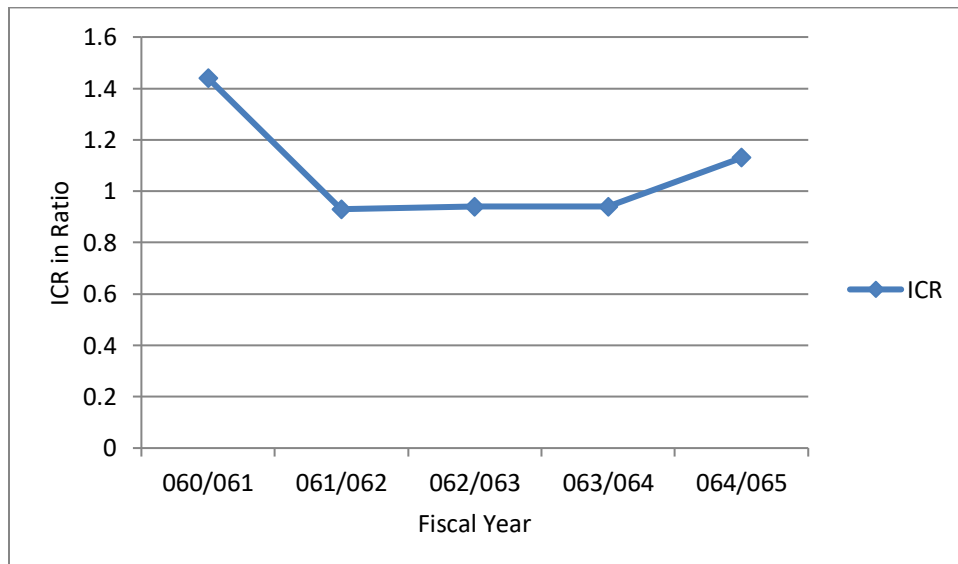
<b>Fiscal Year</b>	<b>Interest overage Ratio</b>	<b>Change Rate %</b>
060/061	1.44	-
061/062	0.93	0.44
062/063	0.94	0.01
063/064	0.94	-
064/065	1.13	1.28
Average	1.076	0.43
<b>SD</b>	<b>0.19</b>	
<b>C.V.</b>	<b>31.74</b>	

*Source: Annual Report of Everest Bank Limited*

The DCR is 1.44, 0.93, 0.94, 0.94 and 1.13 for F/Y 060/061, 061/062, 062/063, 063/064, and 064/065 respectively. The average DCR is 1.076%. The SD and CV are 0.19 and 31.74 respectively. The yearly change rate is 0.44, 0.01 ,nil , and 1.28 for F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 respectively. The annual change rates are all positive. It implies that EBL creates a secure environment to creditors in extending credit and vice versa.

**Figure 4.16**

##### **Line Diagram of Interest Coverage Ratio**



### 4.13 Equity Capitalization Rate Analysis

**Table 4.14**

**Equity Capitalization Rate Position**

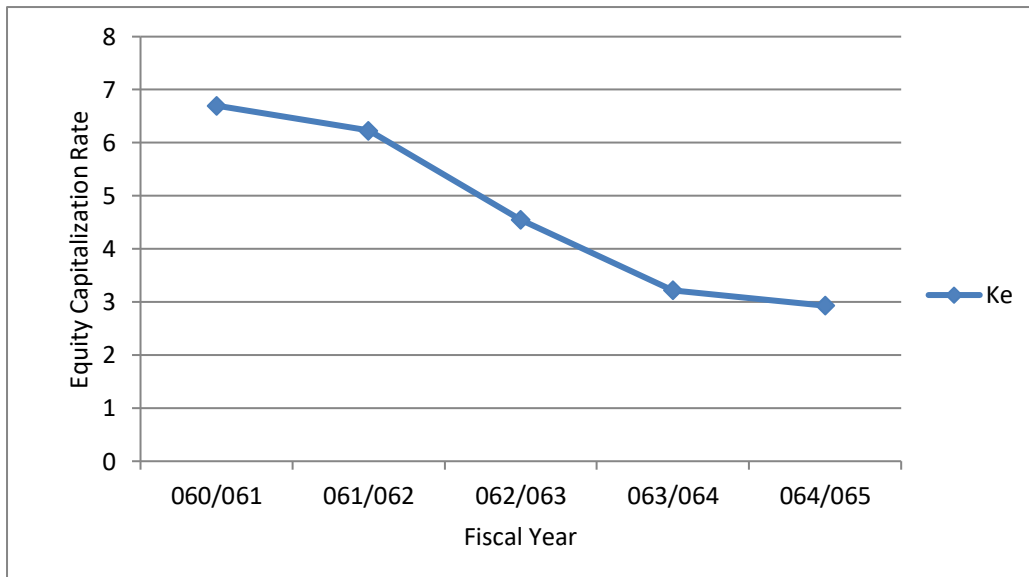
<b>Fiscal Year</b>	<b>Equity Capitalization Rate(Ke)</b>	<b>Change Rate%</b>
060/061	6.7	-
061/062	6.23	-7.01
062/063	4.55	-26.96
063/064	3.22	-29.23
064/065	2.93	-9.00
<b>Average</b>	<b>4.72</b>	<b>-18.05</b>

