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



Master's Degrees by Examination and Dissertation Declaration Form.

I, Kirtan Sondagar, declare that this dissertation has been composed by myself, that the work contained herein is entirely my own except where explicitly stated otherwise in the text, and that this work has not been submitted for any other degree or qualification, in whole or in part, except as specified.

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Abstract

The dissertation explores the factors of capital structure and their influence on profitability of small-capitalisation firms listed on the London Stock Exchange (LSE). Though much has been done on capital structure in large corporations, little has been done on small-cap firms despite their contribution in terms of economic growth, innovation and employment in the United Kingdom. These companies have different financial mechanisms such as restricted access to long-term debt, elevated costs to borrow and greater vulnerability to macro-economic insecurity.

The proposed study has a secondary and descriptive research design involving audited financial data of five UK small-cap firms during 2021-2024. Ratio analysis and cross-firm comparison are used to analyse key financial indicators such as leverage, liquidity, asset tangibility, firm size, growth, return on assets (ROA) and return on equity (ROE). The established theories of capital structures, namely, the Trade-Off Theory and the Pecking Order Theory, can be used in the analysis.

The results show that small-cap companies tend to adopt a conservative capital structure, which implies a greater use of internal sources of financing and equity financing than debt financing. More leveraged firms that have poorer liquidity statuses are more likely to engage in a higher profitability and too much leverage is linked with financial risk and low performance. The paper offers useful information to the financial managers, investors and policymakers in assessing financing strategy in the small-cap arena of the UK.

Table of Contents

1. Introduction	8
2. Literature Review	14
2.1 Overview of the Literature.....	14
2.2 Theoretical Framework of Capital Structure	15
2.3 Determinants of the Capital Structure	17
2.4 Correlation Between Profitability and Capital structure	19
2.5 Financing Problems and Small-Cap Companies	20
2.6 Empirical Research on Capital Structure in Small Cap Markets	22
2.7 Role of Corporate Governance in Capital Structure Decisions of Small-Cap Firms	23
2.8 Impact of Macroeconomic Conditions on Capital Structure and Profitability of Small-Cap Firms	24
2.9 Research Gaps.....	26
2.10 Summary of the Literature Review.....	27
3. Research Methodology	27
3.1 Introduction	27
3.2 Research Design	28
3.3 Research Approach	28
3.4 Sample Selection and Study Period	29
3.5 Data Sources	29
3.6 Data Collection Procedure	30
3.7 Variables and Measurement.....	30
3.8 Analytical Techniques	31
3.9 Methodological Limitations	32
3.10 Chapter Summary.....	32

4. Data Analysis	33
4.1 Introduction to the Data Analysis	33
4.2 Raw Financial Data and Ratio Construction	34
4.3 Cross-Firm Comparison of Capital Structure and Profitability Ratios.....	35
4.4 Ratio Comparison Including Growth Opportunities Across Firms	36
4.5 Variable-Wise Financial Indicator Comparison Across Firms	38
4.6 Consolidated Summary of Firm Financial Structure and Performance	40
4.7 Overall Relationship Between Capital Structure and Profitability.....	41
4.8 Chapter Summary.....	42
Chapter 5: Discussion	43
5.1 Capital Structure Behaviour of Small-Cap Firms in the UK Context	43
5.2 Influence of Firm Size on Financing Decisions	43
5.3 Role of Asset Structure in Shaping Leverage Capacity	44
5.4 Liquidity as a Strategic Buffer in Financing Decisions	45
5.5 Growth Orientation and Conservative Leverage Strategies	46
5.6 Capital Structure and Profitability Trade-Offs.....	47
5.7 Debt Maturity Structure and Financial Stability	48
5.8 Macroeconomic Sensitivity of Small-Cap Financing Decisions.....	49
5.9 Theoretical Interpretation of Observed Financing Behaviour.....	50
5.10 Strategic Implications for Small-Cap Financial Decision-Making	51
Conclusion	52
References.....	56
Appendix	66

1. Introduction

Background and Context

One of the most significant financial decision-making processes that firms face is capital structure, as it is an element that determines stability in the long-run and the extent of risk that firms can bear and profitability of the firms (Elrayah and Mubarak Usman Jalingo, 2023). The debt and equity financing make up is core issues of operational flexibility of a firm, cost of capital, and sensitivity to market variations. Although large corporations have been studied in detail, relatively little focus has been given to a type of small-capitalization (small-cap) companies, despite their major contribution to most levels of economic activity in the United Kingdom, innovativeness, and employment. Small companies quoted on the London Stock Exchange (LSE) do business in a smaller financial framework that is defined by minimal access to capital markets, perceived riskiness and sensitivity of the market situation. These unique characteristics make them a significant group to research on the impact of decision on capital structure and profitability. The small-cap market of the LSE in the United Kingdom is a market characterized by companies that are less market-capitalized, and usually, small or growing companies (Elrayah and Mubarak Usman Jalingo, 2023).

The specific financing requirements that such firms face include tightening of lending conditions, having to rely on venture capital/equity, high cost of borrowing funds and increased fluctuations of equity performance (Rodriguez, 2024). They therefore can have entirely different patterns of capital structure to the larger and more established companies. The consequences of the global financial uncertainties (including those caused by Brexit) and dangers of inflation, as well as occasional fluctuations in interest rates, have further worsened funding difficulties of small-cap companies, accelerating the need to comprehend how such organizations trade debt and equity in such a situation (Rodriguez, 2024). The analytic insights of small-cap firms can be easily analysed through the theoretical principles that drive capital structure behaviour. Trade -Off Theory reveals that firms attempt to establish a trade-off between tax-shields and bankruptcy costs but small businesses tend to have a tendency of low levels of debt due to increased risks of default. The theory of Pecking-Order, which postulates that companies would rather

finance or raise capital internally as opposed to accessing external debt, and would rather issue stock as a final option, is most relevant in small company with unstable cash flow (Rodriguez, 2024).

Profitability is one of the major measures of revenue wellness and business accomplishment in a firm (Khazaei, 2020). Often, because of their limited resources, limited clientele and the lack of economies of scale, profitability is more volatile in small-cap firms. The type of capital structure they use has a direct impact on their ability to reinvest in their operations, finance innovation and withstand economic crunch periods. The above could be the case in which high debt might lead to increased interests and low net profits, or vice versa. Based on this, it is important to know how the determinants of capital structure like the size of the firm, asset's structure, future growth, liquidity, and macroeconomic conditions influence the capital structure to further provide useful information on their entire financial policies (Khazaei, 2020).

The decisions on capital structure are a critical financial decision to firms, which have a direct impact on the financial stability, risk, cost of capital, and the future profitability. The proportion of debt and equity used to finance an operation of a firm is referred to capital structure (Ngoc, Nguyen and Pham, 2023). Although the issue under discussion in the literature has received wide coverage in the context of large, multinational firms, the relatively low level of attention has been paid to small-cap firms, despite their crucial role in the economic progress, job creation, and innovations in the United Kingdom. Being traded on the London Stock Exchange (LSE), these firms tend to have unique financial framework: they normally have weaker market capitalization, fewer external financing possibilities and are also more prone to market fluctuations than larger companies. Accordingly, they often have restricted sources of financing based on high borrowing rate, narrow lending standards, and diminished investor trust, which motivates them to resort to internal sources of financing or equity issue that result in patterns of capital structures radically different than the way large corporations finance themselves (Ngoc, Nguyen and Pham, 2023).

These have been worsened by the UK financial environment. Economic risks posed by Brexit, increasing inflation, and cyclical interest-rate risks have increased financial strain

on small -cap companies (Ngoc, Nguyen and Pham, 2023). Such macroeconomic factors affect the risk perception of lenders as well as the willingness of investors to extend capital and thus such decisions on capital structure become all the more complicated amongst smaller organizations. Therefore, there is a growing need of a delicate insight of how these companies are contracting debt and equity funds (Mohamed, 2020). Theoretically, classical models of capital-structure like the Trade-Off Theory and the Pecking-Order Theory provides a reasonable framework on which financing behaviour can be explained; however, it is still unclear how they can be of relevance to small-cap firms. Smaller companies are faced with high risks of bankruptcy and unreliable cash flows, restricting their ability to take advantage of tax benefits related to debt leverage, and reduced volatility of profits is widened by small economies of scale, a small number of customers, and a lack of flexibility in their operations (Mohamed, 2020).

Considering such circumstances, there is a strong necessity to conduct a stringent analysis of the nexus that exists between capital-structure determinants and profitability of small-cap LSE-listed firms. The current paper provides context-specific information on the combined effect of internal firm attributes and macroeconomic shocks to the overall financing choice and, consequently, to the financial performance thus filling an ample gap in the literature at present (Mohamed, 2020).

Research Aim and objectives

Aim

The primary aim of this study is to check this determinant that influences capital structure decisions and to explain the impact of the capital structure decision on profits of small cap firms listed on the LSE.

Objectives

1. To identify the key elements that guide capital structure decisions among small-capitalization companies on the London Stock Exchange.
2. To analyses relationship between a firm's capital structure and its profitability outcomes.

3. To determine whether the theories of traditional capital-structure can be applicable to small-capital corporations, and especially to the UK.
4. To test the existence of conventional capital-structure theories at the small-cap firms.
5. To provide practical, evidence-driven insights that can support financial managers and investors in selecting suitable capital structure approaches.

Research questions

Q1: What are the major factors that determine the capital-structure decisions undertaken by the small-capitalization firms listed on the London Stock Exchange?

Q2: What is the impact of a capital structure of a firm on the profitability of small-cap businesses, especially the profitability in terms of both the return on assets (ROA) and return on equity (ROE)?

Q3: Which internal, firm-level characteristics significantly affect capital structure decisions within small-cap organizations?

Q4: How well do conventional theories of capital structure predict finance practice by small-cap firms?

Q5: In which ways are the correlation between capital structure and profitability different in different categories in the small-cap market?

Methodology

The research design in this study is a secondary research design which uses financial statutes publicly available in addition to literature available in academic sources to examine what drives the capital structure, and how making such decisions influences the profitability among small-cap companies listed on the London Stock Exchange (Filip, Ghio and Paugam, 2020). Secondary sources include annual reports of the companies, financial reports as well as LSE reports, market databases and industry publications. These offer details on leverage ratios, assets structure, liquidity, growth indicators and profitability factors. The theoretical and empirical literature is also examined in the study

to put findings in perspective in the existing financial frameworks. The analysis of the data is performed through both comparative and descriptive analysis, which have a statistical interpretation of available data. Such a method allows analysing the trends and correlations without any actual data gathering, which allows to incorporate reliability and validity to the corroborated sources and provide an in-depth picture regarding the capital structure behaviour in the small-cap segment (Filip, Ghio and Paugam, 2020).

The study is a secondary-research study that aims at questioning the determinants of capital structure and their effects on profitability of small-cap companies on the London Stock Exchange (Oliveira, 2022). The selected research design of secondary is explained by the presence of credible, publicly reliable financial data and an already developed body of knowledge, therefore, eliminating the primary data collection process that may be rather expensive and time-consuming. The information used in this study is 'found in the reputable secondary repositories, which include annual reports of small-cap company, audited financial statements, publications of the London Stock Exchange, and recognized financial databases. The sources are written extensively on the leverage ratios, asset structure, liquidity, growth indicators and profitability measures including Return on Assets (ROA) and Return on Equity (ROE). The fact that the audited information that is publicly disclosed can be relied upon makes the findings of the study more credible and valid (Oliveira, 2022).

The method of analysis adopted is based on the descriptive and comparative approaches. Descriptive analysis is adopted to detect existing patterns and trends of capital structure and profitability on the sample of small-cap firms and comparative analysis examines the variation between entities and through time. Such a methodological combination allows explaining connections between the capital-structure variables on the profitability without resorting to the complications of the premium econometric modelling, making the results available and easily interpretable (Oliveira, 2022).

Significance of the Study

This research holds high importance to scholars, policy makers, investors as well as small cap companies. To scholars, it bridges a significant gap in terms of focusing on the small-

cap companies as opposed to the large-cap or multinationals which are widely researched (Oraon, 2025). Small-cap companies have very significant difference in size, access to credit, management form, and their exposure to the market and therefore generalization of the results based on bigger companies can obscure the actual financial realities that prevail in smaller businesses. This study contributes to the empirical body of research on financial management in a UK market, by investigating their determinants of capital structure and connections between financial management and their profitability. The study yields information to the policymakers and financial regulators relating to the problems that small-cap firms face when it comes to raising capital. Knowledge of their funding drivers can be used to develop policies that will make financing more accessible. An example is when there are evidence that small-cap companies avoid debt because the lender would perceive too much risk that the government-operated programs would reduce borrowing limitations (Oraon, 2025).

The paper has significant implication to academic scholars, financial managers, investors and policymakers as it sheds light on an untapped area of corporate finance (Puspitasari and Muslim, 2023). Although most of the existing literature is biased towards large corporations, small-cap companies work according to different financial limitations, which should be examined more closely. The research will add to a better equilibrium and inclusive understanding of the capital-structure relations by focusing on small cap companies that are traded on the London Stock Exchange. Academically, the research is significant because it empirically identifies the relevance of traditional theory of capital structures in a small-cap framework. Since small-cap companies are not similar to their bigger counterparts in the number of sizes, accessing funds, risk, and flexibility, it is possible that results using only large companies cannot be sufficient to reflect financial realities of smaller organizations. Based on this, the current research enriches the literature due to the provision of particular empirical knowledge related to the UK small-cap context (Puspitasari and Muslim, 2023).

