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A Study on the Capital Structure of Tata Power

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Abstract

The study includes an analysis of Tata Power's debt and equity financing mix, evaluating how the company balances financial leverage and cost of capital to maximize shareholder value. Utilizing financial data from Tata Power's annual reports, it highlights significant ratios such as return on equity, debt-to-equity, and interest coverage over a specific period of time. Both primary data and secondary data were used when conducting this research study. The primary data includes interviews, and surveys conducted with investors and general public to understand their perceptions of Tata Power, and secondary data include academic studies, websites, various research papers and market reports. This study also provides insights into the characteristics of Tata Power's investors and their perceptions of the company. It notes that a significant portion of surveyed investors are not active investors, indicating a potential gap in financial literacy or investment motivation. Additionally, many investors are unsure about Tata Power's future share performance, reflecting a need for better communication from the company regarding growth plans.

Keywords: Tata power, capital structure, shareholders' value, return on equity, debt-to-equity, financial literacy.

1. Introduction

The capital structure of a company plays a crucial role in determining its financial health, operational efficiency, and long-term sustainability. Capital structure refers to the mix of debt and equity that a firm uses to finance its operations and growth. An optimal capital structure balances the cost of capital while maximizing shareholder value and minimizing financial risk.

This study focuses on the capital structure of Tata Power, one of India's leading integrated power companies. Tata Power has a significant presence in the generation, transmission, and distribution of electricity, with a diversified portfolio that includes renewable energy sources such as solar, wind, and hydro. Given the capital-intensive nature of the power sector, understanding the capital structure of Tata Power is essential for evaluating its financial strategy and performance.

The study aims to analyze the composition of Tata Power's capital structure, the factors influencing its debt and equity mix, and the impact of financial leverage on the company's profitability and risk profile. It will also assess how Tata Power's financing decisions have evolved over time in response to market conditions and business strategies.

2. Objectives of the Study

- To analyze the capital structure of Tata Power.
- To study the trends in Tata Power's financing decisions.
- To evaluate the impact of capital structure on financial performance.

3. Review of Literature

The study is built upon existing literature review on capital, capital structure, Tata Power, and investment.

Harris M. & Raviv A. (1990). Capital structure and the informational role of debt. *The Journal of Finance*, XLV (2), 321–349. This foundational paper discusses how debt plays an informational role in corporate finance. It highlights that firms use debt strategically to signal quality to investors and manage conflicts between shareholders and managers.

Bhaduri S.N. (2002). Determinants of capital structure choice: A study of the Indian corporate sector. *Applied Financial Economics*, 12(9), 655-665. Analyzes capital structure determinants in Indian firms. It finds that size, profitability, and growth opportunities significantly influence leverage decisions, aligning partially with pecking order and trade-off theories.

Bhole L.M., & Mahakud J. (2004). Trends and determinants of corporate capital structure in India: A panel data analysis. *Finance India*, 18(2), 37–55. Uses panel data to explore trends in capital structure among Indian corporates. The study emphasizes the impact of firm-specific factors like asset structure, profitability, and non-debt tax shields on capital structure decisions.

Popli, G. S. & Jaiswal, Gajendra. (2012). Determinants of Corporate Capital Structure of Indian Industries. XIII Annual International Conference on Global Turbulence: Challenges & Opportunities May 5-6, 2012 at Bangkok, Thailand ISBN: 978-81-923211-3-4. Focuses on Indian industries and identifies determinants such as firm size, profitability, and tangibility as crucial in shaping capital structure. Emphasizes the role of economic conditions in financing choices.

Goyal A.M. (2013). Impact of capital structure on performance of listed public sector banks in India. *International Journal of Business and Management Invention*, 2(10), 35–43. Examines the relationship between capital structure and performance in Indian public sector banks. Finds that optimal leverage can positively affect financial performance, suggesting a performance-based approach to capital structure.

Tailab, M. M. K. (2014). The effect of capital Structure on Profitability of Energy American Firm. *International Journal of Business and Management Invention*, 3(12), 54-61. Studies American energy firms and concludes that higher debt levels negatively impact profitability. Supports the pecking order theory, indicating firms prefer internal financing when possible.

Handoo, Anshu & Sharma, Kapil. (2014). A study on determinants of capital structure in India. *IIMB Management Review*. 26. 10.1016/j.iimb.2014.07.009. Analyzes Indian firms and finds that profitability, growth, size, and liquidity are significant determinants of capital structure. Recommends that firms consider these variables for better financial structuring.

