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RESEARCH ARTICLE

THE IMPACT OF FINANCIAL STRUCTURE ON PROFITABILITY: AN APPLIED STUDY ON TRADITIONAL PRIVATE BANKS WORKING IN SYRIA FOR THE PERIOD (2009 – 2013).

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Abstract

The aim of this study is to examine the impact of financial structure on profitability of traditional private banks working in Syria for the period (2009 – 2013). Profitability (dependent variable) is measured by return on assets (ROA) and return on equity (ROE). On the other hand, the independent variable, financial structure, is measured by the proportions of short liabilities to assets (SLA), long liabilities to assets (LLA), and liabilities to equity (LE). While the control variables are size, growth rate, and Syrian crisis. The study used the methods of Panel Data through estimating pooled regression model.

The empirical analysis shows that proportions of (SLA) and (LLA) have a negative and significant impact on (ROA), while the proportion of (LE) has no significant impact on (ROA). On the other hand, there is a negative and significant impact of the proportion of (SLA) on the (ROE), and there is no significant impact of both, the proportions of (LLA) and (LE) on the (ROE).

Introduction:-

The financial structure decisions are among the most crucial decisions for any firm in any sector or economy. This decision is important not only because of the need to maximize the returns, but also due to the impact of such decision on firm's ability to deal with its competitive environment. However, it is usually difficult for firms to determine the appropriate mix between debt and equity.

Financial structure of a firm refers to how a firm finances its assets with all its available resources (Moyer, et al., 2006). In general, firms finance only a part of their assets with equity (ordinary, preference, retained earnings, and reserves) capital, while the other part is financed by other resources such as long term financial debt or liabilities and other short term liabilities (Moyer, et al., 2006).

Financial structure can take any of the following three alternatives: 100% equity: 0% debt, 0% equity: 100% debt or X% equity: Y% debt (David and Olorunfemi, 2010).

Modigliani and Miller are considered to be the founders of the modern school of finance theory since their theorem was published in 1958. However, this theorem is still a controversial subject for researchers in financial management science.

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In Modigliani-Miller theorem, and in the absence of taxes, they insist that there is no optimal financial structure (Modigliani and Miller, 1958).

After being subject to criticism, Modigliani and Miller published an article in 1963, in which they corrected what they felt was flawed and took into consideration the existence of taxes. This theory concluded that since the interests is among the expenses deducted from revenues before tax, the increase in debt would lead to the increase in firm's value as a result of tax shield (Modigliani and Miller, 1963).

In the light of Modigliani and Miller's 1963 article, several theories, for instance, the trade-off theory, theory of agency cost, pecking order theory, signaling theory, and Market Timing theory, have emerged to explain the connection of financial structure decisions with the firm performance.

Trade-off theory states that a firm's choice of its debt – equity ratio is a trade-off between its interest tax shields and the costs of financial distress. The trade-off theory suggests that firms in the same industry should have similar or identical debt ratios in order to maximize tax savings. The tax benefit among other factors makes the after-tax cost of debt lower and hence the weighted average cost of capital will also be lower (Myers, 1984).

The agency cost theory emanates from the principal-agent relationship (Jensen and Meckling, 1976). Its contribution is that leverage firms are better for shareholders as debt can be used to monitor managerial behavior (Roshan, 2009). Thus, higher leverage is expected to lower agency cost, reduce managerial inefficiency and thereby enhancing firm and managerial performance (Jensen 1986; Aghion, et al., 1999).

Signaling theory argues that the choice of firm's capital structure signals to the outside investors the information that the insiders possess. Further, it argues that the problem of information asymmetry makes it difficult for lenders and prospective common stock investors to accurately assess their level of risk, and hence the reliance on what is communicated by the insiders (Ross, 1977).

Pecking Order Theory states that firms prioritize their sources of financing (from internal financing to issuing shares of equity) according to least resistance, preferring to raise equity for financing as a last resort. Internal financing is used first. When that is depleted, debt is issued. When it is no longer sensible to issue any more debt, equity is issued (Myers and Majluf, 1984).

Market Timing theory takes another approach as to how firms choose financing resources. It depends on mispricing instruments in financial markets at the time the firm needs financing (Baker and Wurgler, 2002).

Profitability is considered as a main measure of firm's ability to generate revenues. It is among the crucial factors that owners, investors, and lenders take interest in. It indicates firm's performance efficiency. Erasmus (2008) shows that financial performance measures present a valuable instrument to assess the previous financial performance and the current state of the firm.