The findings provide practical advice to managerial practice in small-cap firms on finance decisions (Puspitasari and Muslim, 2023). The construction of more sustainable financing strategies can be informed by a subtle interpretation of the role of profitability on one

hand, liquidity on one hand, asset composition on the other hand, and growth prospects on the other in terms of capital structure. The paper highlights the risks of high leverage and makes a strong emphasis on the need to establish a well-balanced capital composition to ensure the long-term profitability and financial stability. This research is also beneficial to the investors because it explains the financial behaviour and risk profiles of small-cap firms. Through understanding the impact of capital-structure decisions on profitability, the investors will be able to increase the accuracy of the judgement of small-cap stocks within the London Stock Exchange, which will make the investment judgment more effective (Filip, Ghio and Paugam, 2020).

Regarding policy and regulation, the research has practical implications on how to improve access to finance of small-cap companies (Filip, Ghio and Paugam, 2020). The findings can be used to enable policymakers develop specific financial support measures, including credit guarantees or tailor-made incentive-based lending programmes, which will mitigate the financing limitations that face small businesses. All in all, the study supports evidence-based decision-making in representation of academia, industry, and government policy, thus supporting the financial ecosystem that high-cap companies in the United Kingdom are able to operate in (Filip, Ghio and Paugam, 2020).

2. Literature Review

2.1 Overview of the Literature

This paper is a systematic review of the available literature on the standing of capital structure, its determinants and subsequent impacts on profitability, especially on small-cap businesses listed on the London Stock Exchange (LSE) (Vidal-García and Vidal, 2022). The capital structure studies have been developed with several decades since the onset; the studies have classical theories that mark the decision of financing through debt or equity. Later researchers have furthered the quest to explore the manifestation of the firm-specific attributes, market and industry environment effects on capital-structure decision-making. Modern-day scholarship is disproportionately focused on large companies, due to their relatively stable financial standings, access to credit resources as well as legacy reputational resources. Carranza (2025) said small-cap companies, on

the other hand, have certain peculiarities such as limited lending levels, high financial risk, and unreliable profits. As explained in the current dissertation, small-cap organizations exist in a far more difficult financial context in comparison to the bigger organizations thus affecting their financing behaviour and performance. Earlier studies have often concluded that there exists a strong relationship between capital structure and profitability (Vidal-García and Vidal, 2022).

Although it has been argued by some academicians that debt brings about tax benefits, some have argued that too much debt is a very dangerous financial gamble especially among small companies (Vidal-García and Vidal, 2022). Vidal (2022) agree that small-cap companies require careful balance of finance but they are split on the best capital structure based on the best performance in terms of maximizing returns. Besides, voluminous empirical literature indicates that small-scale businesses face funding problems unlike those facing large organizations. According to the Stoll (2022) these companies face limited access to long-term funding, high cost of borrowing, and the problems associated with the issue of information asymmetry. This means that relatively small firms that have limited resources have been found to focus on internal finances and equity as opposed to debt. Together, the available literature provides valuable information but at the same time has a great number of gaps regarding small-cap organizations. The current review aims at summarizing the available knowledge, outlining the current findings, and identifying areas of research that should be given further research (Stoll et al., 2022).

2.2 Theoretical Framework of Capital Structure

The capital-structure theory forms the intellectual basis of the way companies choose between debt and equity financing. A number of canonical theories explain this decision process and each has its strengths and weaknesses were seen when used in small-cap enterprises (Stoll et al., 2022). According to the Modigliani-Miller (MM) model, the perfect competitive market implies a firm has a value that is independent of its capital-structure structure. Practically, this relationship is varied by such imperfections as taxes, risk, and borrowing constraints. MM points out the tax shield that is provided by the deductibility of debt, but small-cap companies may not be in a position to fully tilt on the advantages, and

their financial performance becomes more unpredictable, and lenders are averse to take on a lot of debt. The Trade-off theory advocates that firms consider tax advantages of borrowing against the costs they are likely to incur at the times of financial distress. In the case of small companies, smaller share-price volatility and less collateral will multiply distress costs leading to a tendency to maintain lower leverage and less risky financing patterns (Stoll et al., 2022).

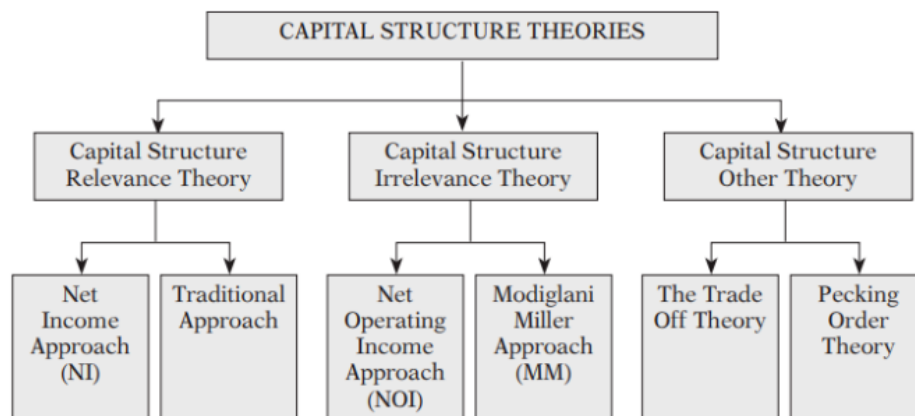


Figure- 1: Capital Structure Theories

Source: (Taxmann, 2022)

The Pecking -Order theory is especially relevant in the case of small-cap organizations, which assumes a chain of financing preferences retained earnings, then debt, and finally, the use of external equity (Altman, Dai and Wang, 2024). Small firms heavily use internal sources of capital since the cost of borrowing is prohibitive and sources of credit are usually scarce making them only issue equity to prevent dilution of ownership. Market-Timing theory argues that, in a situation when stocks have an optimistic market price, companies exercise stock issues and, in a situation, when the company is undervalued, companies are buying back their stock. The volatility in price as well as investor demand in small-cap companies increases, making it hard to define the best time frames of an organization, and decreasing the viability of this business model (Altman, Dai and Wang, 2024).

The agency theory explains the contradictions among the managers, stockholders, and creditors. Leverage with covenantal restraint can be used to curb managerial opportunism but the higher the debt higher the chances that there will be disagreements between lenders and borrowers in case of financial crisis (Altman, Dai and Wang, 2024). Small-cap companies are small, which means that institutional controls are weak, and the lack of distinct boundaries between ownership and management. Taken together, these theoretical approaches help highlight the macro forces that determine the decisions made by capital structures but do not provide sufficient insight into the challenges of small-cap companies. Small businesses that do not adhere to the assumptions of the classical theory have financing behaviour, where they operate on a limited basis, have greater risk likelihood, and varying availability to capital markets (Nguyen and Canh, 2020).

2.3 Determinants of the Capital Structure

The determinants of capital structure include both internal and external variables that determine the choice of optimum debt equity financing combination of a firm. The determinants have increased importance in the case of small-cap companies, which face a different range of challenges compared to large enterprises (Nguyen and Canh, 2020). The size of the firm internal factor; small-cap companies are usually characterized by limited financial resources and severe barriers when it comes to accessing external funding. The bigger businesses, which have consistent income streams, are more likely to receive credit as the banks as opposed to luckier companies which will have to accept tighter credit conditions regularly. The additional data suggests that there is a strong borrowing constraint among small-cap issuers of the London Stock Exchange which can be attributed to their small size and low market share. It is also dependent on asset structure. Companies would have substantial physical resources like land or equipment at their disposal and can provide such assets as security to take loans. On the other hand, small companies which are heavily involved in technology, services or creative industries are known to have a large ratio of intangible assets thus reducing their ability to borrow and thus depending more on equity financing (Nguyen and Canh, 2020).

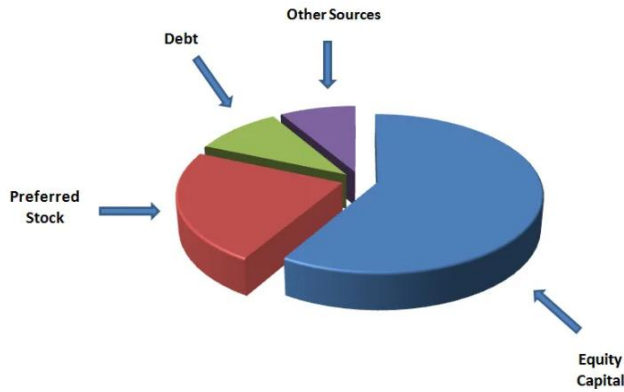


Figure- 2: Determinants of the Capital Structure

Source: (Francis, 2023)

Profitability will affect the capital structure of a firm since profitable firms will be able to use the in-house resources instead of bearing the cost of borrowing. The Pecking Order Theory holds this observation (Essel, 2023). A good number of small-cap companies, though, have unstable incomes as a factor that negatively affects the stock-based capital formation. A decline in profitability means that such companies will turn to costlier external finance. Another very important thing is the liquidity. The strong liquidity position of companies allows them to fulfil their immediate liabilities, which do not require the company to take debts; the poor liquidity position makes companies take debts at high costs increasing the financial risk. Financing decisions also depend on the growth opportunities (Essel, 2023). Fast growing companies need more capital and the companies with high growth rates tend to use equity financing method because equipment's obligations related to paying off debts tend to limit its growth. Yet, investors could also be enticed into buying shares or giving loans when they have viable growth prospects (Essel, 2023).

Market environment including interest rates and macroeconomic stability places an important impact on small -cap financing (Chidimma and Umeaduma, 2024). An increase in interest rates increase the cost of borrowing; the dissertation records that the Brexit shock and increase in the interest-rate risk has worsened the funding position of small-cap businesses and risk aversion to debt. Capital structure is also determined by

industrial features. Capital-intensive industries, e.g. manufacturing, are more likely to utilize debt financing, whereas industries based on innovation e.g. among the small-cap group, use equity financing because intangible assets and perceptible cost issues dominate. All in all, there are peculiarities of small firms when it comes to financing choices; small firms have more significant financial limitations as compared to large ones, and their capital structure determinants should be considered especially relevant when it comes to understanding small firm behaviour (Chidimma and Umeaduma, 2024).

2.4 Correlation Between Profitability and Capital structure

One of the key topics of corporate finance scholarship is correlation between capital structure and profitability (Nguyen et al., 2023). Researchers examine the hypothesis of whether debt has negative and positive implications on profitability and whether a debt or equity policy of financing by the firms can promote optimal financial performance. Debt may increase the profitability in the form of tax shields; companies can minimize taxable income by deducting the interests' payments, which creates savings in tax and increases their net earnings (Nguyen et al., 2023). The main beneficiaries of this tax advantage are firms with consistent income; small, difficult to estimate firms such as small-cap ones might not get the advantage of this benefit fully. High leverage is also a way of increasing financial risk. Companies that cannot fulfil the interest or principal payments are at risk of going bankrupt and small-cap ones are particularly vulnerable to distress caused by lack of resource. Therefore, debt could destroy profitability through an elevation of interest cost and dilution of the net income, a trend confirmed by majority of studies reporting negative association between leverage and profitability in small companies (Nguyen et al., 2023).

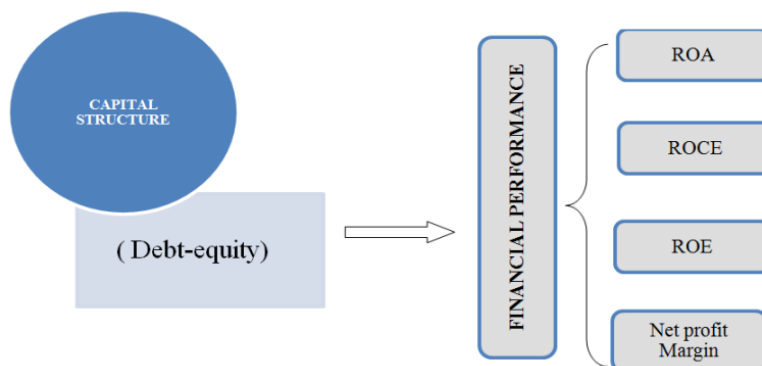


Figure- 3: Impact of Capital Structure on Profitability

Source: (Muhammad et al., 2016)

The Pecking Order Theory suggests that more profitable firms favour the use of internal funds leading to a low debt ratio policy and therefore the non-relationship between leverage and profitability is negative (Perepeczo, 2023). Such a tendency is enhanced among many small -cap companies with most of them not financing their operations with loans but instead using retained earnings. The scale of the relationship is determined by the profitability metric that is used. Return on Assets (ROA) is likely to reduce when companies take high leverage since the money used to pay interests will reduce the net income (Perepeczo, 2023). Leverage could increase the Return on Equity (ROE) when the company is able to raise some earnings used to pay the interest, and this situation is not common among small-cap companies since the cost of borrowing is high. The dissertation also notes that market volatility, lack of financial flexibility, and irregular cash flows, which increase the debt risk, contribute to the profitability of small-cap companies. In general, capital structure and profitability share the complex relationship in small-cap firms. Although a reasonable level of debt may be beneficial to performance, an overload of leverage increases the risk and restricts the profit margin, which explains the need of a reasonable and restrained leverage approach (Perepeczo, 2023).

