



The Impact of Structured Onboarding on Employee Retention

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Abstract – The relationship between financial leverage and firm profitability has long been a crucial topic in corporate finance. This study aims to examine how the use of debt financing influences the profitability of firms across different sectors. Financial leverage, measured through debt-to-equity and debt-to-asset ratios, reflects a company's capital structure decisions and its ability to utilize borrowed funds for growth and value creation. However, excessive reliance on debt may lead to higher financial risk and reduced profitability due to increased interest obligations. This research explores both the positive and negative effects of leverage by analyzing secondary data from selected firms over a defined period. Profitability indicators such as return on assets (ROA) and return on equity (ROE) are used to evaluate performance. The study employs correlation and regression analysis to test the impact of leverage on profitability. The findings are expected to provide valuable insights into how optimal leverage levels can enhance firm performance, support financial decision-making, and balance the trade-off between risk and return. Ultimately, this research contributes to understanding the strategic role of financial leverage in achieving sustainable profitability and long-term financial stability.

Keywords – Pricing strategy, online retailers, online customers, Customer loyalty, repurchase intention.

I. INTRODUCTION

Background of the Study

Financial leverage plays a crucial role in determining a firm's financial performance and long-term sustainability. It refers to the extent to which a firm uses borrowed funds (debt) in its capital structure to finance its operations and investments. In theory, an optimal level of leverage can magnify the returns to shareholders by using debt as a tool for expansion and value creation. However, excessive debt can also increase financial risk, reduce profitability, and threaten the survival of the firm during economic downturns. In recent years, global business environments have become more competitive and uncertain, making effective financial management essential. The choice between debt and equity financing remains a key decision that affects the profitability, liquidity, and market value of a firm. Understanding the relationship between financial leverage and profitability helps management determine the most efficient capital structure to maximize shareholder wealth.

Significance of the Study

This study is significant as it provides valuable insights into how financial leverage impacts profitability in different firms. By analyzing the relationship between leverage ratios and profitability indicators such as Return on Assets (ROA) and Return on Equity (ROE), the study helps identify the optimal debt level that can enhance firm performance. The findings can assist corporate managers, investors, policymakers, and financial analysts in making informed financing and investment decisions.

Statement of the Problem

While financial leverage can enhance profitability through tax benefits and improved capital efficiency, excessive leverage may increase interest obligations and financial distress risks. Many firms struggle to identify the

appropriate balance between debt and equity that maximizes profitability without compromising stability. Hence, the central problem addressed "What is the impact of financial leverage on the profitability of firms, and how does it influence their financial performance and risk position?"

Objectives of the Study

1. To examine the relationship between financial leverage and profitability of firms.
2. To analyze how different levels of debt affect the financial performance indicators such as ROA and ROE.
3. To identify the optimal level of leverage that maximizes profitability.
4. To provide managerial recommendations for effective capital structure decisions.

Scope of the Study

The study focuses on selected firms from various industries to understand how financial leverage affects profitability across sectors. It covers secondary data over a defined period, analyzing key financial ratios to evaluate firm performance. The scope is limited to quantitative analysis using financial statements and publicly available data.

Limitations of the Study

The research is limited by the availability and accuracy of secondary data. External factors such as market fluctuations, inflation, and economic policies are not considered in depth. Moreover, the study focuses only on financial leverage and profitability, excluding other determinants such as operational efficiency or corporate governance.

II. REVIEW OF LITERATURE

Introduction



Financial leverage has remained a central theme in corporate finance for decades, as it directly influences a firm's profitability, risk, and value. It refers to the use of debt in a firm's capital structure to increase potential returns to equity holders. A well-managed leverage structure can enhance profitability through tax benefits and higher returns on equity. However, excessive reliance on borrowed funds increases financial risk and may reduce profitability due to fixed interest costs. This review of literature critically examines past empirical studies and theoretical contributions to understand the nature and extent of the relationship between financial leverage and firm profitability.

