

Impact of Capital Structure on Financial Performance of Small Finance Banks

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ABSTRACT

The paper analyses the influence of capital structure on the financial performance of small finance banks in India. The study covers a period of two years from 2017 to 2018 and 8 banks are selected for the study. The objectives of the study are to examine the impact of capital structure on the financial performance of banks and to analyse the interrelation between financial leverage on the financial performance of banks. To measure the capital structure, debt to total assets ratio and debt to equity ratios are used and to measure the financial performance, return on capital employed (ROCE), net profit ratio (NP) and net interest margin (NIM) are used. Regression analysis has been carried out to test the impact of capital structure on profitability considering capital structure as an independent variable and profitability as the dependent variable. The results of the study indicate that the capital structure has a significant impact on the financial performance of the banks in India.

Keywords: *Capital structure, financial performance of banks, Debt to equity, Debt to total assets*

INTRODUCTION AND LITERATURE REVIEW

Capital structure is one of the essential decisions taken by the finance manager of a company in order to analyse the capital structure decision and determines the overall worth of capital through that we can measure the worth of the firm as well as the profitability of the firm. If firm wants to start a new business, they need huge number of revenues to in order to determine that the firm want to analyse their capital structure. The capital structure determinacy signifies indications that a firm possesses to ponder before preferring its capital structure. So, it is the duty of every firm to maximise its price/value and minimize its value of capital, whereas analysing its capital structure.

Capital structure mainly consists of debt, stock and preferred shares that issued to increase the revenue and to get revenue to numerous long-run business of the firm, in other words, the capital structure is primarily a combination of debt and equity. The Debt holders are the one who mainly look for the compensation for the interest and principle they do not have much long-term commitment towards the firm but the equity holders will have a long-term attachment and commitment towards the firm, the firm would possess extra preserved earnings to

finance their capital outflows so they will get a regular dividend from the company. Hence, the firm's capital structure plays vital impact on the financial performance of the firms. Finance leverage is measured because the quantitative relation of debt and equity that states the link between the borrowed and owner's funds. The main thing that a company must analyse is their ability to form cash from all the sources especially from their various business activities. Each and every firm wants to want to use their resource carefully and with that available resources they want to make their profit for the development of the company.

The profit of the company in this context mainly says about the revenue over the expense of the company and it also explains the how the company performs overall. From the point of view of different banks, the commands of the banks and size of the banks mainly depends on the number of branches that a bank is operating. The revenue of the bank mainly analyses the potential, performance and profitability of the bank. In order to analyse the Profit and performance of the bank NP (net profit) is taken into account. Other than NIM, ROCE is also considered for assessing the profitability of the firm. From 1963 onwards the economic

performance of Malaysia has been one of Asia's best. According to the State government of Malaysia, the real gross domestic product of the country grew by an average of 6.5% per year from 1957 to 2005. However, the economic performance of the country has peaked in the early 1980s through the mid-1990s, through adoption of liberalization policy. Since then to now, the economy has experienced sustained rapid growth around 8% annually. This is highly compared to other parts of developing nations across the globe. In accounting the high level of growth, the levels of foreign and domestic private investment played a significant role as the economy gradually diversified and modernized.

Now, Malaysia is one of the world's largest exporters of semi-conductor components and devices, electrical goods, solar panels, and information and communication technology (ICT) products. Vitar, D.A., (2013) mainly analysed the relationship between the capital structure and the performance of the listed banks he took for the study. The study was conducted among the banks in Ghana. From the study we can clearly come to a conclusion that there is a negative relationship among the performance and capital structure. The study analyse that this was happening mainly because the short-term debt was over dependent and it causes low rate of marketing activities and high disposal rates.

Goyal AM (2013) has explained about the profitability and the strength of Government banks in India. He also explained about how the banks perform effectively and the capital structure of the banks. He mainly used multivariate analysis in order to analyse the relationship between various components like earning per share, return on equity and return on assets with the help of capital structure. RajkumarP (2014) mainly analyse the relationship between the monetary leverage and performance of John keells in sri lanka, the period he took for the study was from 2007-2012. from his result we can clearly interpret that there is negative relationship between the components i.e. monetary performance and leverage of that company.