2.5 Financing Problems and Small-Cap Companies

Small-cap organizations face various financing issues which eventually break their capital structure. Such challenges are based on size of firms, visibility of their markets, financial performance of the firms in the past and environments that they are operating (Li et al., 2022). Very little access to long-term credit is of central concern; very often banks pose with small businesses as high-risk clients due to the lack of collateral and the unsteadiness of the income. According to the literature, dependency on debt financing is aggravated by tightening the terms of borrowing, and high operation costs in London Stock Exchange listed small-cap firms. The one more serious hurdle is a shortage of collateral. Most of small-cap firms are in industries where intangible assets, e.g. software,

branding, or intellectual, are the key asset, which is not readily eligible as collateral, which constrains good loan terms (Li et al., 2022).



Figure- 4: Issues in Small Cap Companies

Source: (Khanna, 2025)

Asymmetry of information contributes to the further complications of funding. Firms that are small have a poor access to easily accessible data that can be utilized by potential investors because of the little available research and market share (Bui and Krajcsák, 2023). This uncertainty triggers insipidation of the investors and increases the cost of capital. Small -cap firms are strongly affected by market volatility. Their stocks are susceptible to any changes in market investor confidence, economic and political factors in the world. That is why small-caprice firms have difficulties in issuing equity or in raising loans in the period of economic crisis. Regulatory compliance also defines the financing prospects as publicly traded companies have high compliance costs that drain resources employed in other business development ventures. Also, financing related operation constraints can be noticed; smaller companies often do not have effective financial planning systems or have not developed financial managers, which lead to the inefficiency of cash-flow forecasting, risk assessment, and financing decisions regarding long-term financing (Bui and Krajcsák, 2023).

2.6 Empirical Research on Capital Structure in Small Cap Markets

There exist a considerable number of empirical studies that study the behaviour of capital structures in small firms and their effect on the performance metrics, which are essential in critical proving the current financing practice in small-cap markets (Manh Nguyen, Wong and Huong, 2023). Regular empirical surveys of the United Kingdom, the United States of America, continental Europe and other emerging economies demonstrates that smaller business enterprises usually have few obligations of debt relative to bigger companies. Such trend can be mostly explained by the increased financial risk aversion, insignificant extension, and the increased exposure to the macroeconomic shifts. The overwhelming impact of information asymmetry on financing mechanisms that small firms use is also supported by empirical evidence. Various literature indicates that the leverage/profitability has a negative correlation in the small-firm sector; high interests' rates and the impending risk of bankruptcy are some factors used to reduce the net income. These results are in line with the results of dissertation studies of volatile earnings streams and financial rigidity within small-cap organizations (Manh Nguyen, Wong and Huong, 2023).

Additional studies suggest that leverage behaviour in small firms is a firm predictor of firm size, asset structure and liquidity provisioning. The high propensity to use debt financing is observed in firms that are endowed with tangible assets and equity financing is used in firms whose assets are intangible (Norkio, 2023). The profitability has another implication in terms of financing decisions as more successful firms have more chance of accessing external financing. The research also indicates the very strong influence of macroeconomic variables, on a small-capital company, as the departure of the United Kingdom out of the European Union, change in the interest rate in the monetary policy, and the general uncertainty in the world all contribute to deterioration of investor confidence and availability of credit. The empirical evidence on the subject in the United Kingdom indicates that small enterprises modify their capital structure more often in turbulent times. In general, these observations support the current opinion that small-cap enterprises have a more conservative capital structure, limited source of debts, and are highly sensitive to the uncertainties in the economy and the market (Norkio, 2023).

2.7 Role of Corporate Governance in Capital Structure Decisions of Small-Cap Firms

Corporate governance plays a central role in the decision on capital structure, especially in the small-cap industry where management and ownership structures often go hand in hand (Nguyen, Wong and Huong, 2023). Corporate governance is also understood as a collection of systems, rules and practices upon which corporations are given direction and control. In small companies, the mechanisms of governance are generally less formalized as compared to large corporations, a property that can highly influence the financial decision-making, including the decision-making that relates to debt and equity financing. Small-cap companies are also characterized by high levels of concentrated ownership, in which case founders or a small group of shareholders have continued to have significant influence on managerial level decision making. Such ownership structure can eliminate the agency problems between managers and owners and on the other hand it may promote the conflict between shareholders and creditors. Therefore, a greater risk will be observed by the lenders when they deal with small-cap companies and they will either place stricter terms in borrowing or charge higher interests. These risk perceptions often lead to frowning upon the overuse of debt and encourages use of internal funding or equity issue (Nguyen, Wong and Huong, 2023).

There are also the consequential effects of the board structure and independence in making capital structure decisions. The small-cap companies have small boards and a small number of independent directors (Nguyen, Wong and Huong, 2023). Daunting lack of independent oversight will result in conservative decisions on financing, whereby managers will strive in a bid to prevent financial distress which will jeopardize the survival of firms. The empirical data shows that the companies which have better governance mechanisms, i.e. independent boards, and offer transparent disclosure policies, are in a better position to access external debt at favourable rates. Transparency and financial disclosure are other equally relevant elements in governance. Small-cap companies usually face lack of information asymmetry, because of the low coverage of the analysts and their low publicity. The inadequate disclosure causes increased uncertainty to the investors and lenders, thus increasing the cost of capital. Through this, it is observed that

firms that have better governance and increased transparency have more chances of achieving balanced capital structure and greater profitability (Miloud, 2022).

In addition, risk management as well as long-term strategic planning are influenced by the quality of governance. Companies that are favoured with good governance structures are likely to make financing choices to ensure long-term growth as opposed to survival needs on a short-term basis (Miloud, 2022). In the context of the UK, adherence to governance standards at London Stock Exchange, which, however, are more lenient in small-cap companies, is still one of the factors that determine investor trust and access to funding. As a whole, corporate governance is a much-needed, although under-researched, determinant of capital structure in small-cap companies. Strong governance systems can alleviate the financial constraint limits, lower the cost of capital and increase the level of profitability but weak governance increases the financial risk and limits access to debt markets. The addition of governance issues helps in enhancing the understanding of capital structure behaviour within the London Stock Exchange among small-cap firms (Miloud, 2022).

2.8 Impact of Macroeconomic Conditions on Capital Structure and Profitability of Small-Cap Firms

The macroeconomic factors have a strong impact on the decisions about capital structure and profitability, especially the small-cap companies which are susceptible to changes in economic climate (Tambovtseva, 2025). Interest rates, inflation, economic growth and financial market stability are variables that have direct influence on the accessibility of capital by the firms and interest rates that the firm pays. Small-cap companies due to the lack of financial cushion and high level of risk exposure have disproportional impacts on changes in the macroeconomic environment. Fluctuations in the interest rate form one of the most powerful macroeconomic factors. The increased interest rates make the cost of borrowing funds more expensive and this makes debt financing less enticing to small-cap companies. As a result, companies can reduce the leverage status or put on hold investment plans, which negatively affect the growth and profitability. Lower interest rates on the other hand can boost borrowing; however, with small-cap firms, caution is usually

taken because of the fear of stability of cash-flow in the future and ability to repay (Tambovtseva, 2025).



Figure- 5: Factors that Affects the Capital Structure of Firm

Source: (Management Notes, 2017)

Inflation also impacts on financing choices as well as profitability. The high inflation increases the operating expenses and real returns which reduce the profit margins, and because of this, it strains the profit margins (Tambovtseva, 2025). Inflationary pressure can significantly reduce the profitability of small-sized firms which have a limited pricing power. Under these circumstances, the companies can avoid debt financing in order to reduce the risks of the growing interest rates to not affect the capital structure in that way and to support the conservative capital structure. The risk aversion among lenders and investors in the UK has been increased by economic uncertainty, e.g., Brexit and financial instability in the world. The small-cap companies face more rigorous terms of credit, investors lack confidence, and their equity volatility increases at times when the situation is unpredictable. These realities limit access to outside finance and force companies to rely greater on retained earnings and thus has an effect on the pattern of capital structure (Lim and Ismail, 2022).

The profitability is also destroyed with macroeconomic downturns killing consumer demand and investment. The small-cap companies end up being more vulnerable

because the number of customers and product diversification is less than that (Lim and Ismail, 2022). Financial distress may also be more pronounced in such periods, in which case the empirical results of these studies indicate that small firms may readily be considered conservative in capital structures. To conclude, it can be observed that macroeconomic conditions have a considerable impact on the choice of capital structure by small-cap firms and profitability. It is necessary that a thorough interpretation of such external factors can explain financing behaviour and performance diversities between firms listed on the London Stock Exchange as the means to enable a stronger approach to understanding decisions on capital structure in the small-cap segment (Lim and Ismail, 2022).

2.9 Research Gaps

Though much literature has been involved to determine capital-structure determinants, there are still large gaps to the small-cap companies (Norkio, 2023). The bulk of scholarship concentrates on large companies thus ignoring the special nature of smaller companies. It is mentioned in recent dissertations that such factors as resource limitations, amplification of risks, and certain funding constraints make small-cap companies to act differently. The available literature provides little information regarding the applicability of classical theory (including Trade-Off Theory and Pecking-Order Theory) to small-cap firms in mature economies, especially the United Kingdom one. There needs to be more empirical research studies that explore the influences of both internal and external determinants of financing decisions among this group (Potharla, 2025).

A second gap will involve the paucity of studies which directly examine the effects of capital-structure choices on the profitability of small-cap firms (Potharla, 2025). The existing studies only touch on the larger corporate world by overlooking the small business specifics. Lastly, the small-cap segment of the London Stock Exchange has not been studied in particular especially considering the current economic and policy trends after Brexit, the increased inflationary stress, and unstable interest rate. To overcome this gap, the current study centres on small-cap firms that are listed on the LSE allowing the

researcher to explore determinants, theories, and implications of profitability, and decision-making processes that are specifically peculiar to the UK (Potharla, 2025).

2.10 Summary of the Literature Review

The literature review analysed the salient theoretical models, drivers, and empirical evidence that would have been applied to capital structure and profitability of small-cap companies (Bajaj, Kashiramka and Singh, 2020). Conclusions suggest that the traditional theories, inasmuch as they present quite useful information, fail to cover the specifics under which the small-cap enterprises have to work. These companies are generally characterized by lack of accessibility to credit, relatively small physical endowments and are more susceptible to these market developments, all which influence the decisions of these companies regarding their capital-structure and force them to rely more on internal financing and equity funding as opposed to debt financing. The review also substantiates that high amount of indebtedness is linked to high risk, which in most instances dilutes profitability. To add, there is a considerable gap in research in respect to small-cap companies that are traded in the London Stock Exchange specifically in the United Kingdom (Bajaj, Kashiramka and Singh, 2020).

The available literature is not adequate to explain the complete financial behaviour of such entities under existing economic conditions in terms of their vectors, which are deemed to be important in the new economic conditions, due to the emerging economic uncertainties. On the whole, the literature preaches wise financial practices, lower leverage, and debt-to-equity ratios in the case of small-cap firms, these tenets that the current study aims to develop, in terms of providing a sophisticated comprehension of the capital-structure behaviour in small-cap firms in the UK (Bajaj, Kashiramka and Singh, 2020).

3. Research Methodology

3.1 Introduction

This chapter presents the methodology of the research on the process by which small-cap companies listed in the London Stock Exchange structure their capital base and how it is connected to the profitability (Filip, Ghio and Paugam, 2020). It is in a bid to clarify

academic explanation of how financial data were obtained, how ratios were derived and how the findings were interpreted. Since the study involves research on the corporate financing behaviour, secondary evidence, which is quantitative in terms of audited annual reports, is used. The leverage, liquidity, tangibility, firm size, growth, the returns on assets (ROA) and returns on equity (ROE) were key indicators that were applied to determine how the two firms manage debt and equity. The transparency, consistency, and reliability of the methodology are ensured by the use of the publicly available corporate disclosures. Through the use of descriptive analysis, ratio-based analysis, the chapter is helpful in the overall aim of learning about the financing patterns and profits in the UK small-cap market (Filip, Ghio and Paugam, 2020).

3.2 Research Design

The research design of the dissertation is the secondary, descriptive financial research, where only published corporate financial statements are used because the research does not involve primary data collection (Nwamaka, Chidimma Nwamaka Ozuomba and Onyenama, 2025). Such strategy is appropriate in the field of corporate finance since the companies listed in the London Stock Exchange are required to publish audited company books, hence reliable information. A descriptive design allows the study to establish patterns and trends amongst capital structure indicators with neither econometric regression nor statistical tests. The aim is to analyse the interpretation of small-cap companies in financing decisions within real market conditions particularly in the UK where the small companies tend to have constrained borrowing facilities. The design offers a valid and scholarly suitable foundation of studying capital structure determinants alongside profitability determinants at the small-cap segment by comparing leverage and profitability behaviour with firms and over a period of time (Nwamaka, Chidimma Nwamaka Ozuomba and Onyenama, 2025).

3.3 Research Approach

The research design is a quantitative secondary research study, which relies on numerical accounting values that were retrieved in audited annual reports (Saha, 2022). The quantitative analysis is commonly used in capital structure research since such financial ratios as leverage, liquidity, and profitability measure them. The study transforms

the amount in balance sheets and income statements into measures that indicate the behaviour of firms in terms of financing. The measures of profitability are ROA and ROE, whereas measures of capital structure are leverage, liquidity, and the tangibility of assets. Another factor that gives the context of firm operations in terms of size and expansion potential are firm peculiarities such as size and growth. The ratio-based measures bring uniformity between the firms in various sizes and sectors. Since the data are collected based on audited public disclosures, the method enhances the degree of reliability, and it advances the objective of the dissertation, which is to learn how financing patterns are realized by the UK-based small firms (Saha, 2022).