Chadha, S. and Sharma, A.K. (2015), "Determinants of capital structure: an empirical evaluation from India", *Journal of Advances in Management Research*, Vol. 12 No. 1, pp. 3-14. Uses empirical analysis to validate capital structure determinants in Indian firms. Confirms the relevance of firm-specific factors and provides policy suggestions for financial decision-making.

"Tata Power: Optimized CGPL's Capital Structure" by Motilal Oswal Financial Services (2017): This report examines the capital structure optimization of Coastal Gujarat Power Limited (CGPL), a subsidiary of Tata Power. It discusses the infusion of quasi-equity by the parent company and the financial strategies employed to manage debt obligations and improve financial stability.

"Fundamental Analysis of Tata Power" by Vishal Prasad (2022): This study provides a comprehensive fundamental analysis of Tata Power, including an assessment of its capital structure. It evaluates the company's financial health through various valuation approaches and financial ratios, offering insights into its financial strategies and market position.

"Tata Power Ltd: Innovation in Financing Growth" by Mayank Joshipura, Vasant Sivaraman, and Sameer M. Nawani (2013): This case study examines Tata Power's fundraising strategies in April 2011, focusing on innovative financing options to balance equity preservation and credit rating considerations. It provides insights into evaluating financial instruments and structuring funding to support capital expenditure and acquisitions.

"Comparative Analysis of the Financial Performance of Tata Power and Adani Power" by Mrinal Gaurav and Diwakar Kumar (2024): This study offers a comparative analysis of Tata Power and Adani Power over five years (2019-20 to 2023-24), assessing profitability, liquidity, solvency, and efficiency ratios. It highlights Tata Power's consistent profitability and stable financial management, while noting challenges in liquidity and financial leverage.

"An Enquiry into Effect of Capital Structure on Firm Value: A Study of Power Sector Companies in India" by R.K. Sinha: This research investigates the impact of capital structure on firm value within India's power sector, including Tata Power. It analyzes how different financing mixes affect company valuation and performance.

"WACC Analysis of Tata Power" by Shubham Shekhar Sinha: This analysis calculates Tata Power's Weighted Average Cost of Capital (WACC), considering the company's equity and debt components. It provides detailed calculations of the cost of equity and debt, offering insights into the company's capital efficiency.

"Rating Rationale" by CRISIL (2017): This report discusses Tata Power's leveraged capital structure, noting a consolidated adjusted gearing of around 3 times as of September 30, 2017. It highlights the company's debt levels and expectations for improvement through equity infusion or sale of non-core investments.

4. Research Methodology

In this study the concept of Capital Structure is being studied in details and the types of Research Methodology done would be Descriptive Research.

There are two different types of data used for research that is Primary Data and Secondary Data. For the purpose of the research study, both, primary data and secondary data were used.

Sample size: Sample size would of 100 people, both, common man and working people for survey.

Sampling design: Population: The population contains people from Navi Mumbai area only.

Sampling elements: There is one company that the study is based on and that company is Tata Power. The data is limited to only 4 years.

5. Data Analysis and Interpretation

1. Gender

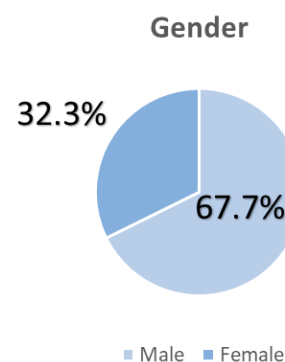


Fig 1.1: Gender Group

Figure 1.1 shows that out of the total respondents, female (67.7%) are more than male (32.3%).

2. Age

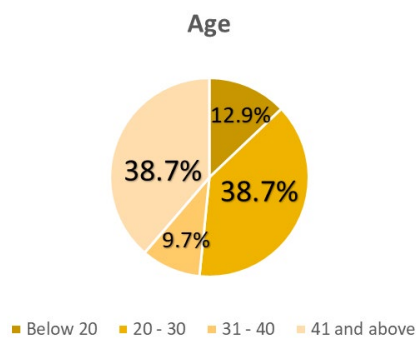


Fig 1.2: Age Group

Figure 1.2 shows that 20 – 30 age group and 41 and above age group are high (38.7%), 12.9% respondents are below 20 age group and 9.7% respondents are 31 – 40 age group.

