

The impact of capital structure on financial performance: Empirical evidence from listed commercial banks in Tanzania

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ABSTRACT

Using data of five Commercial Banks listed in Tanzania (DSE) this study examines the impact of capital structure on financial performance over a period of ten (10) years spanning from 2015 to 2024. The financial leverage, equity capital, retained earnings, and firm size were used as key determinants of financial performance as represented by Return on Assets (ROA). The study was founded on the Pecking Order Theory which associates firms' financing decisions on a hierarchy of funding sources. Panel regression analysis was employed to assess the relationship between the explanatory variables and ROA. The findings reveal that, both, financial leverage, equity capital, retained earnings and firm size have a significant positive effect on bank performance (at $R^2 = 0.783$) signifying that 78.3% of variation in profitability is explained by these variables. Results imply, that, financial leverage enhances returns through effective debt utilization, while equity capital and retained earnings provide stability and internal financing. Additionally, larger banks benefit from economies of scale. The study concludes that optimizing the capital structure is crucial for improving financial performance while mitigating financial risks. It recommends that bank managers strategically balance debt and equity, retain sufficient earnings for reinvestment, and leverage growth opportunities to enhance operational efficiency and sustain long-term profitability. Furthermore, policymakers should support regulatory frameworks that promote sound capital structure management in the banking sector.

Keywords: Capital Structure, Financial Leverage, Equity Capital, Retained Earnings and Financial Performance (ROA)

I. INTRODUCTION

Capital structure refers to the way in which a firm finances its operations and growth through a combination of debt and equity. The choice between these financing sources is a critical financial decision because it directly affects a firm's cost of capital, profitability, risk exposure, and long-term sustainability. In modern business environments characterized by increased competition, financial volatility, and regulatory pressure, the determination of an appropriate capital structure has become a central concern for managers and investors alike. Scholars argue that an optimal capital structure enables firms to minimise financing costs while maximizing firm value and shareholders' wealth (Munisi, 2017; Ganiyu et al., 2019). Consequently, capital structure decisions are widely regarded as a key driver of business performance across industries and economies.

At the global level, extensive empirical research has examined the relationship between capital structure and firm performance, yet the findings remain mixed and inconclusive. Some studies conducted in developed and emerging economies report that higher leverage improves firm performance due to tax advantages and managerial discipline (Nirajini & Priya, 2013; Şamiloglu & Demirgunes, 2008). In contrast, other studies find a negative or insignificant relationship, suggesting that excessive reliance on debt increases financial distress costs and reduces profitability (Rouf, 2015; Gohar & Rehman, 2016). These inconsistencies indicate that the impact of capital structure may vary depending on institutional frameworks, industry characteristics, and country-specific conditions. As a result, there is no universally accepted conclusion regarding the optimal mix of debt and equity, particularly in developing economies where financial markets are less mature.

Regionally, studies conducted in Africa and East Africa have also produced divergent results. Research in countries such as Kenya, Nigeria, and Ghana show that capital structure decisions significantly influence firm and bank performance, although the direction and magnitude of the relationship differ across studies (Swai et al., 2016; Omukaga, 2017; Marigu & Gerald, 2020). In the banking sector, capital structure decisions are especially important because banks rely heavily on debt financing in the form of deposits and borrowed funds while operating under strict regulatory requirements. Banks act as financial intermediaries, mobilizing savings from surplus units and channeling them to deficit units for productive investment. Therefore, poor capital structure decisions in banks may not only affect individual institutions but also threaten financial system stability and economic growth.

In Tanzania, the banking sector plays a vital role in supporting economic development by providing credit, facilitating payments, and mobilizing financial resources (Swai et al., 2016). However, empirical studies focusing specifically on the relationship between capital structure and the performance of listed commercial banks in Tanzania remain limited. Most existing studies either focus on non-banking firms, unlisted banks, or examine capital structure using a narrow set of variables and short time horizons (See for stance, Mwenda et al. (2021); Usman 2019). Moreover, limited attention has been given to the combined effects of financial leverage, share capital, and retained earnings on bank performance while controlling for firm size. This creates a geographical, methodological, and knowledge gap in understanding how capital structure decisions influence bank performance within the Tanzanian context.