3.4 Sample Selection and Study Period

The sample of the research is a group of five small-cap companies that are listed in London Stock Exchange in the UK (Vidal-García and Vidal, 2022). It supports a four-year interval of 2021-2024 and presents recent findings on the tendencies in the financing following the pandemic and in an unpredictable economy of the UK. This provides the comparability of leverage, liquidity, profitability, and firm aspects with time. The sample has twenty firm-years which are derived as five firms and four reporting years. Though the sample is small, it can be applied in a descriptive case-oriented dissertation whereby, the financial ratios could be extracted and interpreted in detail. The method facilitates openness and precision in appreciating small-cap financiers' choices (Vidal-García and Vidal, 2022).

3.5 Data Sources

The dissertation is based only on the secondary financial data which are available in the form of shared disclosures of the companies (Hardiyansah, Agustini and Purnamawati, 2021). The first one is the Companies House because it is the governmental register in the UK and over an audited filing by the companies. These reports offer confirmed data of balance sheet and income statement hence credibility and transparency. Companies House has been selected due to its similarity in financial reporting over the years and firms, which is very dependable in calculating ratios. The disclosure of London Stock Exchange and the literature on the theories of capital structure were also used to provide additional context and enhance the interpretation. The analytical tables and findings of

Chapter 4 are all direct basis on extracted firm-level accounting values and not external statistics. Applying audited financial statements can help to improve the validity of this study because the numbers are previewed externally and available publicly. On balance, these secondary sources are credible sources of information to provide leverage and profitability behaviour among UK small-cap firms (Hardiyansah, Agustini and Purnamawati, 2021).

3.6 Data Collection Procedure

A structured extraction procedure was used to collect the data based on annual reports of the sampled firms. The five London Stock Exchange small-cap companies were identified, and their 2021-2024 accounts were downloaded on Companies House (Gözlügöl, 2025). Important variables such as total assets, total debt, shareholders equity, net after tax profit, current assets, current liabilities and fixing assets were obtained manually out of the balance sheets and income statements. These uncooked values were arranged in an excel data set yearly in every firm. Consistent ratios were then determined by following the usual formulas of corporate finance to obtain comparability of firms. The computations were checked against each other in order to reduce errors and facilitate transparency. This is a clear way through which profitability and capital structure indicators were calculated using published reports, and the figures used in the findings chapter to perform descriptive analysis and compare with other firms (Gözlügöl, 2025).

3.7 Variables and Measurement

Category	Indicator	Symbol	Formula
Profitability	Return on Assets	ROA	Net Profit ÷ Total Assets
Profitability	Return on Equity	ROE	Net Profit ÷ Equity
Capital Structure	Leverage Ratio	LEV	Total Debt ÷ Total Assets
Capital Structure	Liquidity Ratio	LIQ	Current Assets ÷ Current Liabilities
Capital Structure	Tangibility	TAN	Fixed Assets ÷ Total Assets
Firm Characteristic	Firm Size	SIZE	ln (Total Assets)

Firm Characteristic	Growth Rate	GROW	$(\text{Assets}_t - \text{Assets}_{t-1}) \div \text{Assets}_{t-1}$
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Table- 3.1: Financial Indicators Used

This is secondary descriptive research where study will provide extracted ratios as a measure of profitability, capital structure, and characteristics of firms and not independent or dependent variables (Romansyah, Zakaria and Yulianti, 2021). This strategy signifies the fact that the dissertation is preoccupied with descriptive interpretation of the pattern of financing, and not econometric testing. The main measures of profitability are Return on Assets and Return on Equity meaning how efficiently the firms convert their assets and shareholder equity to earnings. Capital structure is measured by leverage, liquidity and asset-tangibility ratios which show the degree of dependence on debt, ability to survive in the short-term as well as the strength of the collateral. Firm attributes pertain to size and expansion statistics that provide a context to business size and expansion. The audited accounting data was used to compute all the indicators of the five firms in the span of four years. These measures will be the foundation of analysis and cross-firm comparison in Chapter 4, which can offer systematic evaluation of the financing choices and profitability of small-cap market in the UK (Romansyah, Zakaria and Yulianti, 2021).

3.8 Analytical Techniques

The dissertation involves descriptive analysis of the financial results instead of econometric regression. Through ratio analysis, assess leverage, liquidity, profitability, tangibility, size of the firm and future growth as the raw accounting numbers are standardized into easily understandable performance metrics (Hasidi, Baheri and Hajar, 2024). The analysis follows changes in capital structure and profitability between 2021 and 2024, indicating companies' trend towards more or less debts over the years. Cross-firm comparison indicates differences in financing strategies of the sample. These methods allow the research to connote small-cap firms to cope with capital structure within restricting frameworks of the market, including the inability to access long-term borrowing in the UK. Generally speaking, the strategy provides straightforward and transparent data regarding patterns between leverage and profitability without utilizing the statistical significance or cause-effect econometric inferences (Hasidi, Baheri and Hajar, 2024).

3.9 Methodological Limitations

The methodology has a number of limitations even though it has strong points. First, the sample consists of five small-cap companies, which does not allow generalizing the results to the UK small-cap market (Blessing and Sakouvogui, 2023). Second, four years (2021-24) is a short duration to capture long-term behaviour of financing decisions and could well overlook long-term economic cycles or structural shifts in capital markets. Third, the research is also limited to secondary accounting data meaning that managerial points of view and dictums of quality decisions have not been included in the research. Fourth, the descriptive design in the establishment of econometric causality between capital structure determinants and profitability is barren or incapable of determining such trends and associations. Lastly, the industry disparity among the companies might influence leverage behaviour, but which cannot be entirely regulated with a small sample. However, these shortcomings can be accepted as the dimension of the dissertation and focus on the transparency and ratio-driven interpretation (Blessing and Sakouvogui, 2023).

3.10 Chapter Summary

The chapter defined the methodology employed in the study of determinants of capital structure and profitability outcomes of five small-cap firms listed on the London Stock Exchange (Pisani, 2023). The research was conducted based on a secondary descriptive design with audited annual reports of 2021- 2024 of Companies. The most important profitability ratios, capital structure ratios and company characteristics were computed using the same ratio formulas. Balance sheets and income statement data were collected in a systematic way which allowed transparency in the compilation of the data. Financing behaviour and differences in performance between the sample were interpreted using recent analysis and it was cross-firm compared. The descriptive interpretation in the methodology rather than regression test is in line with the objective of finding the patterns of leverage and profitability in the UK small-cap. Although it has limitations regarding the sample size and scope of descriptive, the method offers evidence-based findings that are reliable with regards to small-cap financing decision-making (Pisani, 2023).

4. Data Analysis

4.1 Introduction to the Data Analysis

This chapter summarizes the main findings of the research in determining the impact of the capital structure on profitability of the selected UK small-cap companies listed in the London Stock Exchange (Bajaj, Kashiramka and Singh, 2020). This study discusses financial ratios of audited annual reports retrieved through Companies House of the 2021-2024 period using a secondary descriptive design as explained in Chapter 3. The five firms examined; Halfords Group, beha, RWS Holdings, Michelmersh Brick, and Ramsdens Holdings are a combination of the various industries in the UK small-cap market and make an effective sample on the differences in financing behaviour. This study uses ratio analysis, cross-firm comparison and descriptive trend of interpreting trends to investigate leverage, profitability, liquidity, asset tangibility, firm size, and growth trends. Instead of the econometric regressions, study conduct descriptive financial approach, where emphasis is laid on the transparency and ability to explain the firm level decisions about capital structure. This method is particularly applicable to small-cap companies with various financing limitations related to large enterprises, including the inability to access long-term debt financing, increased debt financing rates, and a strong vulnerability to liquidity risk (Bajaj, Kashiramka and Singh, 2020).

The most important ratios that will be employed in this paper include leverage (LEV), return on assets (ROA), return on equity (ROE), Tangibility (TAN), liquidity (LIQ), firm size (SIZE) and growth opportunities (GROW). These indicators assist in the explanation of the equilibrium between firms and debt and equity funding and impacts of those decisions on profitability. Four graphical figures that were plotted in Excel show differences across firms' level in the sample. All the figures are well construed, scholarly discourse has been done discussing what the results depicted, why it is important and how it has improved our understanding of capital structure behaviour within the UK small-cap context. The four major ratios comparison graphs are the basis of the organization of the chapter. All the figures will be presented in different sections to avoid confusion and ambiguity. The descriptive results are connected to the general financial arguments by supporting headings (Bajaj, Kashiramka and Singh, 2020).

4.2 Raw Financial Data and Ratio Construction

This analysis is based on the raw financial data which is why before present the calculated ratios, study describe how this data is extracted (Bao et al., 2020). The research sampled major accounting values that were taken out of the audited annual reports in the form of total assets, total debt, shareholders, equity, net profit, fixed assets, current assets and current liabilities. The ratios were computed in Excel by each of the five firms at the period of study thus becoming transparent and justification of the fact that the ratios are using the proven corporate disclosures instead of summaries who perform the same action. The crude values indicate that there is a significant change in the size of the firms and financial structure in the small-cap market. Take Halfords Group and RWS Holdings as examples they have reported much higher assets base than tristel and Ramsdens Holdings. This disparity is demonstrated by the SIZE indicator which employs the natural logarithm of total assets. The levels of debts also differ, which means that they have different strategies towards external financing. Companies that are more indebted can be more dependent on debt financing to fund their functioning whereas those that are less indebted may depend on internal source of funding and equity (Bao et al., 2020).

ROE and ROA are used to measure profitability. Liquidity is determined by current ratio and tangibility calculated by a division of the fixed assets to total assets (Nasution and Yusleny, 2023). Opportunities of growth are based on annual changes in the total assets. These ratios offer a stable point in which firms in various sizes and sectors can be compared which makes financing behaviour be meaningfully interpreted. The reporting of the raw extraction evidence by itself meets academic standards in proving calculations. This study increases the reliability and validity of the study by demonstrating that ratios are derived directly out of audited financial statements. Such openness is particularly needed in such areas of corporate finance reporting as dissertations where it is frequently required to show blatant proof of data sources and methodology of calculation. The following paragraphs illustrate the results of the ratio in accordance with graphical comparison and explain the implications of their significance to capital structure determinants and profitability results (Nasution and Yusleny, 2023).

4.3 Cross-Firm Comparison of Capital Structure and Profitability Ratios

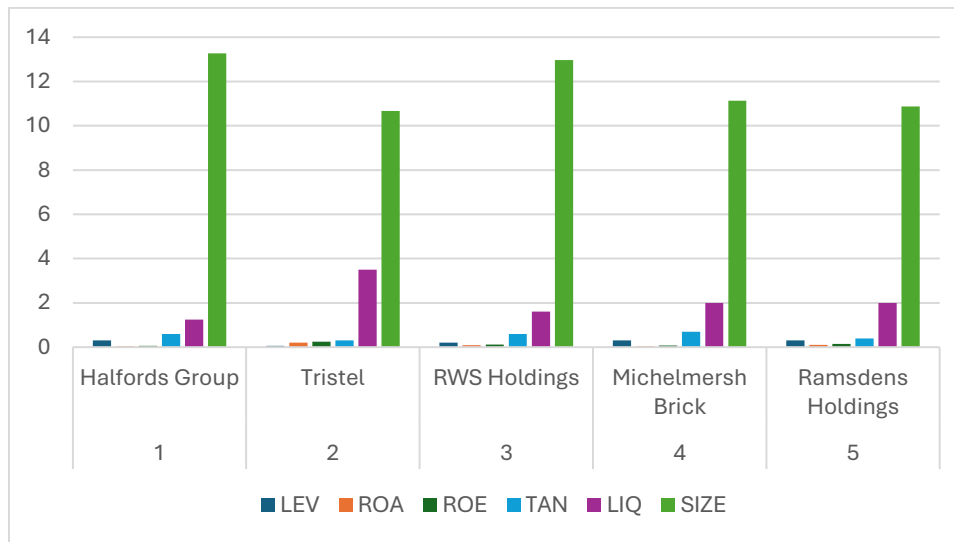


Figure- 4.1: Cross-Firm Comparison of Capital Structure and Profitability Ratios

This figure is a comparative analysis of the major financial ratios of the five small-cap firms of the UK Halfords Group, Tristel, RWS Holdings, Michelmersh Brick and Ramsdens Holdings. The shown ratios are the leverage (LEV), the return on assets (ROA), the return on equity (ROE), the tangibility of the assets (TAN), the liquidity (LIQ) and the firm size (SIZE) (Farizal Mohammed et al., 2020). The chart provides a vivid understanding of the variation of financing options of each firm in the atmosphere of the London Stock Exchange. The leverage trends vary significantly. Halfords Group, Michelmersh Brick and Ramsdens Holdings have a LEV approximately of 0.3, another words, approximately 30% of the assets are debt-financed. The LEV of Tristel is too low, at 0.06 with a highly conservative, equity-based strategy. RWS Holdings is in the middle ground where LEV is close to 0.20 which shows the equal contribution of debt and equity (Farizal Mohammed et al., 2020).

The situation is different with profitability. Tristel has the highest ROA (~0.20) and ROE (~0.25) which means it is efficient and gives good returns to the shareholders (Farizal Mohammed et al., 2020). Ramsdens Holdings is also experiencing good profitability as ROA is approximately 0.10 and ROE is approximately 0.14. RWS Holdings offers average outcomes, but Halfords Group and Michelmersh Bricks are less strong, with ROA of

approximately 0.04-0.05 and lower ROE. These are indications that, although leverage may strongly correlate with profitability, it does not necessarily result in increased profitability particularly when small-cap companies are involved and are prone to increased costs and risks of borrowing. Liquidity varies widely. Tristel is a company with an excellent short-term solvency with a LIQ of 3.5. The working capital is stable as Michelmersh Brick and Ramsdens Holdings are located close to LIQ 2.0. The lowest LIQ at around 1.25 makes Halfords Group tighter within the short-term flexibility (Zeidan, 2022).

