

HOW THE MISUSE OF LEVERAGE CAN SEVERELY IMPACT THE ECONOMY: THE CASE STUDY OF EVERGRANDE AND LESSONS FOR UZBEKISTAN.

<https://doi.org/10.5281/zenodo.15628323>

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Abstract

This paper examines the negative and enduring impact of leverage in the economy resulting from its misuse. The China Evergrande Group crisis serves as an example of the severe troubles in the country's economy caused by the misuse of leverage. Evergrande has been considered one of the world's most powerful real estate companies, but it collapsed due to uncontrollable debt. Through this case study, socially available information and reports are explored, as well as focusing on the main mistakes in its capital structure strategy, causing an economic knock-on effect. This research can be helpful for Uzbekistan's Economy since in many spheres, many institutions rely on debt. In order to avoid making this kind of serious problem, the topic of leverage should not be overlooked. The article emphasizes the essence of debt management, transparency, and the omission of the regulator, recommending key resolutions for policymakers and financial managers. As many say, every process could get a positive result if everything is in moderation, and the same applies to using leverage.

MOLIYAVIY LEVERAGEDAN NOTO'G'RI FOYDALANISH IQTISODIYOTGA JIDDIY TA'SIRI: EVERGRANDE MISOLI VA O'ZBEKISTON UCHUN XULOSALAR.

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Abstrakt. Ushbu maqola leveredjning noto'g'ri ishlatilishi natijasida iqtisodiyotga salbiy va doimiy ta'sirini o'rganadi. China Evergrande Group inqirozi leverajdan noto'g'ri foydalanish natijasida kelib chiqqan mamlakat iqtisodiyotidagi

jiddiy muammolarga misol bo'la oladi. Evergrand dunyodagi eng kuchli ko'chmas mulk kompaniyalaridan biri hisoblangan, ammo u nazorat qilib bo'lmaydigan qarzlarni tufayli qulab tushgan. Ushbu misolni o'rganish orqali ijtimoiy mavjud bo'lgan ma'lumotlar va hisobotlar o'rganiladi, shuningdek, uning kapital tuzilmasi strategiyasidagi asosiy xatolarga e'tibor qaratiladi, bu esa iqtisodiy zarba beradi. Bu tadqiqot O'zbekiston iqtisodiyoti uchun foydali bo'lishi mumkin, chunki ko'p sohalarda ko'plab muassasalar qarzga tayanadi. Bunday jiddiy muammoga duch kelmaslik uchun leveraj mavzusini e'tibordan chetda qoldirmaslik kerak. Maqolada qarzni boshqarishning mohiyati, shaffofligi va tartibga soluvchining e'tiborsizligi ta'kidlanib, siyosatchilar va moliyaviy menejerlar uchun asosiy rezolyutsiyalar tavsiya etiladi. Ko'pchilik aytganidek, agar hamma narsa me'yorda bo'lsa, har bir jarayon ijobiy natija berishi mumkin va xuddi shu narsa leverajdan foydalanishga ham tegishli.

КАК НЕПРАВИЛЬНОЕ ИСПОЛЬЗОВАНИЕ ФИНАНСОВОГО ЛЕВЕРИДЖА МОЖЕТ СЕРЬЁЗНО ПОВЛИЯТЬ НА ЭКОНОМИКУ: КЕЙС EVERGRANDE И УРОКИ ДЛЯ УЗБЕКИСТАНА"

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Аннотация

В данной статье рассматривается негативное и устойчивое влияние кредитного плеча на экономику в результате его неправильного использования. Кризис китайской Evergrande Group служит примером серьезных проблем в экономике страны, вызванных неправильным использованием кредитного плеча. Evergrande считалась одной из самых влиятельных компаний в сфере недвижимости в мире, но она рухнула из-за неконтролируемого долга. В этом тематическом исследовании изучаются общественно доступная информация и отчеты, а также уделяется внимание основным ошибкам в ее стратегии структуры капитала, вызывающим экономический эффект домино. Это исследование может быть полезным для экономики Узбекистана, поскольку во многих сферах многие институты полагаются на долг. Чтобы избежать создания такого рода серьезной проблемы, нельзя упускать из виду тему кредитного плеча. В статье подчеркивается суть управления долгом, прозрачность и бездействие

регулятора, рекомендуются ключевые решения для политиков и финансовых менеджеров. Как говорят многие, любой процесс может дать положительный результат, если все будет в меру, и то же самое относится к использованию кредитного плеча.

