



Financing Growth: Capital Structure Decisions and Expansion Performance of Emerging Businesses

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Abstract

This study examines financing growth through capital structure decisions and their effect on the expansion performance of emerging businesses. The purpose is to assess how debt financing, equity financing, retained earnings financing, and financial leverage influence business expansion outcomes such as sales growth, asset growth, market expansion, and employment growth. The study adopted a conceptual–empirical review design, relying on systematic synthesis of peer-reviewed journal articles, Scopus-indexed publications, and international policy reports from 2020 to 2026. The analysis was conducted using thematic integration to evaluate consistent, conflicting, and mixed findings across different financing dimensions and business environments. Findings reveal that capital structure decisions significantly affect expansion performance, though the relationship is nonlinear and context-dependent. Retained earnings and equity financing generally enhance long-term expansion and financial stability. Debt financing and financial leverage show mixed effects, improving expansion when optimally used but negatively affecting performance when excessive. The study concludes that no single financing source guarantees optimal expansion performance; rather, a balanced capital structure is essential. It recommends that emerging businesses adopt optimal financing mixes, strengthen internal funding capacity, and maintain controlled leverage levels to ensure sustainable expansion.

Keywords: Debt financing, equity financing, financial Leverage, retained earnings financing, expansion performance

1. Introduction

Expansion performance has emerged as a critical indicator of business success in modern economies because it reflects a firm's ability to increase its operational scale, market presence, customer base, assets, revenue, and workforce over time. In simple terms, expansion performance refers to the capacity of a business to grow beyond its current level of operation and achieve sustainable increases in sales, assets, and market share. Contemporary literature recognizes expansion performance as a multidimensional measure of organizational growth and competitiveness. According to the Organisation for Economic Co-operation and Development (OECD, 2024), expanding firms contribute significantly to productivity growth, innovation, employment generation, and economic resilience. Similarly, the World Bank (2024) emphasizes that business expansion is a key mechanism through which enterprises improve competitiveness and contribute to economic development. Consequently, expansion performance remains a major concern for entrepreneurs, investors, policymakers, and researchers seeking to understand the drivers of sustainable business growth.

The significance of expansion performance extends beyond individual firms to the broader economy. Successfully expanding businesses create employment opportunities, stimulate innovation, increase productivity, generate tax revenue, and support industrial development. OECD (2024) reports that small and medium-sized enterprises (SMEs) account for a substantial proportion of employment and business activity globally. Likewise, the World Bank (2024) argues that SME growth contributes significantly to poverty reduction, income generation, and economic diversification. Despite these benefits, many emerging businesses struggle to achieve sustainable expansion due to financing constraints, high borrowing costs, economic uncertainty, weak capital markets, and institutional challenges. OECD (2024) identifies limited access to finance as one of the most persistent obstacles to SME growth, while the World Bank (2024) highlights a substantial financing gap that restricts firms' ability to invest, innovate, and expand.

These persistent financing challenges provide the rationale for this study. Although finance is widely recognized as a fundamental driver of business growth, empirical evidence remains inconclusive regarding the most effective financing structure for achieving expansion performance. Existing studies report positive, negative, and mixed relationships between financing decisions and growth outcomes, suggesting

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that the effectiveness of financing choices may depend on firm characteristics, industry conditions, institutional environments, and macroeconomic factors. This inconsistency creates the need to examine how capital structure decisions influence expansion performance and whether specific financing options are more effective in promoting sustainable business growth.

Capital structure decisions refer to the choices firms make regarding the combination of financing sources used to fund operations and expansion activities. In simple terms, capital structure concerns how businesses obtain the funds required to operate, invest, and grow. Corporate finance literature identifies debt financing, equity financing, financial leverage, and retained earnings financing as key components of capital structure. These financing choices influence firms' cost of capital, risk exposure, financial flexibility, investment capability, and long-term growth prospects. Consequently, the effectiveness of capital structure decisions plays a significant role in determining whether businesses can successfully pursue expansion opportunities.

Debt financing remains one of the most widely used financing options among emerging businesses. It involves obtaining funds from external lenders with an obligation for repayment and interest charges. Empirical evidence regarding its influence on expansion performance remains mixed. Shikumo, et al., (2020) found that short-term debt financing positively influenced financial growth among firms listed on the Nairobi Securities Exchange. Similarly, OECD (2024) reports that access to credit enables firms to acquire productive assets and expand operational capacity. In contrast, the World Bank (2024) notes that high borrowing costs and excessive debt burdens often constrain expansion, particularly among SMEs in developing economies. These findings suggest that debt financing enhances growth when maintained at sustainable levels but may hinder expansion when excessive.

