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# Analysing the influence of ITC Ltd.'s Capital Structure on Financial Performance: A Comparative Study

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**ABSTRACT:** The project titled “Analysing the influence of ITC Ltd.'s Capital Structure on Financial Performance: A Comparative Study” deals with the capital structure of a company which plays a pivotal role in shaping its financial performance and overall strategic positioning. This study aims to analyse the influence of ITC Ltd.'s capital structure on its financial performance through a comparative lens. By examining various financial metrics such as profitability, liquidity, solvency, and efficiency, this research seeks to elucidate the relationship between ITC Ltd.'s capital structure decisions and its performance in comparison to industry peers or benchmarks. Through a comprehensive analysis, this study aims to provide insights into how ITC Ltd.'s capital structure choices impact its financial health and competitive advantage in the market. Such findings can be invaluable for stakeholders, investors, and managers in understanding the dynamics of capital structure management and its implications for sustainable growth and value creation.

The tools used for the data analysis are Net income theory, Net operating income theory , Traditional theory and Financial leverage to analyse the risk by using last 3 years balance sheet and profit and loss account of ITC Ltd.'s which is extracted from its official website .

## I. NEED OF THE STUDY

The influence of a company's capital structure on its financial performance is a crucial aspect of financial analysis. By comparing ITC Ltd.'s capital structure with that of its competitors, you can gain insights into how its financial decisions impact its performance relative to others in the industry. This comparative analysis can help identify strengths, weaknesses, opportunities, and threats related to ITC Ltd.'s capital structure, which can inform strategic decision-making and improve overall financial performance. To conduct this study effectively, you would need access to financial data of ITC Ltd and its competitors, as well as a thorough understanding of financial analysis techniques and industry benchmarks.

## II. RESEARCH GAP

On the basis of literature reviewed, there is a gap in understanding how various factors impact capital structure and how firms maintain it. This study will bridge the gap by examining the relationship between capital structure and financial performance, offering insights into effective capital structure management methods.

Firm- specific analysis for ITC Ltd:

Existing literature lacks a detailed examination of ITC Ltd.'s capital structure and its impact on financial performance.

ITC's diversified business model presents a unique case to study the differential impact of capital structure across various segments.

Comparative Analysis with similar firms:

Comparative studies involving ITC Ltd. and its peers in the FMCG sector or other segments it operates in are limited.

Understanding how ITC's capital structure compares to and affects its performance relative to competitors can provide valuable insights.

Temporal Changes and strategic shifts:

Research focusing on how ITC Ltd.'s capital structure decisions have evolved over time and their long-term effects on performance is lacking.

Strategic shifts, such as changes in debt levels or equity financing in response to market conditions, remain underexplored.

Context of emerging Markets:

Most existing studies are based on developed markets, and the findings may not be directly applicable to emerging markets like India.

Specific factors affecting capital structure decisions in emerging markets, such as regulatory environments, market volatility, and access to capital, need further investigation.

### III. HYPOTHESIS OF THE STUDY

Null Hypothesis (H<sub>0</sub>): There is no significant influence of ITC Ltd.'s capital structure on its financial performance.

Alternative Hypothesis (H<sub>1</sub>): There is a significant influence of ITC Ltd.'s capital structure on its financial performance.

### IV. OBJECTIVES OF STUDY

1. To know the importance of capital structure in the development of the firms
2. To analyze how the capital structure get impacted with other factors of the firms
3. To know what are the methods to maintain or retain the capital structure of the firms

### V. SCOPE OF THE STUDY

The scope of the study involves examining how ITC Ltd.'s capital structure influences its financial performance. It will assess the significance of capital structure for firm development, analyze its interaction with other factors, and explore strategies for maintaining optimal capital structure. The focus is on comparative analysis and practical implications for ITC Ltd. The scope of the study on analysing the influence of ITC Ltd.'s capital structure on financial performance through a comparative study would typically involve examining various aspects such as:

1. Analysing ITC Ltd.'s current capital structure, including its debt-to-equity ratio, leverage ratios, and other financial metrics.
2. Comparing ITC Ltd.'s capital structure with that of its competitors or industry peers to identify any trends or differences.
3. Assessing the impact of ITC Ltd.'s capital structure on its financial performance indicators such as profitability, liquidity, solvency, and efficiency.
4. Investigating how changes in ITC Ltd.'s capital structure over time have affected its financial performance.
5. Identifying factors that may influence ITC Ltd.'s capital structure decisions and how these decisions impact the company's overall financial health.
6. Drawing conclusions and providing recommendations based on the findings of the study to help improve ITC Ltd.'s financial performance through optimal capital structure management.

