



MBA Dissertation Proposal

Capital Structure Determinants and Profitability: A Case Study of Small-Cap Firms on the London Stock Exchange (UK)

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1. Introduction

1.1 Background and context

Capital structure decisions involve some of the major strategic decisions that corporate management face, which have a direct impact on the value of firms, financial risk, and operational flexibility. Debt and equity financing make a difference in the cost of capital but also the profitability, prospect of growth and long-term sustainability (Khan, Akhtar and Qasem, 2024). Although the determinants of capital structure have been widely investigated in large companies, small cap firms are still not well researched despite the large contribution they make towards the growth of the economy and creating employment in the United Kingdom (Rahman, Hossain and Sen, 2023).

Small-cap companies, which are those with a market capitalization of between 50 million and 500 million, have their own funding challenges as opposed to the big firms. Enterprises tend to have an increased degree of information asymmetry, restricted access to capital markets, higher borrowing costs, and increased exposure to fluctuations in the economy (Khan, Akhtar and Qasem, 2024). The insight of the effects of capital structure decisions on their profitability is especially pertinent in the economic environment of the present, where the UK economy is being hit by increasing rates of interest rates, more restrictive lending policies, and ongoing inflationary pressures (Rahman, Hossain and Sen, 2023).

London Stock Exchange involves a large number of small-cap companies in various industries, which offers a good backdrop in research on connection between financing, decision-making and financial performance. The study fills an important gap in the knowledge of the specific implications of capital structure determinants on profitability at less than aggregate listed firms that operate in the UK regulatory framework (Rahman, Hossain and Sen, 2023).

1.2 Research aim and objectives

Aim

The crucial aim of the study is to examine the determinants of capital structure and their effects on profitability in small-cap companies that are listed in London Stock Exchange.

Objectives

To determine the determinants that are significant in the decisions made by capital structure of small-cap companies in the London Stock Exchange.

To address the correlation between capital structure and profitability measures of these companies.

To examine the impact of characteristics peculiar to firms on their choice of capital structure and ensuing profitability.

To test whether the traditional capital structure theories are applicable to small capital firms in the UK case.

To offer evidence-based information to the financial managers and investors on the best capital structure strategies.

1.3 Research questions

What are the key factors that define capital structure decision making in small-cap companies listed in the London Stock Exchange?

What influence does capital structure have on the profitability of small-cap firms expressed in terms of profitability on assets and profitability on equity?

What are the firm-specific attributes that play a significant role in capital structure decisions in small-cap firms?

How well do conventional capital structure theories predict financing behaviour in small-cap?

What are the variations in the capital structure-profitability relationship in various industries of small-cap firms?

1.4 Significance of the study

The study also has an impact in terms of scholarly literature and practice by applying capital structure theories specifically to small-cap companies, which tend to be a neglected subject of research compared to large companies. The results will guide the financial decision-making by the managers of small-cap firms and guide the investors to make judgements on investment opportunities (Khan, Akhtar and Qasem, 2024).

2. Literature Review

2.1 Theoretical framework of capital structure

Capital structure theory has developed a long way since the theoretical masterpiece written by Modigliani and Miller that suggested that capital structure is not relevant to firm value in perfect markets. According to the trade-off theory, it is the trade-off between the tax advantages of debt and bankruptcy costs that enables firms to attain optimal capital structure (Jahanzeb, 2013). The pecking order theory is applicable in that the firms will choose internal financing rather than external financing, and debt rather than equity in the case where they need to finance their operations externally because of information asymmetry. The agency theory is used to point out the conflicts that exist between shareholders, managers, and debt holders and indicates that debt might be a disciplining factor that diminishes managerial discretion (Frank and Goyal, 2009).

2.2 Capital structure determinants

Numerous studies have found out that there are firm-specific factors that affect capital structure decisions. Studies have mixed relationships between leverage and profitability. The size of a firm is usually positively related to leverage because the firms are subjected to less expensive bankruptcy costs and information asymmetry (Frank and Goyal, 2009). Tangibility of assets will allow it to take greater risk, as it will have the protection of collaterals. Growth opportunities usually relate to reduced leverage, with debt limiting the freedom of the managers. Industry factors also have a great influence on capital structure decisions with capital intensive industries having higher debt ratios (Jahanzeb, 2013).