*Source: Annual Report of Everest Bank Limited*

The equity capitalization rate of Everest bank is in decreasing trend. The cost of equity is continuously decreasing which is very good. The cost of equity declines to 2.93 in F/Y 064/065 from 6.7% in F/Y 060/061. Decrease in equity capitalization rate implies good sign for increase in share holders equity. The average Ke rate is 4.72 and the whole change rates for all the fiscal year is negative.

**Figure 4.17**

**Line Diagram of Equity Capitalization Rate**



#### 4.14 Return on Capital Employed (ROCE) Analysis

**Table 4.15**

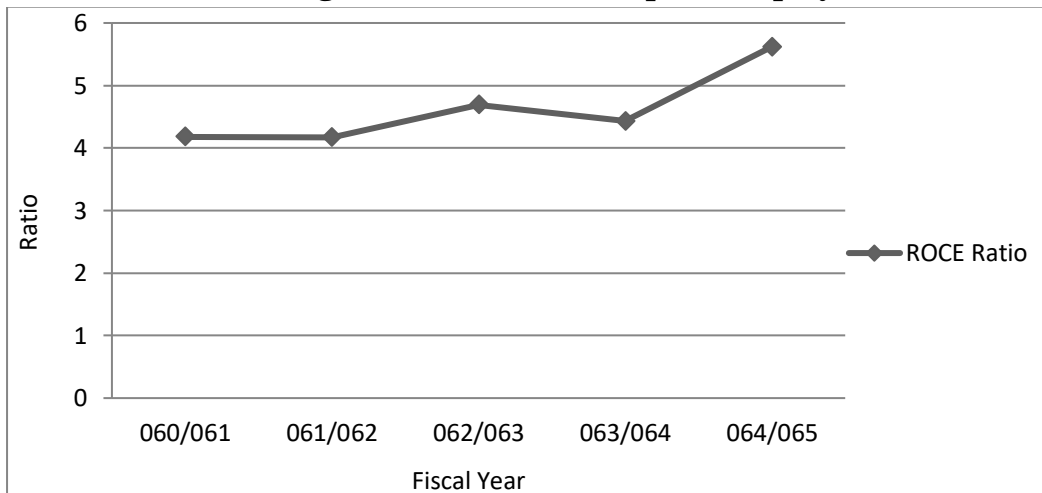
##### **Return on Capital Employed (ROCE) Ratio**

<b>Fiscal Year</b>	<b>ROCE Ratio</b>	<b>Change Rate %</b>
060/061	4.18	-
061/062	4.17	-0.23
062/063	4.69	12.47
063/064	4.43	-5.54
064/065	5.62	26.86
<b>Average</b>	<b>4.61</b>	8.39
<b>SD</b>	<b>0.536</b>	
<b>C.V.</b>	<b>11.62</b>	

*Source: Annual Report of Everest Bank Limited*

Return on Capital Employed (ROCE) of Everest Bank Limited for F/Y 060/061, F/Y 061/062, F/Y 062/063, F/Y 063/064, and F/Y 064/065 are respectively. The overall trend is simply increasing and decreasing. The average ROCE is %. The SD and C.V are respectively. The figure of F/Y 064/065 shows a bit better position of net income in relation to capital employed. For judging operational efficiency, ROCE is more useful measure and it explains net income for each unit of long term funds. The higher the ratio, the more efficient is the use of capital employed.

