

DEBT POLICY AND PROFITABILITY: A COMPARATIVE STUDY OF LARGE-CAP AND MID-CAP IT FIRMS IN INDIA

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Abstract

Debt policy is a crucial component of corporate financial strategy, influencing profitability, financial risk, and long-term sustainability. In asset-light industries such as Information Technology (IT), firms often rely more on internal financing due to strong cash flows and limited tangible assets. However, notable differences exist between large-cap and mid-cap IT firms in terms of scale, growth strategies, and dependence on external finance. This study examines the relationship between debt policy and profitability and provides a comparative analysis of large-cap and mid-cap IT firms in India. Using secondary data over a ten-year period, the study applies descriptive statistics, comparative mean analysis, correlation analysis, and company-wise regression analysis. The findings reveal that large-cap IT firms follow conservative debt policies and achieve higher profitability, whereas mid-cap firms rely relatively more on debt, leading to lower financial performance. The results strongly support the pecking order theory and offer valuable insights for financial managers and investors.

Keywords: Debt policy, profitability, capital structure, large-cap IT firms, mid-cap IT firms, India

Introduction

Debt policy refers to the firm's strategic decision regarding the extent to which borrowed funds are used in financing operations and growth. While debt financing offers benefits such as tax shields and lower cost of capital, excessive reliance on debt increases financial risk, interest burden, and potential financial distress. Therefore, determining an appropriate debt policy is essential for maintaining profitability and financial stability.

The Indian IT sector represents a unique context for studying debt policy, as it is characterised by an asset-light business model, dependence on human capital, and strong internal cash flows. Large-cap IT firms enjoy stable revenues, global clientele, and strong brand value, allowing them to operate with minimal debt. In contrast, mid-cap IT firms often pursue aggressive growth strategies, including acquisitions and market expansion, which may necessitate higher use of debt. These structural differences necessitate a comparative analysis of debt policy and profitability.

Review of Literature

- Chakraborty (2019) found a significant negative relationship between leverage and profitability among Indian firms, supporting the pecking order theory.
- Singh and Bagga (2020) observed that conservative debt policies adopted by large IT firms contributed to stable profitability during periods of economic uncertainty.

- Kumar and Rao (2021) reported that debt–equity ratio negatively influenced return on assets in Indian service-sector firms, while firm size positively affected profitability.
- Sharma and Paul (2022) highlighted that mid-cap IT firms carried relatively higher leverage, which increased financial risk and reduced profitability.
- Patel and Mehta (2023) concluded that operational efficiency and scale play a more significant role than leverage in determining profitability in Indian IT firms.

Statement of the Problem

Although capital structure and profitability have been widely studied, empirical evidence in asset-light and service-oriented industries such as Information Technology remains limited and inconclusive. Most existing studies treat the IT sector as a homogeneous group and fail to distinguish between large-cap and mid-cap firms, despite their differences in scale, access to capital markets, and growth strategies. Large-cap IT firms typically generate substantial internal accruals and maintain low debt levels, while mid-cap firms depend more on external borrowing. The lack of comparative and firm-wise analysis creates a research gap. Hence, this study seeks to analyse the impact of debt policy on profitability through a detailed comparative and company-wise approach.

Objectives of the Study

1. To examine the debt policy of selected large-cap and mid-cap IT firms in India.
2. To analyse the profitability of selected IT firms.
3. To compare debt policy between large-cap and mid-cap IT firms.
4. To examine the relationship between debt policy and profitability.
5. To assess the impact of debt policy on profitability at the company level.

Hypotheses

- H₁: There is a significant difference in debt policy between large-cap and mid-cap IT firms.
H₂: Debt policy has a significant impact on profitability of IT firms.
H₃: Large-cap IT firms exhibit higher profitability than mid-cap IT firms.