The financial sector plays an important role in the economy of a country. Banks are considered as one of the most important financial institutions. Banking sector plays a crucial role in the economic development of a country by receiving deposits and financing investments.

During the last two decades, the Syrian banking sector has experienced a worldwide major transformation in its operating environment. Thus, a great importance has been accorded to the reform of laws, decisions, and other legislations regulating the banking and financial activities. Reinforcement of the banking and the financial sector is one of the most important factors. The banking sector represents the backbone of the Syrian economy and plays an important financial intermediary role (Al-Jafari and Alchami, 2014) .

Various studies examined the impact of financial structure on profitability. However, the studies did not reach a unified conclusion. The results of empirical studies varied between positive, negative, and no impact, and it contradicted other theoretical studies. These different results emerged from the diversity of the examined economics (developed and developing countries), economic sectors (financial, industrial, and utilities sectors), and the years they have being studied, as well as the nature of firm's external and internal conditions. All these factors combined contributed to the variance in the impact of financial structure on profitability.

Due to the importance of determining firms' financial sources mix, its impact on banks activities, and its pursuit to maximize profitability, this paper seeks to examine the impact of financial structure on the profitability of traditional private banks working in Syria for the period (2009 – 2013).

Literature Review:-

Many researchers examined the impact of financial structure on profitability. These studies measured the financial performance by using profitability indicators, e.g., return on assets (ROA), return on equity (ROE), net interests margin (NIM), earning per share (EPS), net profit (NP), and return on capital employed (ROCE). On the other hand, the financial structure is measured by using proportions of liabilities to assets (LA), short liabilities to assets (SLA), long liabilities to assets (LLA), liabilities to capital (LC), short liabilities to capital (SLC), long liabilities to capital (LLC), liabilities to equity (LE), and deposits to assets (DA).

Siddik, et al. (2017) examined the impact of financial structure on profitability of 22 banks in Bangladesh for the period (2005 – 2014) using Panel Data models. He found that proportions of SLA, LLA, and LA have a negative and significant impact on ROA. Secondly, the proportion of LLA has no significant impact on ROE, and the proportions of LA and SLA have negative and significant impact. While the proportions of LA and LLA have no significant impact on EPS, whereas the proportion of SLA has negative and significant impact. The control variables, size, growth rate, and inflation have a positive impact on dependent variables. While the liquidity and real growth domestic product have a negative impact.

Zafar, et al. (2016) examined the impact of financial structure on profitability of 25 banks in Pakistan using Panel Data models. He found that proportions of SLA and LLA have a positive and significant impact on ROA, whereas the proportion of LA has a negative and significant impact, while the proportion of LE has no significant impact. Moreover, the proportion of SLA has no significant impact on ROE, whereas the proportions of LLA and LE have a negative and significant impact, and LA has a positive and significant impact. In such manner, the proportions of SLA and LLA have a negative and significant impact on EPS, while the proportion of LA has a positive and significant impact, and the proportion of LE has no significant impact.

Niko (2015) examined the impact of financial structure on profitability of 17 banks in Tehran Stock Exchange for the period (2009 – 2014) using regression models. He found that the proportion of LE has a positive and significant impact on ROA, ROE, and EPS.

Anarfo (2015) studied the relationship between capital structure and banks performance in 37 countries in Sub-Saharan Africa for the period (2000 – 2006) using Panel Data models. He found there is no significant relationship between the proportions of LA, SLA, and LLA, and the ROA, ROE, and NIM. While as to control variables, he found that size has no significant impact ROA and ROE, but it has a significant impact on NIM. Further, the assets tangibility has no significant impact on ROA, ROE, and NIM. While the growth rate has a significant impact on ROA, ROE, and NIM, while the tax rate and real growth domestic product have no significant impact. While the interest rates have no significant impact on ROE and NIM, but have a significant impact on ROA. Thus, the inflation rate has no significant impact on ROA, ROE, but has significant impact on NIM.

Kumari (2015) investigated the impact of financial structure on profitability of all firms listed in Portuguese Stock Exchange and Spanish stock exchange for the period (2003 – 2013) using Panel Data models. He found that the proportions of LC and LLC have no significant impact on ROE in the Portuguese firms, but the proportion of SLC has a negative and significant impact, while the size and growth rate have a positive and significant impact. Whereas, the proportions of LC, LLC and SLC have a negative and significant impact on ROA in the Portuguese firms, while the size and growth rate have a positive and significant impact. Moreover, the proportions of LC, SLC, and LLC have no significant impact on ROE in the Spanish firms, while size and growth rate have a positive and significant impact. Whereas, the proportions of LC, LLC, and SLC have a negative and significant impact on ROA in the Spanish firms, while the size and growth rate have a positive and significant impact.