**Figure 4.18**  
**Line Diagram of Return on Capital Employed**



#### 4.15 Return on Equity (ROE) Analysis

**Table 4.16**

#### Return on Equity (ROE) Analysis

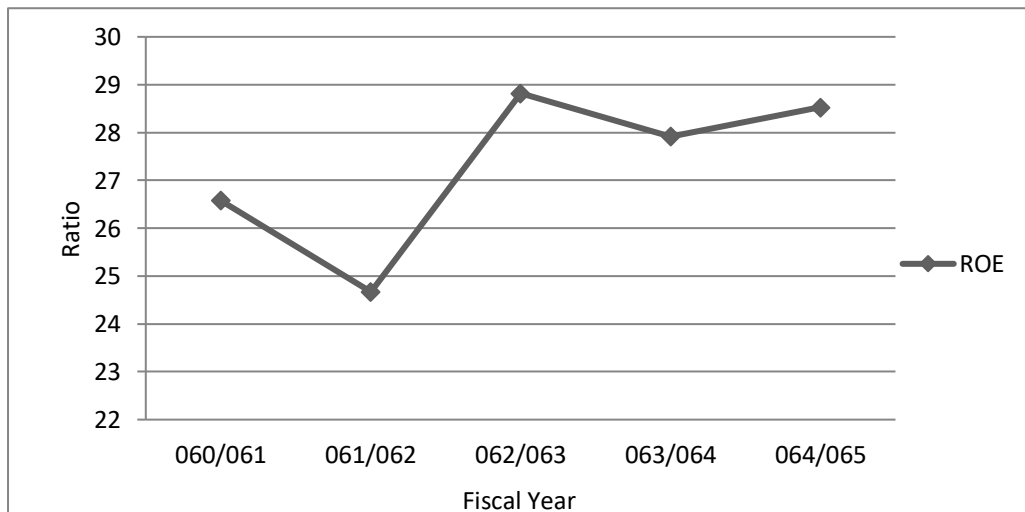
<b>Fiscal Year</b>	<b>ROE Ratio</b>	<b>Change Rate %</b>
060/061	26.58	-
061/062	24.67	7.19
062/063	28.82	16.82
063/064	27.92	-3.12
064/065	28.53	2.19
<b>Average</b>	<b>27.30</b>	<b>2.18</b>
<b>SD</b>	<b>1.52</b>	
<b>C.V.</b>	<b>5.59</b>	

*Source: Annual Report of Everest Bank Limited*

ROE of EBL for F/Y 060/061, 061/062, 062/063, 063/064, and 064/065 are 26.58%, 24.67%, 28.82%, 27.92% and 28.53% respectively. The utilization of equity capital is being done well. The ROE changes by 7.19% from 1<sup>st</sup> year to 2<sup>nd</sup> year, by 16.82% from 2<sup>nd</sup> year to 3<sup>rd</sup> year, 2.19 % from 4<sup>th</sup> year to 5<sup>th</sup> year. The average change rate is 2.175. Since the ROE is high, it is good for the firm. Higher ratio implies more efficient the management and utilization of shareholders fund.

**Figure 4.19**

#### Line Diagram of Return on Equity





#### 4.16 Profitability Analysis

Profitability measures efficiency and the research for it provides an incentive to achieve efficiency. Profitability ratios are those ratios which indicated degree of success in achieving desired profit level. Profit is an important factor that determines the firm's expansion and diversification. A required level of profit is necessary for the firm's growth and survival in the competitive environment. The third main objective of this under study is to examine the different profitability ratios of Everest Bank Limited. In which we have included earnings per share analysis, dividend per share analysis, Dividend payout ratio, market value per share and Price earnings per share of the bank as well the operating and net profits of the bank.

**Table 4.17**  
**Profitability Analysis**

<b>Fiscal Year</b>	<b>EPS</b>	<b>DPS</b>	<b>DPR</b>	<b>MVPS</b>	<b>P/E Ratio</b>
060/061	45.58	-	-	680	14.93
061/062	54.22	20	36.87	870	16.04
062/063	62.78	-	-	1379	21.97
063/064	78.42	30	38.25	2430	30.99
064/065	91.82	30	32.68	3132	34.11
<b>Average</b>	<b>66.57</b>	<b>20</b>	<b>26.95</b>	<b>1698.2</b>	<b>23.60</b>
<b>SD</b>	<b>16.64</b>	<b>4.71</b>	<b>2.37</b>	<b>939.77</b>	<b>7.74</b>
<b>C.V.</b>	<b>25.00</b>	<b>23.57</b>	<b>8.79</b>	<b>55.33</b>	<b>32.82</b>

*Source: Annual Report of Everest Bank Limited*

Earning per share is one of the market related ratio. It is calculated to see the market performance of the bank. Dividend per share is evaluated to know the share of dividend that the shareholder receives in relation to the paid value of the share. MVPS indicates the banks market rat and P/E ratio reflects the price currently paid by the market for each rupee of currently reported EPS. From the above table it is very obvious that all the indicators of profitability analysis has taken a inclination or we may say a increasing trend which is a very good sign of the strength and success of bank. Increasing EPS and MVPS shows a sense of

satisfaction to the shareholders. The table also shows a increasing P/E ratio which is very useful to the prospective investors.

