FBM Insights

eISSN 2716-599X

e-ISSN 2716-599X

VOLUME 10
BULLETIN

FACULTY OF BUSINESS AND MANAGEMENT

UiTM di hatiku

FBM INSIGHTS

Faculty of Business and Management

Universiti Teknologi MARA Cawangan Kedah

e-ISSN 2716-599X

The editorial board would like to express their heartfelt appreciation for the contributions made by the authors, co-authors and all who were involved in the publication of this bulletin.

Published by : Faculty of Business and Management,

Universiti Teknologi MARA Cawangan Kedah

Published date : 17 Oktober 2024

All rights reserved. No part of this publication may be reproduced, copied, stored in any retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission from the Rector, Universiti Teknologi MARA Cawangan Kedah, Kampus Sungai Petani, 08400 Merbok, Kedah, Malaysia.

The views, opinions, and technical recommendations expressed by the contributors and authors are entirely their own and do not necessarily reflect the views of the editors, the publisher and the university.

FBM INSIGHTS EDITORIAL BOARD

Advisor

Dr. Yanti Aspha Ameira binti Mustapha, Universiti Teknologi MARA Cawangan Kedah

Chief Editor

Dr. Zuraidah binti Mohamed Isa, Universiti Teknologi MARA Cawangan Kedah
Dr. Norhidayah binti Ali, Universiti Teknologi MARA Cawangan Kedah Managing

Managing Editor

Dr. Azyyati binti Anuar, Universiti Teknologi MARA Cawangan Kedah
Puan Nurfaznim binti Shuib, Universiti Teknologi MARA Cawangan Kedah
Puan Nurul Izzati binti Idrus, Universiti Teknologi MARA Cawangan Kedah

Editors

Dr. Dahlia binti Ibrahim, Universiti Teknologi MARA Cawangan Kedah
Dr. Roziyana binti Jafri, Universiti Teknologi MARA Cawangan Kedah
Puan Rosliza binti Md. Zani, Universiti Teknologi MARA Cawangan Kedah
Puan Najah binti Mokhtar, Universiti Teknologi MARA Cawangan Kedah
Puan Yong Azrina binti Ali Akbar, Universiti Teknologi MARA Cawangan Kedah
Puan Hanani binti Hussin, Universiti Teknologi MARA Cawangan Kedah
Puan Shakirah binti Mohd Saad, Universiti Teknologi MARA Cawangan Kedah
Encik Mohd Radzi bin Mohd Khir, Universiti Teknologi MARA Cawangan Kedah
Puan Wan Shahrul Aziah binti Wan Mahamad, Universiti Teknologi MARA Cawangan Kedah
Puan Syukriah binti Ali, Universiti Teknologi MARA Cawangan Kedah
Dr Rabitah binti Harun, Universiti Teknologi MARA Cawangan Kedah
Puan Fatihah Norazami binti Abdullah, Universiti Teknologi MARA Cawangan Kedah
Puan Jamilah binti Laidin, Universiti Teknologi MARA Cawangan Kedah

Manuscript Editor

Dr. Siti Norfazlina binti Yusof, Universiti Teknologi MARA Cawangan Kedah
Dr. Berlian Nur binti Morat, Universiti Teknologi MARA Cawangan Kedah
Puan Nor Asni Syahriza binti Abu Hassan, Universiti Teknologi MARA Cawangan Kedah

Secretary

Puan Intan Nazrenee binti Ahmad, Universiti Teknologi MARA Cawangan Kedah
Puan Syahrul Nadwani binti Abdul Rahman, Universiti Teknologi MARA Cawangan Kedah

Technical Board

Dr. Afida binti Ahmad, Universiti Teknologi MARA Cawangan Kedah

Graphic Designer

Dr. Shafilla binti Subri, Universiti Teknologi MARA Cawangan Kedah

TABLE OF CONTENTS

STRATEGIC FINANCE CHOICES: EMBRACING THE RELEVANCE OF EQUITY FINANCING OVER DEBT FINANCING

Fauziah Mohamad Yunus
Faculty of Business and Management, Universiti Teknologi MARA Cawangan Kedah
fauziahyunus@uitm.edu.my

