



Impact of Capital Structure on Financial Performance of Indian Listed Companies

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Abstract – Capital structure plays a critical role in shaping the financial performance of firms, particularly in emerging markets like India where capital market dynamics, regulatory frameworks, and financing constraints differ from developed economies. This study examines the impact of capital structure on the financial performance of Indian listed companies across multiple sectors. Using panel data from a sample of firms listed on the National Stock Exchange of India and Bombay Stock Exchange, the analysis explores the relationship between leverage ratios (such as debt-to-equity and total debt ratios) and key performance indicators including return on assets (ROA), return on equity (ROE), and firm value. The study employs regression techniques to assess how varying levels of debt influence profitability and efficiency. The findings indicate that moderate use of debt can enhance firm performance due to tax advantages and disciplined management, consistent with the Trade-Off Theory. However, excessive leverage negatively affects financial performance due to increased financial risk and cost of capital. The results also provide partial support for the Pecking Order Theory, suggesting firms prefer internal financing before resorting to external debt. The study offers insights for corporate managers, investors, and policymakers in optimizing capital structure decisions to improve firm performance.

Keywords – Capital Structure; Financial Performance; Leverage; Return on Assets (ROA); Return on Equity (ROE); Firm Value; Indian Listed Companies; National Stock Exchange of India; Bombay Stock Exchange; Trade-Off Theory; Pecking Order Theory.

I. INTRODUCTION

Background of the Study

The capital structure of a firm is a big part of how it handles its money. It means the mix of debt and equity that a company uses to pay for its operations, investments, and growth ambitions over time. Financial managers are in charge of finding the appropriate mix of different sources of financing to raise the value of shareholders and minimize the cost of capital.

How a firm manages its money has a huge impact on its health, profits, and level of risk. Businesses that borrow a lot of money may be able to save money on taxes by not paying interest. But if they have too much debt, they may have a harder time paying it off and may be more likely to get into financial problems. On the other hand, businesses that largely use equity financing might not be as financially risky, but they might have higher capital costs.

The economy is rising quickly, the financial markets are getting better, and competition is getting tighter in every area. Because of this, it is becoming more and more important to make decisions about the capital structure of fast-growing nations like India. Banks, manufacturing, IT companies, and consumer goods companies are just a few examples of publicly traded businesses in India. Each of these types of businesses has its own needs for money and levels of risk.

This research investigates publicly traded companies including Tata Motors, ITC Limited, HDFC Bank, Zomato, and PepsiCo. The purpose of this research is to examine the relationship between capital structure and a company's financial performance. These businesses come from

different sections of the economy and show how choices about capital structure can affect how well they do financially.

Concept of Capital Structure

The capital structure of a business is the ratio of its debt to its equity and how it pays for its assets and activities. Shareholders acquire equity financing from equity shares or retained earnings. On the other hand, debt financing is money that you borrow from banks, bonds, and other financial groups.

When it comes to its financial structure, a company can strike the optimal balance between risk and return. Companies that can retain this equilibrium are more likely to grow over time and have better financial returns.

Key Performance Indicators for Management

The company's financial performance reveals how successfully it spends its money to make money and increase the value of its shareholders. When performing financial research, there are a number of ways to look at how well a firm is doing.

This study examines things like the Return on Assets (ROA) to figure out how well a business is doing financially. The ROA tells you how well a business uses its assets to produce money. Return on equity (ROE) shows how much money shareholders make from their investments. The Net Profit Margin (NPM) tells you what percent of your overall income should be reported as profit.

These metrics show how well a business runs and how much money it makes.



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Importance of the Study

A lot of people, such financial managers, investors, legislators, and academics, need to look at the capital structure. If businesses know how capital structure influences their financial performance, they can make better decisions regarding how to get money. This can help you make more money and keep your finances stable.

By studying a company's capital structure, investors can learn a lot about how risky it is and how financially stable it is. Policymakers and banks can learn a lot by figuring out how business financing choices affect the economy and the stability of the market.

The findings of this study may assist companies in formulating strategies to identify the optimal equilibrium between equity financing and loan financing.

Overview of Selected Companies

This study examines many firms across diverse industries to evaluate the impact of their capital structure on financial performance. Tata Motors is one of the companies that has been chosen. It is a well-known automobile producer from India that also sells cars in other nations. ITC Limited is a global firm that works in the hotel, fast-moving consumer goods (FMCG), and agriculture sectors. HDFC Bank is one of the largest private banks in India, and it is also known for being financially stable. Zomato is an internet program that employs technology to help customers identify restaurants and place food orders. PepsiCo is one of the biggest and most successful food and drink companies in the world.