3. How is your Knowledge about Investments?

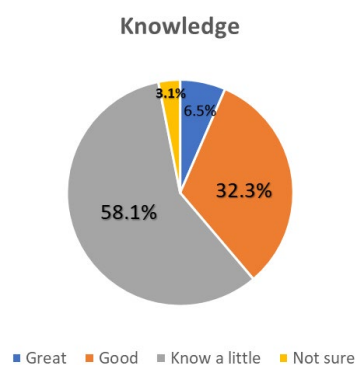


Fig 1.3: Investment Group

Figure 1.3 shows that more than half the respondents (58.1%) only know a little about investments. Only 3.1% are not quite sure about their knowledge about investments. About 32.3% have good knowledge and 6.5% have great knowledge about investments.

4. Are you an Active Investor?

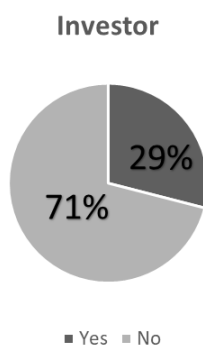


Fig 1.4: Active Investors group

Figure 1.4 shows that out of the respondents, only 29% are active investors and the rest 71% are not active investors.

5. Did you Invest Recently?

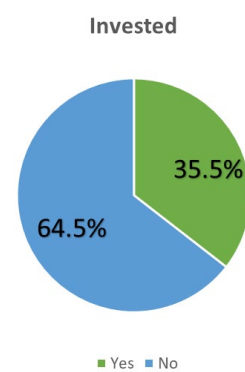


Fig 1.5: Investors group

Figure 1.5 shows that 35.5% of the respondents have recently and the rest 64.5% have not invested recently.

6. Your Portfolio Consists of?

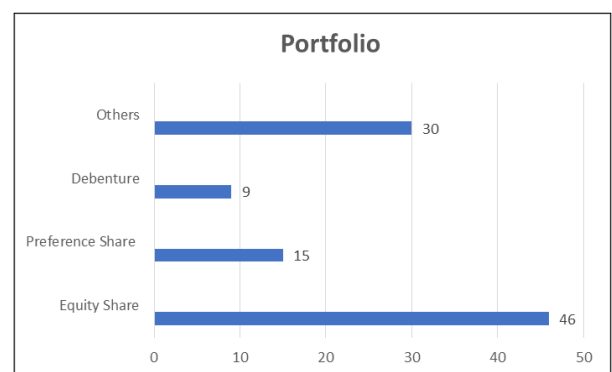


Fig 1.6: Investors Portfolio

Figure 1.6 shows that out of the total respondents, most of the respondents (46) have equity share in their portfolio. 15 respondents have preference share, 9 respondents have debentures and rest (30) have others.

7. Have you Ever Invested in Tata Power?

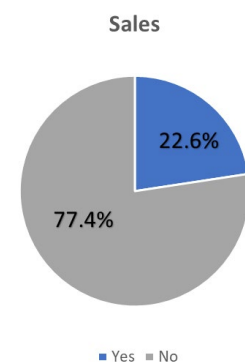


Fig 1.7: Tata Power investors group

Figure 1.7 shows that only 22.6% have invested in Tata Power. Rest (77.4%) have never invested in Tata Power.

8. What was your Reason for Buying Tata Power Shares?

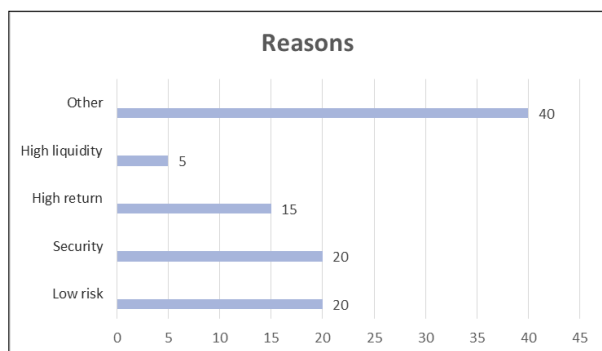


Fig 1.8: Tata Power Shares

Figure 1.8 shows that out of the total respondents, 20 respondents have invested in Tata power because of low risk, 20 respondents because of security, 15 respondents have invested because of high return, 5 respondents because of high liquidity. Rest (40) have invested in Tata power because of other reasons.

9. Have you got any Benefits from Investing in Tata Power?

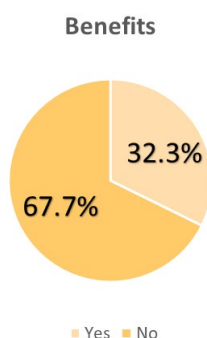


Fig 1.9: Beneficiary Group

Figure 1.9 shows that 32.3% have gotten benefits from investing in Tata power and rest (67.7%) have not gotten any benefits from investing in Tata power.