#### 4.17 Net Profit and Operating Profit

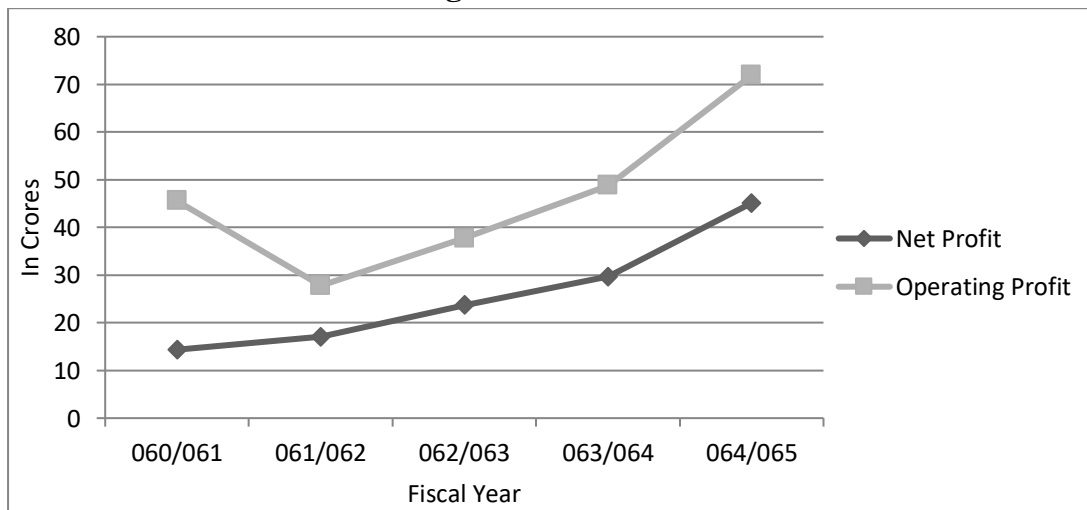
**Table 4.18**  
**Profit Position**

<b>Fiscal Year</b>	<b>Net Profit</b>	<b>Operating Profit</b>
060/061	14.36	45.58
061/062	17.08	27.79
062/063	23.72	37.72
063/064	29.64	48.79
064/065	45.12	71.88

*Source: Annual Report of Everest Bank Limited*

Operating profits before provisioning have increased by 47.32% to Rs 71.88 crore in the fiscal year ended mid July 2008. Similarly net profits have increased by 52.2% and reached Rs 45.12 crore. The average growth of operating profits for the last 5 years is 46.35% .Similarly the average growth of net profits for the last five years is 25.98%. Thus, it has been successfully managing the business profitability. The graph below shows the growth pattern of their operating and net profits (in Crores).

**Figure 4.20**  
**Line Diagram of Profit Position**



#### 4.18 Major Findings

- The position of share capital as shown in the table is lesser than the liabilities. Liabilities are increasing more than the share capital.
- Position of investment according to the extracted figures shows a increasing trend. The bank has managed wisely to invest in highly yielding portfolio and hence increase the income. It has been successfully managing the business profitability.
- Deposit products have been widely accepted over the market. As per the vision and mission it has been successful in serving the middle and lower class of the society and brought them under the banking scenario. Deposits have been growing rapidly this year over last fiscal years. Deposits have grown by over two folds in three years. Hence role of deposit among the whole capital structure is increasing.
- The growth in lending has been well managed through proper risk management and appraisal process. The bank has a major focus on wholesalers and retailers in commercial segment and in the housing loan in terms of retail segment where majority of the growth took place. EBL has been pioneers of retail lending products. The position of advances as shown in figure has a continuous increasing trend.
- With the changing fiscal years Reserves and Surpluses are also changing. It has taken a inclination i.e. it has a increasing trend. But the yearly change rate of R & S is not consistent.
- The position of bills payable is fluctuating. It is highest in F/Y 064/065 with a amount of Rs 4.94 crores.
- It is highly affected by Deposit. It is directly proportionate to deposit. Since the deposit of EBL is increasing, total capital and liabilities is also increasing.
- The total sum of paid up capital and reserves and surpluses is considered as shareholder's equity which is also the net worth of the bank. The

shareholder's equity increases due to several causes like decreasing capitalization rate, bigger reserves funds etc. R&S are more than paid up capital every fiscal year. Hence we conclude that shareholder's equity highly depends upon R & S.