Mohamad Hanif Abu Hassan
School of Business Management, College of Business, Universiti Utara Malaysia
hanifab@uum.edu.my

Muhammad Zarunnaim Haji Wahab
Faculty of Business and Management, Universiti Teknologi MARA Cawangan Kedah
zarunnaim@uum.edu.my

ABSTRACT

This study examines the challenges inherent in debt financing and proposes equity financing as a strategic solution. Issues under debt financing, including financial strain, default risk, substantial interest costs, and restrictive covenants, are analysed. Equity financing is presented as a remedy, allowing businesses to raise capital without incurring debt, reducing financial strain, and eliminating interest costs. The study emphasises equity financing's capacity to enhance financial flexibility, share risks through ownership, foster strategic partnerships, and provide resilience in economic downturns. It concludes by underscoring the need for businesses to align their financial structures with specific needs, acknowledging the trade-offs between debt and equity financing. This exploration invites future research into industry-specific analyses, macroeconomic influences, and hybrid financing models to refine financial strategies. Overall, the study advocates for a nuanced understanding of financing mechanisms to foster sustainable and resilient business practices.

Keywords: Equity Financing; Debt Financing; Islamic Finance; Banking

INTRODUCTION

Equity financing plays a pivotal role in the financial ecosystem, serving as a cornerstone for businesses seeking sustainable growth and development. In the dynamic landscape of corporate finance and business, equity stands out as a powerful tool that allows businesses to access crucial capital without incurring debt (Gompers, & Lerner, 2010). Unlike traditional loans and other debt instruments, equity financing involves the issuance of company shares to external investors in exchange for funds, making these investors partial owners of the business (Mande et al., 2012).

The significance of equity financing lies in its ability to fuel innovation, expansion, and long-term viability for companies across various industries (Zhang et al., 2019). It is a strategic financial approach that not only injects essential capital into the business but also aligns the interests of investors with the success of the company. This alignment creates a symbiotic relationship, where investors benefit from the company's growth and profitability, while the business gains access to the expertise, networks, and resources brought in by its equity partners.

In this era of rapid technological advancements and fierce global competition, the importance of equity financing becomes even more pronounced (Zhang et al., 2019). Startups and established enterprises alike leverage equity funding to navigate the challenges of scaling operations, conducting research and development, and staying ahead of industry trends (Kotey, 1999). Equity financing offers companies the flexibility to pursue ambitious goals and withstand economic downturns without the burden of high-interest debt payments.

LITERATURE REVIEW

Debt financing and equity financing are fundamental components of corporate finance (Goh et al., 2017). Debt typically involves regular interest and principal payments (Dybvig, 2002), while equity represents ownership stakes in the company (Dybvig, 2002; Mande et al., 2012). Research has consistently demonstrated challenges associated with debt financing, including financial strain due to regular payments (Hassan & Yahya, 2020), increased default risk during economic downturns (Betz et al., 2018), substantial interest costs (Angbazo, 1997), and the impact of restrictive covenants on financial flexibility (Betz et al., 2018).

Scholars have highlighted the benefits of equity financing, emphasising its role in alleviating financial strain (Zhang et al., 2019), reducing default risk (Hassan et al., 2023; Kotey, 1999), eliminating interest costs (Angbazo, 1997), and providing greater flexibility by avoiding restrictive covenants (Berlin & Mester, 1992). Research indicates that equity financing enhances financial flexibility, allowing companies to adapt to changing market conditions and better manage risks (Mande at el., 2012; Zhang et al., 2019).

Beyond capital infusion, equity financing facilitates strategic partnerships, with investors contributing valuable industry expertise, networks, and guidance (Gompers & Lerner, 2010). Comparative studies have evaluated the performance and sustainability of businesses based on their financing choices, with empirical evidence supporting outcomes related to debt- and equity-heavy financial structures (Sha’ari et al., 2023). Prior research also suggests that businesses with equity financing exhibit resilience during economic downturns, as the absence of fixed repayments positions them advantageously in challenging economic climates. In conclusion, the literature supports the relevance and significance of equity financing as a strategic solution in corporate finance, providing valuable insights for informed decision-making.