Keywords

Financial leverage, firm performance, financial crisis, downturns, borrowed money, debt-to-equity, return on assets, return on equity.

Introduction.

Definition for Financial leverage is the usage of borrowed money to finance a company's operations and growth, which is a critical aspect of corporate finance.

Considerable benefits can be taken from leveraging debt, for instance, tax advantages and the potential for enhanced returns on equity. However, it could come alongside risks: during the economic crisis, the likelihood of financial distress can rise as high levels of debt. Therefore, it is essential to understand the effects of financial leverage on a firm's performance, particularly in emerging markets where capital markets are still evolving, and in more mature economies, financing access can vary significantly. Emerging markets propose an exceptional environment for investigating financial leverage. Whilst these economies often go through rapid growth and greater integration into the global financial system, they are marked by higher market volatility and regulatory differences. Businesses that operate in these markets might encounter unique financing constraints, which could impact their choices regarding debt and equity financing. In addition, the financial institutions in emerging markets are frequently less advanced, and the levels of investor protection can vary drastically. Certain reasons can affect choices related to corporate capital systems.

When leverage is applied wisely, it can be a powerful financial tool that strategically uses debt funds to enhance potential returns. In contrast, misused or overextended leverage may lead to serious unexpected outcomes capable of bringing down firms, reducing investor confidence, and provoking broader economic instability. The collapse of China Evergrande is a recent and dramatic example of overextended and uncontrollable debt, which has caused severe economic difficulties before defaulting on a real estate giant that accounted for \$300 billion in liabilities.¹

This research investigates the key contributors and outcomes of Evergrande's downfall, explores potential solutions for excessive leverage, and draws lessons for

¹ <https://www.bbc.com/news/business-58579833>

other countries like Uzbekistan, as well as the relationship between financial leverage and firms' performance in emerging markets. Furthermore, to prevent such a serious issue that not only impacts the company but also severely affects the country's economy, these lessons must be applied proactively in some firms to avert a downfall. Today, Uzbekistan is attracting more foreign investors and continuing to open up its economy, which means that sound leverage practices and corporate governance will be essential to avoid such financial crises.

Literature Review

The most suitable definition for Leverage could be the ratio of a company's debt to its equity. Through foundational theories, Modigliani and Miller believe that, under certain conditions, capital structure is irrelevant to firm value. However, in the real world, leverage is vital for financial performance and risk. According to the trade-off theory, debt has tax benefits, but it raises the likelihood of financial distress (Myers, 1984).

Recent financial literature highlights that over-leveraging can exacerbate downturns, particularly in capital-intensive sectors like real estate that are vulnerable to macroeconomic differences. Researchers have observed similarities between Evergrande and previous cases, such as the Lehman Brothers collapse in 2008 (Zhang, 2022). According to literature on Uzbekistan's financial development, the country's external debt has increased substantially, reaching \$64.1 billion by 2024, thereby making leverage practices a pertinent issue (World Bank, 2024).

There are many reasons why leverage is a powerful tool; for instance, it can turn into something strong, which enhances the financial position if it is used properly, or at times, can be something powerful that can destroy the whole economy itself if it is misused or poorly managed. Of course, it is risky to finance through borrowed capital to enhance potential returns, which has been central in corporate finance theory. Leverage can be a factor that magnifies losses, raises default risks, and distresses the entire economy. This issue has been approached by scholars from various perspectives to provide the right management guide.