Equity financing represents another important dimension of capital structure. It involves raising funds through ownership participation by shareholders and investors. Shikumo (2021) found that share capital positively influenced financial growth, earnings per share, and market capitalization among listed firms in Kenya. Likewise, OECD (2024) reports that firms with stronger equity positions often demonstrate greater resilience and stronger long-term growth prospects. However, equity financing may dilute ownership concentration and reduce managerial control, potentially affecting strategic decision-making. Other studies report mixed findings, indicating that the effectiveness of equity financing depends on firm size, governance structure, and the development of capital markets. Thus, the relationship between equity financing and expansion performance remains context-dependent. Financial leverage, which reflects the extent to which firms utilize debt relative to owners' equity, has also

attracted considerable scholarly attention. Arhinful et al. (2023) reported that financial leverage positively influenced financial performance when maintained at optimal levels. Similarly, international evidence suggests that leverage can facilitate expansion by increasing access to external capital. Conversely, excessive leverage exposes firms to financial risk, repayment burdens, and vulnerability during economic downturns. The World Bank (2024) highlights that highly leveraged firms are more susceptible to financial instability, especially during periods of macroeconomic uncertainty. These findings indicate that leverage has a nonlinear relationship with expansion performance, whereby moderate leverage supports growth while excessive leverage constrains it.

Retained earnings financing refers to internally generated profits reinvested into business operations rather than distributed to owners. OECD (2024) reports that retained earnings remain the most common financing source for SMEs because they reduce dependence on external creditors and investors. Supporting evidence suggests that internally generated funds provide financial flexibility and support sustainable business growth. However, retained earnings may be insufficient for large-scale expansion projects, particularly in capital-intensive industries. The World Bank (2024) notes that firms with low profitability often lack adequate retained earnings to finance significant growth initiatives. Consequently, retained earnings support moderate expansion but frequently require supplementation through external financing sources.

Despite the growing literature on capital structure and business performance, several gaps remain. Most studies focus on profitability and financial performance rather than expansion performance as a multidimensional growth construct. Furthermore, many studies examine debt financing, equity financing, leverage, and retained earnings independently without considering their combined influence on expansion outcomes. Existing findings also remain inconsistent, with positive, negative, and mixed results reported across different contexts. Additionally, relatively few studies provide an integrated perspective on how financing decisions collectively shape business expansion.

Against this background, this study investigates the influence of capital structure decisions on the expansion performance of emerging businesses. Specifically, it examines the roles of debt financing, equity financing, financial leverage, and retained earnings financing in shaping expansion outcomes. The study contributes to the literature by providing an integrated perspective on financing-growth relationships and advancing the position that sustainable expansion performance is best achieved through a balanced and strategically managed capital structure.

1.2 Statement of the Problem

Expansion performance is a crucial indicator of business growth and sustainability because it reflects a firm's ability to increase sales, assets, market share, operational capacity, and employment opportunities. Despite its importance, many emerging businesses continue to experience slow growth, limited market penetration, and difficulties in achieving sustainable expansion. These challenges are often associated with inadequate access to finance, high costs of capital, economic uncertainties, and limited financial resources for investment and growth initiatives.

To overcome these challenges, businesses rely on various financing options such as debt financing, equity financing, financial leverage, and retained earnings financing. However, determining the most appropriate financing structure remains a major concern for managers and investors. While some financing decisions may enhance growth by providing the resources needed for expansion, others may increase financial risk, repayment obligations, ownership dilution, or capital constraints, thereby limiting business growth and sustainability.

Furthermore, existing empirical evidence on the relationship between capital structure decisions and business growth remains inconclusive. Previous studies have reported positive, negative, and mixed findings regarding the effects of debt financing, equity financing, financial leverage, and retained earnings on organizational outcomes. In addition, much of the existing literature focuses on profitability and financial performance, with limited attention given to expansion performance as a multidimensional measure of growth.

Consequently, uncertainty remains regarding how capital structure decisions influence the expansion performance of emerging businesses. This study therefore examines the influence of debt financing, equity financing, financial leverage, and retained earnings financing on the expansion performance of emerging businesses with a view to providing a clearer understanding of financing-growth relationships.

3. Conceptual Review

3.1 Concept of Expansion Performance

Expansion performance refers to the extent to which a business grows and increases its operational capacity over time. Also, expansion performance simply means the ability of a business to become bigger, serve more customers, increase sales, enter new markets, employ more workers, and improve its overall position in the marketplace. It reflects the success of a firm in transforming available resources into sustainable growth and development.

