A Study on Capital Structure and Its Impact on the Financial Performance of Companies at Maruti Suzuki, Nagpur

Anuradha Shankar Bansod, Prof. Pratiksha Meshram*
*(Assistant Professor)
Department of MBA, Tulsiramji Gaikwad-Patil College of Engineering & Technology, Nagpur

Abstract— **Capital structure is an elemental element of financial management, which identifies how a business finances its entire operations and expansion, with the use of various sources of funds. This research study aims at examining the implications of the capital structure on the financial performance of Maruti Suzuki as an area of particular concern to business consideration in Nagpur. The study investigates the impact of the debt equity ratio on financial ratios like profitability, liquidity and solvency.**

The available secondary data is based on financial reports and ratio analysis is employed as the main tool of analysis in the study. It brings out the correlation between financial leverage and performance of the company during a given period. The results imply that moderate and conservative capital structure plays a positive role in the financial stability and efficiency of operations. The paper arrives at the conclusion that sustainability of financial performance in the long-run without the risk of excessively relying on a single source of financing requires the optimal combination of both sources of funding.

Keywords: **Capital Structure, Financial Performance, Debt-Equity Ratio, Profitability, Financial Stability.**

I. INTRODUCTION

Financial decision-making is an important part of success and sustainability of a business in the contemporary business world. Among the most crucial financial choices are those linked with choosing the right capital structure. Capital structure is the mix of debt and equity to which a company has propelled its working capital and investment activities. This decision of these sources of finance directly influences the cost of capital, level of risk and the profitability of the firm at large.

Capital structure is well formulated to ensure that the company attains a balance between the risk and the yield. High debt could lead to more financial risk because of fixed interests requirements whereas too much equity financing can dilute ownership and decrease returns to shareholders. Thus, companies strive to ensure an optimum capital structure that will reduce the cost of capital and maximize the wealth of the shareholders.

Maruti Suzuki, one of the best car manufacturing companies in India, is an interesting case to undertake analyzing decisions in capital structure. The firm has a long-time conservative financial policy that relied on minimal reliance on external debt. This has made it achieve good liquidity and financial stability; even in the times of economic uncertainty. The fact that Maruti Suzuki had its presence and presence in the market in locations like Nagpur also represents the significance of Maruti Suzuki in the Indian automotive market.

This study aims at analyzing the effect of capital structure on the financial performance of Maruti Suzuki. The analysis of financial ratios and trends will attempt to determine whether financing decisions made by the company make it profitable and efficient. The study will also give an understanding on how organisations can manage their capital structure in a strategic manner to attain sustainable growth and development in the long-term.

II. LITERATURE REVIEW

The capital structure concept has been one of the major subjects of discussion in financial management and corporate finance over a number of decades. It mainly revolves around the selection of firms that adopt various sources of financing and their effects on the overall performance of the firms and their market worth. The relationship between capital structure and financial performance has been explained in different theories and empirical researches and provided both theoretical and practical understanding.

The capital structure theory had its initial foundation in the writings of Modigliani and Miller who postulated firstly that capital structure does not affect the value of a firm in a perfectly competitive market. Their proposal eliminates taxes, transaction costs and the danger of bankruptcy and therefore, the way in which a company finances itself does not influence its aggregate value. However, in real life these assumptions are not made. The later modifications to the theory put in place a component of corporate tax, and it demonstrates that the debt finance is tax-favoured, and it can increase the value of the company.

Building up on this, the Trade-Off Theory suggests that firms shall seek to achieve their objective to achieve ideal capital structure by exploiting the benefits of debt, including tax shields, over the costs of financial distress and bankruptcy. According to this theory moderate rates of debts may cause a rise in firm value, whereas excessive leverage may result in an increased potential of becoming a bankrupt company and thus with negative financial performance.

The other notable school of thought is the Pecking Order Theory which offers precedence in the decision regarding financing. It means that businesses would select local sources of funds, such as retained earnings, instead of external sources. During the necessity to have external financing, companies prefer to use debt instead of equity because of the reduction of information asymmetry and the cost factor. Equity is usually the last option because it can be interpreted as an indication of underpricing to the market and dilution of ownership.