One of the most foundational is the Trade-Off Theory (Kraus & Litzenberger, 1973), which posits that firms aim to balance the tax advantages of debt against the potential costs of financial distress. Once companies go beyond this optimal threshold, as demonstrated by the Evergrande case, debt transforms from an asset into a liability. Similarly, the Pecking Order Theory (Myers & Majluf, 1984) explains how firms prioritize internal financing, followed by debt, and view equity as a last resort. The choice made by Evergrande to build up a large debt without resorting to

equity issuance underscores the dangers that emerge when there is a lack of internal capital combined with ineffective risk management.²

The Agency Theory (Jensen & Meckling, 1976) further illuminates the misuse of leverage, suggesting that conflicts between managers and shareholders can incentivize excessive risk-taking. This is particularly evident in cases where management is rewarded for rapid expansion or short-term success, often at the expense of long-term stability. Poor governance and lack of accountability in firms – common issues in both developing economies and state-owned enterprises in Uzbekistan – can exacerbate this problem.³

Modern research also points to the Market Timing Theory⁴ (Baker & Wurgler, 2002), where firms choose debt or equity based on perceived market conditions. However, misjudging these conditions can lead to excessive leveraging during booms and collapse in times of busts. This was starkly evident in the real estate frenzy surrounding Evergrande. The Financial Accelerator Theory (Bernanke, Gertler & Gilchrist, 1996) expands the discussion by showing how financial fragility amplifies macroeconomic shocks. Overleveraged firms can cause a ripple effect throughout banking systems and supply chains, making leverage not only a corporate issue but a systemic one.

Moreover, the Too-Big-To-Fail Doctrine suggests that large corporations can afford to take on higher risks, presuming that government bailouts are available as a safety net. This results in moral hazard and weakens market discipline. In Uzbekistan, where certain companies, particularly in the energy and infrastructure sectors, are either state-supported or have strong connections to the public sector, this perception could foster a dangerous dependence on leverage without sufficient risk management.

To sum up, as it is indicated in the literature, although leverage can serve as a powerful tool for growth, its improper use, especially when strong governance, transparency, and regulation are lacking, can lead to catastrophic consequences. These theoretical insights provide a solid foundation for an analysis of the Evergrande case and draw relevant lessons for emerging economies like Uzbekistan.

Methodology

² Kraus, A., & Litzenberger, R. H. (1973). A State-Preference Model of Optimal Financial Leverage. *The Journal of Finance*, 28(4), 911–922.

³ Jensen, M. C., & Meckling, W. H. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 3(4), 305–360.

⁴ Baker, M., & Wurgler, J. (2002). Market Timing and Capital Structure. *The Journal of Finance*, 57(1), 1–32.

Focusing on secondary data, this study employed both qualitative and quantitative case study approaches and illustrated outcomes in graphical form. To depict credible information, sources include financial statements, international institution reports, and are taken from official sites such as the IMF, World Bank, etc, and new reports. To give the estimated financial position and assess leverage, financial metrics are used, like Return on Assets (ROA) and Return on Equity (ROE). Some analytical efforts are made to identify critical turning points from the Evergrande case. By looking at Uzbekistan's present leverage indicators, the significance of these lessons is enhanced, and comparative insights are derived. By understanding these relationships, the study aims to provide insights that will assist corporate managers in making informed capital structure decisions and guide investors in assessing the financial health of firms in emerging economies.

Results

Evergrande Real Estate owns more than **870** projects in more than **280** cities in China, and has established strategic cooperation with more than 860 well-known companies around the world. It follows the strategy of product excellence, to create high-quality and cost-effective products, and is a forerunner in delivering all houses with fine decoration, guaranteeing no-reason house return and online marketing, to build the dream houses for more than 6 million owners.⁵