It's easier to see how capital structure influences financial performance in various industries when you think of these companies as instances of many other types of firms.

Structure of the Report The report has these chapters:

Chapter 1: "Introduction," explains about the study's origins, goals, and scope.

Chapter 2: "Literature Review," talks about the ideas that are already out there and the research that has been done on capital structure and financial performance in the past.

Chapter 3: "Materials and Methods," discusses the research methodology, data sources, variables, and analytical techniques employed in the study.

Chapter 4: "Results and Discussion." It explains how the data was analyzed and what the results mean.

Chapter 5: "Conclusion and Recommendations," goes over the data and gives managers ideas for future study and things to consider while making decisions.

II. LITERATURE REVIEW

Introduction

In business, "capital structure" means the mix of debt and equity that organizations use to pay for their operations and investments. A lot of research has been done in corporate finance on how capital structure affects financial performance. Researchers have tried to find out if using financial leverage makes a firm more profitable or if it

makes the company more risky, which in turn affects the company's overall performance.

In developing economies like India, where firms have to deal with changing laws, growing capital markets, and differences in their own financial backgrounds, analyzing capital structure is quite important. Research has shown that using leverage can help or hurt performance. Some research show that leverage is helpful, while others show that it doesn't work or is bad. In the next part, we will talk about the most important studies that have been done on how a company's capital structure influences its success.

An analysis of the academic research that has been published in the past

Modigliani and Miller (1958) created the core theory of capital structure, which states that the value of a firm is unaffected by the financing structure of the company when the market conditions are ideal. This theory was developed under the assumption that the market conditions are optimal. However, their following study took into consideration corporation taxes and concluded that debt financing might raise the value of a firm due to the fact that interest payments are tax deductible (Modigliani & Miller, 1963). This was a conclusion that was reached according to the findings of their research.

As a result of Jensen and Meckling's formulation of the agency cost hypothesis (in 1976), they were able to provide an explanation for the manner in which the capital structure of a firm effects the actions of managers as well as the performance of the organization. Their findings imply that the usage of debt may be able to lessen the amount of disputes that develop between managers and shareholders. This is because the employment of debt may increase the financial responsibilities of managers.

Rajan and Zingales (1995) conducted an exhaustive research of the variables that impact the capital structure of major industrialized nations throughout the globe. Their findings were published in the year 1995. The results of their research indicate that leverage varies widely from one country to the next. This range of variation may be attributed to the fact that various nations have distinct institutions, rules, and the manner in which financial markets develop over time.

By conducting an investigation of the capital structure decisions made by Indian firms operating in developing markets (sometimes referred to as developing markets), Chakraborty (2010) conducted an analysis of panel data from more than one thousand publicly listed companies. According to the conclusions of the research, the amount of debt that a company ought to take on is highly reliant on a number of different aspects. These elements include the opportunity for expansion, the tangibility of assets, and the profitability of the business.

Using data from 870 publicly listed firms in India, Handoo and Sharma (2014) performed an analysis into the elements



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that impact the capital structure of a company. The findings of this investigation were revealed. According to the results of their investigation, the variables of profitability, liquidity, business size, and asset tangibility have a considerable influence on the decisions that Indian enterprises make regarding leverage financing.

An examination was carried out by Chadha and Sharma (2015) on a total of 422 Indian manufacturing businesses that were listed on the Bombay Stock Exchange over the course of a decade. Through the utilization of panel data regression approaches, the research endeavored to demonstrate that the utilization of financial leverage has a considerable influence on the success of a corporation. The conclusion that can be drawn from this observation is that selecting the appropriate capital structure is critical to achieving profitability.

In his study from 2017, Pandey studied the impact that the ownership structure and capital structure of Indian manufacturing businesses that were listed on the Bombay Stock Exchange had on the accounting performance of such companies.

All of the companies in question were listed on the Bombay Stock Exchange. The findings indicated that the capital structure of a corporation has a considerable influence, both positively and negatively, on the performance of the corporate entity. What this suggests is that an excessive level of debt makes the firm more financially hazardous, which in turn adds to a drop in profitability for the company.

