



Prifysgol Cymru
Y Drindod Dewi Sant
University of Wales
Trinity Saint David

Programme: Master of Business Administration

Module: Dissertation

Module code: LCMB7035

Dissertation proposal

Title: “Debt Financing Versus Equity Financing: Which One is More Effective for Enhancing Profitability? Evidence from Listed Companies in India, China, Japan, and South Korea.”

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Submission Date: 07/11/2025

Word Count: 1695 Words

Table of Contents

Introduction	3
Literature Review	4
Research Methodology	6
Expected Results and Significance	7
Research Limitations.....	7
Gantt Chart	8
Conclusion	8
References.....	9

Introduction

Capital structure—the balance between debt and equity financing—plays a pivotal role in shaping a firm's profitability, value, and long-term sustainability. According to Modigliani and Miller (1958), under perfect market conditions, capital structure is irrelevant to firm value. However, subsequent theories highlight that real-world imperfections make financing decisions strategically significant. The **Trade-off Theory** (Kraus and Litzenberger, 1973) posits that firms seek an optimal leverage level by balancing the tax benefits of debt against bankruptcy and agency costs. In contrast, the **Pecking Order Theory** (Myers and Majluf, 1984) suggests that firms prefer internal financing first, followed by debt, and use equity as a last resort due to information asymmetry.

Empirical evidence on these theoretical predictions remains inconclusive, with studies reporting both positive and negative associations between leverage and profitability across different institutional contexts. Emerging economies often face higher borrowing costs and weaker investor protection, while developed markets benefit from stable financial systems and efficient debt markets. This study examines the relative effectiveness of debt and equity financing in enhancing profitability among listed firms in India, China, Japan, and South Korea. Through this comparative lens, it seeks to test capital structure theories within diverse Asian settings and identify context-specific financing strategies that optimize firm performance.

Research Problem

The central problem addressed in this study is **to determine how debt and equity financing affect firm profitability (measured by Return on Assets and Return on Equity) and whether the effect differs between emerging and developed Asian economies.**

Research Aim and Objectives

Aim

To examine the impact of debt and equity financing on firm profitability among listed companies in India, China, Japan, and South Korea.

Objectives

1. To evaluate the relationship between debt financing and firm profitability (ROA and ROE).
2. To examine the effect of equity financing on firm profitability.

3. To compare the impact of debt–equity structure on profitability across India, China, Japan, and South Korea.
4. To identify the optimal financing approach for maximizing firm profitability in each context.

Research Questions

1. How does debt financing influence firm profitability among listed companies in the four selected Asian countries?
2. What is the effect of equity financing on profitability in these firms?
3. Does the relationship between capital structure and profitability differ between emerging (India, China) and developed (Japan, South Korea) economies?
4. Which financing method—debt or equity—is more effective in enhancing profitability?

Literature Review

Theoretical Framework

Capital structure decisions remain central to corporate finance, shaping firm value and performance. The foundational work of Modigliani and Miller (1958) posits that in perfect markets, capital structure is irrelevant to firm value. Subsequent theories introduced market imperfections, emphasizing the benefits and costs of leverage. The Trade-off Theory (Kraus and Litzenberger, 1973) argues that firms balance the tax advantages of debt against bankruptcy and agency costs to determine an optimal structure. In contrast, the Pecking Order Theory (Myers and Majluf, 1984) suggests firms prefer internal financing, then debt, and issue equity only as a last resort due to information asymmetry. Agency Theory (Jensen and Meckling, 1976) extends this logic by proposing that debt can discipline managerial behaviour through fixed obligations but may also intensify conflicts between shareholders and creditors.

Empirical Evidence

Empirical findings on the capital structure–performance nexus remain mixed across contexts. In emerging economies, Abor (2005) reported a positive relationship between short-term debt and profitability in Ghana, whereas Pandey and Sahu (2019) found that leverage negatively affects firm performance and increases agency costs among Indian manufacturing firms.

Similarly, Pham and Nguyen (2020) observed that debt harms the profitability of Vietnamese listed firms, although board independence mitigates this adverse impact—highlighting the moderating role of corporate governance. In China, Tian, Wang and Kohar (2024) identified a **U-shaped** relationship between leverage and performance, suggesting that moderate debt levels enhance performance through tax shields, but excessive debt suppresses innovation and value creation.

Comparatively, studies from developed Asian economies such as Japan and South Korea (Hirota, 1999; Wiwattanakantang, 1999) have shown a positive debt–profitability relationship, reflecting efficient capital markets and stronger institutions. Zhao and Fang (2023) provided a strategic perspective, demonstrating that debt financing can alter competitive behaviour by easing price competition in differentiated markets, though sometimes at the expense of consumer welfare. Contrastingly, equity-based studies, such as Almanaseer (2024) in Jordan, reveal that equity financing and retained earnings positively influence firm performance by reducing financial risk and supporting reinvestment. A broader meta-analysis by Enow (2025) found that profitability differences are more attributable to firm-specific and operational factors than to capital structure alone.

