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A Study on the Impact of Capital Structure on Financial Performance of Hotel Companies

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Abstract

Capital structure refers to the way a company finances its overall operations and growth by using different sources of funds. These sources mainly include equity (like share capital) and debt (such as loans and bonds). The mix of equity and debt that a company uses is called its capital structure. The capital structure is a vital financial decision that affects a company's risk, performance, and value. A balanced capital structure helps a company grow sustainably while managing costs and risks. This study examines the impact of capital structure on the financial performance of hotel companies listed on the National Stock Exchange (NSE) of India. The five companies Indian Hotel Company Ltd, EIH Limited, Chalet Hotels, Lemon Tree Hotels and Juniper Hotels Limited were taken as sample. The required data were collected from the Annual Reports for the period from 2014-15 to 2023-24. The collected data were analysed by using regression analysis. The study explores the relationship between capital structure variables equity share capital, reserve & surplus, debts and two key performance indicators: Net Profit (NP) and Return on Capital Employed (ROCE). The results of the study reveal that capital structure has no significant impact on net profit and return on capital employed of Hotel companies.

Keywords: Capital structure, financial performance, net profit, ROCE, Hotel companies etc.

Introduction

Capital structure simply means how a company gets the money it needs to run and grow. This money usually comes from two main sources: debt (like loans or borrowed money) and equity (money from the owners or shareholders). A company’s capital structure is the mix of these sources how much it uses debt versus equity.

The main parts of capital structure include common equity, preferred equity, long-term debt, and short-term debt. Some companies also use convertible debt, which is a type of loan that can later be turned into shares this is often seen as a mix of debt and equity.

Choosing the right capital structure is a very important decision for any business. It affects how much profit the company can make, how risky it is, and how much it's worth in the market. The goal is to find the best balance—using enough debt to lower the overall cost of getting money, but not so much that it becomes too risky. When done right, a good capital structure can help the business grow while keeping its financing costs low.

The hotel industry is characterized by high fixed costs, significant capital investments, and cyclical demand patterns, which make financial decisions particularly those related to capital structure crucial for profitability and sustainability. Capital structure refers to the proportion of debt and equity used by a firm to finance its operations. An optimal capital structure balances the benefits of debt, such as tax shields, against the risks of financial distress. This study aims to assess how variations in capital structure affect the profitability of hotel companies.

Theories of Capital Structure

1. **Trade-off Theory**

The trade-off theory of capital structure suggests that companies balance the benefits of debt (such as tax savings from interest) with the costs of debt (such as financial distress and bankruptcy risk). At some point, the cost of adding more debt outweighs the tax advantages.

2. **Pecking Order Theory**

The pecking order theory posits that companies prioritize their financing sources in a specific order: first, internal funds (retained earnings); second, debt; and third, equity. This hierarchy stems from the desire to minimize the costs of external financing and avoid giving up ownership.

3. **Modigliani-Miller Theorem (M&M)**

The Modigliani-Miller theorem, developed by economists Franco Modigliani and Merton Miller, suggests that in perfect markets (no taxes, no bankruptcy costs, etc.), the value of a company is unaffected by its capital structure. However, in real-world markets, taxes, bankruptcy costs, and other imperfections make capital structure a critical decision.

Factors Affecting Capital Structure:

1. Business Risk: Companies in more volatile industries may rely more on equity to avoid the fixed obligations of debt.
2. Tax Considerations: Debt provides tax shields due to the deductibility of interest payments.

3. Financial Flexibility: Companies may prefer to maintain flexibility in raising capital, which may influence how much debt they take on.
4. Market Conditions: The state of the financial markets can influence whether equity or debt is more advantageous at a given time.
5. Size and Age of the Company: Larger, more established companies often have easier access to debt financing, whereas smaller or younger firms may rely more on equity.

Indian Hotel Industry

The Indian hospitality industry, spearheaded by the hotel market, has emerged as one of the primary sectors which are driving the economic growth of the country. In India, hotels are classified based on location (city hotels, airport motels, resorts, etc.), level of service (upscale, mid-market, and economy), and themes (boutique hotels, heritage hotels, etc.).

India’s tourism and hospitality industry is growing fast and has a bright future. By the year 2028, it is expected to generate over ₹5.12 lakh crore (around US$ 59 billion) in revenue. One of the key reasons for this growth is the increasing number of foreign tourists, which is likely to reach 30.5 million by 2028. According to the Tourism Minister of India, the country’s tourism sector is expected to grow at a rate of 20% each year over the next few decades. This growth is mainly because more people in India now belong to the middle-income group and have more money to spend on travel and leisure. The overall travel market in India is also expanding. It is projected to grow from about US$ 75 billion in the financial year 2020 to around US$ 125 billion by the financial year 2027. With more people exploring new places and better infrastructure being developed, India’s tourism industry is on a strong growth path.

Key Players of Hotel Industry

- Indian Hotels Company Ltd. (Taj Group)
- EIH Ltd. (Oberoi Hotels)
- Chalet Hotels Limited
- Lemon Tree Hotels
- Juniper Hotels (affiliated with Hyatt)

Review of Literature

Ravi and Desai (2025) explored the capital structure of Indian IT companies and found that those with low debt levels consistently performed better. The study highlighted that in fast-growing, low-asset sectors, equity-based financing is more effective in supporting profitability and long-term performance.