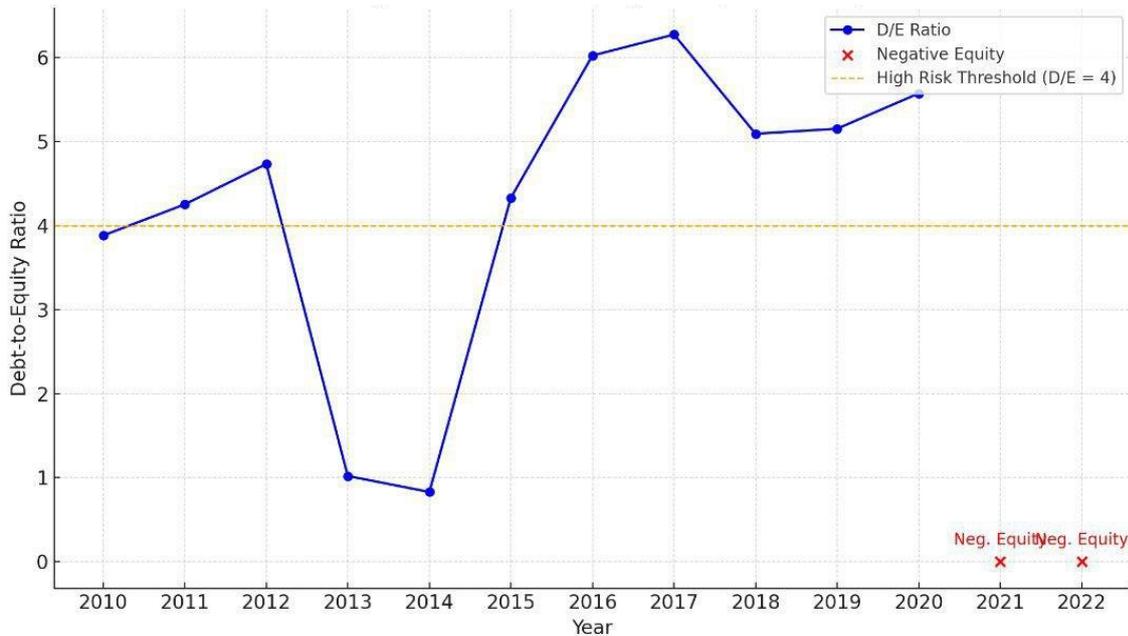
Between 2015 to 2021, Evergrande's debt increased dramatically and reached \$300 billion. In just 2020, the company owed \$ 110 billion in bonds and \$200 billion to suppliers, banks, and investors. Its interest coverage ratio fell below 1 due to decreasing cash flow and increasing interest payments, indicating that it is unable to pay its interest obligations from its earnings.

The debt-to-equity ratio is measured by the comparison between total liabilities and shareholders' equity company's financial leverage. Evergrande tried to maintain a moderate ratio, reflecting balanced growth with manageable debt levels from 2010 to 2014. Between 2015 and 2017, to fund intense expansion and new sectors, the ratio increased steadily as the company leveraged debt aggressively.

⁵ <https://www.evergrande.com/en/home>

By 2018-2020, Evergrande’s ratio reached peak levels, became highly reliant on debt and elevated financial risk amid tightening regulatory conditions. In 2021-2022, the ratio remained at high level during Evergrande’s liquidity crisis, with some lessening as a result of selling assets and restructuring, in contrast overall financial leverage proceeded to contribute solvency challenges due to some factors.

Line graph 1. Evergrande's crisis



The Collapse Timeline

- 2017-2019: Rapid expansion into non-core businesses (e.g., electric vehicles)
- 2020: China imposes "three red lines" policy limiting leverage
- 2021: Evergrande misses payments to lenders and suppliers
- 2022: Official default, major projects halted, investor panic spreads

Discussions

What Went Wrong at Evergrande?

Table 2. Evergrande's financial statement

ye	Revenue	Net income	Total equity	Total liabilities
20	133,1	10,5	142,1	614,9

20	211,4	5,1	192,5	1,158.4
20	311	24,4	242,2	1,519.6
20	466,2	37,4	308,6	1,571.4
20	477,6	17,3	358,5	1,848.0
20	507,2	8.1	350,4	1,950.7
20	250	-476	-473,1	2,580.2
20	230,1	-105,9	-599,1	2,437.4

From 2015 to 2022, the financial trajectory of China Evergrande Group reveals a textbook example of how the misuse of financial leverage, coupled with aggressive expansion and vulnerable risk controls, can lead to catastrophic outcomes for even the largest corporations.

From 2015 onwards, Evergrande has gone through explosive revenue growth, increasing from roughly RMB 133 billion in 2015 to over RMB 507 billion by 2020. This rapid expansion, largely funded by borrowed money, initially gave the illusion of strong performance and market dominance. However, the company's net income during this period remained volatile. While it earned profits in the initial years (with RMB 17 billion in 2016), profitability peaked and then began to drastically decline post-2018. By 2021 and 2022, Evergrande reported record losses, signaling deeper structural issues beneath the revenue figures.