Overall, prior research underscores that the effect of capital structure on profitability is **context-dependent**, shaped by institutional quality, governance, innovation capacity, and market maturity (Fan et al., 2012). However, few studies have systematically compared emerging and developed Asian economies. This gap motivates the present study, which aims to examine how institutional and structural differences influence the leverage–performance relationship across Asia.

Research Gap

Although extensive research has explored the relationship between capital structure and firm performance, existing studies are largely confined to single-country analyses, offering limited comparative insights across Asia. Few studies simultaneously examine how institutional maturity and market development moderate the effects of debt and equity financing on profitability. This study fills that gap by conducting a comparative analysis across India, China, Japan, and South Korea—integrating emerging and developed market contexts to assess the differential impact of financing structure on firm profitability.

Research Methodology

Research Design

This study adopts a **quantitative, comparative, and explanatory research design** to examine the impact of capital structure on firm profitability across four Asian economies. The design is appropriate as it allows for objective measurement of financial variables and the statistical testing of hypotheses (Saunders et al., 2019). Quantitative methods provide a systematic framework for analyzing numerical data, identifying relationships between leverage and profitability, and determining the relative effectiveness of debt and equity financing. The comparative aspect enables cross-country analysis, offering insights into how institutional and market differences influence financing–performance dynamics.

Data Collection

The research will utilize **secondary panel data** from 2019 to 2024, covering listed non-financial firms in China, Japan, South Korea, and India. Financial information—including total assets, total debt, total equity, net income, and revenue—will be obtained from publicly available sources such as Yahoo Finance, company websites, and official stock exchange databases (Shanghai Stock Exchange, Tokyo Stock Exchange, and Korea Exchange). All financial data will be standardized to ensure comparability across firms and countries. Using these data, key financial ratios will be computed: the **debt ratio** (total debt to total assets), **equity ratio** (total equity to total assets), and **debt-to-equity ratio**. These indicators will facilitate the classification of firms according to their dominant financing mode and enable the assessment of how debt and equity financing influence profitability.

Data Analysis

Data will be processed using **Microsoft Excel** for preliminary computations and **SPSS** for statistical analysis. The analytical procedures will include:

1. **Descriptive statistics** to summarize central tendencies and dispersion;
2. **Correlation analysis** to identify the strength and direction of relationships between variables; and
3. **Multiple linear regression analysis** to evaluate the effect of financing structure on profitability.

The variables will be operationalized as follows: **dependent variables**—profitability measured by Return on Assets (ROA), Return on Equity (ROE), and Net Profit Margin (NPM); **independent variables**—debt financing (debt ratio) and equity financing (equity ratio); and **control variables**—firm size (log of total assets), firm age, tangibility (fixed assets to total assets), and GDP growth rate.

Sample Selection and Ethical Considerations

The study will examine approximately **20 listed non-financial firms** from each selected country. Financial institutions are excluded due to their distinct regulatory and capital structure requirements. Only publicly available secondary data will be used, ensuring compliance with ethical research standards. Data integrity, accuracy, and proper referencing will be maintained throughout the analysis, guaranteeing transparency and replicability of results.

Expected Results and Significance

It is anticipated that the relationship between capital structure and profitability will vary across market contexts. In developed economies such as Japan and South Korea, debt financing is expected to positively influence firm profitability, supported by stable interest rates, mature financial systems, and efficient debt markets. Conversely, in emerging markets like India and China, equity financing may prove more advantageous due to higher borrowing costs, limited access to credit, and weaker institutional frameworks. The findings will contribute to the ongoing debate on the effectiveness of capital structure decisions by offering empirical evidence from contrasting economic environments. Moreover, the study aims to provide valuable insights for corporate managers in optimizing financing choices to enhance profitability, while also assisting investors and policymakers in understanding the dynamics of financial structure within different institutional settings. The comparative analysis will strengthen the applicability of existing capital structure theories across diverse Asian contexts.

Research Limitations

The study is constrained by several potential limitations. The use of secondary data may restrict variable accuracy and consistency across countries due to differences in accounting standards and disclosure practices. The relatively small sample size and focus on listed non-financial firms may limit the generalizability of results to other sectors. Additionally, macroeconomic shocks, such as interest rate fluctuations and the residual effects of COVID-19, may influence

firm performance during the study period. Nevertheless, the application of standardized measures and robustness checks will help mitigate these limitations and enhance reliability.

Gantt Chart

Timeline (Weeks)	1	2	3	4	5	6	7	8	9	10	11	12	13
Literature Review	×	×											
Data Collection			×	×									
Data Analysis (correlation/regression/descriptive statistics)					×	×	×						
Interpretation of Results & Findings								×	×				
Writing Dissertation Chapters										×	×		
Revision & Supervisor Feedback												×	
Proofreading & Final Submission													×

Conclusion

This research seeks to empirically assess the relative effectiveness of debt and equity financing in enhancing firm profitability across four major Asian economies—India, China, Japan, and South Korea. By integrating key theoretical perspectives such as the Trade-off and Pecking Order theories with a comparative quantitative approach, the study aims to reveal how institutional and market differences shape financing outcomes. The results are expected to contribute to both academic and practical understanding of capital structure decisions, offering valuable insights for corporate managers, investors, and policymakers seeking to optimize financial strategies and improve profitability within diverse economic environments.

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