International Journal for Innovative Engineering and Management Research
PEER REVIEWED OPEN ACCESS INTERNATIONAL JOURNAL
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A STUDY ON FINANCIAL LEVERAGE ON ROE AT TATA MOTERS, HYDERABAD

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ABSTRACT

This study analyses Tata Motors' capital structure dynamics and the impact of its financial leverage strategies on return on equity (ROE) from FY2020 to FY2024. By examining secondary data from annual financial statements, key metrics like debt–equity ratio, ROE, and return on assets were assessed to identify trends. The findings show that Tata Motors reduced long-term borrowings while maintaining stable equity levels, leading to a decrease in leverage and a significant improvement in ROE, from –40% in FY2020 to +26% in FY2024. The study highlights the effectiveness of deleveraging in capital-intensive industries and offers practical recommendations for finance managers, with implications for strategic leverage management to enhance shareholder value.

Key words: capital structure, financial leverage, return on equity.

INTRODUCTION

This study explores the impact of financial leverage on return on equity (ROE) and its role in shaping corporate capital structure decisions. Financial leverage, defined as the use of borrowed funds relative to equity, can amplify shareholder returns when returns on assets exceed borrowing costs. However, it also introduces fixed obligations, increasing exposure to earnings volatility and financial distress risk. In capital-intensive industries, companies face a trade-off between equity and debt financing, each with its own advantages and risks. Properly managed, leverage can reduce the weighted average cost of capital (WACC) and enhance ROE, but excessive borrowing can erode shareholder value. The study investigates the relationship between leverage and ROE, considering factors like operating leverage, macroeconomic conditions, and strategic corporate initiatives. It aims to provide insights for managers on balancing leverage to optimize shareholder returns while managing risks, contributing both to capital structure theory and practical corporate finance decision-making.

FINANCIAL LEVERAGE

Financial leverage involves using borrowed funds to enhance potential returns for equity shareholders, allowing firms to undertake larger projects than equity alone would permit. When the returns from debt-funded investments exceed borrowing costs, leverage can boost earnings. Common in capital-intensive industries like automotive, it helps expand operations without immediate equity dilution. However, it also increases financial risk, particularly the risk of insolvency if returns are insufficient to cover fixed debt obligations. Additionally, higher leverage raises income volatility and makes ROE more sensitive to changes in operating income

REVIEW OF LITERATURE

1. **Guo (2024)** had analyzed how corporate carbon emission governance affected firms' financial leverage decisions. Using global firm-level data on carbon management practices and leverage ratios, they employed instrumental variable regression to address endogeneity. The study demonstrated that firms with robust carbon governance frameworks maintained lower leverage, reallocating capital toward sustainable investments rather than debt financing. These findings indicated that environmental governance considerations were becoming integral to capital structure choices in the decarbonization era.
2. **Kanoujiya (2023)** had examined how leverage affected the valuation of non-financial firms in India under the moderating effect of profitability, employing quantile regression techniques on firm-level data measured via Tobin's Q. Results indicated that leverage's impact on valuation varied across quantiles: for highly valued firms, additional debt boosted Q, whereas for lower-valued firms, leverage depressed valuation; profitability further moderated these relationships, with high-profit firms benefiting more from leverage.
3. **Li (2022)** had examined how intermediary leverage influenced monetary policy transmission in European economies. Using bank-level balance sheet data and macroeconomic indicators within panel Vector Error Correction Models (VECM), the research revealed that higher bank leverage amplified the pass-through of policy rate changes to lending rates, affecting credit supply; however, excessive intermediary leverage weakened transmission by increasing financial fragility, indicating non-linear policy efficacy effects.

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NEED AND IMPORTANCE

This study was essential due to the growing importance of capital structure decisions in shaping corporate profitability and financial sustainability. Focusing on Tata Motors, known for its significant use of debt financing, the research examined how leverage strategies impact return on equity (ROE). It aimed to determine whether these strategies enhanced value or increased financial risk. The study provided practical insights for finance managers, analysts, and strategists by highlighting the real-world effects of leverage on financial performance, ultimately supporting more informed and effective financial planning.

SCOPE OF THE STUDY

The scope of the study was confined to Tata Motors, focusing solely on the relationship between financial leverage and return on equity (ROE). It involved analysing capital structure, leverage ratios, and ROE using secondary financial data over a specific period. The study concentrated on how leverage affected shareholder returns, without considering operational performance or external economic factors. Its findings were specific to Tata Motors and not meant to be generalized to other companies or industries.

OBJECTIVES OF THE STUDY

1. To study capital structure of Tata Motors.
2. To know the financial leverage strategies at Tata Motors.
3. To know the factors of return on equity (ROE) at Tata Motors.
4. To know the relationship between financial leverage and ROE at Tata Motors.