The most concerning trend was the growth in total liabilities, which escalated from around RMB 1 trillion in 2016 to over RMB 2.4 trillion by 2021. After 2019 started deteriorating, a proportional increase in total equity was not matched with dramatic growth. An early signal of technical insolvency was recognized when a company reported negative equity, indicating that the company's total liabilities exceeded its assets.

The excessive usage of leverage is the underlying reason for this financial downfall. Evergrande relied heavily on short-term borrowing to fund long-term, illiquid real estate projects. As the Chinese government introduced the "Three Red Lines" policy in 2020 to control systemic risk in the property sector, Evergrande's ability to roll over debt was severely constrained. The liquidity squeeze made it

unable to meet its bond repayments, pay suppliers, or complete housing projects, triggering a chain reaction of defaults.

In addition to undermining investor trust, this crisis has impacts for Chinese financial markets as well as international real estate investors. The case of Evergrande demonstrates that debt-driven expansion is not long-term viable in the absence of steady cash flow and equity support.

Evergrande utilized an aggressive growth strategy, using massive amounts of borrowed funds to finance land acquisitions, luxury developments, and businesses that were unrelated. Due to pre-sales that created a Ponzi-like structure, where new funds were necessary to finish las projects. Regulatory tightening from Chinese authorities further exposed the structural weaknesses.

Relevance to Uzbekistan

There have been rapid reforms in the economy of Uzbekistan, and credit is also into infrastructure and housing. In contrast, total external debt has reached \$ 64 billion, with private firms mainly relying on borrowed funds. These indicators may convert into vulnerabilities if there is no proper management.⁶

The financial collapse of Evergrande, whose debt exceeded USD 300 billion by 2021, demonstrates how excessive leverage in the real estate sector can trigger large-scale liquidity crises and ripple effects across the economy. In Uzbekistan, where the construction industry grew by 6.6 per cent in 2023 and makes up around 6–7 percent of GDP, the fast growth of real estate projects, often financed through bank lending, presents similar systemic risk if it is not managed cautiously. As of early 2024, for example, total loans to Uzbekistan’s construction sector exceeded 30 trillion UZS, and more than a dozen of the largest private construction groups operated with a debt-to-equity ratio above 2.5, which is indicative of high leverage. In a rudimentary capital market, these ratios are shocking, especially when credit is short-term and the collateral is linked to volatile asset prices.

Lessons from Evergrande include:

1. Monitoring corporate debt levels through transparent reporting
2. Diversifying revenue sources before expanding through debt
3. Strengthening regulatory oversight of private sector borrowing
4. Encouraging equity financing and sustainable growth strategies

Conclusion

⁶ <https://tradingeconomics.com/uzbekistan/external-debt>

The bankruptcy of China Evergrande Group serves as an apparent example of the serious consequences associated with financial leverage misuse. This article demonstrates how the company's over-reliance on debt, in spite of increasing revenues, resulted in an unsustainable capital structure with growing obligations and declining equity. Unchecked borrowing and inadequate risk management led to financial tragedy, broad defaults, and global anxiety.

Why Evergrande's excessive debt turned into instability can be explained by theoretical frameworks such as the Modigliani-Miller theorem and leverage-volatility relationship. The 2015–2022 data makes it abundantly evident how improper leverage management can distort a company's financial health.

This case provides an important lesson for nations such as Uzbekistan, where financing mainly depends on leverage. Leverage needs to be approached carefully as the economy and infrastructure projects expand. The same vulnerabilities may surface in the absence of efficient financial controls.

When leverage is properly utilized, it promotes growth; when it is not, it poses a threat to both businesses and economies. Evergrande delivers as a global warning about the importance of financial discipline, transparency, and regulation, in addition to being a cautionary tale for China. The Evergrande disaster serves as an indicator of the disastrous consequences that can result from the improper use of leverage. The way forward for the development of economies of nations like Uzbekistan must involve strict monitoring of sovereign and corporate debt, solid financial regulation, and societal awareness about the dangers of over-borrowing. By applying these lessons in practice today, we may prevent future disturbance and support long-term economic resilience.

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