Adeyemi et al. (2024) studied firms in Nigeria and confirmed a strong link between capital structure and financial outcomes. Their research showed that firms with a flexible capital structure, balancing both debt and equity, maintained better financial stability and higher returns.

Verma and Mehta (2023) analyzed data from Indian automobile companies and revealed that firms with a higher proportion of equity capital showed better returns on capital employed (ROCE) and net profit margins. They concluded that equity financing is more favorable in capital-intensive industries.

Rahman and Khan (2022) conducted a study in Bangladesh and highlighted that firms with a high debt-equity ratio tend to underperform. Their results suggested that careful capital planning is key, as excessive debt leads to increased financial risk and weakens financial performance.

Chen et al. (2021) investigated Chinese firms and found that firms with higher equity financing performed better, especially in volatile industries. The research suggested that equity-based capital structures reduce the burden of fixed interest payments, thereby supporting financial stability and growth.

Patel and Joshi (2021) focused on Indian pharmaceutical companies and observed that long-term debt has a stronger negative impact on profitability than short-term debt. Their study recommended that firms rely more on retained earnings and equity for sustainable financial health.

Singh and Bansal (2020) conducted research on Indian service sector firms. Their findings showed that capital structure has a moderate effect on performance. Specifically, companies with higher reserves and moderate levels of long-term debt performed better in terms of profitability and return on equity.

Osei and Amankwah (2020) analyzed Ghanaian listed companies and concluded that capital structure choices significantly affect financial performance. They observed that moderate levels of debt positively influenced returns, but excessive borrowing had the opposite effect, hurting firm value.

Ahmed et al. (2019) examined firms in Pakistan and discovered that using more equity financing rather than debt leads to better financial results. The study emphasized that high debt levels increase financial risk, which can negatively affect return on assets and shareholder value.

Kumar and Sharma (2018) studied manufacturing companies in India to understand how their mix of debt and equity affects profitability. They found that companies with a balanced capital structure tend to perform better. Too much debt, however, was linked to financial stress and reduced profits, suggesting the importance of a well-managed capital mix.

Objectives of the Study

- To evaluate the impact of capital structure on financial performance of Hotel Companies.

Hypothesis

$H_{0:}$ There is no significant impact of capital structure on financial performance of Hotel companies.

RESEARCH METHODOLOGY

The research methodology deals with whole research procedure such as objectives of the study research design, sample design, nature of data required for the present study, sources of data, various tools and techniques used for the analysis of data. The research design of present study is descriptive-cum-analytical in nature. In the present study, all NSE listed Hotels companies are considered as population or universe. The top five Hotels companies such as Indian Hotels, EIH, Chalet Hotels, Lemon Tree Hotels and Juniper Hotels are selected as sample based on marketcapitalisation from all Hotels companies listed in NSE. The present research work mainly focusses on the secondary source of data related to capital structure of sampled companies. The required data collected from the Annual Reports of sampled Hotels Companies during the study period from 2014-15 to 2023-24. The collected data in the preset research work are analysed with help of statistical tools and techniques such as average, standard deviation and multiple regression analysis.

DATA ANALYSIS AND INTERPRETATION

The Data Analysis and Interpretation' involves the analysis of collected data and interpretation of results of research work. This Part of the present research work deals with analysis of impact of capital structure on profitability of Hotel companies sampled companies of Indian Hotel Industry for the study period 2014-15 to 2023-24. In this research work, capital structure is taken as independent variable and profitability is considered as dependents variable. To obtain the objective of the study, equity share capital, reserve & surplus and debts are the proxy variables of capital structure. Whereas, the net profit and return on capital employed are considered as proxy variables of profitability. The analysis of collected data are following:

Table-1

Regression Analysis of Capital Structure and Net Profit of Hotel companies

Model-1	**Dependent Variable: NP**			
Independent Variables	**Coefficients**	**Std. Error**	**T-value**	**P-value**
(Constant)	-13.790	13.130	-1.050	0.299
Equity Share Capital	0.023	0.019	1.233	0.224
Reserve & Surplus	0.004	0.002	1.823	0.075
Debts	-0.004	0.005	-0.755	0.454
R	0.358			
R-square	0.128			
Adjusted R^2	0.071			
F-Statistics	2.250			
p-value	.095			

Source: Researcher Calculations based on Annual Reports of Sampled Companies using SPSS

Table-1 shows that the result of regression analysis of capital structure elements Equity Share Capital, Reserves & Surplus, and Debts and Net Profit (NP) of hotel companies. The results indicate that the overall model explains about 12.8% of the variation in net profit, as shown by the R-square value of 0.128. The adjusted R-square, which accounts for the number of predictors, is slightly lower at 0.071, suggesting that the model has a limited explanatory power.