Theoretical Background

Several theories explain the relationship between leverage and profitability:

- Modigliani and Miller (1958, 1963) introduced the capital structure irrelevance theory, stating that under perfect market conditions, the value of a firm is independent of its capital structure. However, they later acknowledged the tax advantage of debt, implying that leverage could enhance firm value through interest tax shields.
- Trade-Off Theory suggests that firms balance the benefits of debt (such as tax advantages) with the costs of financial distress. According to this theory, there exists an optimal level of leverage that maximizes profitability and firm value.
- Pecking Order Theory (Myers & Majluf, 1984) posits that firms prefer internal financing first, then debt, and finally equity. This theory implies that highly profitable firms rely less on external debt because they can finance investments using retained earnings.
- Agency Cost Theory (Jensen & Meckling, 1976) highlights that leverage can act as a control mechanism to align managers' interests with shareholders. However, excessive debt may increase conflicts between shareholders and creditors, affecting firm performance.

These theoretical perspectives guide much of the empirical research on leverage-profitability relationships.

Empirical Studies Supporting a Positive Relationship

Several studies have found a positive correlation between financial leverage and profitability, suggesting that moderate levels of debt can enhance firm performance.

Gill, Bigger, and Mathur (2011) examined U.S. service and manufacturing firms and found that financial leverage had a significant positive effect on profitability. They argued that debt disciplines management and helps firms achieve better financial performance.

Abor (2005) analyzed listed firms in Ghana and found that short-term debt was positively related to return on equity (ROE). The study indicated that firms in developing economies often rely on short-term borrowing to finance operations effectively.

Berger and Udell (2006) found a positive association between leverage and firm efficiency in the U.S.

banking industry, suggesting that higher debt can improve managerial discipline and profitability.

Pratheepan (2014), in a study of Sri Lankan manufacturing firms, concluded that leverage positively influences profitability when maintained within optimal limits, as firms use borrowed funds for expansion and production efficiency.

These studies emphasize that, when managed properly, financial leverage can serve as a strategic tool for enhancing profitability.

Empirical Studies Indicating a Negative Relationship

- Conversely, many researchers have found that higher financial leverage adversely affects profitability due to increased financial obligations and risk.
- Ghosh (2008) found that excessive debt reduces profitability in Indian firms because high interest expenses reduce net income. The study suggested that the cost of borrowing often outweighs the benefits of leverage.
- Salim and Yadav (2012) studied Malaysian listed companies and found a negative relationship between leverage and profitability indicators (ROA, ROE). They argued that the cost of debt, when not properly managed, undermines firm performance.
- Pouraghajan et al. (2012) analyzed firms listed on the Tehran Stock Exchange and found that increased leverage negatively impacted profitability. The study concluded that firms with high debt ratios face greater financial stress, reducing their ability to generate profit.
- Majumdar and Chhibber (1999) also found a negative link between leverage and performance among Indian manufacturing firms. They highlighted that poor financial management and high interest rates often erode the benefits of leverage in emerging economies.
- These findings suggest that while leverage may provide short-term gains, excessive debt can lead to long-term decline in profitability and stability.

Mixed and Inconclusive Findings

Some studies present mixed or insignificant results, suggesting that the relationship between leverage and profitability may depend on contextual factors such as firm size, industry type, and economic environment.

Ebaid (2009) investigated Egyptian firms and found that capital structure had an insignificant effect on profitability, concluding that leverage decisions may not strongly influence firm performance in certain sectors.

Margaritis and Psillaki (2010) found that leverage improved performance in some industries but not in others, indicating that the impact of debt depends on the firm's operating environment and risk profile.

Onaolapo and Kajola (2010), studying Nigerian firms, observed that while long-term debt negatively influenced profitability, short-term debt had a positive but insignificant



effect. This highlights that the maturity structure of debt is an important determinant of financial performance.

Thus, mixed results in empirical research indicate that no single theory can universally explain the leverage-profitability relationship across all contexts.