- This ratio is more significant to determine whether fixed deposit financing is adequate to strengthen the profitability of the bank or not. It shows the relationship between borrowed fund and owner's capital. The higher debt to equity shows a large share of financing by the creditors relatively to the owner's. Debt to equity ratio in average more than 2 means claim of creditors and shareholders against the property of the firm. A Company's reasonable, proportional use of debt and equity to support its assets is a key indicator of balance sheet strength. A healthy capital structure that reflects low level of debt and a corresponding high level off equity is a very positive sign of investment policy.
- It has increasing decreasing trend. It deals a lot about the total capitalization of the firm.
- As shown in the table no 4.12, the debt capacity of EBL is more fluctuating but the change rates are all positive in all the fiscal years. It shows the bank's capacity to earn sufficient profit to cover the interest of debt. DCR of EBL shows that it creates secure environment to creditors in extending credit and vice versa.
- The Equity Capitalization rate of EBL is in decreasing trend. The cost of equity is continuously decreasing which is very good. Decrease in Equity Capitalization rate implies good sign for increase in shareholder's equity.
- Higher the ratio, the more efficient the management on utilization of capital. A positive change % in ROCE always shows the better position of net income in relation to fixed deposits and net worth.
- ROE analysis as a whole is better and satisfactory.

- The profitability of common shareholder's investment can be measured through EPS. Because EPS is related with market performance. And the market performance of EBL is quite satisfactory.
- Dividend per share is considered excellent when it is higher. Shareholder always preferred the higher ratio of dividend. DPS of EBL is in average level.
- It shows the relation between the price earning ratio and earnings per share of the bank. The market value of Everest Bank Ltd is very good as shown in the data before.
- It is the expectations of the shareholders. It is also very useful to prospective investors. The picture shows a constant increase in P/E ratio of EBL which is a very good sign of success.

# **CHAPTER - V**

## **SUMMARY, CONCLUSION AND RECOMMENDATIONS**

### **5.1 Summary**

As stated earlier, Capital Structure represents the combination of long term sources of capital. It is the left hand side part of the balance sheet. It is also called liabilities part. Everest Bank Limited has strived to establish itself as a strong brand that creates an image of a local bank that is easy to access and is reliable. EBL is the first private commercial bank that has largest network. It has a strong joint venture partner (Punjab National Bank) providing advance technical support. That is the reason why it is said that Everest bank is the name you can bank upon. It is the first to introduce ABBS (any branch banking system) in Nepal. The main concept of the study is to show the banking industry in Nepal and the role of Everest Bank Limited and the Capital Structure part of the Everest bank Limited. The corporate vision and mission of EBL is to evolve and position the bank as a progressive cost effective and customer friendly institution providing comprehensive financial and related services and to provide excellent professional services and improve it's position as a leader in the field of financial related services. Thus, the main objectives of the study under research are,

1. To examine the existing financial position regarding capital structure,
2. To analyze the composition as well as of the mixture of debt and equity,
3. To examine the different profitability ratio and,
4. To suggest and recommend the financial position of Everest Bank Limited.

The main significance of the study is to accomplish according to approved general format of the thesis of Tribhuvan University. It may be used for future research and future business plan or projects. This study covers only five years data. This study is based on secondary data collected from annual report, financial statements

etc. This study is concerned only about Capital Structure of Everest Bank Limited. Capital Structure is influenced by various factors, but this study excludes those factors. For our convenience annual data has been taken which becomes easy for us to perform the study. Information and data are identified and collected. The collected data are properly processed and arranged in the required form for simplicity. Financial and statistical tools are used to analyze those data. Interpretation is made after doing analysis. In the last step, conclusion is drawn. Suggestions and recommendations are made for the company. The scheme of the study is divided into five chapters. The brief introduction of the study has been presented in the first chapter. Second and third chapters include review of literature and research methodology. Available data have been presented and analyzed in the fourth chapter. And this is the last chapter of the study which incorporates summary of the study, conclusion of the analysis and recommendations.

## **5.2 Conclusion**

Total Liabilities and Capital for all fiscal years are continuously increasing. It shows that overall situation of bank is growing up. The change rate is however fluctuating. Liabilities are increasing more than the share capital.

The Position of investment according to the extracted figures shows a increasing trend. The bank has managed wisely to invest in highly yielding portfolio and hence increase the income. It has been successfully managing the business profitability.

Deposit products have been widely accepted over the market. As per the vision and mission it has been successful in serving the middle and lower class of the society and brought them under the banking scenario. Deposits have been growing rapidly this year over last fiscal years. Deposits have grown by over two folds in

three years. Hence role of deposit among the whole capital structure is increasing. The proportion of total deposit among the total liabilities and capital tells the role of deposit in the whole capital structure. The business reached peak when the value was Rs 2397.63 crore. The average proportion rate of deposit over the liabilities and capital is 85.93%. The deposit is directly related to investment policy.