Hailu (2015) examined the impact of financial structure on profitability of 8 banks in Ethiopia for the period (2001 – 2012) using Panel Data models. He found that the proportion of LA has a negative and significant impact on NIM, and the proportion of DA has a positive and significant impact. While the control variables size, growth rate and liquidity have a positive and significant impact.

Saeed et al. (2013) examined the impact of financial structure on performance of 25 banks listed in Karachi stock exchange (KSE) for the period (2007 – 2011) using Panel Data models. He found that the proportions of LC and SLC have a positive and significant impact on ROA, but the proportion of LLC has no significant impact. Secondly, the proportions of LC and SLC have a positive and significant impact on ROE, but the proportion of LLC has a negative and significant impact. Thirdly, the proportions of LC, SLC and LLC have a positive and significant impact on EPS. However, the control variable size has a positive and significant impact on ROA, ROE, and EPS, while growth rate has no significant impact on ROA and ROE, but has a positive and significant impact on EPS.

Niresh (2012) examined the impact of financial structure on profitability of 10 banks in Sri Lanka for the period (2002 – 2009) using Balanced Panel Data models. He found that the proportions of LE and LA have a negative and significant impact on NIM. Further, the proportions of LE and LA have no significant impact on ROE. The proportion of LE has no significant impact on NP, and the proportion of LA has a negative and significant impact. Finally, the proportions of LE and LA have no significant impact on ROCE.

This study will use Return on Assets (ROA) and Return on Equity (ROE) as indicators of profitability of traditional private banks in Syria (Dependent Variables). It will also use the proportions of short liabilities to assets (SLA), long liabilities to assets (LLA), and liabilities to equity (LE) as Independent Variables that are included based on the literature review. In addition, it will use, as control Variables, the size, growth rate, and the Syrian crisis to express the impact of crisis on profitability of traditional private banks in Syria.

Independent Variables:-

Financial structure variables (Independent Variables) will be:

Proportion of short liabilities is measured by short liabilities to assets (SLA). Siddik, et al.(2017) has concluded to exist negative and significant impact on ROA. Zafar, et al. (2016) has concluded to exist positive and significant impact. Anarfo (2015) has concluded to exist no significant impact. Further, Siddik, et al. (2017) has concluded to exist negative and significant impact on ROE, while Zafar, et al. (2016); Anarfo (2015) have concluded to exist no significant impact.

Proportion of long liabilities is measured by long liabilities to assets (LLA). Siddik, et al. (2017) has concluded to exist negative and significant impact on ROA. Zafar, et al. (2016) has concluded to exist positive and significant impact. Anarfo (2015) has concluded to exist no significant impact. Secondly, Siddik, et al. (2017); Anarfo (2015) have concluded to exist no significant impact on ROE, while Zafar, et al. (2016) has concluded to exist negative and significant impact.

Proportion of liabilities to equity is measured by liabilities to equity (LE). Niko (2015) has concluded to exist positive and significant impact on ROA, while Zafar, et al. (2016) has concluded to exist no significant impact. Moreover, Zafar, et al. (2016) has concluded to exist negative and significant impact on ROE. Niko (2015) has concluded to exist positive and significant impact, and Niresh (2012) has concluded to exist no significant impact.

Dependent variables:-

According to many previous studies return on assets (ROA), which is net income after interest and taxes to total assets, and return on equity (ROE), which is net income after interest and taxes to total equity, were proxies for the profitability (Siddik, et al. 2017; Zafar, et al. 2016; Niko, 2015; Anarfo, 2015; Kumari, 2015; Saeed, et al. 2013; Niresh, 2012)

Control variables:-

Bank size (SIZE) is measured by natural logarithm of assets (Siddik, et al., 2017; Saeed, et al., 2013)

Growth rate (GRO) is measured as: (Siddik, et al., 2017; Saeed, et al., 2013)

$$\text{Growth Rate} = \frac{\text{current years assets} - \text{prvious year assets}}{\text{previous year assets}}$$

(SC) resembles the Syrian crisis: it is a dummy variable measured by 0 before crisis, and 1 during crisis (Sahyouni, 2015). Since 2011, Syria has suffered from political crisis invaded the Middle-East, which affected the economic sectors.