In an ideal situation, commercial banks are expected to make rational financing decisions that balance debt and equity in line with the Pecking Order Theory, thereby minimizing the cost of capital and maximizing profitability and long-term sustainability. In reality, however, empirical evidence on the relationship between capital structure and bank performance is contradictory, and Tanzanian banks appear not to consistently follow theoretical prescriptions when making financing decisions. The consequences of this contradiction include increased financial risk, higher costs of capital, reduced profitability, and potential threats to the stability of the banking sector in a highly competitive financial environment. These challenges are further intensified by the limited availability of context-specific empirical evidence to guide financing decisions in Tanzania.

1.1 Research Objectives

- i. To examine the relationship between the financial leverage and financial performance (ROA) of listed commercial banks in Tanzania.
- ii. To examine the relationship between the share capital (Equity Capital) and financial performance (ROA) of listed commercial banks in Tanzania.
- iii. To examine the relationship between Retained Earnings (RE) and financial performance (ROA) of listed commercial banks in Tanzania.
- iv. To determine whether Bank (firm) size has a positive impact on financial performance (ROA) of listed commercial banks in Tanzania.

II. LITERATURE REVIEW

2.1 Theoretical Review

The Pecking Order Theory, developed by Myers (1984) and Myers and Majluf (1984), explains firms' financing decisions based on a hierarchy of funding sources influenced by financing costs and information asymmetry. The central hypothesis of the theory is that firms prefer internal financing (retained earnings) first, followed by debt, and use equity only as a last resort, implying that there is no optimal capital structure but rather a financing order. The theory is relevant to studies on capital structure and firm performance (Swai et al., 2016; Serrasqueiro & Caetano, 2015). This study explores empirical contribution to the Pecking order theory underpinning by examining the relationship between specific components of capital structure, viz, retained earnings, financial leverage, and share capital and financial performance (Return on Assets) as the outcome variable.

2.2 Empirical Review

2.2.1 Financial Leverage and Firm Performance

Mwenda et al. (2021) examined the effect of financial leverage on the financial performance of companies listed on the Dar es Salaam Stock Exchange. The study used panel data from ten listed firms over a six-year period and applied a fixed-effects multiple linear regression model guided by agency cost theory. The findings revealed a negative and significant relationship between financial leverage and firm performance, indicating that excessive reliance on debt reduced firm value. The study concluded that high leverage increases agency costs and financial risk. It recommended that listed firms should adopt prudent debt management strategies to avoid over-leveraging and enhance performance.

Omukaga (2017) investigated the effect of capital structure on the financial performance of commercial banks listed on the Nairobi Securities Exchange using panel data from 2011 to 2016. Descriptive and inferential statistical techniques were employed. The results showed that capital structure significantly influenced return on equity (ROE) and both pre-tax and after-tax income. The study concluded that leverage decisions are critical determinants of bank profitability. It recommended that bank managers should carefully balance debt and equity to improve profitability while maintaining financial stability.

Usman (2019) examined the impact of capital structure on the performance of consumer goods companies in Nigeria. Secondary data were obtained from the financial statements of selected firms, with long-term debt, short-term debt, and shareholders' funds as explanatory variables and return on assets (ROA) as the performance measure. Descriptive statistics, correlation, and regression analysis were used. The findings showed that both short-term and long-term debt had no significant effect on profitability. The study concluded that debt financing does not necessarily improve

firm performance in the consumer goods sector. It recommended that firms should rely more on internal financing and equity to enhance operational efficiency.

Wangombe and Kibati (2019) assessed the effect of capital structure on the financial performance of licensed microfinance institutions in Kenya. The study used panel data obtained from financial reports and adopted a descriptive research approach. The findings indicated that most institutions relied heavily on debt financing and that prudent use of leverage supported cash flow stability. The study concluded that effective debt management is essential for sustaining microfinance institutions. It recommended that managers should carefully structure debt financing to ensure liquidity and long-term sustainability.

