

CHAPTER 1

INTRODUCTION

1.1 Research Background

As a fundamental aspect of financial management, capital structure combines various financing tools to support a company's activities and assets. These tools encompass retained earnings, long-term debt, and equity, forming a complex amalgamation that significantly impacts enterprises' overall value and financial health (Kumar et al., 2020). A company's balance sheet becomes the canvas where this blend is manifested, with long-term and short-term debt, common stock, and preferred stock intricately contributing to the overall capital structure. Among the key metrics used to evaluate this structure, the debt-to-equity ratio is a pivotal indicator, wielding substantial influence over optimizing investment value and, by extension, enhancing the firm's overall value (Gunardi et al., 2020).

Their far-reaching implications for firms underscore the enduring significance of capital structure decisions. These decisions are crucial in shaping a company's financial landscape and have lasting effects on its stability and growth. The global business environment has recently faced unprecedented challenges, with the COVID-19 pandemic introducing a new dimension to studying capital structure. Researchers, such as Priyan et al. (2023), have delved into the impact of the pandemic on capital structure decisions, risk management, and debt financing strategies. This exploration sheds light on the dynamic nature of these decisions in response to external shocks, emphasizing the need for adaptability and resilience in financial management.

Within the realm of capital structure, the debt-to-equity ratio emerges as a critical factor with profound implications for risk assessment. As noted by Jõeveer (2018), Saif-Alyousfi et al. (2020), and Bajaj et al. (2021), this ratio plays a pivotal role in evaluating the risk associated with a firm's borrowing practices. A company heavily reliant on debt financing exhibits an aggressive capital structure, posing more risks to investors. Understanding the intricacies of the debt-to-equity ratio becomes imperative in navigating the delicate balance between leveraging financial resources for growth and managing the associated risks effectively.

The landscape of capital structure decisions continues to evolve, influenced by many factors beyond traditional financial considerations. The COVID-19 pandemic has accelerated the need for

companies to reassess their financial strategies, emphasizing the importance of resilience and adaptability. Moreover, the study of capital structure must now consider a broader spectrum of influences, including sustainability and environmental, social, and governance (ESG) factors, technological advances, regulatory changes, globalization, and the unique challenges faced by emerging markets. These dynamic elements contribute to the complexity and nuance of contemporary capital structure research.

1.2 Research Scope

This research ventures into the dynamic landscape of capital structure decisions, recognizing the transformative impact of the COVID-19 pandemic on the financial strategies of companies. The unprecedented disruptions caused by the pandemic have necessitated a reevaluation of traditional financial paradigms, prompting firms to adapt their approaches to capital structure decisions. The increased market volatility and innovation triggered by the pandemic create a shifting terrain for businesses, requiring a nuanced understanding of how these factors influence financing strategies. Focusing on recent trends shaped by the COVID-19 pandemic, the research aims to uncover the adaptive measures firms take in response to the evolving market dynamics. This includes exploring how companies recalibrate their capital structures to navigate immediate challenges and position themselves strategically for long-term sustainability and growth in an uncertain economic environment.

The scope of this research extends beyond conventional considerations, encompassing a wide array of factors that contribute to the intricate landscape of capital structure decisions. Traditionally, technological advances, regulatory changes, and globalization have played pivotal roles in shaping financial strategies. However, the contemporary landscape demands a more comprehensive approach. This research acknowledges the significance of sustainability and environmental, social, and governance (ESG) considerations, behavioural finance insights, sustainable finance instruments, and the unique challenges faced by emerging markets. The research provides a holistic understanding of the forces shaping capital structure decisions by delving into this diverse set of influencing factors. This comprehensive approach is essential for companies aiming to weather immediate uncertainties and thrive in a rapidly evolving financial ecosystem where traditional norms are continuously challenged. Adaptive strategies are paramount for sustained success.

1.3 Research Problem Formulation

The significance of capital structure research is deeply rooted in its capacity to provide solutions to the pressing issues encountered by companies as they navigate the complexities of evolving financial landscapes. In an era marked by rapid changes, such as those brought forth by the COVID-19 pandemic, understanding how firms strategically shape their capital structures becomes paramount. The pandemic has disrupted conventional business paradigms, necessitating reevaluating financial strategies to ensure resilience and adaptability. This research aims to delve into the specific impact of the COVID-19 pandemic on capital structure decisions, recognizing that the repercussions are far-reaching and require nuanced analysis. By addressing the challenges posed by external shocks, the research offers insights beyond crisis management, providing a foundation for companies to proactively structure their finances to weather uncertainties and thrive in the face of ongoing change.

The crux of the research lies in its pursuit of understanding how firms navigate the ever-changing market dynamics and, in turn, make financing decisions that align with their unique needs and risk tolerance. Market dynamics are inherently volatile and subject to multifaceted influences, ranging from economic shifts to technological advancements and heightened awareness of environmental, social, and governance (ESG) considerations. By exploring how these diverse factors influence capital structure decisions, the research aims to provide a comprehensive understanding of the decision-making processes undertaken by firms. This includes the delicate balance between leveraging financial resources for growth and managing associated risks effectively. Ultimately, the research aspires to empower companies with the knowledge needed to make informed, strategic financing decisions, ensuring their survival in turbulent times and their ability to thrive and contribute positively to the broader financial landscape.

1.4 Research Objectives

1. Evaluate the impact of the COVID-19 pandemic on capital structure decisions.
2. Analyze the influence of sustainability and ESG factors on capital structure choices.
3. Investigate the role of technological advances, regulatory changes, and globalization in shaping capital structure decisions.
4. Explore how behavioural finance insights, sustainable finance instruments, financial crises, venture capital, private equity, and corporate governance impact capital structure.
5. Examine the unique financing challenges faced by companies in emerging markets.

1.5 Research Benefits

This research seeks to contribute significantly to the existing knowledge base on capital structure decisions by delving into recent trends and patterns, particularly within the unique context of the COVID-19 pandemic. The unprecedented challenges posed by the pandemic have undoubtedly altered the landscape of financial decision-making for companies globally. By analyzing how firms adapt their capital structure strategies in response to such external shocks, this research aims to provide nuanced insights that go beyond conventional wisdom. These insights will be invaluable for company stakeholders, including executives, financial analysts, and potential investors, as they navigate the intricate and dynamic dynamics of capital structure. Understanding the recent trends will enable stakeholders to make informed decisions, enhancing their ability to anticipate challenges, seize opportunities, and ultimately contribute to the sustainable growth and financial success of the companies they are involved with.

This research aspires to offer a holistic perspective on capital structure decisions, bridging the gap between theory and real-world application. By incorporating the latest developments and considering a broad spectrum of factors influencing these decisions, the research aims to provide a comprehensive framework for understanding the intricacies of capital structure dynamics. The ever-evolving financial landscape demands a nuanced and adaptive approach to strategic decision-making. As the findings of this research unfold, they are expected to empower companies with actionable insights, allowing them to craft capital structures that align with their goals, risk tolerance, and the demands of the contemporary business environment. Ultimately, the research aims to be a guiding beacon for strategic decision-makers, aiding them in navigating the complexities of capital structure with foresight and agility, fostering financial stability and sustained growth in the face of ongoing uncertainties.