2.3 Relationship between capital structure and profitability

The linkage between profitability and capital structure is still controversial in empirical literature. Other studies have shown positive relationships; the best leverage improves returns due to tax benefits and disciplining influences (Herciu and Ogorean, 2017). Some others indicate that there are negative relationships, which means that excessive debt makes profitability higher due to high costs of financial distress and limited operation flexibility. These paradoxical results indicate that the relationship might be context-specific, different in the sizes of firms, industries, and in different economic circumstances (Frank and Goyal, 2009).

2.4 Small-cap companies and financing issues

Small-cap companies are faced with special financing requirements that are not characteristic of large companies. Poor coverage by analysts increases the level of information asymmetry, which raises the cost of capital (Heller, Karapanagiotis and Nilsen, 2025). Limitation of access to the public debt markets makes it necessary to depend on the bank financing and trade credit. Increases in the probability of bankruptcy increases the risk premiums required by the creditors. These limitations indicate that the capital structure theories, which are formulated in large companies, might need to undergo alteration on their use with small companies (Herciu and Ogorean, 2017).

2.5 Research gap

As the research in capital structure spreads all over, there have been scanty studies that directly concentrate on small-cap companies listed in the London Stock Exchange. The vast majority of the extant research deals with large companies or takes samples that represent different size groups, which may conceal size-related trends. The current paper fills this gap by exploring the determinants of capital structure and profitability relationships solely among small-cap firms established in the UK market environment (Heller, Karapanagiotis and Nilsen, 2025).

3. Methodology

3.1 Research philosophy and approach

This study takes a positive philosophy in that it attempts to establish objective relations between variables by using quantitative analysis. The deductive method is used to verify existing theories on capital structure using empirical evidence of small-cap businesses, which makes it possible to test the various predictions of the theories separately in this small-cap environment (Stock and Watson, 2020).

3.2 Research design

The research adopts a quantitative secondary data analysis that involves the use of panel data regression. The explanatory research design is used to study the causal relationships among the determinants of capital structure and the measures of profitability in small cap firms between different time periods (Stock and Watson, 2020).

3.3 Data collection sources

The secondary financial data will be obtained in various online sources so that the coverage and reliability of the data will be exhaustive. Primary sources can be annual reports, and financial statements published on the websites of companies and London Stock Exchange official portal, which contains audited financial information such as balance sheets, income statements, and cash flow statements. The corporate governance information and past financial filings of all registered companies in the United Kingdom will be provided by firms online database (OECD, 2024).

Peer-reviewed journal articles, working papers, and conference proceedings related to capital structure theories and empirical literature will be found in academic research databases such as Google Scholar, JSTOR and EBSCOhost (OECD, 2024). Standardized financial ratios, market capitalization information and industry groupings should be provided by financial databases like Bloomberg Terminal, Refinitiv Eikon and Capital IQ and will make comparative analysis easier. The London stock exchange site will be used to get the past types of trading, the industry in which the sample companies

are in and regulatory news that has an impact on the sample companies (Stock and Watson, 2020).

3.4 Timeframe and sampling strategy.

Purposive sampling will be used to choose firms that fit the desired criteria: they must be listed on the London Stock Exchange all through the study period, have a market capitalization of between 50 million and 500 million, and must have accessible financial information, which excludes financial services firms as they have different dynamics of capital structure. The time frame of the study is five financial years, 2019-2023, which is adequate as it gives sufficient observations and includes recent economic events in the recovery and pandemic forces (Daskalakis, Balios and Dalla, 2017).

3.5 Variables and measurement

The dependent variables are a return on assets and a return on equity to indicate the performance of profitability. Independence is the debt-to-equity ratio and debt-to-total assets ratio, which represent the composition of capital structure (Kahya et al., 2020). The control variables are the size of the firm by the total assets, the tangibility of the assets in the form of fixed assets which is the ratio of the asset fixed to the total assets, growth opportunities measured by the market-to-book ratios, age of the firm and industry sector dummies as a measure of the specific effects (Daskalakis, Balios and Dalla, 2017).