2.2.2 Equity Capital and Firm Performance

Srivastava (2011) examined the relationship between equity ownership structure and financial performance of firms listed on the Bombay Stock Exchange (BSE 500). The study used secondary data from 500 firms and applied Ordinary Least Squares (OLS) regression analysis. The results showed that equity ownership structure significantly affected accounting-based performance indicators such as ROA and ROE but had no significant impact on market-based performance measures. The study concluded that ownership concentration influences internal financial performance. It recommended that firms should adopt balanced equity ownership structures to enhance managerial efficiency and accountability.

Usman (2019) also investigated the effect of equity capital on the financial performance of consumer goods firms in Nigeria using secondary financial statement data. Descriptive statistics and regression analysis were applied. The findings revealed that equity capital had a significant impact on firm performance. The study concluded that shareholders' funds play a vital role in supporting firm profitability. It recommended that firms should strengthen their equity base to improve financial performance and reduce dependence on debt. Marigu and Gerald (2020) examined the effect of capital structure on the financial performance of industrial and allied firms listed on the Nairobi Securities Exchange using data from 2013 to 2018. Descriptive statistics and multiple regression analysis were employed. The results indicated that equity capital had a negative and significant effect on firm performance. The study concluded that excessive equity financing may dilute returns and reduce profitability. It recommended that firms should optimise equity levels and avoid overcapitalization to enhance returns.

Sung and Jang (2017) analysed the effect of capital structure on the financial performance of restaurant firms using panel data and fixed-effects regression analysis. The findings showed that debt financing increased financing costs and negatively affected firm performance, while equity financing contributed positively to financial outcomes. The study concluded that restaurants benefit more from equity financing than debt financing. It recommended that firms in the service sector should rely more on equity capital to minimise financing costs and improve profitability.

2.2.3 Retained Earnings and Firm Performance

Thirumalaisamy (2020) examined the effect of retained earnings on firm performance among 27 high-growth and profitable Indian companies using data from 2002 to 2016. Inferential statistical techniques were employed. The findings revealed inefficient utilisation of retained earnings and a weak relationship between retained earnings and shareholder wealth creation. The study concluded that retained profits were not effectively invested. It recommended that firms should improve internal investment appraisal and monitoring mechanisms to ensure efficient use of retained earnings.

Yemi and Seriki (2018) investigated the effect of retained earnings on firm value using secondary data from 2003 to 2014. Descriptive statistics and multiple regression analysis were applied. The results showed that retained earnings and earnings per share had a positive and significant effect on firm value. The study concluded that retained earnings enhance shareholders' wealth. It recommended that firms should adopt dividend policies that allow for sufficient profit retention to finance growth and increase firm value. Nwafor (2023) examined the effect of retained earnings on the performance of Nigerian oil and gas firms using secondary data from 2009 to 2018. Simple linear regression analysis was employed, with retained earnings as the independent variable and ROA and ROE as performance measures. The findings revealed that retained earnings had a positive but insignificant effect on performance for most firms, except for Mobil Nigeria Plc, where the effect was positive and significant on ROE. The study concluded that the impact of retained earnings varies across firms. It recommended that firms should align retained earnings with strategic investment opportunities to improve financial performance.

III. METHODOLOGY

3.1 Research Design

This study employed an explanatory (causal) research design to examine the effect of capital structure on the financial performance of listed commercial banks in Tanzania. The design was selected because it allowed the investigation of causal relationships between independent variables financial leverage, equity capital, and retained earnings and the dependent variable, financial performance measured by Return on Assets (ROA). The explanatory

design enabled the identification of the direction and magnitude of influence of capital structure components on bank performance, thereby providing robust insights into the determinants of profitability within the banking sector.

3.2 Sources of Data

The study utilized secondary data obtained from the audited annual financial statements of five (5) large commercial banks listed on Dar es Salaam Stock Exchange (DSE). The selection was based on market capitalisation and availability of relevant financial data. The selected commercial banks represent 71.4 percent of all seven (7) listed banks. We therefore employed secondary financial data of the studied commercial banks for a period of ten (10) years spanning from 2015 to 2024. The additional financial data were collected from the Bank of Tanzania (BOT) and other relevant DSE publications. Secondary data were chosen because they were reliable, accessible, and consistent, which was critical for examining quantitative relationships in financial research. A commercial bank was included in the sample if it had relevant financial data within a specified sample period 2015-2024. However, firms with inadequate data were excluded from the sample

3.3 Measurement of Variables

The financial performance was employed as dependent variable and represented by Return on Asset (ROA) for each of the sampled commercial banks over a research period. This proxy was ideal for this research since “ROA” represents the overall book value financial health of listed firms. The predictor variables, that is, financial leverage of a bank (FINL), Equity capital of bank (EQC); Retained earnings (RTE). Further to that, the respect bank’s size (BS) was taken as a control variable was measured as the natural logarithm of total assets to account for the potential influence of bank scale on profitability.

