Determinants of Capital Structure of Commercial Banks in Sri Lanka

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Abstract

The financing mix of long-term debt and equity is known as capital structure in corporate finance and capital structure decisions are a key issue in a firm's financial strategy. The optimal capital structure indicates the best debt-to-equity ratio for a firm that maximizes its value while minimizing its cost of capital.

This study aims to investigate the most important factors that affect the capital structure of commercial banks in Sri Lanka. Profitability (PROF), Earnings volatility (EVOL), Tangibility (TANG), Growth (GROW) and Bank size (BSZ) were used as independent variables while Book leverage (BLV) is used as the dependent variable. The study used secondary data of eighteen (18) commercial banks covering the period of 2011 to 2020. Data were analyzed using regression analysis and E-Views packages.

The results expect that Profitability, Tangibility and Bank size will have negative impact on Book leverage while other variables have positive impact on Book leverage. This study will discuss the connection of trade- off theory and pecking- order theory with these relationships among variables as well. Findings of the study will be of interest mainly to managers which will help them to identify the bank- specific factors affecting the capital structure and choose the values enhancing optimal capital structure.

Key words: *Book leverage (BLV), Profitability (PROF), Earnings volatility (EVOL), Tangibility (TANG), Growth (GROW)*