# THE INFLUENCE OF CAPITAL STRUCTURE ON RETURN ON EQUITY IN BANKING INDUSTRY IN SRILANKA

## (WITH REFERENCE TO TEN SELECTED PRIVATE BANKS)

A Dissertation Submitted to the Faculty of Management and Commerce, South Eastern University of Sri Lanka, in Partial Fulfillment of the Requirements of the Bachelor of Business Administration Degree.

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# ABSTRACT

The primary objective of the study is to get a clear picture about the influence of the capital structure (i.e. leverage level) on shareholders' return in Banking Industry within the Sri Lankan context. The characteristic of Sri Lankan is different from other western countries the replication of those studies too may leads to unique findings.

Based on understanding of the Sri Lankan context and capital structure puzzles in general researcher was introduced to study the influence of capital structure on the return on equity, that is to assess the impact of leverage on the return on equity in Sri Lankan context.

Financial decisions are very critical in viewpoint of individual companies and economy as a whole. Thus the primary objective of this research is to provide a clear view on the relationship between the leverage level and return on equity as far as possible, there by assist to apply this knowledge in financing, investing and consulting activities.

There are two variables taken into consideration those are independent variable and dependent variable in this study, under the independent variable Leverage of capital structure and under the dependent Variable Return on Equity have been selected for this research Listed and unlisted private bank in the banking industry, which will be the sample frame, for this study secondary data was used. Published data was collected from the selected company annual reports and Colombo Stock Exchange publications; a simple random sampling method was used in selecting 10 sampling units for the research and also Last five year data of the selected companies that is from 2006 to 2010 were collected from the said data sources

This study is to determine the relationship between the return on equity and capital structure and assessing the strength the relationship between them. Regression analysis was used to determine the relationship and then correlation coefficient was computed to assess the strength of the relationship. The coefficient determination ($r^2$) was computed to see the degree of variation in dependent variable attributable to

factors other than the level of financial leverage. Finally F-test was carried out to ascertain the one tail probability that the variances in debt to equity ratio and return on equity are not significantly different.

The subsequent empirical works done by various researchers concluded mostly around the traditional view. A comprehensive industry wise study was carried out by Pandey (1981), which also produced different patterns of behaviors. Except few more empirical works falls somewhat in favor of traditional view.