3.4 Model Specification

Consistent with Mwenda et al. (2021) the quantitative research approach was employed. The multiple regression analysis model below was deployed to establish causal relationship between dependent variable (bank financial performance (ROA) and independent variables (FINL, EQC and RTE) as controlled by bank size (BS).

$$ROA_{it} = \beta_0 + \beta_1 FINL_{it} + \beta_2 EQC_{it} + \beta_3 RTE_{it} + \beta_4 BS_{it} + \varepsilon_{it}$$

Where:

ROA_{it} = Return on Assets of bank i at time t

$FINL_{it}$ = Financial leverage of bank i at time t

EQC_{it} = Equity capital of bank i at time t

RTE_{it} = Retained earnings of bank i at time t

BS_{it} = Bank size of bank i at time t (Control Variable)

β_0 = Constant term

$\beta_1, \beta_2, \beta_3, \beta_4$ = Coefficients of independent variables

ε_{it} = Error term

The regression analysis estimated the significance, strength, and direction of the relationships between capital structure components and financial performance. In order to mitigate unobserved heterogeneity, the study applied Fixed Effects and Random Effects models. The data analysis involved both descriptive and inferential techniques and operationalized in STATA software and observed to be well balanced. The explanatory power (R^2) of the model was used to establish the degree of association between the studied variables. Thus, R^2 of the applied regression model was used to establish the contribution of independent variables ($FINL$, EQC and RTE) on the dependent variable (ROA). The high R^2 is interpreted as presenting the fitness of the model and strong explanatory power of independent variables on dependent variable.

IV. FINDINGS & DISCUSSION

4.1 Descriptive Statistics Results

Descriptive statistics were employed to summarize the characteristics of the data. Table 1 summarises key variables of the study. The analysis includes 50 valid observations derived from secondary data collected across five (5) listed commercial banks over research period. The table outlines the minimum, maximum, mean, and standard deviation for each variable, offering insights into their central tendency and dispersion. These descriptive statistics help to understand the general characteristics and distribution of the data before performing regression and correlation analyses.

Table 1
Descriptive Statistics

Variable	Mean	Median	Std. Dev.	Min	Max
ROA	0.217	0.323	0.207	0.12	0.25
Financial Leverage	0.846	0.845	0.033	0.778	0.918
Equity Capital	0.645	0.659	0.157	0.36	0.986
Retained Earnings	0.012	0.013	0.015	0.033	0.039
Firm Size	13.277	12.179	1.994	10.638	15.992

The average ROA was 0.217 (SD = 0.207), indicating moderate variability in profitability, with values ranging from 0.12 to 0.25. Financial leverage had a mean of 0.846 (SD = 0.033), showing most banks maintained similar debt levels. Equity capital averaged 0.645 (SD = 0.157), reflecting moderate differences in equity funding, while retained earnings were low at 0.012 (SD = 0.015), suggesting limited reinvestment. Firm size averaged 13.277 (SD = 1.994), showing notable differences in bank scale.

The descriptive statistics indicate that listed commercial banks maintain steady profitability and rely heavily on debt in their capital structure. Moderate variability in equity capital and differences in firm size suggest opportunities for some banks to strengthen their equity base and leverage economies of scale. Low retained earnings highlight limited reinvestment, which could constrain growth and future profitability if not addressed. These insights provide a foundation for further analysis and inform strategies for optimizing capital structure to enhance financial performance.