Depending on the literature review and economic theory, the present study examines the following alternative hypotheses:-

H1: There is a negative and significant impact of financial structure on return on assets of traditional private banks in Syria.

H2: There is a negative and significant impact of financial structure on return on equity of traditional private banks in Syria.

Model Specification:-

The 2 models estimated in this study:

$ROA = a + B1SLA + B2LLA + B3LE + B4SIZE + B5GRO + B6SC + e$…Model (1)

$ROE = a + B1SLA + B2LLA + B3LE + B4SIZE + B5GRO + B6SC + e$…Model (2)

Results and Discussion:-

Descriptive Statistics Analysis:-

According to table 1, the mean value of ROA and ROE as proxies of profitability of Traditional Private Banks in Syria during (2009 – 2013) is (0.010665) and (0.048481) respectively. The standard deviation for profitability measures ROA and ROE are (0.037721) and (0.091861) respectively. The mean and standard deviation for independent variables: LE, LLA and SLA, are (8.058139), (4.841378); (0.021454), (0.029512); (0.806548), (0.168996), respectively.

Table 1:- Descriptive statistics for variables

	ROA	ROE	LE	LLA	SLA
Mean	0.010665	0.048481	8.058139	0.021454	0.806548
Median	0.0054	0.0435	6.779	0.0088	0.85295
Maximum	0.2441	0.3194	22.1387	0.1764	0.9478
Minimum	-0.0221	-0.2012	0.3076	0	0.2279
Std. Dev.	0.037721	0.091861	4.841378	0.029512	0.168996
Observations	54	54	54	54	54

Correlation Analysis:-

Based on table 2, it shows the correlations between dependent and independent variables and correlations between independent variables itself. The highest correlation between independent variables is 0.68, which is between LE and SLA.

Correlation above 0.8 between independent variables indicates the existence of the problem of multicollinearity (Ongore and Kusa, 2013). It is clear from correlation matrix that no need to drop any of them, there is no serious multicollinearity problem.

All the correlation coefficients between the independent variables were less than 0.8. The details of correlation matrix are shown in table 2.

Table 2:- Correlation Matrix

Correlations								
	LE	LLA	SLA	ROA	ROE	Size	GRO	SC
LE	1							
LLA	0.018	1						
SLA	.689**	-0.035	1					
ROA	-.316-*	-0.115	-.672-**	1				
ROE	0.23	-0.067	-0.134	.640**	1			
SIZE	.662**	0.046	.413**	-0.005	.433**	1		
GRO	-0.119	-0.034	-0.056	-0.058	-0.194	-.391-**	1	
SC	-.307-*	-0.064	-0.072	0.192	-0.017	0.115	-.342-*	1
**. Correlation is significant at the 0.01 level (2-tailed).								
*. Correlation is significant at the 0.05 level (2-tailed).								

Regression Results:-
In this study, a Panel Data regression analysis is performed. Panel Data is a cross section and time series data. Panel Data models are usually estimated using pooled regression model (PRM), fixed effects model (FEM), and random effects model (REM).

After the comparison between the three Panel Data analysis of ROA and ROE models through comparison between pooled regression model and fixed effects model using (F – test), comparison between pooled regression model and random effects model using Lagrange Multiplier Test (LM), and comparison between fixed and random effects models by using Hausman test (Hailu, 2015). It comes to depend on pooled regression model for both, ROA and ROE.

The following regression results show that financial structure impact on profitability of traditional private banks working in Syria are measured by ROA and ROE. Table 3 and 4 present the output of regression analysis results.

Results of ROA model:-
The F- statistic value of 15.921 and its associated p-value 0.000 show that the model overall is statistically significant. This means that there is a significant linear relationship between the variables; the table shows that R square of this model is about 67%. That is about 67 percent of the variation in the dependent variable, ROA, is explained by the independent variables.

The table also illustrates that coefficient value of SLA is -0.2181 at 0.000 significance level, less than P=0.05. This indicates that the independent variable SLA has a negative and significant impact on ROA as a dependent variable that proxies for profitability. The same findings were conducted by Siddik, et al. (2017). It also illustrates that the coefficient value of LLA is -0.2462 at 0.0291 significance level, less than P=0.05. This indicates that the independent variable LLA has a negative and significant impact on ROA. The same findings were conducted by Siddik, et al. (2017). However, the coefficient value of LE is 0.0005 at 0.6764 significance level, more than P=0.05. This indicates that the independent variable LE has no significant impact on ROA. The same findings were conducted by Zafar, et al. (2016).

