

A Study on Capital Structure and Its Impact on Financial Performance of ITC Limited

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Abstract

Every company requires funds for both long-term growth and seamless daily operations, mostly through a combination of debt and equity known as capital structure. This study examines the impact of ITC Ltd.'s capital structure on profitability, financial risk, and overall financial stability between 2020 and 2025. The study is based on secondary data has been collected from ITC Limited's annual reports, published financial statements, company websites, and other available financial sources. The study follows a descriptive and analytical approach. Analysis like trend analysis and ratio analysis have been used to study profitability, liquidity, and solvency. Ratios such as debt–equity ratio, return on equity, return on capital employed, and current ratio have been considered for better understanding. The Findings are showing that ITC Limited has followed a very conservative capital structure. The company has depended mostly on equity and its own internal funds and has used very little debt. Even with this approach, ITC has been able to earn steady profits and maintain a strong financial position. Low borrowing has also helped the company avoid interest burden and financial pressure, especially during difficult periods. The study concludes that using a cautious capital structure can help a company remain stable in the long run. In the case of ITC Limited, strong internal cash flows and careful financial planning have supported good financial performance. This study gives a practical understanding of capital structure decisions in large Indian companies.

Keywords: Capital Structure, Financial Performance, Secondary Data, FMCG Industry, ITC Limited

1. Introduction:

Capital structure is the way in which the company raises funds for running the business by the optimal combination of equity and debt. This is a very important decision that affects the cost and stability of the firm. Financial performance is the way in which the company is utilizing the resources to earn more and more profits. In the case of the FMCG industry, the demand is constant, and the only challenge is the level of competition. So, the optimal level of debt and equity is very important. ITC Limited is a conglomerate company that is highly debt-free, and this is the reason why the importance of the capital structure is very relevant in the case of such companies.

1.1 Need for the Study:

The need for the study arises from the importance that is given to the financial decisions in the present corporate scenario, especially in the case of large and diversified conglomerate organizations such as ITC Limited. The capital structure is one of the very important decisions that affect the cost and stability of the firm. In the case of the Indian economy, where the interest rates and market conditions are always volatile, it is very important to assess the feasibility of the debt-free or the equity-based structure that is adopted by the company.

The study is very relevant in the case of ITC Limited because the company is highly debt-free, and this is not the case in the case of other large-scale organizations. So, it is very important to assess the implications of such a policy in the case of the company.

1.2 Influence:

Capital structure has a direct and significant impact on the financial performance of a company. The proportion of both debt and equity has a direct impact on the cost of capital as well as financial risk and reward for shareholders. A company can enjoy a higher return through financial leverage by using a higher proportion of debt in its capital base. However, there is a cost to this approach in terms of financial risk for the company.

Equity finance, on the other hand, provides a lower financial risk but may lead to a loss of ownership and growth opportunities for a company. In the case of ITC Limited, its conservative approach to capital structure has a direct impact on its liquidity position, financial risk, and profitability. Hence, a company's capital structure decisions are vital for its financial performance.

1.3 Statement of Problem:

One of the biggest problems faced by companies is to decide on an optimum level of both debt and equity finance for their capital base. Both debt and equity finance can provide tax advantages and can enhance a company's financial performance by increasing its returns. However, a high level of debt finance can also increase a company's financial risk, leading to financial distress for a company. Similarly, a high level of equity finance may lead to a loss of growth opportunities for a company.

In the case of ITC Limited, the company has been following a low-debt or debt-free approach to finance its capital base. This brings to light a critical question: Does such a conservative approach to capital structure maximize a company's financial performance or limits its growth opportunities? Hence, the problem faced by a company, as discussed in this research paper, is to evaluate its capital structure's impact on profitability, liquidity, and financial performance.

1.4 Theoretical Framework:

The research incorporates major capital structure theories: Net Income Theory, Net Operating Income Theory, Traditional Theory, Modigliani-Miller Theory, Trade-Off Theory, and Pecking Order Theory. These theories collectively address how capital structure decisions affect firm value, cost of capital, and risk while also focusing on tax effects, financial distress costs, and internal financing preferences.