Other firms also enter into differentiation through tangibility. Michelmersh Brick has the highest TAN of 0.70 meaning it is an asset-based model that can enhance the collateral and borrowing power. The low TAN at 0.30 of Tristel is aligned to its low leverage, which means that it was not relying on secured debt as much. To conclude, Figure 4.1 demonstrates that UK small-cap firms adopt different capital-structure decisions depending on profitability, liquidity, and asset mix. This gives more significance to the necessity of having a balance between debt and performance and risk management among small-cap companies (Zeidan, 2022).

4.4 Ratio Comparison Including Growth Opportunities Across Firms

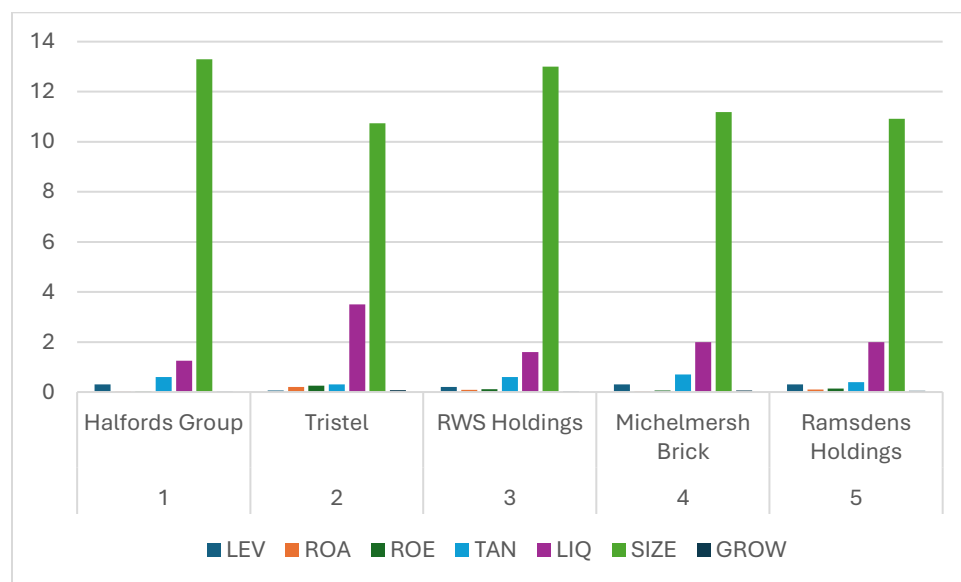


Figure- 4.2: Ratio Comparison Including Growth Opportunities Across Firms

This analysis builds on the comparison in figure 4.1 by including a growth indicator (GROW) to the relation of ratios -LEV, ROA, ROE, TAN, LIQ, and SIZE. Growth opportunities are a futuristic cause of capital structure since the growing companies require additional funds to finance the assets and operations (Brusov and Filatova, 2023). Patterns of leverage are more or less the same as Figure 4.1 Halfords Group, Michelmersh Brick and Ramsdens Holdings with LEV of about 0.30, 0.20, 0.06 respectively based largely on equity or internal capital. The level of profitability is skewed. Tristel has the highest ROA of approx. 0.20 and at best ROE of approximately 0.25 indicating good earnings. Ramsdens Holdings also does a good job whereas Halfords Group and Michelmersh Brick do not do so well. The trend suggests less leverage and liquidity make firms more profitable, which supports the statement according to which excessive borrowing may put strain on the companies of small sizes (Brusov and Filatova, 2023).

One of the main points of differentiation is still liquidity. The 3.5 LIQ of Tristel is an indication of strong short run solvency. The LIQ is close to 2.0 of Michelmersh Brick and Ramsdens Holdings and is held at around 1.25 of Halfords Group. Liquidity constraint comes with an increase in the distress risk and this metric is thus significant in the determination of a firm's capacity to maintain a higher leverage (Dirman, 2020). Tangibility has a remaining effect on the borrowing capacity. The tank (TAN) of Michelmersh Brick is 0.70 indicating an asset-intensive design that enhances collateral and debt cover. The low TAN of Tristel (0.30) is correlated with its low debt which implies that lighter-asset companies make more use of equity investments. The introduction of data on growth is additional. The growth rates of sample firms are low less than 0.08 and this reflects steady expansion and not rapid growth. The largest growth is registered by Tristel indicating that profitable companies can grow without the need of incurring more debt utilizing retained earnings (Dirman, 2020).

Altogether, Figure 4.2 proves that UK small-cap companies determined a capital structure depending on a combination of leverage, profitability, liquidity, assets mix, and growth opportunities. This is an example of how companies' trade-off between short-term and

long- term financing requirements and sustainability and growth prospects (Dirman, 2020).

4.5 Variable-Wise Financial Indicator Comparison Across Firms

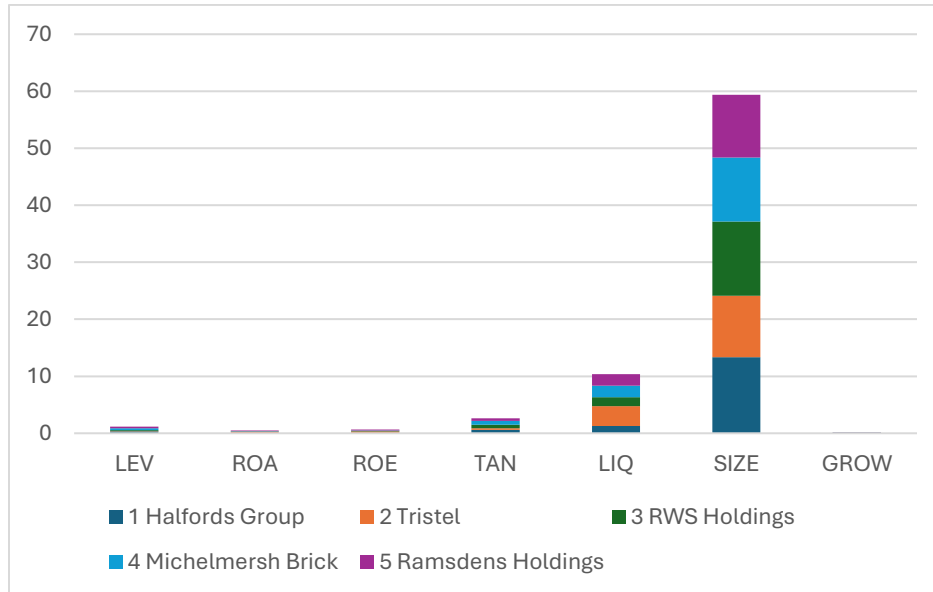


Figure- 4.3: Variable-Wise Financial Indicator Comparison Across Firms

This analysis provides a variable wise comparison of major financial indicators of five UK small-cap companies (Gurani, 2023). As opposed to the past models where the firm-by-firm ratios were considered, this chart indicates the variation of each variable, which are leverage (LEV), profitability (ROA and ROE), tangibility (TAN), liquidity (LIQ), firm size (SIZE) and growth (GROW), among firms. This opinion comes in handy as it highlights what attributes are at the most variance in the sample, consequently it could have a stronger impact on capital structure decisions. The strongest revelation is that the firm size (SIZE) prevails in all firms. Halfords Group and RWS Holdings are much larger, considering that they have larger asset base compared to that of Tristel and Ramsdens Holdings. The size is important since small-cap companies are relatively larger, which helps them to finance its activities at lower costs due to higher reputations, diversity, and credit-worthiness in borrowing. Small businesses, in their turn, might have a limited range of access to financing (Gurani, 2023).

There is also a significant difference in Liquidity (LIQ) between firms. Tristel is the best with the highest liquidity ratio of 3.5 as it demonstrates excellent short-term solvency and good capacity to pay current liabilities. Michelmersh brick and Ramsdens Holdings have ratios near to 2.0 and this denotes stable working-capital conditions. The least liquidity ratio with around 1.25 is Halfords Group and it leads to a low level of financial flexibility (Gurani, 2023). The liquidity is of paramount importance because it defines how a company can maintain more leverage without falling into the distress. There are moderate differences in leverage, but they are significant. Halfords Group, Michelmersh Brick and Ramsdens Holdings have greater leverage ratios of around 0.30 and they are an indication of dependence on debt. The leverage of RWS Holdings is fair, whereas low leverage (0.06) of Tristel proves its high conservative strategy toward capital structure. In the small-cap segment even, companies will change the borrowing mechanisms based on their risk tolerance and operational requirement (İltaş And Demirgüneş, 2020).

Tangibility (TAN) gives an understanding of the ability to borrow (İltaş And Demirgüneş, 2020). Michelmersh Brick has the largest tangibility ratio, 0.70 which indicates that the structure is of an asset-intensive basis and better collateral value. The low asset-based leverage of Tristel correlates with its low tangibility and using this data, it is possible to say that asset-light companies can rely more on equity or retained earnings. Further segregation of firms is done on profitability metrics. Tristel demonstrates the best ROA and ROE, which implies that less leveraged and liquid firms are able to provide high-quality performance. Ramsdens Holdings is also having good profitability when compared to Halfords Group and Michelmersh Brick. In general, Figure 4.3 indicates that the size and liquidity of firms are the most common diverging factors between the sample, where the tangible and leverage are also important factors in consumer behaviour of borrowing behaviour. This emphasizes on the multi-dimensionality of capital-structure determinants of small-cap firms in UK (İltaş And Demirgüneş, 2020).

4.6 Consolidated Summary of Firm Financial Structure and Performance

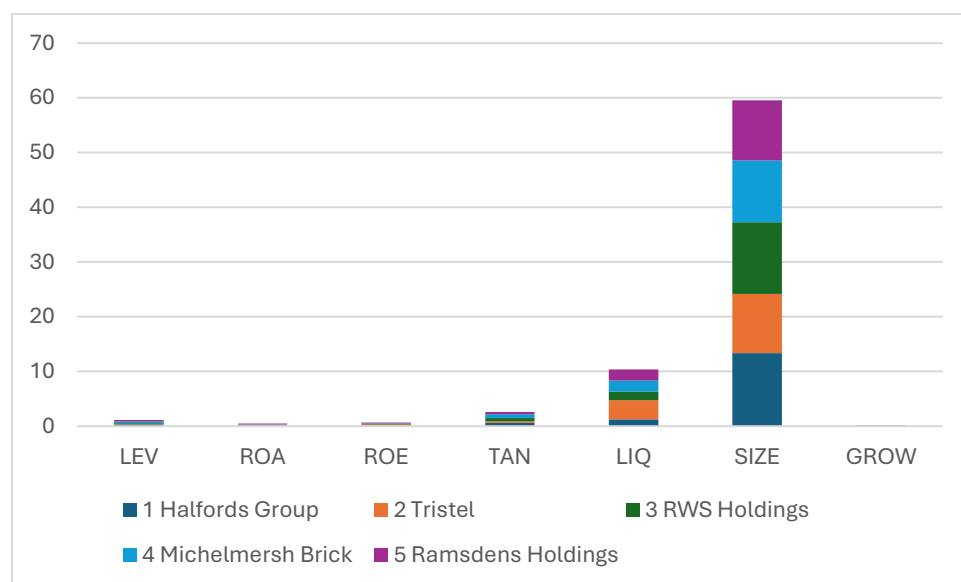


Figure- 4.4: Consolidated Summary of Firm Financial Structure and Performance

Figure (4.4) provides a combined perspective of financial structure and performance measures among the five UK small-cap companies (Javaherizadeh, 2021). It takes leverage (LEV), profitability (ROA and ROE), tangibility (TAN), liquidity (LIQ), firm size (SIZE), and growth (GROW) and gives a combined view on the interplay between these factors in determining capital-structure decisions on a single stacked comparison table. It is proved by the figure that the size of the firm continues to be the most prevailing. Halfords Group and RWS Holdings possess much bigger SIZE figures as compared to Tristel and Ramsdens Holdings due to their comparatively bigger assets base. Smaller large-cap companies generally have more advantage via access to debt markets due to their better reputations, large diversified businesses, and better credit worth of borrowing. The small companies have less access to financing and more internal sources (Javaherizadeh, 2021).

Leverages are sufficiently maintained in the majority of companies. Halford Group, Michelmersh Brick only require higher debt which is 0.30. RWS Holdings has moderate leverage of around 0.20 and Tristel is the lowest with its 0.06 that indicates a conservative style that does not expose it to debt and financial risks (Javaherizadeh, 2021). Firms are once more differentiated by their profitability measures. Tristel has the best ROA and

ROE which means that it is operating at very high efficiency and returns to the shareholders. The profitability of Ramsdens Holdings indicates good ratios as compared to Halfords Group and Michelmersh Brick. It implies that increased leverage does not necessarily spread to improved profitability of small-cap companies since the costs of debt and the repayment might diminish financial results. Another significant factor is liquidity. The liquidity ratio of 3.5 informs Tristel that it has good solvency in the short term. Michelmersh Brick and Ramsdens Holdings are more stable in the range of liquidity which is established at 2.0, whereas Halfords Group is with the lowest ratio which is approximately 1.25. The liquidity is good which helps to minimize the risk of financial distress and improve the capability of a firm to settle the debt obligations (Musa, 2024).