3.6 Data analysis techniques

Fixed effects and random effects models will be used to implement the panel data regression analysis. The appropriate model selection will be done with Hausman tests. Descriptive statistics will be used to summarize variable distributions and correlation analysis will be done to analyse initial relationships. Hypothesized relationships will be tested using a multiple regression analysis that will moderate the confounding factors. Checks on robustness will use alternative specifications of variables and sub-sample analysis that will guarantee the identification of reliability (Daskalakis, Balios and Dalla, 2017).

3.7 Ethical considerations

This study will only use the publicly available secondary data that can be accessed online, which will mean that there will be no issue of consent and confidentiality of participants. Data management will be done in accordance with the academic integrity standards where there will be proper representation and referencing. Every conclusion will be presented in an objective non-misleading manner (Kahya et al., 2020).

4. Expected Findings

According to theoretical frameworks and the literature that is available, several outcomes are expected. The research anticipates determining the firm size, profitability, asset tangibility, and growth opportunities as the determinants of capital structure in small-cap firms (Allini et al., 2018). In terms of the capital structure-profitability relationship, it is expected that there is non-linear relationship between the two, that is, high leverage is expected to increase profitability by tax benefits and excessive debt will reduce returns by financial distress costs (Adair and Adaskou, 2015).

Pecking order theory is likely to prove to be a stronger explanatory factor as compared to trade-off theory among small cap firms since they are highly characterized by information asymmetry and restricted access to the market (Allini et al., 2018). It is hypothesized that firm-specific attributes are more influential on the decisions made on capital structure compared to industry factors, and these small-cap firms will have limited financing options. Sector analysis can indicate heterogeneity, where capital-intensive industries have higher leverage ratios and have a different capital structure-profitability relationship than service-oriented industries (Adair and Adaskou, 2015).

5. Limitations

Data availability and quality

This study is based on publicly released financial data that is found online, which can have reporting anomalies or is not granular with respect to financing structure. Limited disclosure efficiency may be given by some small-cap firms as opposed to the bigger

corporations, which may limit the effectiveness of variable measurements (Petersen, 2009).

Generalizability constraints

Results are also limited to small-cap companies on the London Stock exchange and may not be applicable to unlisted small-cap companies, other categories of sizes, or even other markets in different countries with different institutional settings, regulatory environment, and market conditions.

Methodological limitations

The analysis of secondary data does not allow investigating managerial motivations that lead to decision-making on the capital structure. The relationships are fixed over the time frame of observation in panel data techniques, which may ignore time-specific changes in capital structure relationships based on varying economic situations (Petersen, 2009).

Causality inference

Although regression analysis determines the relationship between variables, it is not easy to determine certain causality. This can cause reverse causality in the sense that profitability affects future capital structure decision and not a case of capital structure affecting profitability.

Mitigation strategies

These shortcomings will be recognized openly in the final dissertation. The test of finding stability will be tested by robustness checks that use alternative specifications and analyses by sub-periods. Triangulation with pre-existing qualitative research can be used to give some contextual insight to offset limitations of secondary data (Petersen, 2009).

6. Timeframe

Phase	Activity	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10
1	Dissertation Proposal and Introduction	■	■	■							
2	Data collection and Analysis			■	■	■					
3	Research Methodology				■	■	■				
4	Statistical analysis and hypothesis testing					■	■	■			
5	Result Interpretation and Discussion						■	■	■		
6	Conclusion							■	■	■	
7	Proofreading and Submission									■	■

Figure 1: Dissertation project Gantt chart

The project will span ten weeks, divided into overlapping stages to ensure steady progress and research integrity. The first three weeks will cover the dissertation proposal and introduction, followed by data collection and analysis in weeks three to five. Research methodology development will occur in weeks four to six, while statistical analysis and hypothesis testing will be conducted in weeks five to seven. Weeks six to eight will focus on results interpretation and discussion, and weeks seven to nine on the conclusion. The final two weeks will be dedicated to proofreading and submission.

7. Conclusion

The proposed dissertation is a proposal of serious research on the determinants of capital structure and the relationship of profitability among small-cap companies listed on the London Stock Exchange. The study fills a major gap in the body of corporate finance literature with its narrow scope on smaller businesses that get little consideration regarding capital structure studies that are usually conducted to identify with large businesses. Based on systematic quantitative research of secondary financial customer information found online, such as company reports and financial databases and scholarly repositories over a five-year timeframe, the study will focus on the impact of financing decisions on profitability whilst considering firm-specific attributes and theoretical models.

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