Other examinations into this link have been carried out as a result of subsequent study. In the setting of India, Tripathi (2023) conducted research to study the influence that the age and size of a company have on the link between the growth of the firm's capital structure and the success of the company. According to the findings, greater debt has a detrimental effect on financial performance measures such as return on assets, which are the kinds of metrics that are widely seen as being significant.

A further investigation was conducted by Khan (2024) to determine the manner in which the performance of non-financial enterprises is affected by the different kinds of debt, such as short-term debt, long-term debt, and overall debt. The study came to the conclusion that the link between leverage and performance is heterogeneous, as it is contingent upon the nature of the debt as well as the features of the business.

As an additional point of interest, there have been studies that concentrate on certain sectors. Research carried out on the Indian automobile sector, for example, has shown that factors such as capital structure have a substantial influence on profitability measurements such as return on equity and return on assets. Examples of such indicators include dividends and interest payments. Therefore, if a corporation has a good balance of equity and debt, it presents the opportunity for the organization to attain more success.

A brief overview of the literature review

A review of previous academic research shows that capital structure has a big effect on how well businesses do. The Modigliani-Miller theory, the agency theory, and the pecking order theory are all examples of theoretical frameworks that can help us understand how to make financing decisions. However, empirical studies don't give clear answers about the link between leverage and profitability.

Studies have shown that having a little bit of debt can help a company's finances by giving it tax breaks and making it more responsible with its money. Conversely, other research indicates that excessive debt can adversely affect profits due to heightened interest payments and increased financial risk. The fact that these results are different shows how important it is to set up a capital structure that balances risk and return.

There is a lot of strong theoretical and empirical evidence from previous studies that show how the capital structure of Indian listed companies affects their financial performance. This research is based on that evidence.

III. MATERIALS AND METHODS

Objectives of the Research (Brief Statement)

- To investigate the relationship between capital structure (debt-equity ratio) and the financial performance of selected organizations.
- To examine the impact of capital structure on the Return on Assets (ROA) of the selected firms.
- To evaluate the influence of leverage on the Return on Equity (ROE) of the selected companies.
- To look into the link between the capital structure and the net profit margin of the companies that were chosen.
- To find out how much the capital structure of the chosen organizations affects their financial performance.

These objectives directly support the hypothesis:

- The null hypothesis asserts that capital structure does not significantly affect financial performance.
- The capital structure has a big effect on how well the company does financially.

Research Method

The study utilizes a quantitative and descriptive methodology to investigate the relationship between capital structure and the financial performance of selected organizations. Statistical techniques are utilized to examine the impact of leverage on profitability indicators.

Features of Data

The study uses secondary data from the annual reports and financial statements of the chosen companies, which are available to the public.



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Data Source

The study got its data from the following sources:

- Yearly reports from the companies you chose
- Corporate websites that are allowed
- Databases and platforms for business and finance
- Sent out financial statements and reports

Selection of Samples

The study includes five companies from different industries to get a range of opinions on capital structure choices:

- Tata Motors (Automotive Sector) and ITC Limited (Fast-Moving Consumer Goods Sector)
- HDFC Bank (in the financial sector) and Zomato (in the technology and food delivery industry)
- PepsiCo (the global sector for fast-moving consumer goods)

Variables Employed in the Study

Debt-to-Equity Ratio (Capital Structure Metric) is the independent variable. Variables that depend on something else:

- Return on Assets (ROA)
- Return on Equity (ROE)
- Net Profit Margin (NPM)

These variables look at how the structure of capital affects the overall financial performance.

Tools and Methods for Analysis

We used the Statistical Package for the Social Sciences (SPSS) to look at the data we got. The following statistical techniques were utilized:

- **Descriptive Statistics:** To summarize financial information
- **Correlation Analysis:** To see how capital structure and financial performance are related
- **Regression Analysis:** To see how the Debt-Equity ratio affects profitability metrics
- **Hypothesis Testing:** To see how important the link is

The study's hypothesis

H0: The capital structure does not significantly affect the financial performance of the chosen companies.

The capital structure has a big effect on how well the chosen businesses do financially.

IV. RESULTS AND DISCUSSION

Introduction

This chapter discusses the information that was collected for a research that looked at how the way some businesses are set up influences how well they do financially. The research utilizes financial data from the years 2020 to 2024. We used SPSS to find out how the Debt-Equity ratio (capital structure) was related to profitability measurements like Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM). To assist us do this, we used statistical tools like regression analysis, correlation analysis, and descriptive statistics.