4.2 Pair-wise Correlation Results

The correlation matrix (Table.2) showed the relationships among the key variables. ROA, the measure of financial performance, exhibited a moderate positive correlation with financial leverage ($r = 0.496$, $p = 0.002$), indicating that higher leverage was associated with improved profitability. ROA also had a weak positive correlation with equity capital ($r = 0.214$, $p = 0.004$) and a moderate positive correlation with retained earnings ($r = 0.446$, $p = 0.007$), suggesting that both equity and reinvested profits contributed to performance, though less strongly than debt. Bank size had a weak negative correlation with ROA ($r = -0.309$, $p = 0.070$), implying that larger banks might face operational inefficiencies affecting profitability. Financial leverage correlated positively with retained earnings ($r = 0.493$, $p = 0.003$), while equity capital negatively correlated with retained earnings ($r = -0.443$, $p = 0.008$), reflecting trade-offs in capital allocation. A weak negative correlation was observed between bank size and financial leverage ($r = -0.235$, $p = 0.174$), suggesting larger banks may depend less on debt.

Table 2
Correlation Matrix

Variables	ROA	Financial Leverage	Equity Capital	Retained Earnings	Bank Size
ROA	1.000				
Financial Leverage	0.496	1.000			
Equity Capital	0.214	0.473	1.000		
Retained Earnings	0.446	0.493	-0.443	1.000	
Bank Size	-0.309	-0.235	-0.193	0.339	1.000

The correlations suggest that a balanced capital structure, particularly leveraging debt and reinvesting earnings, can enhance bank profitability. The weak or negative associations with bank size indicate that operational scale alone does not guarantee higher returns, emphasizing the need for efficient capital allocation. These insights support strategies aimed at optimizing financial leverage, equity, and retained earnings to improve performance among listed banks. None of the correlation matrix of pair-wise correlations coefficients show singularity (1) which suggest non-existence of multicollinearity according to Hair et al. (2003).

4.3 Multicollinearity Test Results

The multicollinearity test results (Table 3) showed no severe multicollinearity, as all Variance Inflation Factor (VIF) values were below 10, with a mean VIF of 1.812 (Kothari, 2004). Bank size had the highest VIF (2.104), followed by retained earnings (2.018), financial leverage (1.692), and equity capital (1.435), all within acceptable limits. These results indicate that the predictors were sufficiently independent, ensuring reliable regression estimates. The findings confirm that financial leverage, equity capital, retained earnings, and bank size can robustly explain bank performance (ROA) without bias from multicollinearity.

Table 3*Multicollinearity Test*

Variables	VIF	1/VIF
Bank Size	2.104	0.789
Retained Earnings	2.018	0.563
Financial Leverage	1.692	0.417
Equity Capital	1.435	0.406
Mean VIF	1.812	

4.4 Main Empirical Results and Discussion

The pooled regression model results presented in Table 4 reveal a significant relationship between the selected independent variables and Return on Assets (ROA), demonstrating the model's strong explanatory power. The model produced an R-squared value of 0.783, indicating that approximately 78.3% of the variation in ROA is explained by financial leverage, equity capital, retained earnings, and firm size. This high explanatory capacity underscores the relevance of these predictors in understanding the financial performance of listed commercial banks. The f-coefficients generated from the model is 21.368 (at $p = 0.0000 < 0.05$) confirming that the model significantly predicts ROA. The reported f-values suggest a significant overall explanatory power (R^2) of the model at 5% level of significance. Further, the mean dependent variable (ROA) was 0.217 with a standard deviation of 0.207, consistent with moderate variability in bank profitability. The model selection criteria, including Akaike Information Criterion (AIC = -26.123) and Bayesian Information Criterion (BIC = -18.346), further support the reliability of the model.

In more specific terms, results show that, the predictor variables ($FINL_{it}$; EQC_{it} and RTE_{it}) combined had a significant explanatory power ($R^2 = 78.3\%$) on the dependent variable (ROA_{it}) for studied firms during the examination period. This entails that, capital structure significantly influences the financial performance of commercial banks, such that, the unbalanced capital structure corresponds with poor financial performance. This result is consistent with this study's overall prediction (H_1), that, although there is no optimal structure, firm's capital structure has significant positive impact on firm performance.

The table also exhibits results regarding specific hypotheses of the study which was sought to document the direction and significance of correlation of each specific independent variable component of financial reporting quality ($FINL_{it}$; EQC_{it} , RTE_{it} and BS_{it}) and financial performance (ROA_{it}).