Shareholder's equity is the composition of paid up capital, reserves and surpluses, other reserves and undistributed profit. Unlike other items mentioned, shareholder's equity is increasing regularly. The average yearly change rate is 31.23% and average proportion over the total liabilities is 5.49%. The maximum net worth per share is Rs 321.77 for last fiscal year.

The relationship of debt and share capital is shown by debt to equity ratio. For the first fiscal year it was 5.36% and then it decreases to 4.91% in another fiscal year then it again increases to 5.30% in F/Y 063/064. It further decreases to 4.08% in F/Y 064/065. The average DER is 4.96% and average change rate is -5.925. This shows the relationship between borrowed fund and owner's capital. Higher debt to equity ratio shows a large share of financing by the creditors relatively to the owners. In all the fiscal years DER is greater than 2, it means greater claims of creditors and shareholder's against the property of the firm. It has extremely used debt capital in its financial structure or we can say it to have higher geared up capital.

How much debt is there in items of capital is shown in debt to total capital ratio. It deals a lot about the total capitalization of the firm. As like above ratios, this ratio is also in increasing decreasing trend. The maximum DCR is 0.84% in F/Y 060/061 and 063/064 and the average rate is 0.83%. The yearly change rate is in highly fluctuating trend. The average change rate is -0.59%.



Debt capacity of any bank is a prime factor for stakeholder's of the bank. It shows whether the bank is able to earn sufficient profit to cover the interest of debt. The larger the ratio is greater the ability to pay interest will be. DCR of EBL shows that it creates a secure environment to creditors in extending credit and vice versa.

Under net operating approach, it is said that, the total valuation of the firm is unaffected by the capital structure. Equity capitalization is calculated under this thought. The rate of Equity capitalization of EBL is in decreasing trend. The cost of equity is continuously decreasing. Decrease in equity capitalization rate implies good sign for increase in shareholder's equity. The average cost of equity is 4.72 and the whole change rates for all the fiscal years are negative.

The relationship between net profit and capital employed is shown in the capital employed ratio analysis. This ratio has a fluctuating trend. The average ratio is 4.61%. The return on capital employed ratio carries the relationship of return to the success of fund. It shows whether the bank has earned a satisfactory return from it's internal sources or not. The average change rate of this ratio is 8.39%. ROCE measures and explains net income for each unit of long term funds. The higher the ratio, the more efficient is the use of capital employed.

Earnings per share of companies are calculated to see the strength of the share in the market. EPS is one of the market related ratio. EPS of EBL is continuously increasing. Average EPS is 66.57 and average change rate is 19.18%. EPS shows a very good market position if EBL and is satisfactory to the shareholders. It has significant strength of share in the market.

Dividend per share is evaluated to know the share of dividend that the shareholder's receive in relation to the paid value of the share. The trend of DPS is not consistent. The average DPS is Rs 20.

Dividend payout ratio represents the percentage of profit, distributed as dividend and the % retained as revenue and surpluses for the growth of bank. DPR has a increasing and decreasing trend. The average DPR id 26.95%.

Market value per share indicates the bank's market value. The trend is highly increasing as shown in table. The average MVPS is Rs 1698.2. The average change rate is 47.89%. It shows the relation between the price earnings ratio and EPS of the bank. The market value of Everest Bank ltd is very good as shown in the data before.

Price earnings ratio reflects the price currently paid by the market for each rupee of currently reported EPS. It measures investor's expectations and the market appraisal of the performance of a firm. The trend is highly increasing. The picture shows a constant increase in P/E ratio of EBL which is a very good sign of success.

Operating profits before provisioning have increased by 47.32% to Rs 71.88 crore in the fiscal year ended mid July 2008. Similarly net profits have increased by 52.2% and reached Rs 45.12 crore. The average growth of operating profits for the last 5 years is 46.35% .Similarly the average growth of net profits for the last five years is 25.98%. Thus, it has been successfully managing the business profitability.

### **5.3 Recommendations**

The bank's performance can be seen by various ways. Different analysis gives different recommendations and suggestions to the bank. On the basic of above analysis and descriptions, following recommendation have been made for this organization. It is expected that the provided suggestions would help in taking

decisions in relation to capital structure management and profitability for mitigating the constraints.