DATA SOURCES AND METHODOLOGY

METHODOLOGY

The study used a descriptive and analytical research design to examine the relationship between financial leverage and ROE at Tata Motors. Relying on past financial data, it focused on identifying patterns without altering variables. Data from company reports and financial databases were analysed statistically to draw objective, fact-based conclusions.

DATA SOURCES

Primary Data:

Although traditional primary data collection was not applicable, the study utilized key financial indicators such as total debt, equity capital, net income, and return on equity as primary data. These figures were directly extracted from Tata Motor's audited annual reports for the past five financial years, ensuring data authenticity and accuracy for analysis.

Secondary Data:

The study also made extensive use of secondary data, drawing from sources like annual reports, company websites, financial databases, academic journals, textbooks, and online financial portals. This secondary information provided the necessary theoretical framework, contextual background, and support for interpreting the financial findings effectively and efficiently.

LIMITATIONS OF THE STUDY

1. The study covers only a five-year period, which may not capture longer-term capital structure dynamics.
2. Analysis excludes qualitative factors such as management policies and market sentiment.
3. Macroeconomic variables (e.g., interest rates, exchange rates) were not incorporated into the model.
4. The impact of non-recurring items (e.g., asset impairments) on financial metrics was not separately analysed.
5. Industry-level comparisons were not conducted, limiting benchmarking insights.
6. The study relies solely on published financial statements, which may be subject to accounting discretion.

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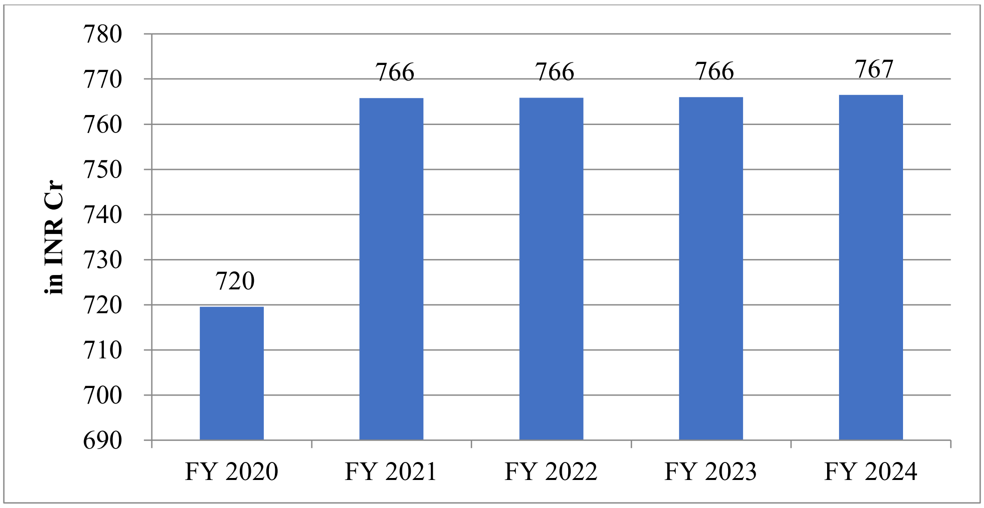
DATA ANALYSIS & INTERPRETATION