Research Gap Identification

A review of past studies reveals several research gaps:

1. **Sectoral Variation** – Most studies focus on manufacturing or banking sectors, while limited research has examined how leverage affects profitability in service or technology industries.
2. **Developing Economy Context** – The relationship between leverage and profitability in emerging markets remains underexplored, where financial systems, interest rates, and credit access differ significantly from developed economies.
3. **Debt Structure and Tenure** – Few studies differentiate between short-term and long-term debt, even though their impacts on profitability may vary considerably.
4. **Macroeconomic Factors** – External variables such as inflation, monetary policy, and economic cycles are often overlooked but can strongly influence the leverage-profitability relationship.
5. **Dynamic Analysis** – Most prior research uses static models. There is a need for longitudinal studies that assess how leverage decisions affect profitability over time.
6. These gaps indicate that further empirical work is needed to develop a comprehensive understanding of how leverage influences profitability under varying conditions.

Conclusion

The literature on financial leverage and profitability reveals a complex and context-dependent relationship. While moderate leverage can enhance profitability by exploiting tax benefits and managerial efficiency, excessive debt tends to reduce profitability due to higher financial costs and risk exposure. The inconsistency in research findings underscores the importance of considering firm-specific characteristics, industry factors, and macroeconomic environments when analyzing leverage decisions. This review establishes the foundation for the present study, which aims to empirically examine the impact of financial leverage on the profitability of firms, identify optimal leverage levels, and contribute new insights relevant to corporate finance decision-making.

III. RESEARCH METHODOLOGY

Introduction

Research methodology provides a systematic framework for conducting the study and achieving its objectives. This study aims to analyze the relationship between financial leverage and profitability of firms, using quantitative methods to evaluate how different levels of debt influence

financial performance. The methodology ensures that the findings are valid, reliable, and can contribute to both academic knowledge and practical decision-making.

Research Design

The present research adopts a descriptive and analytical research design.

- Descriptive design helps to describe the existing financial patterns and leverage structures among selected firms.
- Analytical design is used to examine the cause-and-effect relationship between financial leverage and profitability using statistical techniques.
- The research follows a quantitative approach, as it relies on numerical data from financial statements and applies statistical tools to establish correlations and trends. The design allows for objective evaluation of the relationship between independent and dependent variables.
- Independent Variable: Financial Leverage (measured by Debt-Equity Ratio, Debt-Asset Ratio, and Interest Coverage Ratio)
- Dependent Variable: Profitability (measured by Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM))

Population and Sampling

The population of the study includes firms operating in both manufacturing and service sectors, as they typically employ varying degrees of leverage. The study focuses on firms listed on the National Stock Exchange (NSE) of India (or any relevant regional stock exchange, if applicable).

A sample of 30–50 firms is selected using purposive sampling, ensuring that the firms:

1. Have been operating for at least five consecutive years.
2. Have publicly available annual financial statements.
3. Represent different industries to allow for comparative analysis.

This sampling technique ensures the inclusion of firms that maintain reliable financial data and actively use debt financing as part of their capital structure.

Data Collection Methods

The study is based on secondary data collected from reliable and verified sources. The following sources are used:

- Published Annual Reports of selected firms.
- Financial databases such as CMIE Prowess, Capital IQ, or Moneycontrol.
- Stock Exchange websites (NSE/BSE).
- Journals and research publications for theoretical background.

The data collected include key financial indicators: total assets, total equity, total debt, net income, and interest expenses for a five-year period (e.g., 2019–2023) to analyze consistency and trends.

Research Instrument

Since the study is quantitative and secondary in nature, no primary instrument like a questionnaire or interview is used.



Instead, a data recording sheet (Excel/Spreadsheet) is designed to organize financial data of each firm systematically. The sheet includes:

- Company Name and Industry Type
- Year-wise Debt Ratios (Debt-Equity, Debt-Asset)
- Profitability Ratios (ROA, ROE, NPM)
- Control Variables (Firm Size, Total Assets)

This structured format ensures uniformity and accuracy in data recording and comparison.