With reference to H_2 , the financial leverage ($FINL_{it}$) was anticipated to yield a positive and significant influence on the financial performance (ROA_{it}). Consistent with this prediction, the financial leverage exhibited a positive and statistically significant effect on ROA (at $\beta = 0.989$, p – value of = $0.034 < 0.05$). This finding suggests that banks effectively utilizing debt financing experience higher profitability, reflecting the advantage of leveraging external capital for operational and investment activities. The positive relationship aligns with the trade-off theory (Kraus & Litzenberger, 1973) and Agency Cost Theory (Jensen & Meckling, 1976). The reported findings are corroborative to prior studies, such as, Omukaga (2017) and contradicts conclusion by Mwenda et al., (2021) and Usman (2019) arguing that, debt financing does not necessarily improve firm performance. The implications for Tanzanian commercial banks are substantial. By carefully managing leverage, banks can optimize profitability while avoiding excessive financial risk. This finding suggests that regulators and bank managers should encourage strategies that strike a balance between debt and equity, leveraging the tax benefits of debt without exposing the institution to financial distress. Moreover, the positive effect of leverage indicates that Tanzanian banks have the capacity to utilize borrowed funds efficiently, which may enhance their competitive advantage in the local banking sector.

Consistent with the study's H_3 , the coefficient of the Equity Capital (EQC_{it}) is observed to have significant and positive impact on Return on Assets (ROA) (at $\beta = 0.345$, p – value of = $0.019 < 0.05$). The findings suggest a higher proportion of equity capital enhances the bank's financial resilience and stability, contributing to improved performance. This indicates that a well-capitalized bank is better positioned to absorb financial shocks, invest in growth opportunities and maintain investor confidence. This result is consistent with the Pecking Order Theory, which asserts that firms prefer internal financing, such as equity and retained earnings, over debt due to lower costs and reduced financial risk (Myers & Majluf, 1984). Further, this finding is consistent with other prior studies (Srivastava, 2011; Usman (2019); Sung & Jang, 2017; Omukaga, 2017; Marigu & Gerald, 2020; and Wangombe & Kibati, 2019). This finding also emphasizes the importance of strategic equity planning as a tool for managing cost of capital, maintaining solvency, and achieving sustainable growth in a competitive banking environment.

The study further documents that, Retained Earnings (RE) were highly significant and positively associated with Return on Asset (ROA) at $\beta = 0.071$, $p = 0.000 < 0.05$. This result upholds and concurs with the study hypothesis 4 (H_4) which predicted a “significant positive relationship between retained earnings and ROA”. The reported result is corroborative to prior empirical studies by Nwafor (2023) and Yemi and Seriki (2018). This result emphasizes the critical role of reinvested profits in supporting sustainable growth and improving profitability. It implies that Banks that efficiently reinvest their earnings can finance expansion, enhance operational efficiency, and reduce reliance on external

financing. This result upholds the theoretical underpinning of the Pecking Order Theory, which posits that firms prefer to finance investments using internal funds to avoid the higher costs and risks associated with external financing (Myers & Majluf, 1984).

Table 4

Pooled Regression Model

ROA	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
Financial Leverage	0.989	1.653	1.60	0.034	2.387	4.365	**
Equity Capital	0.345	0.14	2.47	0.019	0.06	0.631	**
Retained Earnings	0.071	0.014	5.28	0.000	0.044	0.099	***
Firm size	3.02	0.722	4.18	0.000	4.495	1.544	***
Constant	1.59	0.648	2.45	0.02	0.267	2.913	**
Mean dependent var.	0.217	SD dependent var	0.207				
R-squared	0.783	Number of obs.	50				
F-test	21.368	Prob > F	0.000				
Akaike crit. (AIC)	-26.123	Bayesian crit. (BIC)	-18.346				

*** $p < .01$, ** $p < .05$, * $p < .1$

Source: Researcher, 2025

Lastly, the current study hypothesised that “Firm (Bank) size has a significant positive effect on ROA (H_5). Consistent to this hypothesis the findings found that, the firm (Bank) size showed a strong positive impact on ROA (at $\beta = 3.02$, $p = 0.000 < 0.05$), indicating that larger banks tend to achieve superior performance. This effect can be attributed to economies of scale, operational efficiency, diversified revenue streams, and better access to capital markets. The Resource-Based View (RBV) further suggests that larger banks possess superior resources, capabilities, and market influence, which enhance competitive advantage and performance. As such, larger banks are more capable of spreading costs over a broader asset base, thereby improving profitability.