Quadra (2016) mainly analyse the effectiveness of capital structure on performance. The study was conducted among various Indian banks and the period he took for the study was 6 years. The main components he took for the study to

analyse the profitability was NIM, NP and ROCE and Debt/Total equity and Debt/Total Fund ratios are used as a components of capital structure. From the study we can clearly interpret that the debt/equity has decreasing throughout this shows that the risk is reducing among various banks. From the conclusion we can clearly know that there is a positive impact on among performance of the various banks taken for the study. Prantik Ray, (2016) XLRI Jamshedpur, India, small Banks in India—Issues and Challenges. This paper discusses the requirement for monetary inclusion of an oversized priority sector in India that's left unbanked or informally-banked. It discusses the RBI policy to further monetary inclusion and also the recent licensing of small Finance Banks so as to achieve therefore. small finance banks begin with great promise of business to rural and urban poor and therefore the the} unbanked phase of population however they also face immense challenges in terms of building the specified capability, infrastructure to service a large kind of clients and also to coach its existing work force to reorient themselves for providing a additional full-fledged service than a typical MFI. The paper tries to review the rules through that the RBI has licenced these banks, the backdrop of this new experiment and also the problems and issues shared by a large body of stakeholders.

The paper would additionally wish to cite the instance of Ujjivan, a number one NBFC-MFI, that possesses the small bank license and supported the interactions with the key executives and different stakeholders of the firm the paper would really like to elucidate the sort of future situation the new entrants within the banking field would likely to encounter. In India, Microfinance has been defined by “The National Microfinance Taskforce, 1999” as “provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and Improve living standards Microfinance is a term used to refer to the activity of provision of financial services to Clients who are excluded from the traditional system on account of their lower economic status. The financial services will most commonly take the form of loan and savings by removing collateral requirement and creating banking system which is based on mutual trust. “What is the exact definition of

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microfinance?” is the underlying question of understanding microfinance. According to Consultative Group to Assist the Poor (CGAP)’s homepage, microfinance’s definition is: “Microfinance offers poor people access to basic financial services such as loans, savings, money transfer services and micro insurance” (www, Consultative Group to Assist the Poor, 1, 2011).(www.wikipedia.org).

RESEARCH METHODOLOGY AND DATA ANALYSIS

The study is mainly conducted to analyse the capital structure and financial performance of SFB (Small Finance Banks) in India. The methodology adopted for this study is analysed from the various other studies conducted on this same issue. This relationship had mentioned in various studies so abstract frame work of this study relies on deduction methodology and quantitative methods are used to collect information from various secondary sources. Methodology had been adopted to induce the objectives, which mainly analyse the level of the performance of the banks. The data is collected from the PROWESS CMIE database, Annual Reports of various Small Finance Banks and from the various Websites of the respected banks. The variables used for this study are mentioned below.

Variables and Hypotheses Description

Dependent Variables

It is mainly taken to measure the financial performance of various companies which are taken for the study, so the main variables are Return on Equity (ROE), Return on capital employed (ROCE), Net profit margin (NPM) and Net Interest Margin (NIM).

Independent Variables

It is taken in order to analyse the capital structure of various companies which are taken for the study, so the variables are Debt to Total Equity Ratio (DER), and Debt to Total Funds Ratio.

Hypothesis Taken for the Research:

- H1. There’s major impact of debt to equity on Net Profit.
- H2. There’s major impact of debt to equity on Return on Capital Employed.
- H3. Debt to Equity includes a vital impact on Return on equity.
- H4. Debt to Equity contains a vital impact on

Net Interest Margin.

H5. There’s major impact of debt to total funds on Net Profit Margin.

H6. There’s major impact of debt to total funds on Return on Capital Employed.

H7. Debt to total funds contains a vital impact on Return on Equity.

H8. Debt to total funds contains a vital impact on Net Interest Margin.

Data Collection

The population of this study is conducted using 8 different Small Finance Banks in India. The selected banks are A U Small Finance Bank Ltd., Capital Small Finance Bank Ltd, Equitas Small Finance Bank Ltd, ESAF Small Finance Bank Ltd., North East Small Finance Bank Ltd, Suryoday Small Finance Bank Ltd, Ujjivan Small Finance Bank Ltd, Utkarsh Small Finance Bank Ltd.