The recommendations are as below:

- The capital and Liabilities analysis says that the overall condition and position of capital and liabilities is very good. It is recommended to have its capital structure into high geared because at this point they can meet their fixed interest expenses.
- It is recommended to keep some debt policy and to provide various schemes to attract more depositors to the bank.
- The Capital Structure of the bank is highly levered. The proportion of debt and equity capital should be decided keeping in mind the effects of tax advantage and financial distress. Since the debt equity ratio of the bank is higher, the capital structure position is not good. Keeping this fact in mind, the bank is required to maintain improved capital structure by increasing equity base i.e. issuing more capital, expanding general reserve and retaining more earnings. With this improved capital structure of the bank, it will compromise among the conflicting factors of cost and risk.
- Fixed Deposit among the total deposit is assumed to be long term debt of bank. So, it is a sensitive part of capital structure. As like whole liabilities, the fixed deposit has also increasing trend but the annual change rate is not consistent. It has to bring various deposit schemes and provide higher interest rates to retain the existing customers and to make new customers. The more fixed deposit, the more it can lend long-term investments. Debt equity ratio of EBL is 4.96% in average which is comparatively higher. This indicates that the proportion of debt is higher. Higher debt capital creates risk, which is a dangerous signal from creditors point of view. Company may feel the pressure of creditors and burden of interest. If it was other business rather than bank, it could be advised to reduce the debt or the fixed deposit. But to

collect deposit is itself its business, reduction of debt cannot be advised but the profit should be increased in any cost, which will manage this condition. Generally rational DER is assumed to be 2. Therefore, to remain in a general line of Capital Structure, profit should be maximized more than two times of present. In addition it is suggested to reduce NPA (non performing assets) which decreases the profit.

- Interest Coverage ratio of Everest Bank Limited in average is 1.076%. Interest generally cannot be changed and interest decrease tool (decrease in debt) is not right solution. Interest decreasing tool is generally out of control because market determines the interest rate. Therefore, to increase the interest rate, it must necessarily increase the profit. The standard ICR is higher than 1 and in average ICR of EBL is also higher than 1, to maintain this ratio, it is suggested to bank to increase the profit. Due to competition the margins has squeezed and hence it should look to build their low cost deposits and high yield advance to maintain spread. It should focus on offering better facilities to the customer and gain loyalty.
- The bank has been able to show a satisfactory level of return ratios. ROCE and ROE have a better position. EPS is also growing, MVPS & P/E ratio in the similar way has increasing trend but the dividend policy is not found to be sound. DP ratio is not satisfactory. Hence it is suggested to provide bonus share and cash dividend both at the same time to increase and retain goodwill of the bank.
- Majority of joint venture banks including Everest bank Limited is found to be profit oriented ignoring their social responsibility and which is not a proper strategy to sustain in long term. Rural communities have been neglected by JVB's. They have not opened their branches to serve society adequately. But this bank is the one to have largest banking network having at this date 35 branches and 5 extension counters, but still to make and build up its image it has to open its branches to the rural areas and where there is demand from its

customers to open branches in different places to serve society adequately which will definitely lead it to profitability.

- The economic liberalization policy adopted by government has created an environment of strict competition even in the banking sectors. In this context we can conclude that the bank is performing well. The whole economy is in slack. So, to get off this crisis, effort of single bank is not sufficient. Nevertheless EBL should open all the doors to make it more competent. Especially it should invest, formulate and implement some sound and efficient financial strategies to meet required level of profitability as well as the social responsibility.
- Even though, there is cut throat competition in this industry, and the whole economy is down streaming, this bank is rated as a successful bank and running well among 2 dozens competitors. It does not need other square of fund. It is satisfactory symbol for all the stakeholders of the bank.

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**Website:**

**[www.everestbankltd.com](http://www.everestbankltd.com)**

**[www.googlesearch.com](http://www.googlesearch.com)**

**APPENDICES**  
**APPENDIX - I**  
**BALANCE SHEET OF EVEREST BANK LIMITED FOR LAST FIVE FISCAL**  
**YEARS (060 TO 065)**

