
RETAINED EARNINGS AS A SOURCE OF INTERNAL FINANCING FOR BUSINESS EXPANSION: EVIDENCE FROM INDIAN LISTED FIRMS — A COMPARATIVE EXPLORATORY STUDY OF RELIANCE INDUSTRIES, TATA CONSULTANCY SERVICES, AND INFOSYS (FY2021–FY2025)

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ABSTRACT

This paper examines the role of retained earnings as a source of internal financing for business expansion in the Indian corporate context. Although the literature on capital structure has extensively explored debt-equity decisions, comparatively less attention has been paid to retained earnings as a distinct financing variable. The study adopts a faculty-style exploratory empirical design and uses a five-year comparative panel (FY2021–FY2025) for three major Indian listed firms: Reliance Industries, Tata Consultancy Services, and Infosys. A retained earnings proxy is constructed using reserves and surplus relative to total assets, given differences in reporting presentation across firms. Business expansion is interpreted through revenue growth, asset growth, and investment intensity, while leverage is considered as a financing-quality control. The comparative evidence suggests that firms with stronger retained earnings intensity exhibit greater internal financing capacity, lower dependence on debt (especially in IT firms), and more sustainable expansion profiles. The paper argues that retained earnings should be viewed not merely as an accounting residual but as a strategically significant financing reservoir. The findings are broadly consistent with pecking order reasoning and provide a practical framework for a fuller panel-data study across a larger sample of Indian firms.

Keywords: retained earnings; internal financing; business expansion; Indian firms; pecking order theory; corporate finance; reserves and surplus

1. INTRODUCTION

The financing of business expansion remains a foundational concern in corporate financial management. Firms may fund growth through external sources such as debt and equity issuance, or through internal sources such as retained earnings and depreciation-based accruals. Among these, retained earnings occupy a distinctive position: they represent profits that have been generated by the firm and reinvested rather than distributed to shareholders. In principle, such funds provide a non-dilutive and relatively low-friction financing source.

The classical pecking order argument predicts that firms prefer internal funds before turning to debt and, only subsequently, to new equity (Myers & Majluf, 1984). This preference is especially relevant in emerging markets, where financing frictions, information asymmetry, and the cost of capital may be more pronounced. Yet empirical work often treats retained earnings as a residual component within equity rather than as an analytically distinct source of finance.

This issue is materially relevant in India. Large listed firms in technology, consumer sectors, and diversified industrials often accumulate substantial internal reserves over time. These reserves may support capacity expansion, technology investments, acquisitions, network deepening, digital transformation, and balance-sheet strengthening.

The present paper adopts a deliberately cautious faculty-style exploratory design. Rather than claiming full causal inference, it uses a five-year comparative framework for three large Indian firms—Reliance, TCS, and Infosys—to demonstrate how retained earnings (proxied by reserves and surplus) relate to scale, asset base, and financing structure.

2. LITERATURE REVIEW AND THEORETICAL FRAMING

Retained earnings are conceptually important in corporate finance but often under-specified in empirical research. While accounting standards report them as part of equity, their strategic role lies in their function as internally generated investible surplus. Unlike debt, retained earnings do not require periodic servicing. Unlike new equity, they do not dilute ownership or trigger market signaling concerns.

The most relevant theoretical framework is the Pecking Order Theory (Myers & Majluf, 1984), which suggests that firms prefer internal financing, then debt, and then external equity. This ordering reflects the lower transaction costs and lower informational frictions associated with internal funds.

A second useful lens is the sustainable growth perspective, under which a firm's growth capacity is linked to profitability, retention, and leverage discipline. Retained earnings are therefore central not merely because they add to book equity, but because they expand the firm's ability to finance growth without destabilizing its capital structure.

3. RESEARCH OBJECTIVE AND HYPOTHESIS

Objective: To examine whether retained earnings (proxied by reserves and surplus) function as a meaningful source of internal financing associated with business expansion in selected Indian listed firms.

Hypothesis (H1): Firms with higher retained earnings intensity (reserves and surplus / total assets) exhibit stronger business expansion capacity and lower dependence on debt financing.

4. METHODOLOGY

This study adopts a comparative exploratory empirical design using secondary financial data.

Sample: Three large Indian listed firms were selected for demonstration because of sectoral relevance, high disclosure quality, availability of consistent five-year data, and contrasting financing profiles. The firms are Reliance Industries, Tata Consultancy Services, and Infosys.

Period: FY2021–FY2025.

Data Sources: Company annual reports / financial statements (primary conceptual source), Moneycontrol balance sheet data for consistent 5-year cross-firm extraction (comparative numeric source), and official company filings for specific equity / leverage definitions.

Operational Measures:

- **Retained Earnings Proxy (REP)** = Reserves & Surplus / Total Assets
- **Asset Base** = Total Capital and Liabilities (proxy for total assets)
- **Leverage Quality** = Long-term borrowings and debt-equity / net gearing commentary

Important Note: This manuscript intentionally uses a demonstration panel rather than overstating econometric certainty. The design is suitable for extension into a full 10-firm or 50-observation panel study.

5. EMPIRICAL DATA

Five-Year Extracted Table (Real Values)

6. FIRM-LEVEL ANALYTICAL DISCUSSION

Reliance Industries: Reliance differs materially from the IT firms because of its scale, sectoral breadth, and capital intensity. The firm's reserves and surplus increased substantially over the period, indicating continued internal accumulation at a very large scale. In capital-intensive firms, retained earnings may not eliminate debt but materially strengthen equity, lower net gearing, and improve the sustainability of expansion.

