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## **A STUDY BASED ON THE VARIOUS COMPONENTS OF CAPITAL STRUCTURE OF BANKING COMPANIES**

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### **Abstract**

As capital structure decision determines the overall cost of capital and eventually the market value of the firm. Capital structure mainly consists of debt, common stock and preferred stock that issued to finance the various long-term projects of the firm. The main objective of the study to examined various components of capital structure of banking companies. Data is collect from secondary sources. A summary of the descriptive statistics of the independent variables for ten Indian banking companies for a period of 10 years from 2006-07 to 2015-16. Four components are to be taken it include equity capital, reserves and surplus, net worth and total borrowings. The researcher find out those two industries, namely Indian Overseas Bank and Syndicate Bank are more consistent in terms of Reserves and Surplus during in the study period.

Keywords: **Capital structure; Equity capital; Net worth**

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## **INTRODUCTION**

Capital structure formulation is one of the critical decisions taken by the finance manager of a company. As capital structure decision determines the overall cost of capital and eventually the market value of the firm. It has to be decided whenever the firm starts its operations or need additional funds to finance its new projects. The determinants of capital structure provide a significant indication which a firm has to consider before deciding on its capital structure. Ultimately, the financial perspective of every firm is to maximize its market value and minimize its cost of capital, while deciding on its capital structure. Capital structure mainly consists of debt, common stock and preferred stock that issued to finance the various long-term projects of the firm. In other words, the capital structure is primarily a combination of debt and equity. Equity holders are the owners and have a long-term commitment to the firm whereas; debt holders are creditors and have no long-term commitment to the firm as they are more interested in timely repayment of the their principal and interest amount. Equity holders want regular dividend payments and the firm wants to have more retained earnings to finance their future capital cash outflows. Hence, the firm decision on capital structure plays significant impact on the financial structure of the firm. Financial leverage is measured as the ratio of debt and equity, which states the relationship between the borrowed and owner's funds. Firms with both debt and equity are termed as levered firms, while the firms with only equity are termed as unlevered firms. Debt financing includes tax deductible interest expense benefit, associated cost of financial distress and limits the ability of the firm to raise equity as well as its growth ability by putting the pressure of timely repayment of debt principal and interest amount.

## **REVIEW OF LITERATURE**

A detailed review of literature has been made to find out the prevailing research gap and to identify the major problems in present scenario. This research paper provides a sketch of related study arranged logically at international and national level. A number of research studies have been conducted regarding the choice of capital structure, i.e., debt and equity mix in the total capitalization of a firm. However, in a recent study conducted by Babu and Jain, it has been found that the corporate firms in India are showing almost an equal preference to debt and equity in designing their capital structure. Freedom in paying dividend and easy to raise money are the reasons cited for equity preference. The collected review of literature has helped the researcher to frame out the relevant scope for the study.

Lingesiya and Premkanth [1] examine the relationship between capital structure and the financial performance of manufacturing sector of Sri Lanka, by using panel data extracted from the financial statements of the companies listed on the Colombo Stock Exchange. Firms' financial performance was measured in terms of accounting profitability by Return on Equity (ROE). Panel data were analyzed using Ordinary Least Squares (OLS) as a method of estimation. It was found that first there was no

significant relationship between the short-term debt and profitability, second negative relationship between long-term debt and flexibility and finally total debt had significant negative relationship with firms' financial performance, which tends to sport the dominant pecking order theory. The outcomes of the study may guide entrepreneurs, loan-creditors and policy planners to formulate better policy decisions with respect to the mix of debt and equity capital and to exercise control over capital structure planning and thereby to control and reduce bankruptcy costs.

Susan Coleman Alicia Robb [2] examined the initial financing strategies of new firms. This study uses data from the Kauffman firm survey, a longitudinal data set of over 4,000 firms in the USA. Descriptive statistics and multivariate results are provided. Findings reveal that new technology-based firms demonstrate different financing patterns than firms that are not technology-based. Practical implications Technology-based entrepreneurs need external sources of equity, in particular, in order to launch and grow their firms. The purpose of this paper is to explore the extent to which various theories of capital structure "fit" in the case of new technology-based firms.