Concerning the relationship between control variables and ROA, the following table illustrates that the control variable, size, has a positive and significant impact on ROA. While the growth rate and the Syrian crisis have no significant impact.

Table 3:- ROA model results:

Dependent Variable: ROA				
Method: Panel Least Squares				
Sample: 2009 2013				
Periods included: 5				
Cross-sections included: 11				
Total panel (unbalanced) observations: 53				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
SLA	-0.21818	0.027665	-7.886889	0.0000
LLA	-0.24621	0.109289	-2.252913	0.0291
LE	0.000562	0.001338	0.420067	0.6764
SIZE	0.022233	0.007095	3.133690	0.0030
GRO	0.001086	0.003844	0.282564	0.7788
SC	0.003708	0.008563	0.433042	0.6670
C	-0.35392	0.167310	-2.115359	0.0398
R-squared	0.674974	Mean dependent var		0.010942
Adjusted R-squared	0.632579	S.D. dependent var		0.038027
S.E. of regression	0.023050	Akaike info criterion		-4.579789
Sum squared resid	0.024440	Schwarz criterion		-4.319562
Log likelihood	128.3644	Hannan-Quinn criter.		-4.479718
F-statistic	15.92119	Durbin-Watson stat		1.238269
Prob(F-statistic)	0.000000			

Results of ROE model:-
The F- statistic value of 6.36 and its associated p-value 0.000 show that the model overall is statistically significant. This means that there is a significant linear relationship between the variables; the table shows that R square of this model is about 45%. That is about 45 percent of the variation in the dependent variable, ROE, is explained by the independent variables.

The table also illustrates that coefficient value of SLA is -0.2551 at 0.0053 significance level, less than P=0.05. This indicates that the independent variable SLA has a negative and significant impact on ROE as a dependent variable that proxies for profitability. The same findings were conducted by Siddik, et al. (2017). It also illustrates that the coefficient value of LLA is -0.367 at 0.2916 significance level, more than P=0.05. This indicates that the independent variable LLA has no significant impact on ROE. The same findings were conducted by Siddik, et al. (2017); Anfaro, (2015). However, the coefficient value of LE is 0.002 at 0.6224 significance level, more than P=0.05. This indicates that the independent variable LE has no significant impact on ROE. The same findings were conducted by Niresh, (2012).

Concerning the relationship between control variables and ROE, the following table illustrates that the control variable, size, has a positive and significant impact on ROE. While the growth rate and the Syrian crisis have no significant impact.

Table 4:- ROE Model Results:

Dependent Variable: ROE				
Method: Panel Least Squares				
Sample: 2009 2013				
Periods included: 5				
Cross-sections included: 11				
Total panel (unbalanced) observations: 53				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
SLA	-0.25506	0.087165	-2.926247	0.0053
LLA	-0.36739	0.344348	-1.066933	0.2916
LE	-0.00209	0.004216	-0.495741	0.6224
SIZE	0.094190	0.022355	4.213464	0.0001
GRO	-0.00890	0.012112	-0.735278	0.4659
SC	-0.04695	0.026982	-1.740244	0.0885
C	-1.97563	0.527159	-3.747704	0.0005
R-squared	0.453697	Mean dependent var		0.049523
Adjusted R-squared	0.382440	S.D. dependent var		0.092418
S.E. of regression	0.072626	Akaike info criterion		-2.284478
Sum squared resid	0.242631	Schwarz criterion		-2.024251
Log likelihood	67.53867	Hannan-Quinn criter.		-2.184407
F-statistic	6.367061	Durbin-Watson stat		1.500516
Prob(F-statistic)	0.000062			

Conclusion:-

The purpose of this study is to examine the impact of financial structure on the profitability of Traditional Private Banks working in Syria for the period 2009–2013. For the dependent variable, profitability measured by return on assets (ROA) and return on equity (ROE). For the independent variables, financial structure measured by the proportions of short liabilities to assets (SLA), long liabilities to assets (LLA), and liabilities to equity (LE). The control variables, size, growth rate, and Syrian crisis. The empirical results indicate that SLA and LLA have a negative and significant impact on ROA, while LE has no significant impact. However, SLA has a negative and significant impact on ROE, while LLA and LE have no significant impact.

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