

Impact of capital structure on profitability of listed banks in Colombo Stock Exchange in Sri Lanka

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Abstract

Capital structure is an important decision area of the business to fix the mixture of debt and equity capital. This study aims to investigate the impact of capital structure on profitability of listed banks in Colombo Stock Exchange. In order to meet the objectives a quantitative research approach was employed. The data were obtained from the audited financial statements of ten listed banks in Colombo Stock Exchange for the period of six years from 2010 to 2015. Total debt to equity, interest coverage ratio and total debt to assets ratio were used as the measures for capital structure while net profit ratio, return on equity and net interest margin are used as the proxy for profitability. Moreover asset growth rate and firm size are used as control variables. Descriptive and inferential statistical techniques were used in data analysis. The findings revealed that capital structure, as measured by interest coverage ratio and total debt to assets ratios, has a significant and negative effect on net profit ratio. Similarly, total debt to equity and total debt to assets ratios have a significant and negative impact on return on equity. Therefore, banks should give due consideration to manage their debts properly and mobilize deposit sufficiently to keep costs of financing at minimum level and hence optimize profitability and the value of banks. Besides, the policy maker should set optimum minimum capital requirement for financial companies. Finally, future researchers should focus their studies to assess the overall profitability of banks and other industries to validate these findings.

Keywords: *Capital structure, listed banks, profitability*