The Agency cost Theory points out that tension of conflict of interest exists between the stakeholders i.e. between the shareholders and the debt holders. The costs associated with agency might be encountered when the level of debt is high as it is possible that the managers are encouraged to take actions that would benefit shareholders and harm the creditors. This may have an impact on the financial stability and performance of the firm.

Empirical investigation has produced inconclusive results over the relationship between capital structure and financial performance. Other scholars have observed a positive correlation meaning that leverage is capable of increasing profitability by utilizing resources and tax benefits effectively. Other people have observed negative relationship meaning that high level of debt increases financial risk and low profitability. As it has been applied in the automobile industry, the capital structure in firms would make the companies to have better performances due to stable cash flows and controlled exposures of risks.

Overall, it is stated in the literature that there is no optimal capital structure which would apply to every firm although firms ought to pay a lot of attention to their financial policies based on the internal and external market factors. The case of Maruti Suzuki provides a good illustration of how the conservative financing policy may be used in supporting the performance of the financial performance.

III. RESEARCH METHODOLOGY

Research methodology provides a scientific framework of undertaking the research and assists in guaranteeing that the goals are achieved in a logical and respectable manner. This research is descriptive and analytical in research design in an attempt to examine the research problem in the form of how capital structure influences the financial performance of Maruti Suzuki.

The descriptive component of the study targets on the understanding of the existing capital structure and financial performance of the business as compared to the analytical component of the study that determines the relationship of the two variables relative to the financial data. The research is largely based on secondary data, collected with the help of credible and reliable sources such as annual reports, financial reports, company publications, as well as other financial sources.

The time frame in the research paper has been selected to analyze the trend and pattern in capital structure and financial performance. Important tools of analysis have been employed such as debt-equity ratio, return on equity, net profit margin and current ratio using financial ratios. These indicators will help in determining financial strength, profitability and liquidity position of the company.
The organized and analyzed data obtained have been done through the comparison analysis

techniques. The paper has also discussed the trend in the financial ratios to find out whether the changes in the capital structure have influenced the performance of the company as years have progressed. The analysis will be objective in terms of achieving research objectives, which will be done through the methodology.

Hypotheses of the Study 3.1.
The hypotheses directing the study are the following:

Null Hypothesis (H_0):
There is not a significant correlation between the capital structure and financial performance of Maruti Suzuki.

Alternative Hypothesis (H_1):
Capital structure has a great correlation with the financial performance of Maruti Suzuki.

Testing of these hypotheses involves the financial ratios and the trends that have been observed. The hypotheses get accepted or disapproved based on the data that is gathered in the study and analyzed.

The first one is the Modigliani and Miller approach that describes the irrelevance of capital structure in the ideal conditions. However, capital structure decisions are highly effective in the real-life settings of taxes and financial distress costs.
One of the major theoretical bases of the current study is the Trade-Off Theory that explains how firms balance the advantages and disadvantages of debt. It is useful to support the idea that debt optimum can enhance the financial performance.
The Pecking Order Theory is equally significant as it is adopted to explain why internal financing is superior which is a conservative financial approach by the Maruti Suzuki. This theoretical perspective can be seen in the fact that the firm relies on retain funds as opposed to borrowing.

IV. MARUTI SUZUKI COMPANY PROFILE

Maruti Suzuki India Limited is the most trustworthy and largest company that deals with the manufacturing of automobiles in India. Incorporated in 1981, it is a joint venture between Suzuki Motor Corporation of Japan and the Government of India and has helped in reshaping the Indian passenger car industry.
With its headquarters in New Delhi, Maruti Suzuki is famously renowned in the making of low priced, fuel saving and reliable vehicles. The company has also managed through the years to develop a good brand image and has had a vast network of distribution and services network within the country. It has also dominated the key markets such as Nagpur, which is a large market in terms of vehicle selling, service and communicating with the customers.

