Debt Structure Diversity and Corporate Financial Decision-Making: Evidence from India

Abstract

Capital structure decisions play a central role in corporate finance, influencing firm value, investment behaviour, risk exposure, and governance outcomes. Traditional capital structure theories largely assume debt homogeneity, overlooking the widespread practice of debt diversification, wherein firms raise capital from multiple sources. Creditors, beyond their role as lenders, exert significant influence over key corporate policies, including governance, dividend distribution, debt management, and mergers and acquisitions. Moreover, debt heterogeneity has profound implications for corporate decisions, affecting leverage dynamics, equity returns, cost of capital, agency conflicts, and overall firm value. Despite its critical relevance, empirical research on the impact of debt heterogeneity on corporate decision-making remains scarce.

This dissertation investigates the role of debt heterogeneity in shaping corporate decisions within Indian firms, utilizing a comprehensive sample from two major exchanges, namely the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE). The thesis addresses four central research questions concerning the firm–creditor relationship: (1) How does debt heterogeneity influence tunneling practices in Indian firms? (2) What is the impact of debt heterogeneity on the speed of capital structure adjustment (SOA)? (3) How does debt heterogeneity affect investment efficiency? and (4) What role does debt heterogeneity play in corporate risk-taking?

The empirical analysis of the first research question investigates how debt heterogeneity serves as an external governance mechanism to curb the tunneling behavior of controlling shareholders. Analyzing 2,535 listed Indian firms from 2011 to 2022, the study finds that a diverse debt structure enhances external monitoring and mitigates resource tunneling. The effect is particularly significant in family-controlled firms, where concentrated ownership amplifies tunneling risks. Covenant violations prompt creditors to strengthen monitoring, leading to a reduction in tunneling. Banks play a key role in curbing tunneling practices.

The second objective of the study examines the impact of debt heterogeneity on the speed of capital structure adjustment (SOA). Analyzing 2,913 Indian-listed firms from 2011 to 2023 with a partial adjustment model, we find that firms with diversified debt structures adjust 21% to 41% faster toward their target leverage than those with a homogeneous borrowing structure. The effect is particularly significant among group-affiliated firms, where the speed of adjustment increases by 41%–82%, supported by internal capital markets and intergroup guarantees. The implementation of the Insolvency and Bankruptcy Code (IBC) has further amplified this effect, increasing adjustment speed by 73% and confirming the IBC's role in improving credit access for firms. We also observe that debt heterogeneity significantly accelerates the adjustment speed in over-leveraged firms.

The third objective of the dissertation is to examine the role of debt heterogeneity as an external governance mechanism in enhancing investment efficiency and mitigating overinvestment and underinvestment issues. Consistent with the Efficient Monitoring Hypothesis, firms with diverse debt structures experience enhanced investment efficiency, primarily by mitigating both underinvestment and overinvestment. The effect is particularly pronounced in business group firms and cash-rich firms with high agency conflicts. However, debt heterogeneity appears less effective in addressing underinvestment issues. Post-IBC 2016, intensified creditor monitoring further constrains inefficient capital allocation, particularly by limiting excessive investments.

Finally, the study investigates the impact of debt heterogeneity on corporate risk-taking. Firms with diversified debt structures exhibit significantly lower risk-taking behavior, reinforcing the role of debt heterogeneity as an external governance mechanism. The risk-mitigating effect becomes more pronounced following the implementation of the IBC 2016, highlighting its role in strengthening creditor rights. Firms with higher agency conflicts derive the greatest risk-reduction benefits from debt diversification, underscoring its effectiveness in improving financial discipline and stability.

By presenting empirical evidence on the influential role of debt heterogeneity in corporate decision-making, this thesis contributes to the literature on tunneling, capital structure adjustment, investment efficiency, corporate governance, and risk management. The findings offer valuable insights for policymakers, creditors, and corporate managers seeking to optimize financing

strategies, strengthen governance mechanisms, and enhance financial stability through debt diversification.

Keywords: Debt Heterogeneity, Family Firms, Tunneling, Covenant Violation, Speed of Adjustment, IBC 2016, Group Firms, Investment Efficiency, Agency Problems, Corporate Risk Taking, Governance, Monitoring