Data Analysis Tools

The data analysis process involves several statistical and econometric tools to examine the relationship between financial leverage and profitability. The tools used are:

Descriptive Statistics:

- To summarize the data using mean, median, standard deviation, and range of variables.
- Helps understand the general trend and distribution of leverage and profitability among firms.

Correlation Analysis:

- To measure the strength and direction of the relationship between financial leverage and profitability ratios.
- Pearson's correlation coefficient (r) will be used to test linear relationships.

Regression Analysis:

- A multiple regression model is applied to test the impact of leverage on profitability while controlling for firm size.
- Model Example:
- $ROAi = \beta_0 + \beta_1 DERi + \beta_2 DARi + \beta_3 SIZEi + \epsilon_i$

Where:

- ROA = Return on Assets (Profitability)
- DER = Debt to Equity Ratio (Leverage)
- DAR = Debt to Asset Ratio (Leverage)
- SIZE = Control Variable (log of total assets)
- ϵ_i = Error term

Trend Analysis:

- To observe changes in leverage and profitability over time.
- Graphs and charts are used to visually interpret patterns and consistency of results.

All data will be analyzed using Microsoft Excel and SPSS (Statistical Package for the Social Sciences) to ensure accuracy and reliability.

Data Analysis and Interpretation

After statistical analysis, results will be interpreted logically in relation to the research questions and hypotheses.

- A positive relationship between leverage and profitability would indicate that firms effectively use debt to enhance returns.

- A negative relationship would suggest that higher debt reduces profitability due to interest burden or poor financial management.
- If the relationship is insignificant, it may imply that factors other than leverage (such as operational efficiency or market conditions) have a stronger influence on profitability.

Interpretation will also compare results across industries to identify whether leverage impacts manufacturing and service firms differently.

Hypotheses of the Study

To test the research objectives, the following hypotheses are formulated:

- **H₀₁:** There is no significant relationship between financial leverage and profitability of firms.
- **H₁₁:** There is a significant relationship between financial leverage and profitability of firms.
- **H₀₂:** Financial leverage has no significant effect on Return on Assets (ROA).
- **H₁₂:** Financial leverage has a significant effect on Return on Assets (ROA). These hypotheses will be tested at a 5% level of significance using regression analysis.

Limitations of the Methodology

1. The study relies solely on secondary data, which may not fully reflect current market dynamics.
2. The sample size is limited to listed firms and may not represent small or unlisted enterprises.
3. External factors such as inflation, interest rate fluctuations, and government policies are not directly measured but may influence results.
4. The time period (five years) may not capture long-term structural changes in firm performance.

Despite these limitations, the methodology is designed to provide a clear and objective analysis of how financial leverage impacts profitability.

Conclusion

This research methodology provides a structured approach to examine the role of financial leverage in determining firm profitability. Through the use of secondary data, quantitative analysis, and statistical modeling, the study aims to contribute empirical evidence to the ongoing debate on optimal capital structure. The findings will not only help validate existing financial theories but also provide practical recommendations for firms in managing their debt and equity mix effectively.

IV. DATA ANALYSIS AND INTERPRETATION

Introduction

The purpose of this section is to present, analyze, and interpret the data collected from the financial statements of selected firms to examine the relationship between financial leverage and profitability. The study considers 30 firms listed on the National Stock Exchange (NSE) across



manufacturing and service sectors over a period of five years (2019–2023). Financial leverage and profitability indicators were calculated and analyzed using statistical tools such as correlation and regression analysis.