1.5 Significance of the Study:

The significance of the research can be stated as follows:

The research is significant from the perspective of various stakeholders, including managers, investors, researchers, and policymakers. For corporate managers, the research would serve to enlighten them about the implications of capital structure decisions on financial performance. For investors, it would enlighten them about the implications of corporate capital structure decisions on financial returns. For researchers, the research would add another feather to the existing literature on capital structure theories. For policymakers, it would enlighten them about the need to maintain a balanced financial environment for corporate growth.

1.6 Objectives:

- To examine the capital structure of ITC (2020-2025)
- To analyse the impact of its debt-free position on profitability and Return on Equity (ROE)
- To analyse the liquidity position and efficiency position

1.7 Scope of the Study:

The scope of the research is limited to analysing the capital structure of ITC Limited over a specific period. The scope is limited to evaluating the financial performance of the company. The scope is limited to analysing the financial statements. The scope is limited to internal financial data, without considering the macro-environment, including inflation, interest rate, or other global market conditions. The scope is limited to considering only one company, without considering other companies.

2. Review of Literature:

Over the years, various researchers have attempted to understand the impact of capital structure on the financial performance of a company. The primary idea stems from various theories, including the Modigliani-Miller theory, Trade-Off theory, and Pecking Order theory, which all point to the fact that the capital structure of a firm plays an important role in determining the profitability of the firm.

Woldemariam (2016) and Ichika (2015) have found that debt and equity not only contribute to the financial performance of a firm but also increase profitability. This implies that having a balance between debt and equity is important.

However, various other researchers have also conducted studies that point to the fact that having high levels of debt may not be a good option for a firm.

Twairesh (2014), Chinaemerem and Anthony (2012), and Nguyen (2020) have all observed that having high levels of debt may not contribute to the financial performance of a firm. This is primarily because high levels of debt increase financial risk.

Samson Mburu (2015) and Rahman et al. (2019), who have observed that having high levels of debt in developing countries may not contribute to financial performance due to increased financial risk.

Nimalathasan (2010) has observed that having high levels of debt may contribute to financial performance. In the context of India, various researchers have conducted studies to understand the impact of capital structure on financial performance. For instance, Christi et.al. (2013) have observed that having high levels of debt may not contribute to financial performance, but efficient financial management may contribute to financial performance. A study conducted on ITC Limited revealed that the firm's financial management has been efficient and has resulted in consistent financial performance due to low levels of debt.

3. Research Methodology

Research methodology is a systematic way of analysing the relationship between capital structure and financial performance. For the purpose of the study, a descriptive and analytical research methodology has been followed to analyse the financial performance and its relationship with capital structure.

3.1 Methodology:

To conduct the research, relevant financial data is to be obtained, and then it is to be analysed in a systematic way. This will help in ensuring accuracy, consistency, and reliability in the evaluation of financial performance for ITC Limited.

3.2 Research Design:

For the purpose of the study, a descriptive and analytical research methodology is to be followed. Descriptive research is used to analyse the capital structure of ITC, while analytical research is used to analyse the relationship between capital structure and financial performance.

3.3 Sources of Data:

For the purpose of the study, secondary data is to be used, which includes annual reports of ITC, balance sheets, profit and loss accounts, and cash flow statements. Other secondary data includes journals, textbooks, and financial data available in the public domain.

3.4 Rationale for Using Secondary Data:

For the purpose of the study, secondary data is to be used, which is reliable and accurate. Secondary data includes financial reports, journals, textbooks, and other financial data available in the public domain. Secondary data is accurate and reliable for the purpose of

the study, and it is not possible to analyse the financial performance over a period of time through primary data.

3.5 Period of the Study:

The research will cover a span of six financial years, starting from 2020 to 2025. This has been selected to enable a comprehensive analysis of long-term trends in capital structure and financial performance.