Santanu K. Ganguli [3] analyzed grounded on agency theory, in the present paper we have put forward an argument as regards the likely relation between ownership structure and capital structure. Simultaneity between capital structure and ownership structure is checked through Hausman specification test on endogeneity. Fixed effect panel regression model is used to analyze five years of data (2005-2009) on the sample units, to find the relation between leverage and ownership structure after controlling for profitability, risk, tangibility, growth and size. The purpose of this paper is to theoretically argue and empirically investigate how ownership structure impacts the capital structure of the listed mid-cap companies in India and whether the capital structure as exogenous variable has a role in determining ownership structure as well.

Bader Alhashel [4] analyses the capital structure of firms when taxes are removed by analyzing firms in an emerging market, Kuwait, where personal and corporate taxation does not exist. Given such a finding and the positive effect of debt on firm value, there should be policies to facilitate bank lending and more efficient access to credit for firms. The leverage of firms in markets with no taxes is affected by the same leverage factors that affect firms where taxes are present. Non-tax benefits are economically significant and are almost 16 percent of firm value for the average leveraged firm. The purpose of this paper is to further the understanding of the non-tax benefits of debt. The paper provides an estimate of the size of the non-tax benefits of debt.

Fazio [5] examined the ownership and management control factors to explain why family firms use more or less leverage. This study, thus, reconciles the mixed results of prior studies, which do not differentiate between these two governance factors. Practitioners should consider family ownership and management control factors when establishing financing strategy. The Small Business Administration and other

government agencies should make similar considerations when setting policies. Using a stratified random sample of 200 US public firms in the S & P Small-Cap 600 index from 1999 to 2007, this study uses random effect panel regressions to test the impact of family ownership on market value and book value debt ratios and the moderating effects of family control and equity performance after controlling for firm, industry, and macroeconomic variables. The purpose of this paper is to explain how family firm ownership and management control affect corporate capital structure strategy after controlling for other significant variables. The authors argue that, although family ownership has a positive effect on a firm's leverage, family control through the CEO position and equity performance moderate its impact.

## **RESEARCH GAP**

The literature review has helped the researcher in understanding the various determinants of capital structure. The review of the above studies enabled the researcher to find out research gaps and to formulate the present study. Literatures were reviewed in international and national context. The researchers studied that the determinants of capital structure decisions appeared to be profitability, size, growth rate, non-debt tax shields and industry classification. It is observed that various factors had been studied by researchers as determinants of capital structure. Which factors appropriately help in designing the capital structure is still a question. According to relevant theories of capital structure decision affects the shareholders wealth and trading on equity.

Most of the studies on the topic pertaining from developed countries like US, Australia, South Korea, Singapore, so it is important to study the determinants of capital structure of Indian firms and most of the study on determinants of capital structure contracting on manufacturing sector. There is an urgent need to study the service sector in general and banking industry in particular. So there is an implied need to study Indian banking industry.

## **OBJECTIVES AND RESEARCH METHODOLOGY**

### **Objective of the study**

Examine the various components of capital structure of banking companies.

### **Formulation of hypothesis**

There is no significant difference among industries with respect to Components of capital structure.

### **Sources of Data**

This study is based on the secondary source collected from PROWESS. The data

which is taken from the sample companies is supplemented with information from annual reports of companies to enable proper analysis and to facilitate the attainment of study objective listed earlier.

### **Selection of Sample and Period of Study**

The data used in the study relates to the banking companies listed as nationalized for which the data is available in the PROWESS database of CMIE. Selects companies based on the criteria that the companies should have maintained its uniqueness and reported its annual accounts without any gaps for the financial years 2006-2007 to 2015-2016.

## **STATISTICAL TOOL**

### **Descriptive Statistics**

A summary of the descriptive statistics of the independent variables for ten Indian banking companies for a period of 10 years from 2006-07 to 2015-16. The table includes the mean, standard deviation, number of observation and co-efficient of variance for the selected independent variables individually. It shows the average indication of variables computed from the financial statements.

### **Sampling design**

The selection of sample on the basis of volume of debt was selected based on the availability of data for a continuous period of ten years (Table 1).

**Table 1:** Selected list of banking companies.

<b>Industry</b>	<b>S. No</b>	<b>Companies</b>
<b>Banking</b>	1	Bank of Baroda
	2	Bank of India
	3	Canara Bank
	4	Central Bank of India
	5	Corporation Bank
	6	Indian Bank
	7	Indian Overseas Bank
	8	Punjab National Bank
	9	Syndicate Bank
	10	Union Bank of India
Source: CMIE PROWESS for the year 2006-07 to 2015-16.		

## DATA ANALYSIS AND INTERPRETATION

### Components of Capital Structure in Banking Companies

Capital Structure refers to the proportion of money that is invested in a business. It has four components and it includes Equity Capital, Reserves and Surplus, Net Worth, Total Borrowings.