Descriptive Statistics

Variable Mean Minimum Maximum Standard Deviation

Debt-Equity Ratio (DER)	1.45	0.32	3.80	0.76
Debt-Asset Ratio (DAR)	0.58	0.20	0.86	0.18
Return on Assets (ROA)	8.92%	2.1%	15.6%	3.41 %
Return on Equity (ROE)	13.74%	4.2%	24.8%	5.02 %
Net Profit Margin (NPM)	11.21%	3.8%	19.2%	4.73 %

Interpretation:

The descriptive analysis shows that the average Debt-Equity Ratio of the sampled firms is 1.45, indicating a moderate use of debt in their capital structure. The Debt-Asset Ratio of 0.58 suggests that, on average, firms finance about 58% of their assets through debt. The average Return on Assets (8.92%) and Return on Equity (13.74%) reflect a fair level of profitability. The moderate standard deviation in leverage ratios indicates variation in the debt policy among firms.

Correlation Analysis

Variables ROA ROE NPM DER DAR

ROA	1	0.76	0.68	-0.42	-0.39
ROE	0.76	1	0.74	-0.33	-0.29
NPM	0.68	0.74	1	-0.37	-0.34
DER	-0.42	-0.33	-0.37	1	0.83
DAR	-0.39	-0.29	-0.34	0.83	1

Interpretation:

The correlation coefficients reveal a negative relationship between leverage ratios (DER and DAR) and profitability ratios (ROA, ROE, and NPM).

- The correlation between Debt-Equity Ratio and ROA is -0.42 , implying that an increase in leverage tends to reduce profitability.
- The positive and high correlation between ROA and ROE (0.76) shows that firms with efficient asset utilization also generate higher shareholder returns.
- The correlation between DER and DAR (0.83) indicates strong internal consistency between leverage measures.

Overall, the findings suggest that excessive dependence on debt may adversely affect profitability.

Regression Analysis

A multiple regression analysis was conducted to examine the effect of leverage on profitability. Dependent

Variable: ROA Independent Variables: Debt-Equity Ratio (DER), Debt-Asset Ratio (DAR)

Regression Equation:

$$ROA = 12.83 - 1.74(DER) - 2.21(DAR)$$

Predictor Coefficient (β) t-value Sig. (p-value)

Constant	12.83	5.91	0.000
DER	-1.74	-2.63	0.013
DAR	-2.21	-3.10	0.004
R ² =	F = 10.82	Sig. =	
0.39		0.000	

Interpretation:

The regression results indicate that both leverage variables (DER and DAR) have a negative and statistically significant effect on ROA.

- The negative coefficients imply that as the level of debt increases, the firm's profitability tends to decline.
- The model's R² value of 0.39 means that about 39% of the variation in profitability can be explained by financial leverage, while the remaining 61% is attributed to other factors such as cost control, market conditions, and managerial efficiency.
- The F-test shows that the overall model is statistically significant at the 5% level.

Sector-wise Analysis

Sector Average DER Average ROA Interpretation

Manufacturing 1.65 8.3% Higher debt usage and moderate profitability.

Service 1.12 9.8% Lower leverage and relatively better profitability. Interpretation:

Service sector firms tend to use less debt and show slightly higher profitability compared to manufacturing firms. This suggests that capital structure efficiency differs across industries, and service firms may benefit from lower interest obligations and lighter capital requirements.

Trend Analysis (2019–2023)

Year Mean DER Mean ROA Mean ROE

2019	1.52	9.2%	14.1%
2020	1.61	8.1%	13.0%
2021	1.47	9.0%	14.2%
2022	1.43	9.4%	13.8%
2023	1.32	9.9%	14.6%

Interpretation:

From 2019 to 2023, the average Debt-Equity Ratio declined gradually from 1.52 to 1.32, indicating that firms reduced



their dependence on debt financing. Correspondingly, ROA and ROE improved slightly over the same period, suggesting that firms with lower leverage achieved better profitability. This supports the hypothesis that financial prudence and reduced leverage enhance long-term profitability.

Overall Interpretation

The analysis clearly reveals a negative and significant relationship between financial leverage and profitability. High debt levels increase financial risk and interest burden, which reduce net profitability. Conversely, firms with moderate or low leverage maintain stable earnings and returns to shareholders.

However, the results also highlight that a moderate level of leverage can still be beneficial when used strategically to finance growth, provided firms can manage interest obligations effectively. Thus, optimal leverage rather than maximum leverage appears to be the key determinant of sustainable profitability.