The company has very diverse car models: hatchback, sedan, SUV, utility vehicles that are arranged to accommodate different classes of customers. Its best selling models have sustained an impressive demand in the market, which has translated to the stable income-generation of the company.
Financially, Maruti Suzuki has been in a good and sound position. The conservative capital structure with a low reliance on external debt and increased reliance on equity and retained earnings is one of the major features of the company. This will minimize the financial risk and enhance liquidity and the company will be in position to absorb the impacts of economic variable.
The product has assisted the company to expand and profit in the long term because it has continuously focused on the cost- efficiency, innovation and customer satisfaction. It has sustainable business practices in its monetary policy and is therefore an ideal one to examine how capital structure influences the financial performance.

V. CONCEPTUAL FRAMEWORK OF THE STUDY

The conceptual framework of the study provides an ordered information of the effect of capital structure on the financial performance of an organization. It defines the relationship between independent and dependent variables and the direction within which the variables interact. In this study, the independent variable is the capital structure that takes into consideration the factors such as the ratio of debt and equity, the debt-equity ratio and the financial leverage.

These are the determinants of the way business is financed by a company. In its turn, financial performance is regarded as the dependent one. It is measured in terms of such criteria as profitability (return on equity, net profit margin), the liquidity (current ratio) and stability of the finances, in general.

The model assumes that the capital structure does influence the financial performance directly. One such case is that an increase in the market value of the debt, due to tax advantages, can create an increase in returns, and also it can create an increase in financial risk. On the other hand, equity may increase the risk but decrease the returns since leverage benefits are not enjoyed.

The framework hence establishes a cause and effect relationship, in which financial performance is determined by decisions in capital structure. It is also conscious of other externalities such as market conditions, cost of capital and management strategies, which can bear an indirect relationship in this relationship.

VI. DATA ANALYTICS AND RESULTS

The financial data analysis is important in the determination of the effect of capital structure on the financial performance of Maruti Suzuki India Limited. This part will provide an analysis of major financial ratios within a chosen period to find out the tre nd and correlation of capital structure and performance.

Ratio analysis is the main tool of analysis used in the study. The chosen indicators are the Debt-Equity Ratio, Return on Equity (ROE), Net Profit Margin, and Current Ratio. All these factors are an indication of the financial leverage, profitability and liquidity position of the company.

Table 6.1: Financial Ratio Analysis

Year	Debt-Equity Ratio	ROE (%)	Net Profit Margin (%)	Current Ratio
2021	0.05	12	8	1.8
2022	0.04	14	9	2.0
2023	0.03	16	10	2.2

Diagram 6.1: Capital Structure Composition (2023)

Equity Financing: 97%
Debt Financing: 3%

(Visual Interpretation: Equity takes up the majority of the pie, with a very small section of the pie being debt.) Elaborate Analysis and Interpretation.

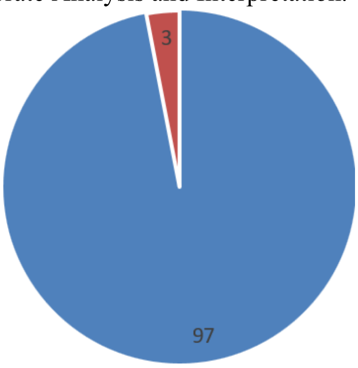

Fig 6.1Capital Structure Composition (2023)

The statistics show clearly that the company has a very low debt-equity ratio, which has been decreasing since 0.05 in 2021 to 0.03 in 2023. This is an indication of high equity financing and internal funding preference as compared to external. Theoretically, this is in line with the Pecking Order Theory where companies focus on internal sources of funds to save the cost and risks of using debt.

Meanwhile, Return on Equity (ROE) indicates a steady growth of 12-16% in the three years. This gain implies that the firm is utilizing the funds of shareholders in the most efficient way possible in order to make profits. Interestingly, although the financial leverage is low, the profitability is increasing, which shows that the operational efficiency and control over costs are more important drivers of returns than leverage.