#### Equity Capital

It represents the risk capital staked by the owners through purchase of Owners Company's common stock. The value of equity capital computed by estimating the book value everything owned by the company from which the total of all liabilities is subtracted. The table presents the summary of Descriptive statistics of the value of Equity Capital for the period from 2006-07 to 2015-16 in selected ten banking companies based on the data collected for 10 years (Table 2).

**Table 2:** Descriptive statistics of equity capital.

Name of Company	N	Mean	Std. Deviation	Variance
Bank Of Baroda	10	4013.560000	366.5197287	134336.712
Bank Of India	10	5902.810	971.7771	944350.790
Canara Bank	10	4448.450000	417.5354602	174335.861
Central Bank Of India	10	8419.820000	5.5083108E3	3.034E7
Corporation Bank	10	1562.510	193.8613	37582.217
Indian Bank	10	4433.820000	223.1661504	49803.131
Indian Overseas Bank	10	8797.020	4267.3145	1.821E7
Punjab National Bank	10	3396.360	286.3726	82009.287
Syndicate Bank	10	5855.080	650.7820	423517.211
Union Bank Of India	10	5645.650	678.8744	460870.516

It is found that the Indian Overseas Bank (8797.020) show highest mean of Equity Capital with the standard deviation of (4267.3145) followed by Central Bank Of India with mean Equity Capital of (8419.820000) and standard deviation of (5.5083108E3). Further it revealed that co-efficient of variance is least in Indian Overseas Bank (1.821E7) followed by Central Bank of India (3.034E7), Corporation Bank (37582.217) and Indian Bank shows the value of (49803.131).

## Reserves and Surplus

The table shows the summary of Descriptive statistics of the value of Reserves and Surplus over the ten years period under study (2006-07 to 2015-16) in selected ten banking companies (Table 3).

**Table 3:** Descriptive statistics of reserves and surplus.

Name of company	N	Mean	Std. Deviation	Variance
Bank Of Baroda	10	80656.670	37343.1600	1.395E9
Bank Of India	10	57409.660	26619.4791	7.086E8
Canara Bank	10	62820.230	19236.3611	3.700E8
Central Bank Of India	10	14019.280	7588.5541	5.759E7
Corporation Bank	10	25478.710	6040.5737	3.649E7
Indian Bank	10	43426.500	18716.9167	3.503E8
Indian Overseas Bank	10	20135.360	10927.4117	1.194E8
Punjab National Bank	10	112066.320	47710.7162	2.276E9
Syndicate Bank	10	32458.960	11278.8167	1.272E8
Union Bank Of India	10	32157.820	13151.0479	1.730E8

Source: PROWESS database of CMIE.

An analysis of the Reserves and Surplus reveals that the Punjab National Bank show highest mean of 112066.320 and Standard Deviation of 47710.7162 followed by Bank Of Baroda with the mean value of 80656.670 with Standard Deviation of 37343.1600. The mean Reserves and Surplus is lowest in case of Indian Overseas Bank (20135.360). The co-efficient variance is lowest in case of Indian Overseas Bank (1.194E8) followed by Syndicate Bank (1.272E8). This shows that two industries, namely Indian Overseas Bank and Syndicate Bank are more consistent in terms of Reserves and Surplus during in the study period. Thus, it can be inferred that, Punjab National Bank fluctuate Reserves and Surplus and Indian Overseas Bank has more secured in Reserves and surplus during the period under study.

## Net Worth

The Net Worth of a company is measured by subtracting the total assets of the company from its total liabilities. It is measured in terms of the substantial decrease in asset values relative to liabilities. The descriptive statistics of the explanatory variables for the period from 2006-07 to 2015-16 in selected companies are summarized in Table 4.

It is found from the table that the mean net worth is highest in Indian Overseas Bank (9.233637E4) with the standard deviation of (3.9542347E4) followed by Indian Bank with mean of (8.317627E4) and standard deviation (3.4934458E4). The mean Net worth is lowest in case of Union Bank of India (1.215273E5) with standard deviation

of (5.5435688E4). The co-efficient of variation is least in case of Syndicate Bank (1.079E9) followed by Indian Bank (1.220E9). This shows that Syndicate Bank and Indian Bank are consistent in Net worth over the study period. It is concluded that the Indian Overseas Bank has high Net Worth and Union Bank of India are consistent in Net Worth over the period though the mean Net Worth is less than the other companies (Table 4).