10. Do you think that Tata Power Shares Price Increase or Decrease?

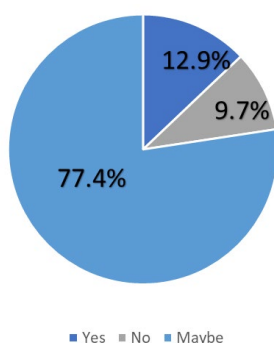


Fig 2.1: Tata Power Shares

Figure 2.1 shows that 12.9% respondents think that Tata power share price will increase or decrease, 9.7% respondents think that share price will not increase or decrease and 77.4% of the respondent not sure if share price will increase or decrease.

11. Will you invest in Tata power in future?

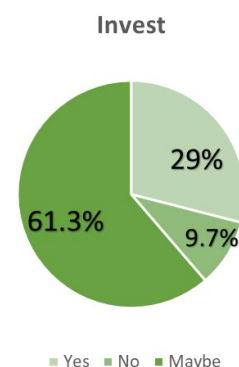


Fig 2.2: Tata Power Shares

Figure 2.2 shows that out of the total respondents, 29% of the respondents will invest in Tata power in the future, 9.7% of the respondents will not invest in Tata power and rest of respondents (61.3%) are not sure.

12. What are Your Reasons for not investing in Tata Power?

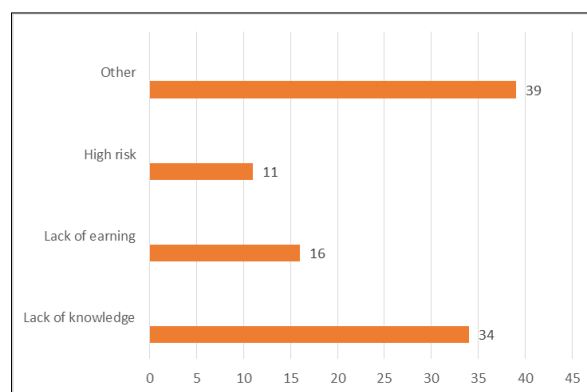


Fig 2.3: Beneficiary Group

Figure 2.3 shows that 34 of the respondents have not invested in Tata power because their lack of knowledge, 16 respondents because of lack of earnings, 11 respondents because of high risk and rest have other reasons for not investing in Tata power.

13. Equity Shares are More Beneficial.

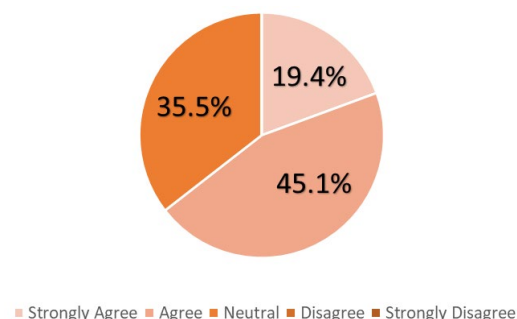


Fig 2.4: Beneficiary Group

Figure 2.4 shows that out of the total respondents, no one strongly disagrees or disagrees that equity share are most beneficial. 19.4% strongly agree that equity shares are the most beneficial, 45.1% agree and rest (35.5%) are neutral.

14. Equity Shareholders have More Rights in the Company than Preference Shareholders or Debenture Holders.

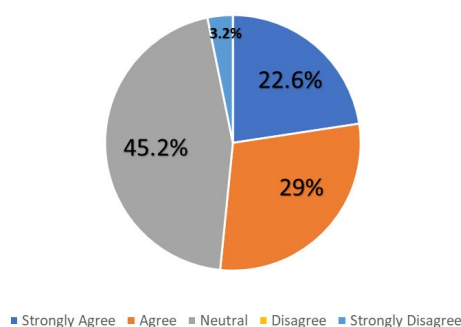


Fig 2.5: Shareholders group

Figure 2.5 shows that out of the total respondents, no one disagrees, 3.2% strongly disagrees that equity shareholders have more rights in the company than preference shareholders or debenture holders. 22.6% strongly agree, 29% agree and rest (45.2%) are neutral.