				Amount in Crores”	
Share Capital and Liabilities			Schedule	060/061	
061/062	62/063	063/064		064/065	
1	Share Capital		4.1	45.50	51.80
	51.80	51.80	83.14		
2	Reserves and Surplus		4.2	22.53	31.46
	44.48	68.35	108.98		
3	Debentures and Bonds		4.3	-	30.00
	30.00	30.00	30.00		
4	Loan and Borrowings		4.4	-	-
	-	-	-		
5	Deposit Liabilities		4.5	806.39	1009.7
	1380.2	1818.6	2397.62		
6	Bills Payable		4.6	2.20	1.77
	1.58	2.67	4.94		
7	Proposed and unpaid dividend			-	2.35
	11.46	6.81	14.07		
8	Income Tax Liabilities			-	0.33
	-	1.52	4.11		
9	Other Liabilities		4.7	84.23	45.75
	76.35	163.46	72.04		
<b>TOTAL LIABILITIES</b>				<b>960.85</b>	
	<b>1173.22</b>	<b>1595.92</b>	<b>2143.25</b>	<b>2714.93</b>	
<b>ASSETS</b>					
1	Cash in hand		4.8	19.25	19.25
	25.93	53.49	82.29		
2	Balance with Nepal Rastra Bank		4.9	85.73	77.96
	113.95	117.81	108.09		
3	Balance with other banks and financial institutions		4.10	-	7.77
	15.41	67.82	76.40		
4	Money at call and Short Notice		4.11	57.00	57.00
	6.69	-	34.60		
5	Investments		4.12	212.89	212.89
	420.05	498.43	505.95		



6	Loans, advances and Bills Purchased	4.13	761.86	761.86
	980.13	1366.4	1833.90	
7	Fixed Assets	4.14	13.40	13.40
	15.20	17.00	36.05	
8	Non-Banking Assets	4.15	-	2.45
	0.74	-	-	
9	Other Assets	4.16	29.04	20.62
	17.80	22.26	37.62	
	<b>TOTAL ASSETS</b>		<b>960.85</b>	
	<b>1173.22</b>	<b>1595.92</b>	<b>2143.25</b>	<b>2714.93</b>

**APPENDIX - II**  
**PROFIT AND LOSS A/C**  
**EVEREST BANK LIMITED FOR LAST FIVE FISCAL YEARS (060 TO 065)**  
**Amount in Crores”**

	<b>Particulars</b>			<b>Schedule</b>	<b>060/061</b>	<b>061/062</b>
	<b>062/063</b>	<b>063/064</b>	<b>064/065</b>			
1	Interest Income		4.18		65.72	71.92
	90.34	114.44	154.86			
2	Interest Expenses		4.19		(31.63)	(29.95)
	(40.13)	(51.71)	(63.26)			
	<b>Net Interest Income</b>				<b>34.09</b>	<b>41.97</b>
	<b>50.20</b>	<b>62.72</b>	<b>91.60</b>			
3	Commission and Discounts		4.20		7.43	7.81
	9.68	11.77	15.02			
4	Other Operating Income		4.21		-	3.14
	4.89	6.27	7.91			
5	Exchange Income		4.22		2.77	2.70
	1.43	2.84	6.44			
	<b>TOTAL OPERATING INCOME</b>				<b>44.29</b>	<b>55.64</b>
	<b>66.21</b>	<b>8.41</b>	<b>120.98</b>			
6	Staff Expenses		4.23		4.85	(6.05)
	(7.09)	8.61	15.79			
7	Other Operating Expenses		4.24		10.38	(12.90)
	(14.35)	17.75	23.37			
8	Exchange Loss		4.22		-	-
	-	-	-			
	<b>Operating Profits Before Provision</b>				<b>29.06</b>	<b>36.67</b>
	<b>44.76</b>	<b>57.76</b>	<b>81.81</b>			
	<b>for possible loss</b>					
9	Provision for possible losses		4.25		(8.17)	(8.89)
	(7.04)	8.96	9.93			
	<b>Operating Profit</b>				<b>20.89</b>	<b>27.78</b>
	<b>37.72</b>	<b>48.79</b>	<b>71.88</b>			

10	Non-operating Income/Loss		4.26	-	0.29
		0.29	0.13	0.45	
11	Write-back from loan loss Provision		4.27	-	0.52
		-	1.16	2.020	
	<b>Profit from regular activities</b>			<b>20.89</b>	<b>28.60</b>
		<b>38.01</b>	<b>50.09</b>	<b>74.35</b>	
12	Profit/Loss from transaction of		4.28	-	(0.52)
	extraordinary nature		(0.079)	(1.89)	
	<b>Profit after inclusion of all types</b>			<b>20.89</b>	<b>28.08</b>
	<b>of transaction</b>				
		<b>38.01</b>	<b>50.01</b>	<b>72.45</b>	
13	Provision for Staff Bonus			(2.34)	(2.80)
		(3.45)	(4.54)	6.58	
14	Provision for Income Tax			6.75	8.19
		10.67	15.82	21.69	
	Less: Deferred tax Assets			-	(0.25)
		(0.15)	-	(0.94)	
	Net after deferred tax			-	
		10.52	-	20.74	
	<b>Net Profit</b>			<b>14.35</b>	<b>16.82</b>
		<b>23.72</b>	<b>29.64</b>	<b>45.12</b>	