This study would involve in-depth financial analysis, comparative analysis, and possibly statistical analysis to draw meaningful conclusions about the relationship between ITC Ltd.'s capital structure and its financial performance.

### VI. RESEARCH METHODOLOGY AND DATA COLLECTION

#### a) Data Collection Method

##### Secondary data

- Secondary data annual reports, financial statements, industry reports, and databases such as Bloomberg and Capital IQ.
- Period of study: 2021-2023 to capture long-term trends and strategic shifts.

##### Tools for Data Collection

- Financial Statements: The primary source of data for analysing the capital structure and financial performance of ITC Ltd. would be its financial statements, including the balance sheet, income statement, and cash flow statement. These documents provide information on the company's assets, liabilities, revenues, expenses, and cash flows, which are essential for assessing its capital structure and financial health.
- Annual Reports: ITC Ltd.'s annual reports contain detailed information about its financial performance, strategic initiatives, capital structure decisions, and future outlook. Analysing these reports can provide valuable insights into the company's capital structure dynamics and its impact on financial performance over time.

#### b) Data Analysis Plan

- c) Net income theory
- d) Net operating income theory
- e) Traditional theory

- f) EBIT – EPS Analysis
- g) Financial leverage to analyse the risk

## VII. LIMITATIONS OF THE STUDY

1. The study may be limited by the timeframe within which the analysis is conducted.
2. The findings of the study may be specific to ITC Ltd. and may not be generalizable to other firms or industries.
3. The analysis may be influenced by external factors beyond the control of ITC Ltd., such as changes in economic conditions, regulatory environment, industry dynamics, and market trends.

The most important decision a company makes in pursuit of maximizing its value is typically the decision concerning what products to manufacture and/or what services to offer. The decision on how to finance investments (e.g., in factories and equipment), the so-called capital structure decision, is often seen as less important, even secondary. As we will see in this reading, the importance of the capital structure decision depends on the assumptions one makes about capital markets and the agents operating in it.

Under the most restrictive set of assumptions, the capital structure decision—the choice between how much debt and how much equity a company uses in financing its investments—is irrelevant. That is, any level of debt is as good as any other. The capital structure decision is not only secondary but also irrelevant. However, as some of the underlying assumptions are relaxed, the choice of how much debt to have in the capital structure becomes meaningful. Under a particular set of assumptions, it is even possible to have an optimal level of debt in the capital structure—that is, a level of debt at which company value is maximized.

### Capital structure

Combination of various component of capital is called capital structure. The overall cost of capital may reduce as the proportion of debt increases in the capital structure because cost of debt is less than cost of equity, while on the other hand risk of the firm increases with the increase in the fixed contractual obligation, which again increases the weighted average cost of capital. The firm may use only equity, or only debt, or a combination of equity +debt, or a combination of equity + debt + preference shares or may use other similar combinations to form capital structure.

### Types of Capital Structure

The meaning of Capital structure can be described as the arrangement of capital by using different sources of long term funds which consists of two broad types, equity and debt. The different types of funds that are raised by a firm include preference shares, equity shares, retained earnings, long-term loans etc. These funds are raised for running the business.

### Equity Capital

Equity capital is the money owned by the shareholders or owners. It consists of two different types

- a) Retained earnings: Retained earnings are part of the profit that has been kept separately by the organisation and which will help in strengthening the business.
- b) Contributed Capital: Contributed capital is the amount of money which the company owners have invested at the time of opening the company or received from shareholders as a price for ownership of the company.