15. A Good Capital Structure ensures that the Funds are Used Effectively.

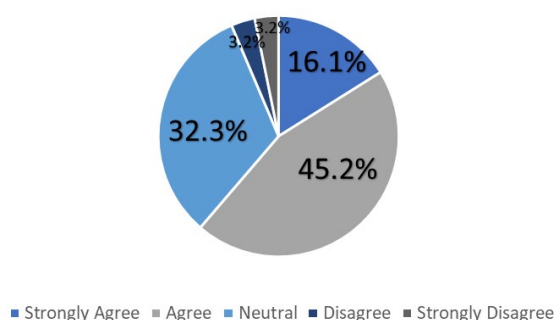


Fig 2.6: Capital Structure

Figure 2.6 shows that out of the total respondents, 3.2% strongly disagrees, 3.2% disagrees that a good capital structure ensures that the funds are used effectively. 16.1% strongly agree a good capital structure ensures that the funds are used effectively, 45.2% agree and rest (32.3%) are neutral.

16. The Capital Structure is not Impacted When Rules or Policies of Government Change.

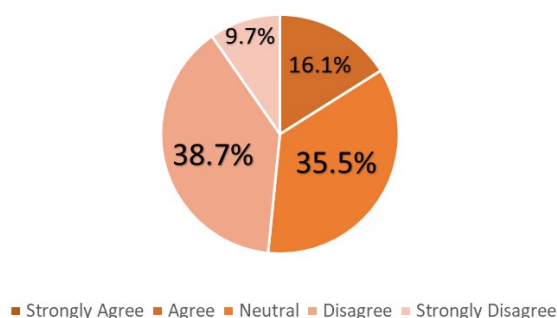


Fig 2.7: Capital Structure

Figure 2.7 shows that out of the total respondents, no one strongly agrees, 9.7% strongly disagrees, 38.7% disagree that the capital structure is not impacted when rules or policies of government change, 16.1% agree and rest (35.5%) are neutral.

6. Finding of the Study

Capital structure represents debt plus shareholder equity on a company's balance sheet. Understanding it can help investors size up the strength of the balance sheet and the company's financial health. That, in turn, can aid investors in their investment decision-making. Various financial ratios are used to analyse the capital structure of a firm. These can give investors and analysts a view of how a company compares with its peers and therefore its financial standing in its industry.

The D/E ratio compares a company's debt position to its equity position. The calculation for this ratio is total debt divided by total equity. The long-term debt to capitalization ratio (one of several capitalization ratios) compares long-term debt to the capital structure of a company, which is represented by long-term debt and total shareholder equity. The calculation for the long-term capitalization ratio is long-term debt divided by the total of long-term debt and shareholder equity.

- Tata Power maintains a balance between equity and debt, but the debt levels are significant.
- The company's authorized share capital has remained stable over the years, while it's issued and paid-up capital show consistency.
- A significant portion of surveyed investors are not active investors, indicating a potential gap in financial literacy or investment motivation.
- Many investors are unsure about Tata Power's future share performance, reflecting a need for better communication from the company regarding growth plans.
- Tata Power's market capitalization and return on equity (ROE) indicate a stable financial position.
- The company's price-to-earnings (P/E) ratio suggests that the stock may be overvalued or that investors have high expectations.
- Tata Power's debt levels are substantial, which could lead to financial strain if not managed efficiently.
- The company's enterprise value suggests strong financial backing, but reliance on debt could pose risks in the long term.
- While some investors see Tata Power as a secure and low-risk investment, others cite a lack of knowledge or earnings as reasons for not investing.
- A majority of respondents believe equity shares are the most beneficial, showing a preference for stock ownership over other forms of investment.
- A large percentage of respondents believe that government policy changes impact capital structure, showing investor sensitivity to external economic and policy shifts.

Conclusion

Every business has different needs, especially when it comes to capital structure. The cash flow and financial support requirements for an international large corporation are likely going to be more involved and complicated.

Similarly, the capitalization needs of a company focused on consumer goods, which may carry a lower risk, will vary in comparison to a travel company, where needs and demands ebb and flow with the seasons. But both businesses still need to determine what kind of capital structure is going to help them be successful and meet their goals.

A company's capital structure constitutes the mix of equity and debt on its balance sheet. Though there is no specific

level of each that determines what a healthy company is, lower debt levels and higher equity levels are preferred.

A credit rating agency is a company that offers ratings for debt issued by companies. These agencies rates the debt according to a company's ability to pay principal and interest to the debt holders. Each agency has its rating method. Generally, the higher the rating, the better the risk for investors that the company will pay back what it borrowed.

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