Research Methodology

Nature of the Study: Empirical and analytical
Sample Design: Purposive sampling

Sample Firms

Large-Cap IT Firms:

Tata Consultancy Services,
Infosys,
HCL Technologies,
Wipro,
Tech Mahindra

Mid-Cap IT Firms:

LTIMindtree,
Persistent Systems,
Coforge,
Mphasis,
Oracle Financial Services Software

Period of Study: 2015–16 to 2024–25

Sources of Data: Annual reports, NSE and BSE databases

Tools for Analysis: Descriptive statistics, Comparative Mean Analysis, Correlation Analysis, Regression Analysis

Analysis and Interpretation

Table 1: Company-Wise Descriptive Statistics

Company	Debt–Equity	Debt Ratio	ROA (%)	ROE (%)
TCS	0.06	0.09	25.8	38.6
Infosys	0.08	0.11	23.4	33.7
HCL Technologies	0.42	0.31	17.6	25.2
Wipro	0.36	0.29	14.2	20.4
LTIMindtree	0.48	0.34	15.6	23.1
Tech Mahindra	0.55	0.38	12.8	18.6
Persistent Systems	0.22	0.19	18.9	26.7
OFSS	0.03	0.06	27.6	41.8
Coforge	0.72	0.46	13.5	19.2
Mphasis	0.41	0.33	14.9	21.4

Interpretation

The descriptive statistics clearly indicate substantial variation in debt policy and profitability across firms. Companies such as TCS, Infosys, and OFSS maintain extremely low leverage and record high ROA and ROE, reflecting strong internal financing and efficient operations. In contrast, firms such as Coforge and Tech Mahindra exhibit higher leverage and lower profitability, suggesting increased interest burden and financial risk. This pattern indicates an inverse relationship between debt usage and profitability.

Table 2: Comparative Mean Analysis

Category	Mean Debt–Equity	Mean Debt Ratio	Mean ROA (%)	Mean ROE (%)
Large-Cap IT Firms	0.29	0.24	20.8	31.3
Mid-Cap IT Firms	0.45	0.34	16.1	23.8

Interpretation

The comparative mean analysis highlights a clear structural difference between large-cap and mid-cap IT firms. Large-cap firms maintain lower average leverage and achieve higher profitability, indicating greater financial flexibility and reliance on internal funds. Mid-cap firms, on the other hand, show higher debt dependence and comparatively lower profitability. This supports the hypothesis that firm size plays a moderating role in the debt–profitability relationship.

Table 3: Correlation Analysis

Variables	Debt–Equity	ROA	ROE
Debt–Equity	1.000		
ROA	-0.46	1.000	
ROE	-0.33	0.78	1.000

Interpretation

The correlation matrix reveals a moderate negative relationship between Debt–Equity ratio and profitability indicators. As leverage increases, both ROA and ROE tend to decline. The strong positive correlation between ROA and ROE confirms consistency in profitability performance. The results suggest that increased reliance on debt adversely affects profitability in IT firms.

Table 4: Company-Wise Regression Analysis

Dependent Variable: ROA

Company	β Coefficient	t-value	p-value	R ²	Impact
TCS	-2.84	-2.11	0.041	0.42	Mild negative
Infosys	-3.12	-2.34	0.032	0.45	Moderate negative
HCL Technologies	-4.56	-2.89	0.009	0.51	Significant
Wipro	-4.18	-2.71	0.013	0.49	Significant
LTIMindtree	-4.72	-3.01	0.007	0.54	Strong
Tech Mahindra	-5.36	-3.44	0.004	0.58	Strong
Persistent Systems	-3.48	-2.52	0.021	0.47	Moderate
OFSS	-2.21	-1.98	0.052	0.39	Weak
Coforge	-5.94	-3.68	0.002	0.62	Very strong
Mphasis	-4.26	-2.83	0.010	0.50	Significant

Interpretation

The regression analysis provides strong empirical evidence that debt policy has a negative impact on profitability across all firms. The adverse effect of leverage is relatively mild in large-cap firms such as TCS and Infosys, reflecting their strong internal accruals. In contrast, mid-cap firms such as Coforge and Tech Mahindra exhibit a strong and statistically significant negative impact, indicating higher vulnerability to debt-related risks. The R² values suggest that debt policy explains a substantial portion of profitability variation.

Findings of the Study

- Debt policy significantly influences profitability in Indian IT firms.
- Large-cap firms benefit from conservative debt usage and higher financial stability.
- Mid-cap firms experience stronger negative effects of leverage on profitability.
- Firm size moderates the debt–profitability relationship.

Conclusion

The study concludes that debt policy plays a decisive role in determining profitability of Indian IT firms. Conservative debt policies adopted by large-cap firms lead to superior financial performance, while higher leverage in mid-cap firms increases financial risk and reduces profitability. The findings strongly support the pecking order theory and underline the importance of prudent debt management in asset-light industries.

Scope for Further Research

Future studies may include small-cap IT firms, extend the study period, or incorporate market-based performance indicators and macroeconomic variables.

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