Table 1: Equity Share Capital

Year	in INR Cr.
FY 2020	720
FY 2021	766
FY 2022	766
FY 2023	766
FY 2024	767

Figure 1: Equity share capital



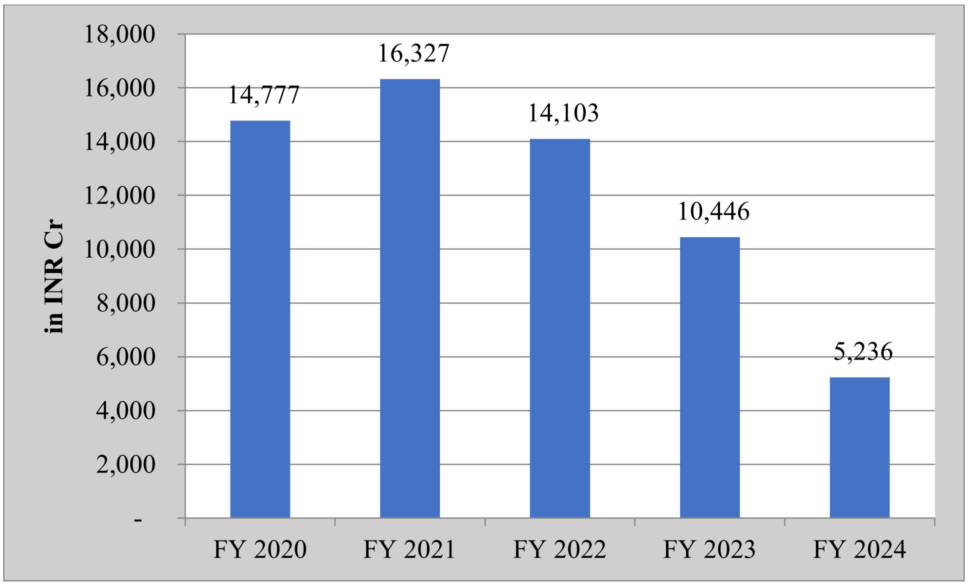
Interpretation

Over the five-year period from FY2020 to FY2024, Tata Motors' equity share capital exhibited minimal fluctuation, increasing marginally from ₹720 Cr to ₹767 Cr. This stability suggests that the company neither pursued significant equity issuances nor engaged in substantial buybacks, implying a deliberate decision to maintain consistent ownership stakes. Such steadiness in the equity base may reflect management's confidence in internal cash generation to fund operations and capital expenditures, rather than diluting or concentrating shareholding through market transactions, thereby preserving shareholder value and minimizing dilution risk.

Table 2: Long-Term Borrowings

Year	in INR Cr.
FY 2020	14,777
FY 2021	16,327
FY 2022	14,103
FY 2023	10,446
FY 2024	5,236

Figure 2: Long-Term Borrowings



Interpretation

Tata Motors' long-term borrowings contracted substantially over the period, declining from ₹14,777 Cr in FY2020 to ₹5,236 Cr in FY2024. This significant deleveraging indicates a strategic emphasis on reducing reliance on long-dated debt obligations, likely motivated by the desire to curtail interest commitments and improve leverage ratios. By systematically repaying or refinancing long-term liabilities, the company has mitigated refinancing risk and reinforced its balance sheet resilience, albeit potentially at the cost of foregoing some growth opportunities that require extended financing horizons.

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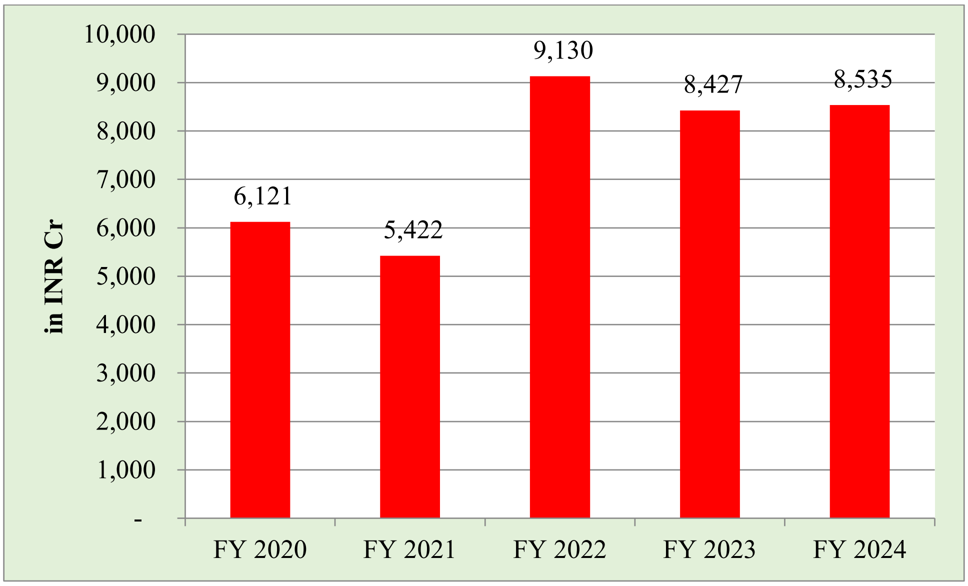
Table 3: Short-Term Borrowings

Year	in INR Cr.
FY 2020	6,121
FY 2021	5,422
FY 2022	9,130
FY 2023	8,427
FY 2024	8,535

