The effect of Georgian Banks'Interest Rates on Corporations Leverage Structure

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Abstract

"Debt can make you rich beyond your wildest dreams"

Debt is the word that everyone is afraid of; however, it can also be a positive thing if used properly. A company needs financial capital in order to operate its business. Capital structure is the combination of the capital raised by the company;it is how a firm finances its operations and growth by using different sources of funds. The mix of debt and equity that makes up a company's capital structure has many risk and return implications.The decision regarding the capital structure is very important because it affects the earnings per share or wealth of the shareholders.Therefore, corporate management has an obligation to use a thorough and prudent process for establishing a company's target capital structure.

Debt can be used as leverage to exponentially multiply the returns and make company richer. One may often ask a question to the effect of "If the company is really strong, why it would have any debt at all?" Many people still feel uncomfortable with the idea that "debt can be good."

A firm's capital structure is among the major fields of both theoretical and empirical modern corporate finance.It has been 60 years since Franco Modigliani and Merton Miller first proposed that a company's value is independent of its capital structure - no matter how you slice it.

Miller and Modigliani's theorem was first published in 1958 and it was a groundbreaking model in corporate finance. The M&M theorem on capital structure claims that in an efficient market and in the absence of taxes, bankruptcy costs and asymmetric information, the value of a firm is unaffected by how it is financed. That is how the firm

decides to raise capital, whether it is by taking on debt or by using existing equity, does not affect the value of the company.

Controversial from the beginning, after the half of a century the irrelevance propositions are proving to be anything but irrelevant, still raising hackles in academic circles. An entire generation of academics has been hard at work bringing M&M down from the "frictionless" world of theory to the real world of empirical research.

Scholars and researches face difficulties in observing the general level of Leverage in Georgia, because the data is not available and is almost impossible to obtain from private firms. The statistics of NBG is very general and financial information published in annual reports of Publicly Traded Companies is not enough to analyze the overall Capital Structure set up and leverage level in Georgia. In general, experts assume that SMEs are less leveraged but still under the constant risk of bankruptcy due to the poor access of external funding, while the big corporations have better access to the business loans and affordable deals from local banks.

Key Words: Leverage, Capital Structure, Interest Rates, Corporate Loans, Debt/equity ratio, Capital Structure Theories, Corporate Finance, Georgian Corporations