The results highlight the importance of maintaining a balanced capital structure to enhance financial performance. The positive effects of financial leverage and equity capital suggest that banks should optimize their funding mix to maximize profitability while maintaining financial stability. Retained earnings’ significance underscores the necessity of reinvesting profits to fund operations and future growth. Additionally, the strong influence of firm size implies that policies promoting operational efficiency and strategic expansion can improve bank performance. Collectively, these findings provide actionable insights for bank managers and policymakers seeking to strengthen profitability and sustain long-term financial health.

V. CONCLUSION & RECOMMENDATIONS

5.1 Conclusion

Employing a positivist research paradigm and quantitative approach the study examined the impact of capital structure on the financial performance of listed commercial banks at the Dar es Salaam Stock Exchange (DSE), with a specific focus on financial leverage, equity capital, and retained earnings and Bank Size. Secondary data of ten (10) years spanning from 2015 to 2024 were collected from audited financial statements and official reports of selected banks. The descriptive statistics revealed that listed banks maintained moderate profitability, with an average ROA of 0.217, high financial leverage averaging 0.846, moderate equity capital at 0.645, and low retained earnings at 0.012. Firm size exhibited notable variation, reflecting operational diversity among the banks. Correlation and multicollinearity tests confirmed the independence and reliability of the predictor variables, while the Pesaran Cross-section dependence test indicated no serial correlation, validating the robustness of the regression models. Overall, the study provided a comprehensive understanding of how capital structure influences financial performance in the Tanzanian banking sector.

The regression analysis demonstrated a significant positive relationship between financial leverage, equity capital, retained earnings, firm size, and ROA, with an R-squared value of 0.783, suggesting that 78.3% of the variation in profitability was explained by these variables. Financial leverage positively affected ROA, confirming that prudent use of debt financing can enhance profitability in line with the Trade-off Theory. Equity capital and retained earnings were also significant contributors, aligning with the Pecking Order Theory by emphasizing the importance of internal financing and reinvestment for sustainable growth. Firm size was found to positively influence ROA, highlighting economies of scale, operational efficiencies, and the competitive advantage that larger banks enjoy. Collectively, these findings illustrate that a balanced capital structure, effective reinvestment of profits, and strategic operational expansion are critical for enhancing bank performance. The statistical significance of the F-test (21.368, $p = 0.000$) further

confirmed the reliability of the model, providing robust evidence to guide managerial and policy decisions. The overall implication of the reported empirical results is that maintaining a balanced capital structure could be instrumental in enhancing financial performance of commercial listed banks. The findings provide actionable insights for bank managers and policymakers seeking to strengthen profitability and sustain long-term financial health.

5.2 Recommendations

On the basis of the study findings, several recommendations are proposed to improve the financial performance and sustainability of listed banks. These include (i) Banks should optimize their capital structure by maintaining a strategic balance between debt and equity, leveraging the benefits of financial leverage while managing associated risks through rigorous risk assessment frameworks (ii) Banks should prioritize the reinvestment of retained earnings to fund expansion, technology upgrades, and infrastructure development, which are essential for long-term growth and operational efficiency (iii) Policymakers and regulators should facilitate an enabling environment that encourages equity accumulation, supports bank growth through mergers and acquisitions, and provides incentives for operational efficiency improvements, particularly for smaller banks. Lastly, additional measures, such as targeted financial literacy programs for management and investors, can enhance decision-making around capital allocation and reinvestment strategies. By implementing the forementioned specific recommendations, banks can achieve enhanced profitability, operational effectiveness, and financial stability, thereby contributing to the resilience and competitiveness of the Tanzanian banking sector in a dynamic financial landscape.

Declaration of Interest

The authors declare that they do not have any known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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