Figure 3: Short-term borrowings



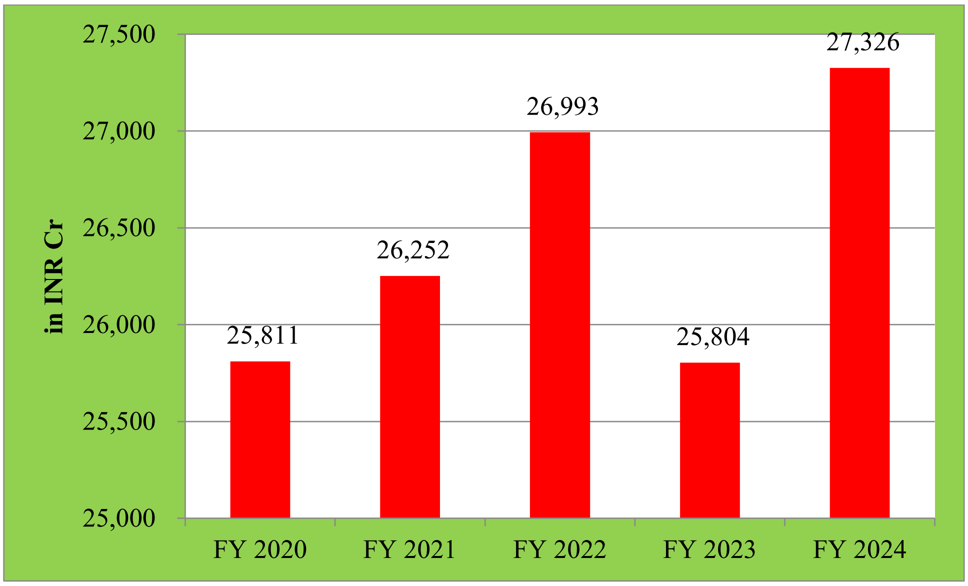
Interpretation

Short-term borrowings followed a more volatile pattern, decreasing from ₹6,121 Cr in FY2020 to ₹5,422 Cr in FY2021, spiking to ₹9,130 Cr in FY2022, and then moderating to ₹8,535 Cr by FY2024. This oscillation suggests that management strategically adjusted working-capital financing to navigate liquidity needs and market conditions, possibly leveraging short-term credit facilities during periods of revenue stress or inventory buildup. While increased short-term debt can enhance flexibility and lower borrowing costs compared to long-term instruments, it also heightens rollover risk and requires vigilant cash-flow management.

Table 4: Current Liabilities

Year	in INR Cr.
FY 2020	25,811
FY 2021	26,252
FY 2022	26,993
FY 2023	25,804
FY 2024	27,326

Figure 4: Current Liabilities



Interpretation

Current liabilities exhibited a gradual increase, rising from ₹25,811 Cr in FY2020 to ₹27,326 Cr in FY2024. This upward trend, though moderate, signals that the company's obligations due within one year have grown in line with or slightly above operational scale. The steady rise may reflect higher accruals for trade payables, short-term provisions, or other payables, underscoring the need for effective short-term liquidity management to ensure seamless operations and creditor confidence.

FINDINGS

- Tata Motors' equity share capital remained largely stable between FY2020 and FY2024.
- Total shareholders' funds exhibited a consistent upward trend over the five-year period.
- Long-term borrowings declined markedly from FY2020 to FY2024.
- Short-term borrowings fluctuated, peaking in FY2022 before stabilizing in subsequent years.
- Current liabilities increased gradually from FY2020 to FY2024.
- Current assets rose until FY2021, dipped in FY2023, and recovered by FY2024.
- Fixed assets contracted sharply after FY2021 and then plateaued through FY2024.
- Total assets remained relatively stable, with minor fluctuations across the years.
- Total revenue decreased in FY2021 but then grew substantially through FY2024.
- Finance costs peaked in FY2022 and declined to their lowest level by FY2024.
- Net profit moved from significant losses in FY2020–FY2022 to strong profitability in FY2023–FY2024.
- Earnings per share followed net profit trends, shifting from negative values to robust positive growth.

SUGGESTIONS

- Maintain the reduced long-term debt ratio to preserve financial flexibility.
- Monitor short-term borrowing levels closely to avoid liquidity risks.
- Reinvest a portion of retained earnings into high-return projects to further boost equity value.
- Explore diversified financing sources such as hybrid instruments to balance cost and flexibility.
- Strengthen working capital management to mitigate fluctuations in current assets and liabilities.
- Conduct periodic stress tests to assess resilience under adverse economic scenarios.
- Benchmark debt policies against industry peers to identify best practices.
- Enhance disclosure on debt covenants to improve creditor confidence.

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- Implement hedging strategies to manage interest rate exposure on floating-rate borrowings.

CONCLUSION

This study analysed Tata Motors' capital structure from FY2020 to FY2024, highlighting a shift from long-term debt to a more equity-focused approach. This change reduced interest costs, improved liquidity, and led to better profitability, particularly in FY2023–FY2024. The findings show that effective debt-equity management is key to sustaining shareholder value, especially in capital-intensive industries. While financial metrics support the strategy's success, other factors like market trends and strategic planning also influence outcomes. Tata Motors' case offers useful insights for finance managers aiming to balance leverage with long-term goals.

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