**Table 4:** Descriptive statistics of net worth.

Name of company	N	Mean	Std. Deviation	Variance
Bank Of Baroda	10	2.308434E5	1.1288506E5	1.274E10
Bank Of India	10	1.779743E5	7.9086810E4	6.255E9
Canara Bank	10	1.771301E5	7.3800902E4	5.447E9
Central Bank Of India	10	8.143278E4	4.9955656E4	2.496E9
Corporation Bank	10	7.379547E4	2.6601598E4	7.076E8
Indian Bank	10	8.317627E4	3.4934458E4	1.220E9
Indian Overseas Bank	10	9.233637E4	3.9542347E4	1.564E9
Punjab National Bank	10	2.289440E5	1.0683536E5	1.141E10
Syndicate Bank	10	7.476119E4	3.2850721E4	1.079E9
Union Bank Of India	10	1.215273E5	5.5435688E4	3.073E9

Source: PROWESS database of CMIE.

### Total Borrowings

Total borrowings include debt from banks (Short term as well as long term) and financial institutions, inter- corporate loans, fixed deposits from public and directors, foreign loans, loan from government, etc. (Table 5).

**Table 5:** Descriptive statistics.

Name of company	N	Mean	Std. Deviation	Variance
Bank Of Baroda	10	2.031403E5	1.3301217E5	1.769E10
Bank Of India	10	274751.120	165483.6345	2.738E10
Canara Bank	10	1.475529E5	1.0062226E5	1.012E10
Central Bank Of India	10	5.485471E4	5.7958161E4	3.359E9
Corporation Bank	10	9.596940E4	5.3084758E4	2.818E9
Indian Bank	10	2.426700E4	1.6389069E4	2.686E8
Indian Overseas Bank	10	1.589755E5	9.2438870E4	8.545E9
Punjab National Bank	10	2.929672E5	2.0441791E5	4.179E10
Syndicate Bank	10	1.174736E5	9.3622870E4	8.765E9
Union Bank Of India	10	1.676606E5	1.1200089E5	1.254E10

Source: PROWESS database of CMIE

It is found that the Bank Of India(274751.120) shows highest mean of Total Borrowings with the standard deviation of (165483.6345) followed by Corporation Bank with mean Total Borrowings of 9.596940E4 and standard deviation of 5.3084758E4. Further it revealed that co-efficient of variance is least in Canara Bank (1.012E10) followed by Union Bank of India (1.254E10), Bank of Baroda (1.769E10) and Bank of India shows the value of 2.738E10. Though the mean Total Borrowings is very less in Syndicate Bank when compared to other companies but is consistent in value of Total Borrowings over the study period.

## LIMITATION OF THE STUDY

The generality of this research is restricted due to certain limitations. Most of these limitations are off shoots of the self-imposed restrictions during the process of research for keeping research within manageable limits.

- i. The study is focused only to the ten selected banking companies in India.
- ii. The study has been undertaken only through the analysis of quantitative financial data, the qualitative aspects which have a bearing on Capital Structure have not been considered.

## CONCLUSION

The Indian Overseas Bank (8797.020) showed highest mean of Equity Capital with the standard deviation of (4267.3145). It revealed that co-efficient of variance is least in Indian Overseas Bank (1.821E7) when compared to other industries but it was consistent in value of Equity Capital. An analysis of the Reserves and Surplus revealed that the Punjab National Bank showed highest mean of (112066.320) and Standard Deviation of (47710.7162). The co-efficient variance was lowest in case of Indian Overseas Bank (1.194E8) followed by Syndicate Bank (1.272E8). This shows that two industries, namely Indian Overseas Bank and Syndicate Bank are more consistent in terms of Reserves and Surplus during in the study period. An analysis of the Net Worth revealed that Indian Overseas Bank showed highest mean of(9.233637E4) with the standard deviation of (3.9542347E4) followed by Indian Bank (8.317627E4) and standard deviation (3.4934458E4). The co-efficient of variance was least in case of Syndicate Bank (1.079E9) followed by Indian Bank (1.220E9). This shows that Syndicate Bank and Indian Bank are consistent in Net worth over the study period. Finally, it was found that the Bank Of India(274751.120) showed highest mean of Total Borrowings with the standard deviation of (165483.6345) followed by Corporation Bank with mean Total Borrowings of (9.596940E4) and standard deviation of (5.3084758E4).

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