The information or Data is collected from the Annual Report of these banks and also from the Prowess Cmie Database and these data were analysed using the multiple Regression model. The main objective of this study is to analyse the relationship between the financial performance and capital structure of the Small Finance Banks in India.

Regression Model

$$P = F(CS)$$

P= Performance

C= Capital structure

P = NP, ROCE, ROE, NIM

CS=DER, DTF

Model 1

$$\text{Net Profit} = a_0 + a_1x_1$$

$$\text{Net Profit} = a_0 + a_1x_2$$

Model 2

$$\text{Return on Capital Employed} = a_0 + a_1x_1$$

$$\text{Return on Capital Employed} = a_0 + a_1x_2$$

Model 3

$$\text{Return on Equity} = a_0 + a_1x_1$$

$$\text{Return on Equity} = a_0 + a_1x_2$$

Model 4

$$\text{Net Interest Margin} = a_0 + a_1x_1$$

$$\text{Net Interest Margin} = a_0 + a_1x_2$$

REGRESSION EQUATION

Table1.

Concept	Variable	Measurement
	Return on Equity (ROE)	Net Income/Shareholders Equity
	Return on Capital Employed (ROCE)	Net Operating Profit/Employed Capital
Financial Performance	Net Profit ratio (NPR)	Net profit after Tax/ Net Sales
	Net Interest Margin (NIM)	(Interest Received - Interest Paid) / Average Invested Assets
Capital Structure	Debt to Total Equity Ratio	Total Liability/ Shareholders Equity
	Debt to Total Funds Ratio	Total liabilities / Total assets

ANALYSIS & RESULTS

Table2.

Variable	Summary of Descriptive Statistics				
	Observation	Mean	Std. Dev.	Min	Max
ROE	8	0.509161	0.457679	0.000278	1.280622
ROCE	8	0.050589	0.046223	0.0042176	0.1362419
NPM	8	15.93	24.10934	0.02	66.67
NIM	8	0.051106	0.061936	0.0000493	0.1884685
Debt to Total Fund Ratio	8	0.568727	0.287377	0.092513	0.9167981
Debt to Total Equity Ratio	8	3.4175	2.708303	0	7.51

In this Table 2 it mainly provides the summary of the Descriptive statistics which mainly taken the dependent and independent variables of 8 SFB (Small Finance Banks). This table mainly analyse the profitability using the variables lie NP, ROCE, NPM, NIM which is 50.92%, 5.06%, 15.93% and 5.11% respectively. And

debt/equity ratio stood at 56.87% and debt to total funds averaged 341.75%. The maximum and minimum values for debt/equity ratio indicate that the debt/equity composition varies substantially among the Small Finance Banks in India.

Regression Analysis

Predictors of Profitability

Model Summary 1

Table3.

Model	Dependent variable	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	NPM	.484 ^a	.234	.107	22.78765
2	NIM	.407 ^a	.166	.026	.0611126
3	ROE	.335 ^a	.113	-.035	.4657089
4	ROCE	.118 ^a	.014	-.150	4.95755%

a. Predictors: (Constant), Debt to Total Equity Ratio

The R2 values were 0.484, 0.407, 0.335, and 0.118 for NPM, NIM, ROE, ROCE respectively and is explained by Predictors: (Constant) Debt to Total Equity Ratio which is the independent

variable used for this study. The values of R2 indicates that there may be number of variables which can have impact on profitability other than the Debt/Total Equity ratio.

Table4. ANOVAa

Model		Sum of Squares	df	Mean Square	F	Sig.
1) NPM	Regression	953.161	1	953.161	1.836	.224 ^b
	Residual	3115.662	6	519.277		
	Total	4068.823	7			
2) NIM	Regression	.004	1	.004	1.190	.317 ^b
	Residual	.022	6	.004		
	Total	.027	7			
3) ROE	Regression	.165	1	.165	.761	.417 ^b
	Residual	1.301	6	.217		
	Total	1.466	7			
4) ROCE	Regression	2.094	1	2.094	.085	.780 ^b
	Residual	147.464	6	24.577		
	Total	149.557	7			

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a. *Dependent Variable: NPM, NIM, ROE, ROCE*

b. *Predictors: (Constant), Debt to Total Equity Ratio*

Predictors: (Constant), Debt to Total Equity Ratio

Predictors of Profitability

Model Summary 2

Table5.