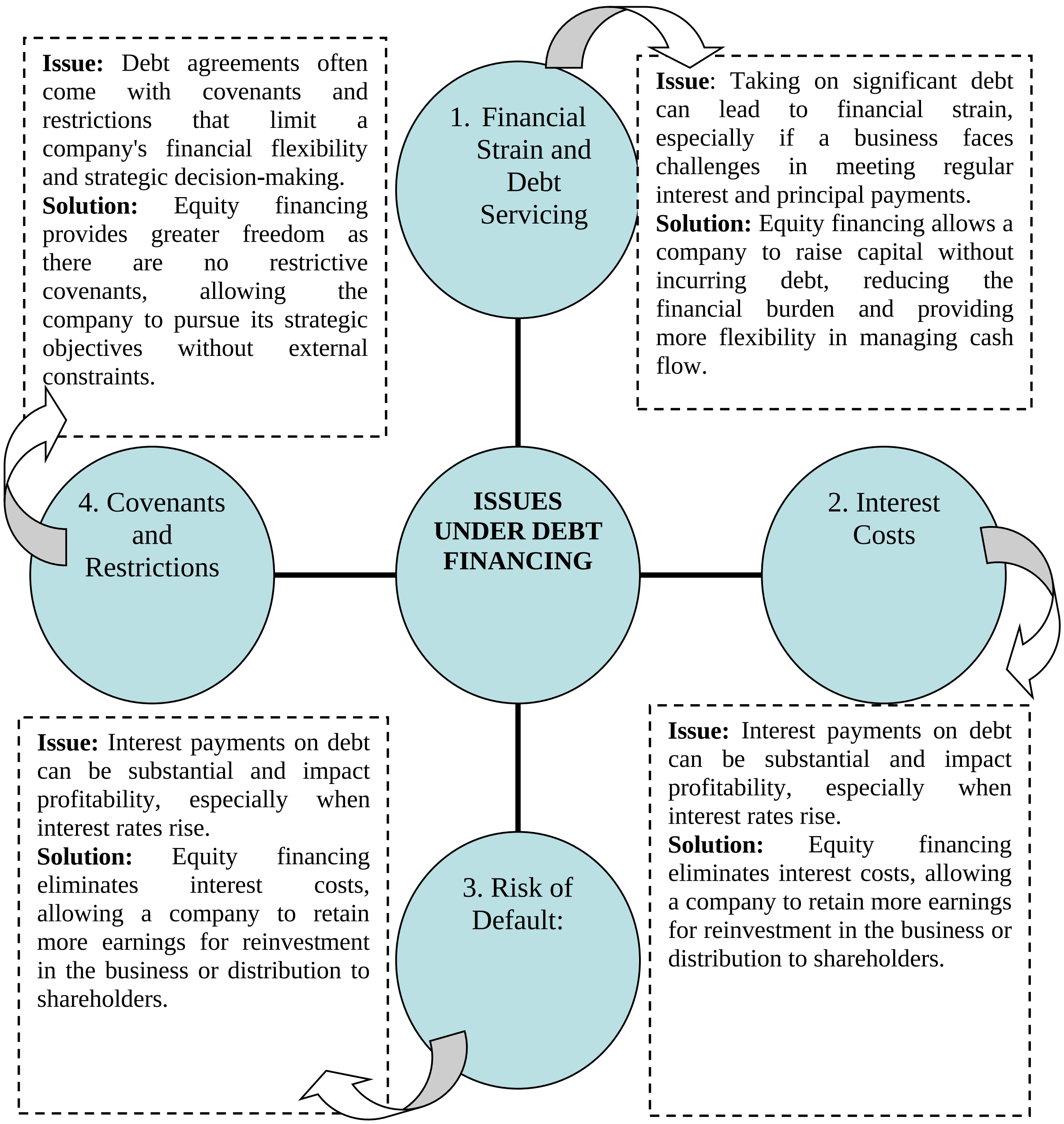

Figure 1. Issues, Challenge and Solution

DISCUSSION AND CONCLUSION

The exploration of issues under debt financing and the corresponding solutions through equity financing is important in the realm of corporate finance. Understanding the challenges inherent in debt financing and the mitigating factors associated with equity financing contributes to informed decision-making for businesses. This study sheds light on the complexities of financial structures, providing insights into the potential consequences of relying heavily on debt and the alternative avenues available for sustainable growth and resilience.