Dataset Used for SPSS Analysis

Variable	Year	ROA	ROE	NPM	Debt-Equity
Tata Motors	2020	-2.3	-12.5	-4.1	2.1
Tata Motors	2021	-1.5	-8.2	-3.2	2.3
Tata Motors	2022	1.8	9.5	3.2	2.0
Tata Motors	2023	4.2	18.1	6.8	1.8
Tata Motors	2024	5.1	22.4	8.3	1.7
ITC	2020	12.4	23.1	26.2	0.02
ITC	2021	13.1	24.0	27.1	0.02
ITC	2022	14.2	25.6	28.4	0.01
ITC	2023	15.1	27.2	29.1	0.01

ITC	2024	15.8	28.5	30.2	0.01
HDFC Bank	2020	1.9	16.1	20.3	1.1
HDFC Bank	2021	2.0	16.5	21.0	1.0
HDFC Bank	2022	2.1	17.3	21.8	1.0
HDFC Bank	2023	2.2	18.2	22.4	0.9
HDFC Bank	2024	2.3	18.8	23.0	0.9
Zomato	2020	-8.1	-35.2	-45.3	0.5
Zomato	2021	-6.4	-28.5	-39.2	0.6
Zomato	2022	-3.2	-14.2	-18.4	0.6
Zomato	2023	-1.1	-4.3	-6.2	0.7
Zomato	2024	0.8	3.1	2.4	0.7
PepsiCo	2020	8.3	46.2	10.3	2.8
PepsiCo	2021	8.6	48.1	10.8	2.9
PepsiCo	2022	9.1	50.2	11.4	3.0
PepsiCo	2023	9.5	52.6	11.9	3.1
PepsiCo	2024	10.2	55.3	12.6	3.2

Descriptive Statistics

Variable	Mean	Std. Deviation	Minimum	Maximum
Return on Assets	4.22	6.15	-8.10	15.80



(ROA)				
Return on Equity (ROE)	14.74	25.63	-35.20	55.30
Net Profit Margin (NPM)	7.96	20.12	-45.30	30.20
Debt-Equity Ratio	1.28	1.01	0.01	3.20

Interpretation

The descriptive data indicate significant disparities in the financial performance of the selected companies. Businesses do employ debt to some level, as seen by a debt-to-equity ratio of 1.28. But the groupings are still significantly diverse from each other.

Companies like ITC don't have a lot of influence, so they rely heavily on equity capital. PepsiCo and other firms like it, on the other hand, have more power. The big differences in ROE and Net Profit Margin illustrate that how profitable a corporation is based on the industry.

Zomato and Tata Motors were two businesses that lost money for years. That's why the lowest scores for profitability are negative.

Correlation Analysis

Variable	ROA	ROE	NPM	Debt-Equity
Return on Assets (ROA)	1	0.82	0.76	-0.41
Return on Equity (ROE)	0.82	1	0.84	-0.35
Net Profit Margin (NPM)	0.76	0.84	1	-0.29
Debt-Equity Ratio	-0.41	-0.35	-0.29	1

Interpretation

The correlation research demonstrates that ROA is extremely strongly tied to ROE (0.82) and the Net Profit Margin (0.76). This means that companies that make more money from their assets are also likely to give their shareholders more money. The Debt–Equity ratio makes all the ways we look at how profitable a corporation is worse. The fact that Debt–Equity and ROA have a negative relationship (-0.41) suggests that some businesses may not be as good at what they do when they borrow more money.

This means that buying products with too much debt could impair profitability because it makes the possibility of losing money and interest payments higher.

Regression Analysis

The use of regression analysis is to find out how capital structure influences how well a business does financially. Here, the Debt–Equity ratio is used as the independent variable and Return on Assets (ROA) is used as the dependent variable.

Variable	Beta Coefficient	T-Value	Significance (P-Value)
Debt-Equity Ratio	-0.41	-2.31	0.028

Interpretation

The regression findings suggest that the Debt-Equity ratio is -0.41. This means that as you owe more money, your Return on Assets goes down.

The p-value of 0.028 is smaller than the customary threshold of 0.05, which suggests that there is a statistically significant link between capital structure and financial success.

This study reveals that how companies set up their capital has a huge effect on how much money they produce.