From an academic perspective, expansion performance has been defined in different ways. According to the Organisation for Economic Co-operation and Development (OECD, 2024), expansion performance refers to the ability of firms to achieve sustainable

growth through increases in employment, sales, productivity, innovation, and market reach. This definition emphasizes growth as a multidimensional outcome that extends beyond financial performance alone. Similarly, the World Bank (2024) defines expansion performance as the capacity of enterprises to scale their operations, improve competitiveness, and increase their contribution to economic development through investments, innovation, and market expansion. This definition highlights the strategic role of business growth in enhancing both organizational and economic outcomes.

Furthermore, the International Finance Corporation (IFC, 2025) views expansion performance as the process through which firms increase productive capacity, penetrate new markets, diversify products and services, and strengthen long-term sustainability. This perspective underscores the importance of expansion as a mechanism for achieving competitive advantage and organizational resilience. A synthesis of these definitions suggests that expansion performance is a multidimensional construct encompassing increases in sales volume, asset base, market share, production capacity, profitability, customer base, employment generation, and geographical coverage.

Expansion performance has become increasingly important in today's highly competitive business environment. Firms that expand successfully are better positioned to exploit emerging opportunities, achieve economies of scale, attract investment, strengthen brand reputation, and improve long-term survival prospects. At the macroeconomic level, expanding firms contribute significantly to employment generation, innovation, industrial development, and economic growth. The OECD (2024) notes that high-growth firms play a vital role in driving productivity and economic transformation across both developed and developing economies.

The measurement of expansion performance varies across studies. Common indicators include sales growth, asset growth, market expansion, employment growth, profitability growth, production capacity expansion, customer acquisition, and geographical diversification. Among these indicators, sales growth and market expansion are frequently used because they directly reflect a firm's ability to strengthen its market presence and competitive position.

In the context of emerging businesses, expansion performance is particularly important because such firms often operate in dynamic and resource-constrained environments. Their ability to expand depends largely on access to finance, managerial capability, market opportunities, technological innovation, and supportive institutional conditions. Consequently, financing decisions play a critical role in determining whether firms can successfully pursue expansion opportunities and sustain long-term growth. Within the present study, expansion performance is

viewed as the ability of emerging businesses to achieve sustainable increases in sales, assets, market coverage, and employment through the effective utilization of available financial resources. It serves as the dependent variable because it represents the ultimate outcome that capital structure decisions are expected to influence.

3.2 Concept of Capital Structure Decisions

Capital structure decisions refer to the choices firms make regarding the combination of financing sources used to fund business operations, investments, and growth activities. In simple terms, capital structure decisions involve determining where a business obtains the money required to operate and expand. These decisions require managers to choose among borrowed funds, owners' investments, retained profits, or a combination of these financing sources. Because financing influences both risk and return, capital structure decisions are among the most important strategic decisions in business management.

From an academic perspective, capital structure has attracted considerable attention in corporate finance literature because of its influence on organizational performance and sustainability. According to the Organisation for Economic Co-operation and Development (OECD, 2024), capital structure refers to the mix of debt and equity financing employed by firms to support operations and investment activities. Similarly, the World Bank (2024) defines capital structure as the arrangement of internal and external financial resources used by firms to finance business activities and achieve strategic objectives. The International Finance Corporation (IFC, 2025) further describes capital structure as the proportion of debt, equity, retained earnings, and other financial instruments utilized to finance assets and operations.

A synthesis of these definitions suggests that capital structure decisions involve selecting the most appropriate combination of financing sources to achieve organizational objectives while maintaining acceptable levels of financial risk. Effective capital structure management seeks to balance financing costs, financial flexibility, and growth opportunities in a manner that maximizes firm value and long-term sustainability.

The major dimensions of capital structure include debt financing, equity financing, financial leverage, and retained earnings financing. Debt financing provides access to external funds but creates repayment obligations. Equity financing strengthens the capital base without repayment pressure but may dilute ownership. Financial leverage reflects the extent to which firms rely on debt relative to equity, while retained earnings financing involves reinvesting internally generated profits into business operations.

Within the context of this study, capital structure decisions are viewed as strategic financing choices involving debt financing, equity financing, financial leverage, and retained earnings financing that support business operations and expansion activities. These

decisions constitute the independent variable of the study because they are expected to influence the expansion performance of emerging businesses.

3.3 Concept of Debt Financing

Debt financing refers to the process through which a business obtains funds from external sources with an obligation to repay the borrowed amount, usually with interest, within a specified period. In simple terms, debt financing involves borrowing money from banks, financial institutions, bondholders, or other lenders to support business operations, investments, and expansion activities. It is one of the most widely used sources of business finance because it enables firms to access additional capital without surrendering ownership or control.