There is also an upward trend in the Net Profit Margin which has been on the rise and stands at 8 to 10%. It is an indication of a better cost control, better pricing strategies, and general operational effectiveness. It also supports the argument that a company is not always in need of high debt levels to promote higher profitability.

The Liquidity ratio (Current Ratio) changes to 2.2, an improvement over 1.8. This implies that the company is very capable of settling its short-term debts. Liquidity is high and lowers financial risk and increases stability of the company especially during uncertain economic times.

The pie chart presentation shows that the equity has been the most significant in the capital structure and they take up about 97 percent of the total financing. The percentage of debt is very low, approximately 3. This arrangement will have little interest to pay and less chance of financial distress. Nevertheless, the Trade-Off Theory suggests that this amount of debt can also be used to indicate that the company is not capitalizing on the tax benefits of borrowing.

On the whole, the findings indicate that there is a positive correlation between a conservative capital structure and financial performance. Low debt policy has also helped it achieve a stable profitability, good liquidity and a lower financial risk. Nonetheless, the capital structure could also be optimized and a moderate leverage could be introduced in order to maximize returns without much risk.

VII. FINDINGS AND DISCUSSION

To provide some critical points that could be correlated with the existing financial theories, the Capital structure and financial performance of Maruti Suzuki India Limited have been analyzed.

One of the most significant findings is that the company has a very low debt-equity ratio that implies that the company does not rely heavily on the external loan. This is a conservative financial practice that is under the Pecking Order Theory. According to this theory, companies will rely on internal companies financing logistics such as retained earnings as opposed to borrowing and equity financing. This technique is possible because of high internal cash flows of Maruti Suzuki.

The other important observation is that the profitability indicators, including the net profit margin and the return on equity have been steadily improving. Low financial leverage has helped the company to accumulate good returns. It happens to be one of the issues with the traditional intuition of the Trade-Off Theory that higher levels of debt lead to higher levels of profitability due to tax benefits. In its place, it insinuates that profitability can also be fuelled by effective operational management and cost management.

Another conclusion reached in the paper is that liquidity levels are large and stable and this helps to reduce financial risks. The leverage of debt is an issue according to the Agency Cost Theory, the lower the level of debt, the better the avoidance of the conflicts between the shareholder and the creditors. This results in easier decision making and increase in financial discipline in the organization.

Furthermore, with respect to the findings, it is indicated that, the company does not assume excessive debt but the firm may be failing to capitalize on the benefits of financial leverage. The theory proposes that debt can be used to increase the value of the firms using the Modigliani and Miller Theory (with taxes) in view of the fact that the debt is tax-shielded. However, Maruti Suzuki does not appear to be as high growth oriented as using leverage.
Generally speaking, this discussion has shown that the company has defined its capital structure strategy in such a way that capital structure in the long term is being aligned with profit maximization at the short-term level. Its good financial performance has been achieved due to the low risk and consistent returns balance.

VIII. PROSPECTIVE OF THE RESEARCH

The current research is restricted to one company and uses secondary data as the main source of information. As such, there is much space in the future research on the area of study.

Nevertheless, future studies have the potential to add to the study by using a number of corporations of the automobile sector to provide a certain scale of comparative interpretation of capital structure practices. This would help in determining the trends and best practice in the industry.
In addition, to collecting primary data, researchers can use other methods of gathering data including interviewing financial managers and executives, to understand the decision making process concerning capital structure.

Secondly, the use of the advanced statistical tools, i.e., the regression analysis and the correlation techniques can be used to give more specific and quantitative evidence of the correlation between the capital structure and the financial performance.
Another direction that could be chosen as research in the future is the comparison of the external factors such as economic conditions, changes in

interest rates, and governmental policies, which may impact the decision of the capital structure. This would give the analysis a more comprehensive and dynamic aspect.

IX. RECOMMENDATIONS

As per the results and theoretical knowledge, it is possible to give a number of recommendations concerning the improvement of capital structure decisions.