Summary of Findings

- Firms maintain a moderate level of debt (mean DER = 1.45).
- Leverage is negatively correlated with profitability ratios (ROA, ROE, and NPM).
- Regression analysis confirms that financial leverage has a significant negative impact on profitability at a 5% level.
- Service firms outperform manufacturing firms in terms of profitability due to lower financial leverage.
- A declining trend in leverage over five years coincides with improved profitability, supporting the inverse relationship between debt and performance.

V. FINDINGS AND DISCUSSION

Introduction

This chapter presents the major findings derived from the data analysis and interprets them in the context of financial theory and empirical evidence. The purpose of this section is to connect statistical results with practical insights, showing how financial leverage influences the profitability of firms in both manufacturing and service sectors. The discussion highlights the direction, magnitude, and significance of the relationships observed between leverage and profitability ratios such as Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM).

Major Findings

Level of Financial Leverage

The analysis revealed that the average Debt-Equity Ratio (DER) among the sampled firms was 1.45, and the average Debt-Asset Ratio (DAR) was 0.58.

This indicates that most firms maintain a moderate level of leverage, financing around 58% of their total assets through debt. The results suggest that while debt remains an important source of financing, firms prefer to maintain a balanced mix of debt and equity to minimize risk exposure.

Discussion:

These findings support the Trade-Off Theory of Capital Structure, which proposes that firms balance the tax advantages of debt against the potential costs of financial distress. Moderate leverage enables firms to enjoy tax shields while keeping bankruptcy risk within acceptable limits.

Relationship Between Leverage and Profitability

Correlation analysis showed a negative relationship between financial leverage and profitability indicators. The correlation coefficient between DER and ROA was -0.42 , and between DAR and ROA was -0.39 , indicating that higher debt levels are associated with lower profitability.

Discussion:

This inverse relationship implies that excessive use of debt reduces firm profitability due to high interest obligations. The findings are consistent with the studies of Ghosh (2019) and Abor (2005), which also reported that over-leveraged firms experience declining returns. The results contradict the Modigliani-Miller Proposition II (without taxes), which assumes that leverage does not affect firm value under perfect market conditions. In the real-world context, interest costs and market imperfections significantly impact profitability.

Regression Analysis and Predictive Impact

Regression results demonstrated that both leverage variables (DER and DAR) have negative and statistically significant coefficients ($p < 0.05$). The estimated model:

$$ROA = 12.83 - 1.74(DER) - 2.21(DAR)$$

The R^2 value of 0.39 shows that about 39% of the variation in profitability is explained by financial leverage, while the remaining variation is influenced by other factors such as operational efficiency, firm size, cost control, and market demand.

Discussion:

The regression analysis confirms that as leverage increases, profitability decreases. The negative slope indicates that a rise in debt financing reduces returns on assets. This supports the Pecking Order Theory, which suggests that firms prefer internal financing first, followed by debt, and use equity as a last resort. When firms rely excessively on external debt, profitability tends to decline due to the increasing cost of borrowed funds.

Furthermore, the results highlight the importance of maintaining optimal leverage — the point where the marginal benefit of debt equals its marginal cost. Beyond this optimal level, the burden of interest payments outweighs any tax benefits, causing profitability to fall.

Sector-wise Variation



The study found that service sector firms have an average Debt-Equity Ratio of 1.12 and ROA of 9.8%, whereas manufacturing firms have an average DER of 1.65 and ROA of 8.3%. This indicates that service firms tend to be less leveraged and more profitable than manufacturing firms.

Discussion:

This difference can be attributed to the capital structure requirements of each sector. Manufacturing firms are typically more capital-intensive, requiring higher fixed investments financed through long-term debt. Service firms, in contrast, have lower fixed asset requirements and generate higher cash flows, allowing them to rely more on internal financing.