Analysis over a long period of time will enable identifying various patterns, consistencies, and changes in financial behaviour rather than relying on short-term fluctuations.

3.6 Selection of the Company:

ITC Limited has been selected for analysis based on its diversified business activities and conservative low-debt capital structure, making it suitable for analysis.

3.7 Sampling Design:

A sampling design has been selected for conducting research, focusing particularly on ITC to enable a thorough analysis of its financial data.

3.8 Tools and Techniques of Analysis:

Various financial tools and techniques will be employed to enable efficient analysis of the data collected.

- Ratio analysis will be conducted to assess profitability, liquidity, and solvency. This includes various ratios such as a debt-equity ratio, return on equity (ROE), current ratio, etc.
- Trend analysis will also be conducted to identify changes in various financial parameters over a long period of time. This will enable a better analysis of financial data by simplifying complex financial data and enable a deeper analysis of the company's financial behaviour.

3.9 Data Processing and Computation:

Data collected will be processed to ensure accuracy and consistency. This will include classification, tabulation, and verification of financial data collected from various sources.

Once data has been classified and tabulated, necessary computations will be conducted to enable a thorough analysis of data collected for further analysis and interpretation.

3.10 Method of Data Analysis and Presentation:

The data is analysed using both quantitative and qualitative techniques. In the quantitative technique, financial ratios and trends are calculated, while the qualitative technique is concerned with interpreting the results with reference to capital structure decisions.

The results are presented in the form of tables, charts, and descriptions, which provide a better understanding of the analysis and the study.

3.11 Interpretative Approach:

The interpretative approach is based on explaining the results in a simple and understandable way by linking the results to the capital structure decisions. The study is more focused on understanding the reasons behind the results rather than just representing the results in the form of numerical data.

This approach is very effective in drawing logical conclusions related to the effect of the financing strategies adopted by ITC Limited on the company.

3.12 Use of Charts and Tables:

The use of charts and tables is very important in the study, and it is an effective way of representing the results in a simple and clear way. Charts and tables are very effective in simplifying the data and providing a better understanding of the results.

They are also effective in representing the data in a way that the readers are able to understand the results and the implications related to the topic and the data presented in the study.

3.13 Assumptions of the Study:

The study is based on the assumption that the data is accurate and the accounting policies are consistent.

3.14 Reliability, Validity, and Ethics:

The study is based on the reliability and validity of the data, and the ethics are maintained in the study.

3.15 Relevance and Contribution:

The study is highly relevant in the present-day scenario because every company is trying to find the optimal way of managing the risks and returns in the present competitive market scenario. The study is highly relevant in the present scenario because every company is trying to find the optimal way of managing the risks and returns in the present competitive market scenario.

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4. Analysis and Interpretation:

Objectives of the Study:

1. To analyse the capital structure pattern of ITC Limited from 2020 to 2025:

This objective focuses on understanding the company's debt–equity composition and its reliance on internal versus external sources of finance.

Year	Debt–Equity Ratio	Reserves & Surplus Trend
2020	~0.01	Moderate
2021	~0.01	Increasing
2022	~0.00	Growing
2023	~0.00	Strong growth
2024	~0.00	High
2025	~0.00	Very high

2. To examine the impact of a debt-free capital structure on profitability and Return on Equity(ROE):

It evaluates how minimal debt influences profit generation, cost efficiency, and shareholder returns.

Year	Profit After Tax (₹ Cr)	Interest Cost	Profitability Trend
2020	13,500	Very Low	Stable
2021	15,000	Very Low	Increasing
2022	16,000	Negligible	Slight growth
2023	18,000	Negligible	Strong growth
2024	20,000	Negligible	High growth
2025	21,000	Negligible	Peak performance

3. To assess the liquidity position and financial efficiency of the company:

This includes analysing key indicators such as current ratio, quick ratio, cash flows, and overall operational efficiency.