Tata Consultancy Services (TCS): TCS provides one of the clearest cases of retained earnings as internal financing. Across FY2021–FY2025, reserves and surplus remained strong, total assets expanded, and long-term borrowings remained at zero. This suggests that internal accruals serve as a primary funding layer.

Infosys: Infosys exhibits a similarly strong internal financing profile, with rising reserves and surplus, increasing asset base, and zero long-term borrowings. In knowledge-intensive firms, retained earnings support growth that may not be fully visible in physical capex, including digital capability, delivery capacity, and strategic investment.

7. COMPARATIVE INTERPRETATION

A faculty-level reading of the three firms suggests that retained earnings influence business expansion through three distinct mechanisms:

- 1. Direct Financing Channel:** Most evident in TCS and Infosys. High reserves relative to total assets, combined with zero long-term borrowings, imply that internal accruals serve as a primary funding layer.
- 2. Balance-Sheet Strengthening Channel:** Most evident in Reliance. Internal accumulation increases equity and improves leverage metrics even where debt remains part of the financing mix.
- 3. Strategic Flexibility Channel:** Most evident in IT firms. Because business expansion in TCS and Infosys is not purely plant-and-machinery driven, retained earnings support intangible and strategic growth—technology platforms, digital infrastructure, talent, and acquisitions.

8. DISCUSSION

The evidence supports a more nuanced view than the simplistic claim that retained earnings either “fund growth” or do not. Instead, retained earnings matter through sector-dependent financing pathways.

For IT services firms such as TCS and Infosys, retained earnings function as a dominant financing base. For capital-intensive diversified firms such as Reliance, retained earnings may not replace debt, but they substantially improve the quality of financing by enlarging equity buffers and containing gearing.

This distinction is important from a faculty perspective. Retained earnings should not be evaluated solely by asking whether they fully substitute for borrowing. Rather, they should be assessed by asking whether they reduce marginal financing risk, improve balance-sheet resilience, increase managerial flexibility, and support sustainable rather than fragile expansion.

9. CONCLUSION

This paper argues that retained earnings are best understood as a strategically significant internal financing reservoir in Indian listed firms. Using a five-year comparative demonstration panel of Reliance, TCS, and Infosys, the analysis shows that TCS and Infosys exhibit exceptionally strong retained earnings intensity and zero long-term borrowings across FY2021–FY2025, while Reliance demonstrates that in capital-intensive settings, retained earnings strengthen total equity and improve gearing quality even when debt remains part of the financing mix.

The paper therefore supports the proposition that retained earnings are a material source of internal financing associated with business expansion. However, the strength and mode of that relationship are sector-dependent. From a scholarly standpoint, the present study should be read as a faculty-grade exploratory empirical note rather than a definitive causal test.

10. LIMITATIONS

1. The study uses a 3-firm demonstration sample, not a full 10-firm panel.
2. “Retained earnings” is proxied by reserves and surplus for cross-firm comparability.
3. Revenue and capex were not fully standardized across the three firms in this concise manuscript version.
4. The paper is comparative and interpretive, not a full econometric test.

11. DIRECTIONS FOR FURTHER RESEARCH

A natural extension is a 10-firm, 5-year panel (50 observations) including Reliance, TCS, Infosys, HUL, Asian Paints, Titan, Maruti, Sun Pharma, Dabur, and Nestlé India. That next version should include standardized revenue from operations, total assets, capex / additions to PPE, debt-equity, correlation matrix, and panel regression.

REFERENCES

Myers, S. C., & Majluf, N. S. (1984). Corporate financing and investment decisions when firms have information that investors do not have. *Journal of Financial Economics*, 13(2), 187–221.

Reliance Industries. Consolidated balance sheet and annual report disclosures (FY2021–FY2025), including reserves & surplus and net gearing metrics.

Tata Consultancy Services. Balance sheet disclosures (FY2021–FY2025) and statement of changes in equity showing retained earnings.

Infosys. Balance sheet disclosures (FY2021–FY2025) and equity note defining retained earnings.

Table 1. Five-Year Balance Sheet Extract (₹ crore)

Firm	FY	Reserves & Surplus	Total Assets*	Long-Term Borrowings	Retained Earnings Proxy (R&S / Assets)
Reliance	2021	693,727	—	—	—
Reliance	2022	772,720	—	—	—
Reliance	2023	709,106	—	—	—
Reliance	2024	786,715	—	—	—
Reliance	2025	829,668	—	—	—
TCS	2021	74,424	109,381	0	0.680
TCS	2022	76,807	121,263	0	0.633
TCS	2023	74,172	119,827	0	0.619
TCS	2024	71,758	121,148	0	0.592
TCS	2025	75,255	132,788	0	0.567
Infosys	2021	69,029	93,939	0	0.735
Infosys	2022	66,597	99,387	0	0.670
Infosys	2023	64,793	101,337	0	0.639
Infosys	2024	79,101	114,950	0	0.688
Infosys	2025	85,256	124,936	0	0.683

* For TCS and Infosys, “Total Capital and Liabilities” from the balance sheet is used as a total-assets equivalent.

Note: Reliance is interpreted primarily through official leverage and equity disclosures in the manuscript discussion, as a standardized total-assets extraction was not finalized in this concise version.