### Debt Capital

Debt capital is referred to as the borrowed money that is utilised in business. There are different forms of debt capital:

- a) Long Term Bonds: These types of bonds are considered the safest of the debts as they have an extended repayment period, and only interest needs to be repaid while the principal needs to be paid at maturity.
- b) Short Term Commercial Paper: This is a type of short term debt instrument that is used by companies to raise capital for a short period of time

### Optimal Capital Structure

Optimal capital structure is referred to as the perfect mix of debt and equity financing that helps in maximising the value of a company in the market while at the same time minimises its cost of capital.

Capital structure varies across industries. For a company involved in mining or petroleum and oil extraction, a high debt ratio is not suitable, but some industries like insurance or banking have a high amount of debt as part of their capital structure.

### Importance of Capital Structure

Capital structure is vital for a firm as it determines the overall stability of a firm. Here are some of the other factors that highlight the importance of capital structure

1. A firm having a sound capital structure has a higher chance of increasing the market price of the shares and securities that it possesses. It will lead to a higher valuation in the market.
2. A good capital structure ensures that the available funds are used effectively. It prevents over or under capitalisation.
3. It helps the company in increasing its profits in the form of higher returns to stakeholders.
4. A proper capital structure helps in maximising shareholder's capital while minimising the overall cost of the capital.
5. A good capital structure provides firms with the flexibility of increasing or decreasing the debt capital as per the situation.

### Features of an appropriate capital structure

Every firm wants to have an appropriate capital structure. Each firm strives to have that level of debt-equity proportion which helps to maximize the market value of share and minimize the cost of capital. Following are the features of an appropriate capital structure

- 1) Profitability: A sound capital structure can allow for the most effective use of leverage at the lowest possible expense in order to improve performance and thereby maximise earnings per share.
- 2) Flexible: A financial manager should be able to modify the firm's capital structure with a minimal expense if required. It should therefore be necessary for the company to supply funding whenever required to support its productive operations.
- 3) Solvency: Excessive debt jeopardizes the company's solvency and credit scores. Debt financing can be limited to the degree that it can be properly repaid.
- 4) Conservatism: A company's debt capability can never be exceeded to the extent that it becomes difficult to service its debt. Both the interest and the principal balance must be paid on the debt. Future cash flows are expected to make these payments. Cash insolvency will lead to legal insolvency if potential cash flows are inadequate.
- 5) Control: The capital structure should not be changed so much that it leads to loss of control in the company. The proportion of debt and equity thus be kept in such a manner that there is no loss of control

## VIII. FINDINGS

1. We can see that as the amount of debt financing increases the capital mix the WACC i.e. overall cost of capital ( $K_o$ ) is reducing. More debt is cheaper because of the ability to deduct interest and lower taxes.
2. Thus, the maximum value under the net income approach is with 100% debt financing.
3. Increase in the EBIT and value of the firm which has direct relationship with the capital structure and there is also increase in the financial performance with increase in the EBIT.
4. Under NOI approach the company seeks financing that is the easiest and quickest to secure. Hence there is a constant cost of equity. Increase in debt will increase the risk perception of equity shareholders resulting in an increase in cost of equity ( $K_e$ ).

## IX. SUGGESTION

- The company should take suitable steps to improve its financial performance. It should apply tools, techniques and new technologies to increase its profitability.
- The firm should attain the optimal Capital structure to maximize the value of company and wealth of its shareholders by issuing required Debentures or Shares.
- The Long-Term Borrowing is nil in the financial statements which shows there is no tax leverage. Hence the company should take the advantage of tax leverage.

## X. CONCLUSION

The company's overall position is at a good position. Particularly the current year's position is well due to a raise in the profit than the previous year. It's better for the organization to diversify the funds to different sectors in the present market scenario. ITC Ltd is showing fluctuations in its profitability position in the past few years, which is concluded with the financial statement analysis.

The analysis of capital structure highlighted that the company's operating performance is in efficient manner and the sales during the study period shows increasing trend and it is expected sales can increase in forthcoming years. The study reveals that the financial performance of ITC Ltd is in satisfactory position. The study concluded that ITC Ltd.'s capital structure shows that maximum finance is raised through its owner's capital and the contribution of debt is reduced over the years. It is suggested that it can increase its debt finance in capital structure to take the advantage of financial leverage.

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