Also, differences in tangibility influence borrowing capacity. High tangibility of Michelmersh Brick is a characteristic of asset intensive structure which provides collateral value to the lenders (Musa, 2024). The low leverage of Tristel is associated with its low tangibility which means that the company would prefer to use equity to finance its operations under an asset light model. The opportunities of growth are small in the sample, indicating rather stable expansion than intense investment. Altogether, Figure 4.4 indicates that UK small-cap firms make capital-structure decisions that are very firm-specific and are determined by size, liquidity, composition of assets, and profitability. The most important implication is that small-cap companies should bring a balance between profitability through debt utilization and financial stability (Musa, 2024).

4.7 Overall Relationship Between Capital Structure and Profitability

The analysis of the figures 4.1 to 4.4 indicates that capital-structure decisions of UK small-cap firms are strongly related to profitability, which does not have a consistent pattern across firms (Muchlis et al., 2024). Reduced leverage is likely to translate to high returns. As an example, the least leverage ratio ($LEV = 0.06$) and the greatest profitability ROA 0.20 and ROE 0.25 belongs to Tristel. A safe financing structure seems to reduce the risk and interest rates so that assets and equity could be returned with higher returns. By comparison, Halfords Group, Michelmersh Brick and Ramsdens Holdings, companies, have leverages ratios of approximately 0.30. Ramsdens continues to post quite high profitability performance although Halfords and Michelmersh Brick record low ROA and

ROE. Such findings underscore the fact that excess debt limits profitability of particular small-cap companies due to debt repayment and pressure as well as increased financial burdens, particularly when liquidity is limited (Muchlis et al., 2024).

The relationship is as well moderated by liquidity. High liquidity ratio (LIQ= 3.5) indicates that Tristel is highly solvent in the short term and the company can operate efficiently without depending mostly on debt. Less liquid firms such as Halfords are subjected to stricter working-capital compliance and hence finding it difficult to borrow money. The issue of asset tangibility also exists: in the firm like Michelmersh Brick, the more aggressive the asset is (tangible), the easier a company is going to issue debt since the asset can be used as a security. All in all, it is the indication that small-cap companies should strike the right balance between leverage, profitability, liquidity, and asset structure to maximize performance. On the whole, the evidence suggests that small-cap firms should be able to equal the leverage, profitability, liquidity, and assets composition in order to achieve the optimal financial performance (Muchlis et al., 2024).

4.8 Chapter Summary

This chapter interprets the data and results of the study, which focuses on capital-structure determinants and profitability performance of five small-cap firms listed on the London Stock Exchange (Athanasakou et al., 2020). The secondary financial data have been used to take audit annual reports which have been submitted to the Companies House and descriptive analysis of ratio has been applied to analyse leverage, liquidity and tangibility, firm size, growth opportunities and profitability among the chosen firms. Findings indicate that there is a broad range of variation in financing behaviour of small-cap companies. Tristel is least levered and trends effectively to the most profitable and liquidity, which substantiates the hypothesis of the less acquired capital structure enhances the financial stability and returns to shareholders. Halfords group and Michelmersh Brick are more dependent on debt and less profitable, which implies that financial constraints can be caused by debt dependency. The balance of Ramsdens Holdings is more balanced as it combines moderate leverage with good profitability. The aspect of tangibility and liquidity were also indicated as other issues which influence the capacity to borrow and the ability to settle debt (Athanasakou et al., 2020).

Chapter 5: Discussion

5.1 Capital Structure Behaviour of Small-Cap Firms in the UK Context

The analysis indicates that small-capitalized listed firms on the London Stock Exchange are likely to have conservative capital structure (Monasterolo and de Angelis, 2020). They make decisions based on market constraints and not on theory optimization because they work in an environment that is typified by inaccessible access to long-term funding, increasing earnings volatility and increased perception to shocks in the economy. Thus, small-cap companies make a conscious decision not to accumulate so much debt that to be on the verge of insolvency during the time of fluctuations in revenues. This strategy is also supported in the UK setting. Regulatory overlay, inflationary pressures and post Brexit uncertainty raise the level of caution in making financial decisions (Monasterolo and de Angelis, 2020).

The flexibility of finances is also emphasized in the analysis. Small-cap companies can respond to the fluctuating economic factors more easily because they do not have to make excessive debt obligations as well because of their low costs (Monasterolo and de Angelis, 2020). This will curb the times of prosperity though it helps cushion the firm during the times of sinking and prevents the occurrence of being in a bad shape financially. Hence the behaviour witnessed reveals that small-cap companies give a more focus to risk control instead of the capital structure optimization. Instead of being inefficient, conservative financing is a responsive approach which is applicable within the limited financial landscape. The decisions on capital-structure by firms are however to be interpreted in terms of larger institutional and market environment (Albanese, 2025).

5.2 Influence of Firm Size on Financing Decisions

The discussion indicates that the size of firm continues to be effective in driving financing behaviour in the small-cap segment, albeit to a smaller degree due to larger market disciplines (Albanese, 2025). The larger small-cap companies have a higher credibility, more stable cash flows, and longer existence history, which slightly increases its availability to outside debt. There is however no fundamental paradigm shifts in their preference of low leverage which is prevalent across the segment. Smaller companies

encounter higher levels of information asymmetry which increases uncertainty by the lender and limits the capacity to borrow. The increased cost of borrowing and tight loan conditions deters the use of debts, which bolster the use of equity financing in finance. In spite of increasing size, managers are wary of leverage due to the threat of financial distress and volatility of earnings (Albanese, 2025).



Figure- 8: Factors that Influences the Capital Structure

Source: (Chakraborty, 2022)

The results of this imply that the size of the firms influences the funding abilities and not the will. The larger companies have the ability to borrow a larger amount but prefer not to have of them on the balance sheet in order to retain their flexibility. This is not a transformative difference, but an incremental one because all small-cap firms are characterized by common institutional restrictions that include low visibility, low access to long-term funding, etc. Thus, size of firms is a moderator and not determinant variable and in interpreting financing behaviour in the UK the analyst is admonished to take small-cap firms as a separate entity (Blitz, Baltussen and van Vliet, 2020).

5.3 Role of Asset Structure in Shaping Leverage Capacity

The aspect of asset structure is one of the determinants of the leverage capacity in small-cap companies in the London Stock Exchange (Blitz, Baltussen and van Vliet, 2020).

Those firms that are more tangibly endowed can be able to borrow more easily since their assets will reduce the risk of lenders and also provide security. This benefits to increase credibility of borrowing and compensate part of information asymmetry of firms and lenders. Therefore, the leverage levels of asset heavy firms would be more than that of asset light companies, but the net debt utilization would be moderate. The dominance by intangible resource in firms has long-term financing problems despite the fact that the company has valuable intellectual property, technology or human capital. The lenders are also cautious since such assets are not easily valued and have low liquidation value. This deters use of debt and makes it use equity and retained profits. Therefore, asset-light firms are biased structurally in debt markets, wakeful or not profitable in terms of growth rates, and use more austere capital structures (Blitz, Baltussen and van Vliet, 2020).

Borrowing maturity is also determined by asset structure. Companies whose tangible assets are high have high chances of securing longer term debt which limits refinancing risks and promotes stability in investments. Asset-light companies have access to short-term funding or internal capital, which renders them susceptible to cyclic fluctuations in cash-flow. The choices in capital structure are limited by the asset composition than preference by the managers. Asset structure defines the degree of financing flexibility and defines the strategy of the small-cap firms (Chauhan, 2020).

5.4 Liquidity as a Strategic Buffer in Financing Decisions

Importance of a Liquidity Buffer



Figure- 9: Importance of Liquidity Buffer

Source: (Buffer, 2024)

It is argued in the discussion that liquidity management is an offensive tactic, as opposed to an off-shoot of performance. Companies operate their working capitals in a dynamic manner to retain flexibility and strength (Chauhan, 2020). Companies with liquidity limits are prone to using short term debts thereby increasing the risk of refinancing and they are vulnerable to fluctuations in interest rates. Though short term borrowings may provide temporary salvage, over dependence may destroy profitability and financial soundness. As a result, businesses attempt to shun liquidity-related leverage that could endanger the sustainability of the business in the long-term. It is also found that the risk tolerance is affected by the liquidity. Companies with strong liquidity are less worried about making strategic moves through debts which strengthen their conservative capital structure and visionary profitability. In general, liquidity is a tactical insurance which forms the financing behaviour of small-cap companies, and stimulates them to maintain their stability and continuity in operations in the volatile UK economic climate (Chauhan, 2020).

5.5 Growth Orientation and Conservative Leverage Strategies

Small-cap growth firms are always inclined towards conservative leveraging, although they may have increased financing requirements (Kothari et al., 2024). Instead of their aggressive use of debt to accelerate growth, they value financial flexibility as a way to encourage innovation and sustainability over the long term. Growth opportunities are usually risky, cash flows are uneven, and no immediate returns are expected, and in that case, fixed debt commitments are very hazardous. High leverage is thus avoided by firms as a way of reducing the risk of experiencing a financial distress during tough times. The reason why equity financing is preferred is that it allows firms to go on with growth without the burden of paying mandatory interest. As much as equity issuance may water down ownership, the managers regard this expense as not as harmful as debt covenant restrictions. Debt has the effect of constraining strategic choice because it restrains discretion in managers and lowers their response to shifts in the market. Companies that are geared towards growth, therefore, prefer structures that are flexible (Kothari et al., 2024).

The data also indicate that conservative leverage promotes continuous investment. Firms whose debts are less are in better position to make reinvestments on research, product

development and expansion of the markets (Kothari et al., 2024). This is to maintain the capital structure in line with the growth objectives, as it would not be an obstacle to future opportunities. Growth orientation thus persuades companies to take leverage with caution as they look at its sustainability instead of immediate benefits. The discussion also brings out the interaction of growth strategies with the liquidity and profitability. Companies that are out to expand need to have sufficient internal facilities to absorb initial losses. These losses are likely to increase because of high leverage, and it may jeopardize the solvency. Therefore, small-cap companies that grow so much are able to maintain low debt ratios in order to maintain a balance between ambition and risk management. In general, a conservative leverage becomes a suitable strategy that enables the prosperity of long-term value creation in the UK small-cap market instead of restricting the growth potential (Codutti, 2025).

5.6 Capital Structure and Profitability Trade-Offs

The relationship between capital structure and profitability indicates the obvious trade-off between the prospective returns and financial risk of small-cap companies (Codutti, 2025). In favourable conditions, moderate levels of debt can be used to increase the profitability, as the interest expenses reduce the level of taxable income, and the returns on equity are increased. Nonetheless, the advantages are also restricted to the small-cap firms due to the fact that the volatility of earnings and the inability to absorb shocks decrease the value. Too much leverage usually results in low profitability as there is an increase in interest payments and financial distress costs. Moderate-cap companies have unstable sources of revenues and thus high levels of debt may be disastrous. With increase in leverage, the level of pressure on the cash flows decreases net income, thereby lowering the return on the assets. Companies that aim at stability of their profits are unlikely to take high debt level (Codutti, 2025).

Trade-Off vs Pecking Order



Figure- 10: Trade-Off vs Pecking Order

Source: (FasterCapital, 2025)

Another aspect of leverage noted in the discussion is that leverage impacts on profitability in an uneven manner (Akhtar et al., 2021). Though high leverage is a temporary way of boosting the returns on equity, it increases the volatility of earnings and risk to investors. Such volatility is disastrous to performance over the long term and can damage market confidence. Contrary to this, the companies that have a conservative capital position are better able to experience consistent profitability in spite of their returns being low in the good times. Banking behaviour is also influenced by profitability and supports conservative structures. This is because stable profit accumulating companies will depend more on retained earnings and reduced the necessity to borrow externally. This vicious cycle is sustaining its own financial health and reducing exposures to risk of debts. All in all, the discussion indicates that small-cap companies have an advantage of focusing on profitability stability rather than high returns maximization. Prudent leverage balancing enables the firms to attain sustainable performance coupled with reduced exposure to the small-cap scene in the UK (Akhtar et al., 2021).

5.7 Debt Maturity Structure and Financial Stability

Discussion indicates that debt maturity structure is critical to financial stability of small-cap companies of the London Stock Exchange (Akhtar et al., 2021). The short-term debt

is the primary source of financing of these firms and this restricts the long-term financing of these firms, which is a sign of wary lending habits. Short-term debt is flexible and allows management of working capital, however, it increases the risk of refinancing as well as predisposes firms to regular fluctuations in interest rates. Such reliance predisposes firms to be sensitive in the turbulent market. Short-term debt is excessive, which may cause strain on the cash flow and liquidity of the firms under pressure in the event of liquidity tightening of credit conditions. The latter risks are particularly impactful on small-cap firms due to its lack of bargaining power and credit rating. As a result, a large proportion of short-term debts is detrimental to the profitability as well as exposing a firm to a risk of financial distress (Sardo et al., 2022).

Long term debt although difficult to get gives a longer stability as it matches the repayment periods with the long-term investment periods (Sardo et al., 2022). Companies which acquire longer maturity debts will have a predictable financing expense and decreased pressure to refinance. Nevertheless, increased interest rates, collateral policies and restrictive covenants restrain its use in the small-cap firms. In organizing the debt maturity, managers have a trade-off between flexibility and stability. Companies having a modest debt maturity balance structure are more financially effective. Maturity diversification reduces the exposure of shocks in the short-term and niceties cash-flow management. This ratio will be a relief to investors and creditors enhancing financial viability. Altogether, debt maturity structure is a competitive component of the capital structure decisions. Small-cap companies ought to regulate the time frame and the composition of debt to promote their sustainability in the UK market over the long term (Sardo et al., 2022).