Looking at the individual variables, Equity Share Capital has a positive coefficient of 0.023, meaning it has a mild positive impact on net profit, but this result is not statistically significant since the p-value is 0.224. Similarly, Reserves & Surplus also show a positive relationship with net profit, with a coefficient of 0.004. Interestingly, its p-value is 0.075, which is closer to the commonly accepted significance threshold (0.05), indicating a potentially meaningful influence that may require further investigation. On the other hand, Debts have a negative coefficient (-0.004), suggesting a negative impact on profit, but again, this result is not statistically significant due to a high p-value of 0.454.

The model's F-statistic is 2.250 with a p-value of 0.095, indicating that the overall regression model is only marginally significant. In simple terms, while there is some evidence that capital structure elements, especially reserves, might influence hotel companies' profits, the relationship is not strong or conclusive in this analysis. Further studies with larger datasets or additional variables might help in achieving clearer results.

Table-2

Regression Analysis of Capital Structure and Return on Capital Employed (ROCE) of Hotel companies

Model-2	**Dependent Variable: ROCE**			
Independent Variables	**Coefficients**	**Std. Error**	**T-value**	**P-value**
(Constant)	3.437	2.629	1.307	0.198
Equity Share Capital	0.001	0.004	0.235	0.815
Reserve & Surplus	0.001	0.000	1.864	0.069
Debts	0.000	0.001	-0.422	0.675
R	0.322			
R-square	0.104			
Adjusted R^2	0.045			
F-Statistics	1.776			
p-value	0.165			

Source: Researcher Calculations based on Annual Reports of Sampled Companies using SPSS

Table-2 presents the results of a regression analysis that explores the relationship between capital structure components and the Return on Capital Employed (ROCE) of hotel companies. The capital structure variables included in the model are Equity Share Capital, Reserve & Surplus, and Debts. The analysis aims to understand how these financial factors impact the company's efficiency in generating returns from its capital.

The R-square value is 0.104, meaning that only about 10.4% of the variation in ROCE can be explained by the model. The adjusted R-square drops to 0.045, indicating that after adjusting for the number of predictors, the model's explanatory power is even weaker. This suggests that other factors outside the ones included here may be playing a more significant role in determining ROCE.

Looking at the individual coefficients, Equity Share Capital has a very small positive effect on ROCE (0.001), but it is statistically insignificant with a high p-value of 0.815. Reserve & Surplus also shows a small positive effect (0.001), and while it comes closer to significance with a p-value of 0.069, it still does not meet the usual cutoff of 0.05. Debts show a negligible negative impact (coefficient 0.000) and are not statistically significant, as indicated by a p-value of 0.675.

The F-statistic of 1.776 and corresponding p-value of 0.165 further confirm that the overall model is not statistically significant. In simple terms, this means the variables related to capital structure do not have a strong or reliable influence on the return on capital employed for hotel companies in this analysis. More robust models or additional variables may be needed to better explain ROCE in this sector.

Findings

The study used regression analysis to understand how capital structure affects the financial performance of hotel companies listed on the NSE. Two key financial indicators were tested: Net Profit (NP) and Return on Capital Employed (ROCE).

1. Net Profit:

- The regression model explains only 12.8% of the variation in net profit of hotel companies, meaning most changes in profit are influenced by factors not included in this model.
- After adjusting for the number of variables used, the explanatory power drops slightly to 7.1%, suggesting that the model is not very strong.
- Equity Share Capital shows a small positive effect on net profit (coefficient = 0.023), but the result is not statistically reliable as the p-value is 0.224.
- Reserves & Surplus also have a positive impact (coefficient = 0.004), and with a p-value of 0.075, it comes close to being statistically significant. This means it could influence profit, but more research is needed to confirm it.
- Debt has a negative effect on net profit (coefficient = -0.004), but the relationship is not significant due to a high p-value of 0.454.
- The F-statistic is 2.250 with a p-value of 0.095, indicating that the overall model is only marginally significant and not very strong.

2. Return on Capital Employed (ROCE)

- The R-square value is 10.4%, which means the model explains only a small portion of the changes in Return on Capital Employed (ROCE) for hotel companies.
- After considering the number of variables, the adjusted R-square drops to just 4.5%, indicating the model has very limited ability to explain ROCE.
- The effect of Equity Share Capital on ROCE is very small (coefficient = 0.001) and not significant, as shown by the high p-value of 0.815.
- This variable has a small positive effect (coefficient = 0.001) and a p-value of 0.069, which is closer to significance, but still not strong enough to be conclusive.
- The coefficient for Debts is 0.000, showing almost no effect on ROCE, and it is not statistically significant with a p-value of 0.675.

- The F-statistic is 1.776 with a p-value of 0.165, meaning the overall model does not statistically explain the changes in ROCE.

Conclusion

The study concludes that the capital structure elements such as Equity Share Capital, Reserves & Surplus, and Debts have a very limited impact on the Return on Capital Employed (ROCE) of hotel companies. The model used in the study explains only a small portion of the changes in ROCE, and most of the results are not statistically significant. While Reserves & Surplus show a slight positive effect, it is still not strong enough to be considered reliable. Overall, the findings suggest that capital structure alone cannot explain how efficiently hotel companies use their capital to generate returns. Other important factors, such as operational efficiency, management quality, or market conditions, may play a bigger role.

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