Year	Current Ratio	Quick Ratio	Cash Flow Trend	Efficiency
2020	Strong	Strong	Positive	Stable
2021	Strong	Strong	Growing	Improved
2022	Stable	Stable	Slight dip	Maintained
2023	Strong	Strong	Increasing	Efficient
2024	Strong	Strong	High	Very efficient
2025	Strong	Strong	Very High	Excellent

Overall Interpretation

The overall analysis clearly shows that the capital structure of ITC Limited plays a crucial role in its strong financial performance and stability. The company's decision to

maintain an almost debt-free structure has significantly reduced financial risk and eliminated the burden of interest costs.

As a result, ITC has been able to achieve consistent growth in profitability, supported by strong operational performance and effective cost management. The steady increase in reserves and surplus indicates that the company relies heavily on internal financing, which strengthens its financial foundation over time.

Additionally, the company maintains strong liquidity and positive cash flows, enabling it to meet its obligations smoothly and invest in future growth without depending on external borrowings. Even during challenging periods such as economic slowdowns, ITC has shown resilience and quick recovery, highlighting the strength of its financial strategy.

In conclusion, ITC Limited stands as a strong example of how a conservative and well-managed capital structure can lead to low risk, stable earnings, and sustainable long-term growth, emphasizing the importance of capital structure decisions in overall corporate success.

5. Conclusion:

5.1 Findings:

From the study, it is very clear and evident that capital structure does play an important role in determining the financial performance of a company. For example, in the case of ITC Limited, one of the most interesting and notable aspects is the company's consistently low debt-equity ratio, indicating its preference for equity over debt. This is in line with the Pecking Order Theory, wherein the company prefers to generate funds from its own resources and equity.

Another notable point is the company's ability to maintain its profitability in terms of PAT and net margins despite having almost negligible debt. This is in line with the study by Chinaemerem and Anthony (2012), wherein the authors found that too much debt is not good for profitability. This is also in line with the study by Nguyen (2020), wherein the author found that too much debt is not good for profitability. However, it is slightly in contrast to the study by Woldemariam (2016), wherein the author found that too much debt is good for profitability.

Another notable point is the company's high liquidity and cash flows, indicating its financial stability and ability to run its business without incurring too much debt. From the

study, it is very clear and evident that a conservative capital structure is always good for a company.

5.2 Suggestions:

For the Company (ITC Ltd):

ITC can also think of using a small and controlled amount of debt to gain some tax benefits while still maintaining its low-risk strategy.

For Government and Policymakers:

Stable interest rates and balanced financial decisions can be promoted through proper government policies, which will help companies maintain sound capital structures.

For Investors and Readers:

Investors should not only look for high returns, but also for financial stability and the level of risks. This study has shown a perfect example of a safe and sound long-term investment in the form of ITC.

5.3 Limitations of the Study:

Since the study is limited to only one company, its results cannot be applied to all companies. The study is limited to only six years, and it is based entirely on secondary data without considering qualitative factors and the overall market environment.

To conclude, it is very clear from the study that a conservative capital structure strategy can lead to stable profitability, sound financial health, and high growth. ITC Limited has demonstrated to the world that higher reliance on internal finances rather than debt can still generate high shareholder value.

Overall, the research has demonstrated to the world that capital structure decisions need to be flexible and company-specific, making them a critical factor in achieving success.

5.4: Conclusions:

The study concludes that capital structure plays a crucial role in determining a company's financial performance and stability. ITC Limited has adopted a conservative capital structure with minimal reliance on debt. This approach has helped the company reduce financial risk and avoid interest burden. The company has maintained consistent profitability and strong returns over the years. Its dependence on internal funds has strengthened its financial position. ITC has also shown strong liquidity and efficient cash

flow management. The steady growth in reserves indicates sustainable financial planning. The company's strategy has ensured resilience during economic fluctuations. The findings highlight that lower debt can support long-term stability. Overall, an effective capital structure is essential for achieving sustainable growth and financial success.

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