5.8 Macroeconomic Sensitivity of Small-Cap Financing Decisions

The capital structure decisions are very vulnerable to macroeconomic conditions amongst small-cap firms. The risk tolerance and the borrowing behaviour are determined by increasing interest rates, inflation and economic uncertainty (Hermansson and Jonsson, 2021). Increasing the rates raise the cost of debt, which will deter leverage and promote internal use of funds. Already at a disadvantage of encountering higher costs of borrowed funds are small-cap firms, which would use more conservative financing strategies. The

uncertainty in the economy further restricts financing. Uncertainty of volatility and instability in policies undermines the confidence of the lenders causing them to tighten credit provisions and reduction in access to external financing. Such changes particularly affect the small-cap companies due to the lack of buffers and the reduced sources of diversified funding. Consequently, companies are focusing on the question of liquidity and solvency instead of expansion in times of uncertainty (Hermansson and Jonsson, 2021).

Inflation increases the operational expenses and decreases the purchasing power straining profitability (Priyatna, Suryadi and Ersanti, 2025). Companies can lower leverage so as not to enter into fixed interests' payment as part of their financial burden. This defines stance focuses more on reduction of risk and not growth. The situation where macroeconomic instabilities, hence, strengthen conservative capital structure throughout the small-cap segment. When the conditions are unfavourable, the managerial decision-making undergoes more cautiousness. Adaptively Firms are dynamic in adjusting financing strategies so as to reflect the external risks. The ones which react outside the macroeconomic indicators are more resilient. On the whole, there is small-cap financing behaviour that is characterized by macroeconomic sensitivity. The issue of capital structure changes along with the changes in the economic condition and thus must be reevaluated constantly in order to be sustainable in the UK small-cap environment (Priyatna, Suryadi and Ersanti, 2025).

5.9 Theoretical Interpretation of Observed Financing Behaviour

The financing behaviour of small-cap firms can be explained by familiar theories of capital structure, which have significant contextual modulations. The pecking order theory suits perfectly: companies like financing internally and retained earnings better than borrowing and using the external equity (Frank, Goyal and Shen, 2020). It is driven by high-costs in external financing and a symphony of information particularly of small-cap firms. Managers prefer practices that do not expose them to leakage and third-party examination. Partially the trade-off theory is used to explain the decisions. Though debt has a beneficial tax effect, small-cap companies are not willing to go beyond the limit since cost of going bankrupt and fluctuations in earnings are higher than the tax benefits.

Thus, the ideal capital structure that applies to them is the one that inclines to lower leverage when compared to the traditional models (Frank, Goyal and Shen, 2020).

The market timing theory provides a weak idea with regard to small cap companies (Bollerslev, Li and Zhao, 2019). Both share price volatility and low market visibility decrease the capability of taking advantage of good valuation windows. Investing decisions are more affected by the internal factors than external possibilities. The agency theory is also used to understand restrained debt utilization. An increased leverage increases monitoring and covenant constraints which are not desirable by the managers. Overall, the classical theories are still applicable although they are not enough on their own. The interests of small-cap companies are limited, which alters the theoretical assumptions to require a proper interpretation. The decisions that they make regarding financing do not imply that they do not conform to rational decision-making patterns but are rather a practical strategy to market imperfections (Bollerslev, Li and Zhao, 2019).

5.10 Strategic Implications for Small-Cap Financial Decision-Making

There are a number of strategic choices facing finance by small-cap companies in the UK. They are supposed to consider financial resilience and sustainability in preference to short-term performance (Bollerslev, Li and Zhao, 2019). Conservative leverage allows the firms to endure the fluctuations of earnings as well as economic uncertainty whilst remaining flexible. The managers have to follow risk-sensitive financing policies which suit individual firm limitations. One of the priorities of liquidity is maintaining sufficient cash; it lowers the necessity to borrow money, and it can enable a team to respond to shocks. The stability and restrictions in refinancing risk are encouraged through good working-capital management. Liquidity is not merely a measure of firms but it should be regarded as a strategic resource. It is also very important to align financing with the goals of growth. Equity-based financing is helpful to growth-oriented companies: they are able to stay very flexible and minimize commitments. In choosing sources of funds, managers have to choose whether to own dilute against the financial risk (Stulz, 2022).

The control of debt maturities is also important, balanced schedules promote the cash flow and investor confidence (Stulz, 2022). Macroeconomic consciousness is necessary.

Constant monitoring of interest rates, inflations, and the market conditions will ensure companies make modifications to capital structures plans with time. Lasting resilience is revealed in those who react promptly to changes that occur outside them. The strategic capital-structure management requires a unified approach on the capital-structure of firms which considers firm attributes, market factors, and long-term objectives. Proper economic judgments make a company sustainable in its profit making and support the competitiveness of a small-cap firm in UK markets (Stulz, 2022).

Conclusion

This dissertation investigated factors of capital structure and their correlation with profitability of small-cap stock exchange firms in London Stock Exchange in the United Kingdom. The decisions of capital structure are some of the most significant financial decisions that a firm wants to make since they determine the level of financial stability, risk, cost of capital and its long-term performance. The vast majority of research conducted in the corporate finance is concerned with large multinational corporations, whereas a small-cap company has to work under different conditions. They have low credit access, cognizant risks and sensitivity to economic uncertainty. Therefore, the present research fills a substantial gap because it focuses on the segment of small-cap in the UK. The main interest was to determine the critical determinants of capital structure decisions, and to otherwise assess the impacts of financing decisions with regard to profitability. The research employed a secondary descriptive research design based on audited financial reports of five small UK cap firms Halfords Group, Tristel, RWS Holdings, Michelmersh Brick, and Ramsdens Holdings, both in terms of market size and timeframe (2021- 2024). There were some key financial indicators that were calculated such as leverage, liquidity, tangibility, firm size, growth, return on assets as well as return on equity. The analysis relying on ratios and comparing firms provided good transparency and interpretability without using econometric regression models, which should be the main emphasis of the dissertation accordingly.

Results indicated that there are wide deviations in capital structure behaviour observed between firms, which are conditioned by internal factors. Debt to equity: Halfords, Michelmersh and Ramsdens exhibited middle ground debt utilization whereas Tristel was

conservative with low debt leverage. This indicates that financing strategies rely on operational environment, risk aversion, and composition of assets in the case of small caps too. The difference in profitability was also quite high. Being the most profitable in terms of ROA and ROS and the least leverage Tristel delivered the best results. That is why, this supports the assumption that cautious financing has the ability to increase profitability through lessening the interest's burden and lowering risk of distress. Companies that were more leveraged did not always perform better in that the debt did not always make smaller firms work with greater performance as borrowing costs and repayment issues are more acute in small businesses. Ramsdens operated in a moderate leverage and healthy profitability mixture, which indicates a balance between debts and equity can provide the stability.

Flexibility of financing came out as a major source of liquidity. Companies that are well liquidated like Tristel had enhanced short-term solvency and less dependence on outside debt. Liquidity provides a strategic buffer and, through it, firms are able to fulfil the outlay without over-borrowing. On the other hand, those companies that had low liquidity such as Halfords, had less flexibility, tightened working capital, and more risk. Companies that had greater tangibles asset ratio such as Michelmersh had better collateral ground thus accessing money more easily. The asset-intensive firms tend to achieve higher debt-wise due to the physical assets that are taken to guarantee against default by lenders. Conversely, other firms including Tristel were more dependent on equity and retained earnings as part of asset-light firms. This is similarly in line with theory, which argues that collateral availability is the determinant of borrowing behaviour, particularly in information asymmetric credit markets.

The size of firm was still a context. The bigger small-caps were Halfords and RWS that had more asset bases that could boost their credibility in debt markets. The presence of size however moderately influenced financing capacity as opposed to altering the conservative borrowing tendency across the segment. Although somewhat large small-caps embrace conservative leverage despite uncertainties, market volatility, and the lack of access to long-term funding. Promotional chances were there but small. Growth ratios consisted of comfortable and not aggressive growth, suggesting that most of the UK small

caps are concerned with financial sustainability and not blistering growth. The better the profitability of firms the greater their ability to finance growth in house and this is in line with the Pecking Order Theory which states that retained earnings are used first before external finance is obtained by the firm or issuing of equity.

The discussion chapter supported the fact that small-cap firms are affected by special institutional and macroeconomic pressure. There was uncertainty post-Brexit, inflationary pressures, and a changing interest rate, which increased the riskiness of lenders and investors creating conservative patterns in capital structure. The classic theories such as Trade-Off Theory and Pecking Order Theory are also applicable in providing explanations in financing small-cap companies but a careful approach to the use of the theory should take into account the increased vulnerability and restricted access to markets that small companies have. In general, the dissertation finds that the decisions of capital structure in UK small-cap firms are influenced by the ability to leverage, liquidity position, asset structure, stable profitability, and orientation to growth. There is reason to believe that conservative leverage policy is often associated with lower profitability in cases where companies are well-liquid and exploit internal capital to fund their operations. Over borrowing may over strain finances and damage profitability in the small cap setup where the cost of distress and cash flows are more unstable.

The research provides managers, investors and policy makers with practical idea. Managers in small-cap should learn to strike the balance between debt utilization and liquidity maintenance and risk management to continue making profits. Leverage and liquidity indicators can be used to determine financial resilience of small-cap stock challenges by investors. The policymakers may consider special financial support systems to alleviate the borrowing restrictions and enhance accessibility to cheap capital by the smaller listed companies. The weaknesses of the study include the small sample size and descriptive design that limits the research to generalization and a causal conclusion. The future studies can further extend the sample size, use econometric regression analysis, and explore industry-specific variations across the wider market of the UK small-cap. However, the dissertation offers empirical data on profitability outcome

determinants in capital structure among the distinctive capital structure setting of the UK-based small-cap companies, which are listed on London Stock exchange.

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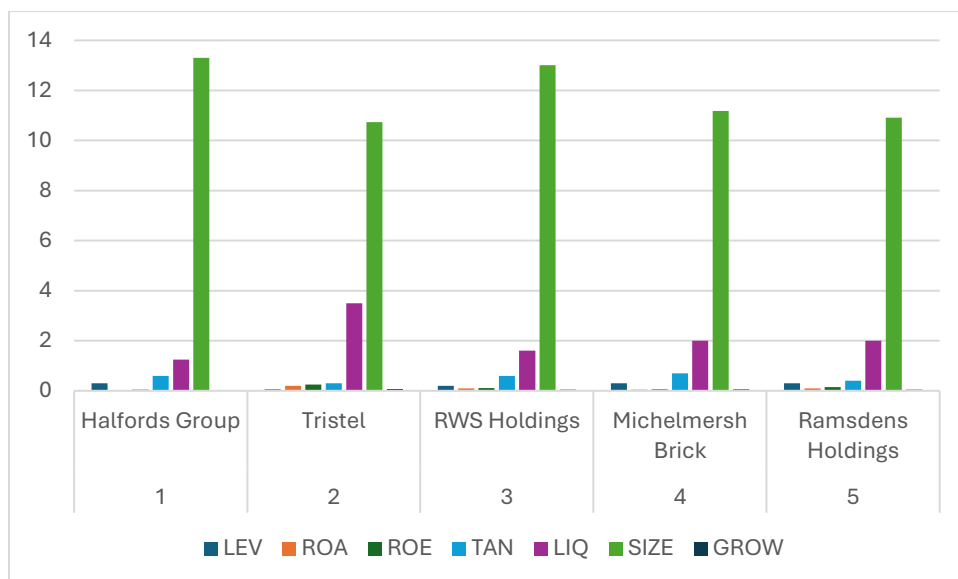
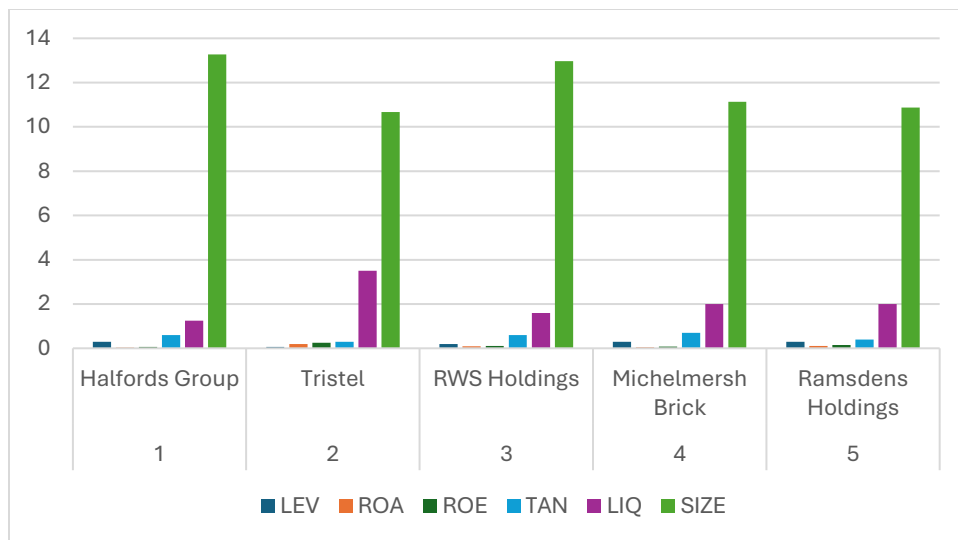
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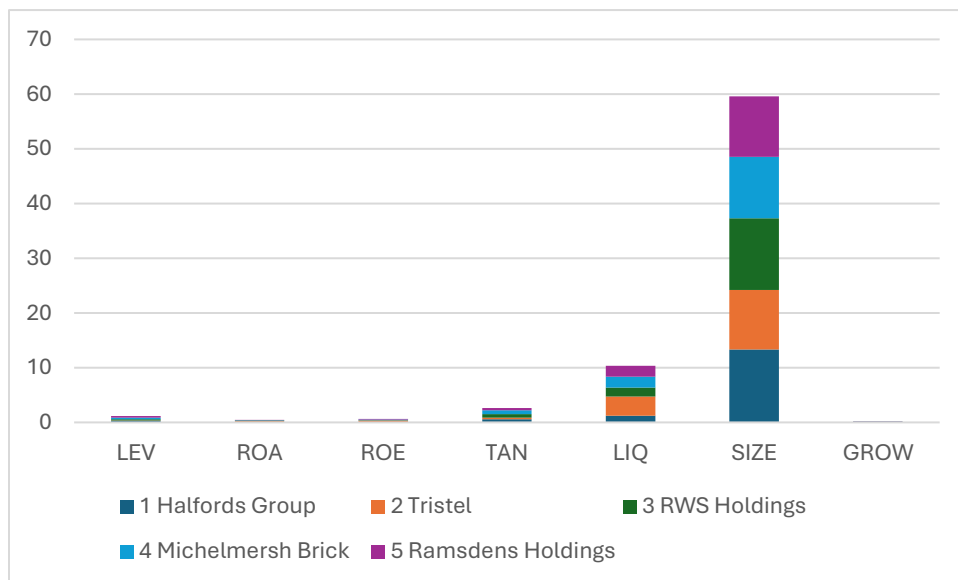
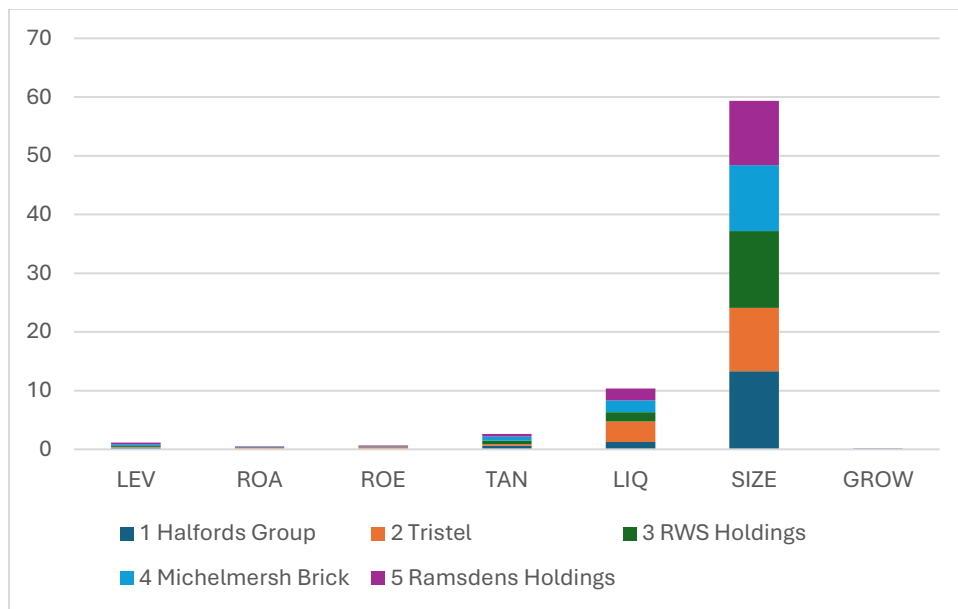
Appendix