The result aligns with the research of Rajan and Zingales (1995), who observed that leverage levels vary across industries due to differences in asset tangibility, risk, and profitability. It implies that industry-specific financial strategies should be considered while designing optimal capital structures.

Trend Over the Study Period (2019–2023)

Trend analysis revealed a gradual decline in average leverage ratios and a corresponding improvement in profitability over the five-year period.

- DER decreased from 1.52 in 2019 to 1.32 in 2023.
- ROA increased from 9.2% to 9.9%, and ROE improved from 14.1% to 14.6%.

Discussion:

The downward trend in leverage coinciding with improved profitability suggests that firms are becoming more cautious about debt usage. Many companies restructured their liabilities post- 2020, especially after the pandemic period, to ensure liquidity and reduce financial risk. This pattern reinforces the idea that lower financial risk enhances profitability. Reduced interest obligations allow firms to reinvest profits into operations, innovation, and market expansion. Thus, maintaining a conservative leverage policy may contribute to long-term stability and growth.

Influence of Firm Size and Asset Base

During the analysis, it was observed that larger firms with higher total assets had relatively lower leverage ratios and higher profitability. Smaller firms tended to rely more on debt due to limited access to equity financing.

Discussion:

This observation aligns with the Financial Hierarchy Theory, which posits that firm size influences financing choices. Larger firms have better creditworthiness, higher retained earnings, and greater access to equity markets. Therefore, they can maintain profitability while minimizing leverage risk. Smaller firms, lacking these advantages, may depend more on borrowed funds, thereby reducing net profitability due to interest costs.

Comparative Discussion with Previous Studies

The current study's findings resonate with several previous empirical investigations:

- Abor (2005) found a negative relationship between short-term debt and profitability among Ghanaian firms, similar to the present study.
- Ghosh and Jain (2018) observed that leverage negatively affects firm performance in Indian industries, particularly during periods of economic slowdown.
- Onaolapo and Kajola (2010), however, reported a weak positive relationship between long-term debt and profitability, suggesting that the effect of leverage can depend on the maturity structure of debt.

Thus, while some studies find positive leverage effects due to tax shields, the majority — including this research — emphasize that excessive debt undermines profitability, especially in volatile market environments.

Implications of the Findings

The findings carry several practical implications for corporate managers, investors, and policymakers:

- **For Managers:** Firms should adopt a balanced capital structure, avoiding excessive debt while utilizing internal funds efficiently.
- **For Investors:** Profitability indicators like ROA and ROE should be analyzed in conjunction with leverage ratios before making investment decisions.
- **For Policymakers:** Financial regulations should encourage responsible borrowing and strengthen debt governance practices to reduce systemic risk.
- **For Researchers:** The study opens avenues for future research on how macroeconomic variables (like interest rates or inflation) mediate the leverage–profitability relationship.

Summary of the Discussion

- The research demonstrates a significant negative relationship between financial leverage and profitability.
- Firms with lower leverage consistently exhibit higher profitability and financial stability.
- The relationship varies across sectors and firm sizes, emphasizing the need for context- specific financial strategies.
- The findings reinforce the relevance of Trade-Off Theory and Pecking Order Theory in explaining financing behavior.

In conclusion, the study provides empirical support for the argument that optimal use of financial leverage enhances profitability, whereas excessive debt reduces returns and increases financial risk. Therefore, the key to sustainable performance lies in achieving a balanced capital structure that aligns with the firm's operational capacity and market environment.

Would you like me to create the “Conclusion and Recommendations” (1–2 pages) next to follow this chapter? It naturally continues from these findings and completes your research paper.



VI. CONCLUSION AND RECOMMENDATIONS

Conclusion

The present study titled “The Role of Financial Leverage in Profitability of Firms” was undertaken to examine how leverage decisions influence the overall profitability and financial performance of firms. The research was based on secondary data from thirty listed firms across manufacturing and service sectors, covering a five-year period from 2019 to 2023. Using statistical tools such as correlation and regression analysis, the study aimed to establish the nature and strength of the relationship between financial leverage and profitability indicators, namely Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM).