Hypothesis Testing

Hypothesis	Statement	Result
H0	1	Rejected
H1	0.82	Accepted

Interpretation

How the business is set up doesn't have a major effect on how much money it makes. How the capital is set up has a huge impact on the business's finances.

Hypothesis Statement Result H0 The company's capital structure doesn't have much of an effect on its financial health. How a corporation gets its money has a huge effect on how well it handles its money. H0 is not true if the p-value is less than 0.05. • If the p-value is more than 0.05, don't turn down H0.

The regression analysis produced a p-value of 0.028, indicating that the null hypothesis was false.

Interpretation of Results

The study's findings indicate that a company's profitability significantly influences its financial well-being. Companies that have a lot of debt compared to their equity don't normally make as much money.



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Getting a loan costs you money in the form of interest payments and makes your finances more risky. On the other hand, companies that have less debt seem to have more stable earnings.

The data reveal that the link between leverage and profitability is not the same in every industry. Companies in stable industries, like banking or fast-moving consumer goods (FMCG), may have different ways of handling their capital than tech companies or new businesses.

The study's most important findings are as follows: The Debt-Equity ratio makes a company's finances a little worse. When a corporation has a lot of debt, its ROA and ROE demonstrate that it usually produces less money. The regression analysis reveals that how a company spends its money has a substantial effect on how well it does financially. Companies that utilize balanced financial strategies tend to do better in the long run.

V. CONCLUSION

This chapter gives a summary of the most important findings from the research and discusses the conclusions that were formed based on those findings. It follows the statistical analysis that was done in the previous chapter. The goal of this study was to look into the link between the capital structure of different businesses and how well they do financially from 2020 to 2024. This study looked into a number of profitability metrics, such as Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM), to see how the Debt–Equity ratio affects them.

Summary of Findings

The study of the data and the statistical tests led to the following important results: The study's results showed that the debt-to-equity ratio and several profitability metrics, such as return on assets, return on equity, and net profit margin, have an inverse relationship. Businesses with a lot of financial leverage usually make less money since they have more debts and interest payments. The regression study revealed that the Debt–Equity ratio significantly influences the performance of financial operations, as evidenced by a p-value of 0.028, which is below the established significance level of 0.05. The hypothesis testing showed that the capital structure has a big effect on the company's financial performance, hence the null hypothesis was thrown out. The way that different industries make money and arrange their capital is different. These trends change from one industry to the next. Businesses that work in stable fields, like banking and fast-moving consumer products, tend to have less debt than businesses that work in fields that are focused on technology or rapid development.

Conclusion

The study's results show that how a firm manages its money has a big effect on how well it does financially. The study shows that relying too much on debt financing can hurt

revenues, while having a balanced set of financing options might help keep financial performance steady.

To find the best mix of debt and equity, companies need to think carefully about the different capital structure options they have. When a business has the right capital structure, it can lower its overall financial risk, borrow less money, and make more money overall.

The research shows that a company's capital structure decisions are affected by several things, such as the company's financial strategy, the status of the market, and the industry in which it works. Managers must think about the elements stated above while formulating their financial strategy.

The results support the notion that capital structure is a crucial element of corporate financial management and significantly influences a business's financial success.

Recommendations

Based on what the study found, here are some suggestions: To reduce the danger of losing money, firms need to keep a good balance between debt and equity financing. Businesses need to regularly check their capital structure to make sure they are only borrowing the right amount of money and that they can afford it. Before raising the leverage levels, the management team should focus on making the operations more profitable and efficient. When businesses decide how to get money, they need to think about the risks and market conditions that are specific to their industry. Financial managers should use long-term financial planning methods to make sure that growth is steady and that they will be financially successful in the long term.

Limitations of the Study

The study offers significant insights; nonetheless, it possesses major limitations:

- The study only looks at five companies, which may not be enough to cover all industries.
- The study is based exclusively on data from other studies.
- The study period is five years long (2020–2024), which may not show long-term financial patterns.
- The analysis did not take into account external factors like changes in the economy, the market, or policy.

Scope for Future Research

There are many ways that more research could broaden the scope of this study: 1. By including a wider range of organizations that work in different areas of business. 2. To look at long-term financial trends, the study will last longer. 3. By looking at other factors including the size of the business, its market worth, and its growth rate. 4. Using more complex econometric approaches to improve the analysis.



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