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No.	Company Name	LSE Ticker	Company Number	Sector	Market Cap (£m)	Description
1	Halfords Group PLC	HFD	04457314	Retail	316	Automotive parts and bicycle retailer
2	~~Tristel~~ PLC	TSTL	02789911	Healthcare	191	Infection prevention and contamination control products
3	RWS Holdings PLC	RWS	03002645	Professional Services	285	Translation and intellectual property support services
4	~~Michelmores~~ Brick Holdings PLC	MBH	03426011	Construction Materials	89	Manufacturer of clay bricks and pavers
5	Ramsdens Holdings PLC	RFX	03188850	Financial Services	76	Pawnbroking, foreign exchange, and jewelry retail

Statistic	LEV	ROA	ROE	TAN	LIQ	SIZE	GROW
Mean	0.232	0.09533 3367	0.12583 7679	0.51998 7855	2.07013 0631	11.87139 191	0.04463 2045
Median	0.300	0.090	0.1125	0.600	2.000	11.23056 255	0.04576 9764
Std Dev	0.09762 9035	0.05950 5858	0.07214 6759	0.15212 093	0.79466 0308	1.12529 0301	0.01258 1042
Minimum	0.060	0.03000 0836	0.04285 8337	0.300	1.24999 7461	10.7342 204	0.02738 6676
Maximum	0.300	0.200	0.25006 445	0.700	3.500	13.3574 355	0.07242 9907
Count	15	15	15	15	15	15	15





Firm	Company Name	Total Assets (£000)	Total Debt (£000)	Fixed Assets (£000)	Current Assets (£000)	Current Liabilities (£000)	Net Profit (£000)	Shareholders Equity (£000)
1	Halfords Group	582400	174720	349440	232960	186176	23296	407680
2	Tristel	42800	2568	12840	29960	8560	8560	34240
3	RWS Holdings	428500	85700	257100	171400	107125	38565	342800
4	Michelmersh Brick	68200	20460	47740	20460	10230	3410	47740
5	Ramsdens Holdings	52800	15840	21120	31680	15840	5280	36960

Firm	Company Name	Total Assets (£000)	Total Debt (£000)	Fixed Assets (£000)	Current Assets (£000)	Current Liabilities (£000)	Net Profit (£000)	Shareholders Equity (£000)
1	Halfords Group	598350	179505	358901	239449	191259	17951	418845
2	Tristel	45900	2754	13770	32130	9180	9180	36720
3	RWS Holdings	445600	89120	267360	178240	111400	40104	356480
4	Michelmersh Brick	72100	21630	50470	21630	10815	2884	50470
5	Ramsdens Holdings	55200	16560	22080	33120	16560	5520	38640

Firm	Company Name	Total Assets (£000)	Total Debt (£000)	Fixed Assets (£000)	Current Assets (£000)	Current Liabilities (£000)	Net Profit (£000)	Shareholders Equity (£000)
1	Halfords Group	615280	184584	369168	246112	196890	24611	430696
2	Tristel	48500	2910	14550	33950	9700	9700	38790
3	RWS Holdings	461800	92360	277080	184720	115450	41562	369440
4	Michelmersh Brick	75400	22620	52780	22620	11310	3770	52780
5	Ramsdens Holdings	57800	17340	23120	34680	17340	5780	40460

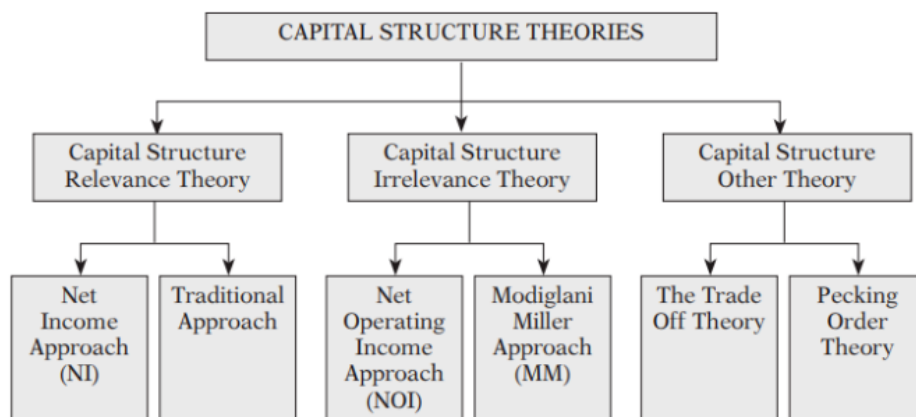
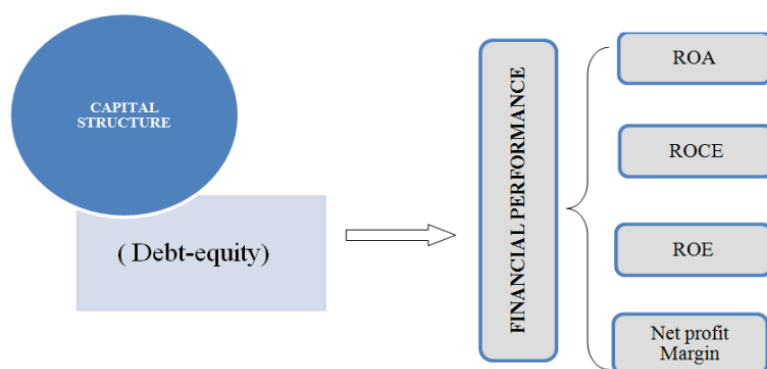
Company Name	Total Assets (£000)	Total Debt (£000)	Fixed Assets (£000)	Current Assets (£000)	Current Liabilities (£000)	Net Profit (£000)	Shareholders Equity (£000)
Halfords Group	632500	189750	379500	253000	202400	31625	442750
Tristel	51200	3072	15360	35840	10240	10240	40960
RWS Holdings	478500	95700	287100	191400	119625	43065	382800
Michelmersh Brick	78900	23670	55230	23670	11835	3945	55230
Ramsdens Holdings	60500	18150	24200	36300	18150	6050	42350

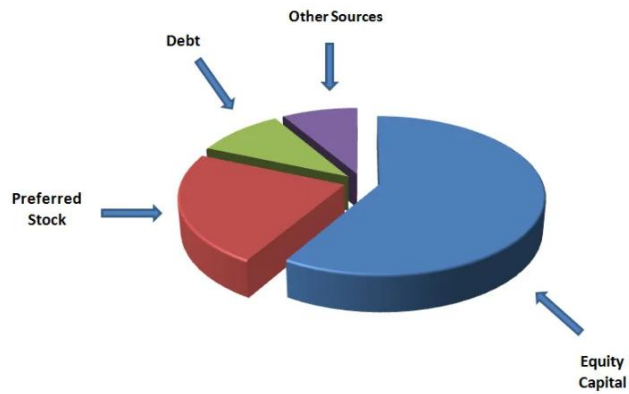
Average Ratios by Year - All 5 Companies

Year	Avg LEV	Avg ROA	Avg ROE	Avg TAN	Avg LIQ	Avg SIZE	Avg GROW
2021	0.232	0.096	0.126785714	0.52	2.070257821	11.7823437	N/A
2022	0.232	0.092000167	0.121071667	0.519963566	2.0703924	11.82957121	0.048472506
2023	0.232	0.095999935	0.126798511	0.52	2.069999492	11.87146912	0.042833209
2024	0.232	0.098	0.129642857	0.52	2.07	11.91313539	0.042590421



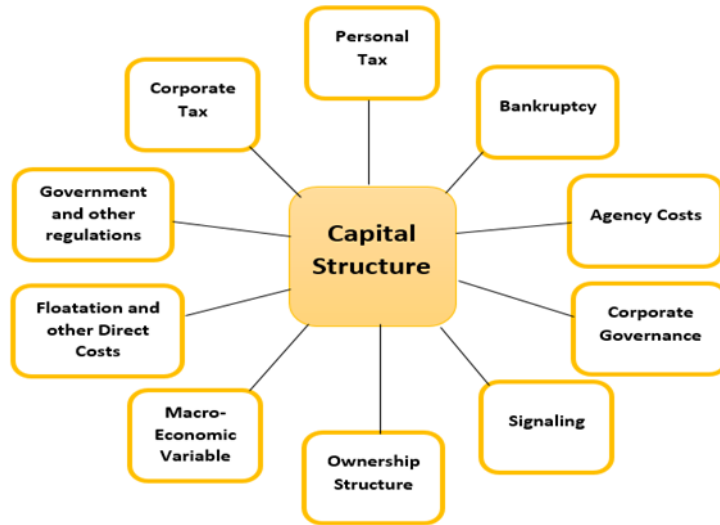
Category	Indicator	Symbol	Formula
Profitability	Return on Assets	ROA	Net Profit ÷ Total Assets
Profitability	Return on Equity	ROE	Net Profit ÷ Equity
Capital Structure	Leverage Ratio	LEV	Total Debt ÷ Total Assets
Capital Structure	Liquidity Ratio	LIQ	Current Assets ÷ Current Liabilities
Capital Structure	Tangibility	TAN	Fixed Assets ÷ Total Assets
Firm Characteristic	Firm Size	SIZE	ln (Total Assets)
Firm Characteristic	Growth Rate	GROW	$(\text{Assets}_t - \text{Assets}_{t-1}) \div \text{Assets}_{t-1}$



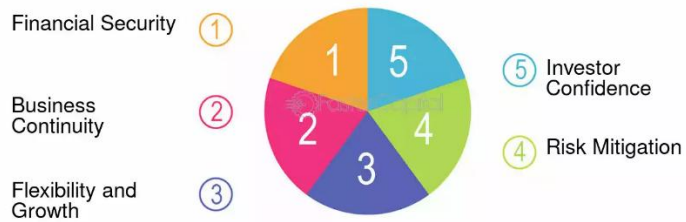


Factors affecting Capital Structure of a Firm





Importance of a Liquidity Buffer



Trade-Off vs Pecking Order