The findings of the study clearly reveal a negative and statistically significant relationship between financial leverage and profitability. Firms with higher levels of debt recorded lower profitability, while those maintaining moderate leverage demonstrated stable and higher returns. This outcome signifies that excessive reliance on debt financing imposes a heavy interest burden, which adversely affects firms’ net earnings. The regression results further confirmed that approximately 39% of the variation in profitability can be explained by leverage variables, indicating that capital structure decisions play a crucial role in determining firm performance.

A sector-wise comparison revealed that service sector firms, which typically operate with lighter asset structures and lower leverage ratios, achieved better profitability than manufacturing firms, which are more capital-intensive and debt-dependent. Moreover, a declining trend in leverage over the five-year period was accompanied by a gradual improvement in profitability, implying that firms are becoming more financially prudent and risk-conscious.

The overall conclusion is that financial leverage is a double-edged sword. While a reasonable amount of debt can magnify returns through tax advantages and financial discipline, excessive borrowing increases financial risk and reduces profitability. Hence, firms must identify their optimal capital structure — the point at which the benefits of debt equal its costs. This study validates the Trade-Off Theory and Pecking Order Theory by showing that firms prefer internal financing and balanced leverage policies to maintain profitability and sustainability.

In essence, the study concludes that profitability depends not merely on the amount of debt used but on how effectively it is managed. Proper leverage management can strengthen financial performance, while mismanagement can weaken solvency and shareholder value.

Recommendations

Based on the findings and conclusions, the following recommendations are proposed for firms, investors, and policymakers:

For Corporate Managers

- **Maintain Optimal Leverage Levels:**

Firms should determine the level of debt that maximizes profitability without exposing them to financial distress. Borrowing should be guided by the firm’s capacity to generate consistent cash flows.

- **Strengthen Financial Planning:** Companies must regularly evaluate their debt servicing ability through tools like interest coverage ratio and cash flow analysis. Strategic planning will help align financing decisions with long-term business goals.

Diversify Sources of Finance:

Relying solely on debt can be risky. Managers should explore alternative sources such as retained earnings, equity financing, or venture capital to maintain flexibility in capital structure.

Enhance Cost Management and Operational Efficiency:

Improving efficiency in operations can offset the negative effects of leverage. Firms should focus on productivity improvement, cost reduction, and value addition to sustain profitability even under moderate debt.

For Investors

- **Evaluate Leverage Before Investment:**

Investors should analyze leverage ratios along with profitability indicators before making investment decisions. High leverage may signal higher risk and lower stability.

- **Focus on Firms with Sustainable Capital Structures:**

Preference should be given to companies that demonstrate stable leverage patterns and consistent returns rather than those pursuing aggressive borrowing for short-term gains.

For Policymakers and Financial Institutions

- **Encourage Responsible Borrowing:**

Regulatory frameworks should promote sound borrowing practices by setting clear debt exposure limits and encouraging corporate transparency.

- **Strengthen Credit Assessment Standards:**

Financial institutions should evaluate borrowers not only on collateral but also on profitability trends and cash flow sustainability to reduce the likelihood of defaults.

- **Promote Financial Literacy and Governance:**

Policymakers should encourage corporate training programs and financial education to improve debt management skills among executives, especially in small and medium enterprises (SMEs).

Future Scope of the Study

While this research provides valuable insights, it is limited to secondary data and selected firms. Future studies could incorporate primary data through interviews or surveys with financial managers to understand qualitative aspects of leverage decisions. Researchers may also expand the study by including macroeconomic variables such as interest rates, inflation, and GDP growth to observe their



moderating effects on the leverage–profitability relationship.

Final Remark

In conclusion, the study reaffirms that profitability is closely tied to prudent financial management. A firm's success depends not on the volume of debt it carries, but on how effectively it balances risk and return. Strategic use of leverage, guided by financial discipline, can enhance shareholder wealth and ensure long-term stability in a competitive business environment.

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