In conclusion, the study underscores the critical role of equity financing in addressing challenges posed by debt financing. The issues identified, such as financial strain, risk of default, interest costs, and restrictive covenants, illustrate the inherent vulnerabilities of debt-heavy financial strategies. The corresponding solutions presented highlight the merits of equity financing in offering businesses a more flexible, resilient, and strategic approach to capital acquisition. This dichotomy between debt and equity financing prompts a reconsideration of traditional financing paradigms, emphasising the importance of aligning financial structures with the unique needs and circumstances of individual companies.

Future research in this domain could delve deeper into specific industry contexts to discern how the dynamics of debt and equity financing vary across sectors. Exploring the impact of macroeconomic factors on the efficacy of these financing mechanisms during economic downturns could provide valuable insights for risk management strategies. Additionally, investigating the long-term performance and sustainability of businesses based on their financing choices may contribute to a more comprehensive understanding of the implications of debt and equity financing. Further research could also explore innovative hybrid models that combine both debt and equity elements to optimise financial structures for different business scenarios. Overall, ongoing inquiry into the nuanced interplay between debt and equity financing remains crucial to refining financial strategies and fostering the resilience of businesses in a dynamic economic landscape.

REFERENCES

Angbazo, L. (1997). Commercial bank net interest margins, default risk, interest-rate risk, and off-balance sheet banking. *Journal of Banking & Finance*, *21*(1), 55-87. https://doi.org/10.1016/s0378-4266(96)00025-8

Berlin, M., & Mester, L. J. (1992). Debt covenants and renegotiation. *Journal of Financial Intermediation*, *2*(2), 95–133. https://doi.org/10.1016/1042-9573(92)90005-x

Betz, J., Kellner, R., & Rösch, D. (2018). Systematic effects among loss given defaults and their implications on downturn estimation. *European Journal of Operational Research*, *271*(3), 1113-1144. https://doi.org/10.1016/j.ejor.2018.05.059

Dybvig, P. H., & Wang, Y. (2002). *Debt and equity.* SSRN Electronic Journal. https://doi.org/10.2139/ssrn.334921

Goh, B. W., Lim, C. Y., Lobo, G. J., & Tong, Y. H. (2017). Conditional conservatism and debt versus equity financing. *Contemporary Accounting Research*, *34*(1), 216-251. http://dx.doi.org/10.1111/1911-3846.12237

Gompers & Lerner (2010). *Equity financing. Handbook of entrepreneurship research: An interdisciplinary survey and introduction*. Springer Science & Business Media.

Hassan, M. H. A., Yahya, S., & Shari, W. (2023). Factors affecting repayment behaviour in Islamic microfinance programs. *International Journal of Academic Research in Accounting Finance and Management Sciences*, *13*(1). https://doi.org/10.6007/ijarafms/v13-i1/16553

Hassan, M. H. A., & Yahya, S. (2020). Determinants of repayment behaviour in Islamic microfinance programs: Case study of the rural economy funding scheme. *3rd UUM International Islamic Business Management Conference 2020 (IBMC 2020)*, 12–31.

Kotey, B. (1999). Debt financing and factors internal to the business. *International Small Business Journal*, *17*(3), 11–29. https://doi.org/10.1177/0266242699173001

Mande, V., Park, Y. K., & Son, M. (2012). Equity or debt financing: Does good corporate governance matter? *Corporate Governance: An International Review*, *20*(2), 195-211. https://doi.org/10.1111/j.1467-8683.2011.00897.x

Sha'ari, U. A. S., Hamzah, S. R. B., & Kamil, K. H. (2023). Financial sustainability of a firm: debt-based or equity-based financing to pursue? *Journal of Islamic Monetary Economics and Finance*, *9*(2), 199-224. https://doi.org/10.21098/jimf.v9i2.1653

Zhang, L., Zhang, S., & Guo, Y. (2019). The effects of equity financing and debt financing on technological innovation: Evidence from developed countries. *Baltic Journal of Management*, *14*(4), 698-715. https://doi.org/10.1108/bjm-01-2019-0011