To start with, companies should endeavor to maintain the optimal debt equity ratio. The Trade-Off Theory suggests a tax benefit is maximized when moderate debt is used and hence even though a conservative strategy may protect against financial risk, leverage could maximize returns.
Second, firms should periodically calculate their cost of capital in order to make financing decisions in a cost effective manner. Wage financial planning can be implemented well, which can make use of cutting costs and maximizing the shareholder value.

Thirdly, the dynamic financial approach should be adopted, and it will be capable of adapting to the changes in the market. The growth prospects are hampered by extreme adherence to one approach of funding.
Secondly, the companies are advised to improve their internal financial management systems to ensure that the retained earnings are put into good use. However, the necessity to finance externally can be reduced with the help of effective allocation of domestic funds.

Finally, a good liquidity position should be the permanent agenda as it will offer the company the stability to keep on with its operations besides it will also offer investor confidence.

X. CONCLUSION

Capital structure is an important element that determines financial performance and sustainability of a firm. In this paper, the relationship between capital structure and financial performance was observed concerning Maruti Suzuki India Limited and determined that the conservative system of financing has been positively related to this financial stability of the organization.
The studies forwarded come to the conclusion that capital structure has a strong connection to financial performance and thus instances the alternative hypothesis. The fact the company relies on internal sources and very little on debt is in compliance with the Pecking Order Theory, and the stress on stability can be regarded as a security-conscious method of the Trade-Off Theory.
Low leverage is applied to reduce financial risk but it might also economize potential advantages of debt financing. Companies should therefore take the time to consider their financing decisions in order to attain the best capital structure.

To sum up, the management of capital structure must find a balance between risk and returns. A good financial plan is the sure method of maximizing profits along with attaining long term expansion and sustainability in a competitive business world.

REFERENCES

[1] Brealey, R. A., Myers, S. C., & Allen, F. (2020). *Principles of Corporate Finance* (13th ed.). McGraw-Hill Education.
[2] Brigham, E. F., & Houston, J. F. (2019). *Fundamentals of Financial Management* (15th ed.). Cengage Learning.
[3] Pandey, I. M. (2018). *Financial Management* (11th ed.). Vikas Publishing House.
[4] Khan, M. Y., & Jain, P. K. (2017). *Financial Management: Text, Problems and Cases* (7th ed.). McGraw-Hill Education.
[5] Modigliani, F., & Miller, M. H. (1958). The cost of capital, corporation finance and the theory of investment. *American Economic Review*, 48(3), 261–297.
[6] Modigliani, F., & Miller, M. H. (1963). Corporate income taxes and the cost of capital. *American Economic Review*, 53(3), 433– 443.
[7] Myers, S. C. (1984). The capital structure puzzle. *Journal of Finance*, 39(3), 575–592.
[8] Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions. *Journal of Financial Economics*, 13(2), 187– 221.
[9] Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior and agency costs. *Journal of Financial Economics*, 3(4), 305–360.
[10] Titman, S., & Wessels, R. (1988). The determinants of capital structure choice. *Journal of Finance*, 43(1), 1–19.

[11] Rajan, R. G., & Zingales, L. (1995). What do we know about capital structure? *Journal of Finance*, 50(5), 1421–1460.
[12] Frank, M. Z., & Goyal, V. K. (2009). Capital structure decisions: Which factors are reliably important? *Financial Management*, 38(1), 1–37.
[13] Bhaduri, S. N. (2002). Determinants of capital structure choice: A study of the Indian corporate sector. *Applied Financial Economics*, 12(9), 655–665.
[14] Chakraborty, I. (2010). Capital structure in an emerging stock market. *Research in International Business and Finance*, 24(3), 295–314.
[15] Zeitun, R., & Tian, G. G. (2007). Capital structure and corporate performance. *Australasian Accounting Business and Finance Journal*, 1(4), 40–61.
[16] Maruti Suzuki India Limited. (2021–2023). *Annual Reports*. Retrieved from official company website.