Model	Dependent variable	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	NPM	.054 ^a	.003	-.163	26.00252
2	NIM	.204 ^a	.041	-.118	.0654966
3	ROE	.653 ^a	.426	.331	.3744215
4	ROCE	.385 ^a	.148	.006	4.60811

Predictors: (Constant), Debt to Total Funds Ratio

This Table mainly shows R2 values as .003,.041,.426, and .148 for NPM, NIM, ROE, ROCE respectively and is explained by Predictors: (Constant) Debt to Total Funds Ratio which is the independent variable used for this

study. The values of R2 indicates that there may be number of variables which can have impact on profitability other than the Debt/Total Funds ratio.

Table6. ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1) NPM	Regression	12.036	1	12.036	.018	.898 ^b
	Residual	4056.787	6	676.131		
	Total	4068.823	7			
2) NIM	Regression	.001	1	.001	.260	.629 ^b
	Residual	.026	6	.004		
	Total	.027	7			
3) ROE	Regression	.625	1	.625	4.459	.079 ^b
	Residual	.841	6	.140		
	Total	1.466	7			
4) ROCE	Regression	22.149	1	22.149	1.043	.347 ^b
	Residual	127.408	6	21.235		
	Total	149.557	7			

Dependent Variable: NPM, NIM, ROE, ROCE

Predictors: (Constant), Debt to Total Funds Ratio

Table7. Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Correlations			Collinearity Statistics	
		B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
		1) NPM	(Constant)	30.655			13.529		2.266	.064	
	Debt to Total Equity Ratio	-4.309	3.180	-.484	-1.355	.224	-.484	-.484	-.484	1.000	1.000
	(Constant)	18.525	21.513		.861	.422					
	Debt to Total Funds Ratio	-4.563	34.199	-.054	-.133	.898	-.054	-.054	-.054	1.000	1.000
2) NIM	(Constant)	.083	.036		2.285	.062					
	Debt to Total Equity Ratio	-.009	.009	-.407	-1.091	.317	-.407	-.407	-.407	1.000	1.000
	(Constant)	.076	.054		1.404	.210					
	Debt to Total Funds Ratio	-.044	.086	-.204	-.510	.629	-.204	-.204	-.204	1.000	1.000
3) ROE	(Constant)	.703	.276		2.542	.044					

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	Debt to Total Equity Ratio	-.057	.065	-.335	-.872	.417	-.335	-.335	-.335	1.000	1.000
	(Constant)	-.082	.310		-.266	.799					
	Debt to Total Funds Ratio	1.040	.492	.653	2.112	.079	.653	.653	.653	1.000	1.000
4) ROCE	(Constant)	5.749	2.943		1.953	.099					
	Debt to Total Equity Ratio	-.202	.692	-.118	-.292	.780	-.118	-.118	-.118	1.000	1.000
	(Constant)	1.539	3.813		.404	.701					
	Debt to Total Funds Ratio	6.190	6.061	.385	1.021	.347	.385	.385	.385	1.000	1.000

Table 8. Hypotheses Testing

No	Hypotheses	Results	Tools
H1	There's major impact of debt to equity on Net Profit.	Accepted	Regression
H2	There's major impact of debt to equity on Return on Capital Employed.	Rejected	Regression
H3	Debt to Equity includes a vital impact on Return on equity.	Accepted	Regression
H4	Debt to Equity contains a vital impact on Net Interest Margin.	Accepted	Regression
H5	There's major impact of debt to total funds on Net Profit Margin.	Rejected	Regression
H6	There's major impact of debt to total funds on Return on Capital Employed.	Accepted	Regression
H7	Debt to total funds contains a vital impact on Return on Equity.	Accepted	Regression
H8	Debt to total funds contains a vital impact on Net Interest Margin.	Rejected	Regression

FINDINGS AND INTERPRETATION

This study mainly identified the impact of capital structure on financial performance of Small finance banks in India. In this study a sample of 8 small finance banks in India is selected and the study period was from 2017-2018. From this study it indicates that there is a significant impact of capital structure on financial performance of small financial banks. so we concluded that small finance banks should use an optimum mix of equity as well as debt while designing the capital structure and financial activities as it provides an important implication on profitability.

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