According to the Organisation for Economic Co-operation and Development (OECD, 2024), debt financing refers to financial resources obtained through loans, credit facilities, bonds, and other borrowing arrangements that require future repayment. Similarly, the World Bank (2024) defines debt financing as the acquisition of external capital through borrowing agreements that obligate firms to repay both principal and interest according to predetermined terms. The International Finance Corporation (IFC, 2025) further describes debt financing as a financing arrangement through which firms obtain funds from creditors to support investments, operational activities, and business growth.

Debt financing may take several forms, including bank loans, overdrafts, trade credit, lease financing, and corporate bonds. Its major advantages include access to substantial capital, retention of ownership control, and potential tax benefits associated with interest payments. However, it also exposes firms to repayment obligations, financial distress risk, and reduced financial flexibility.

Within the context of this study, debt financing refers to funds obtained from external creditors through borrowing arrangements that require repayment with interest and are utilized to support business operations and expansion activities. It constitutes an important dimension of capital structure decisions and a key determinant of expansion performance among emerging businesses.

3.4 Concept of Equity Financing

Equity financing refers to the process through which a business raises funds by offering ownership interests to investors in exchange for capital. In simple terms, equity financing means obtaining money for business operations and expansion by allowing individuals or institutions to become part owners of the business. Unlike debt financing, equity financing does not require repayment of the funds received, as investors share in the risks and rewards of the enterprise.

According to the Organisation for Economic Co-operation and Development (OECD, 2024), equity financing refers to funds provided by shareholders and investors in exchange for ownership claims in a business. Similarly, the World Bank (2024) defines equity financing as the acquisition of capital through the issuance of ownership interests that provide investors with residual claims on the assets and earnings of the enterprise. The International Finance Corporation (IFC, 2025) further describes equity financing as a funding mechanism through which businesses obtain resources from investors who assume ownership stakes and share in business risks and benefits.

Equity financing may take different forms, including ordinary shares, preference shares, venture capital, private equity investments, angel investments, and public offerings. Its major advantage is that it provides long-term capital without creating repayment obligations, thereby reducing financial pressure and enhancing financial stability. Equity investors may also contribute managerial expertise, strategic guidance, and valuable business networks that support organizational growth.

However, equity financing may lead to ownership dilution and reduced managerial control as new investors acquire ownership rights. Raising equity capital can also be costly and time-consuming due to regulatory and administrative requirements.

Within the context of this study, equity financing refers to capital obtained through ownership participation by shareholders and investors to support business operations, investments, and expansion activities. It constitutes an important dimension of capital structure decisions and a key determinant of expansion performance among emerging businesses.

3.5 Concept of Financial Leverage

Financial leverage refers to the extent to which a business utilizes borrowed funds relative to owners' equity to finance its operations and investment activities. In simple terms, financial leverage means using borrowed money to increase the resources available for business activities with the expectation of generating higher returns. It is a fundamental concept in corporate finance because it influences both the growth potential and risk profile of a business.

According to the Organisation for Economic Co-operation and Development (OECD, 2024), financial leverage refers to the degree to which firms rely on debt financing relative to equity financing in funding operations and investments. Similarly, the World Bank (2024) defines financial leverage as the use of borrowed funds to increase investment capacity and potential returns while simultaneously increasing exposure to financial obligations and risk. The International Finance Corporation (IFC, 2025) further describes financial leverage as a financial strategy through which

businesses employ debt capital to enhance returns generated from investments and operational activities. Financial leverage is commonly measured using indicators such as the debt-to-equity ratio, debt ratio, equity multiplier, and interest coverage ratio. Its major advantage lies in its ability to increase investment capacity, support business expansion, and improve returns when investments generate earnings that exceed borrowing costs. Leverage may also provide tax benefits because interest payments are often tax deductible.

However, excessive leverage exposes firms to financial distress, repayment pressures, and reduced financial flexibility. High debt levels may increase the risk of insolvency, particularly during economic downturns. Within the context of this study, financial leverage refers to the extent to which emerging businesses utilize borrowed funds relative to owners' equity to finance operations and expansion activities. It is examined as a key dimension of capital structure decisions and an important determinant of expansion performance.

3.6 Concept of Retained Earnings Financing

Retained earnings financing refers to the use of internally generated profits that are reinvested into a business rather than distributed to owners or shareholders as dividends. In simple terms, it means using profits already earned by the business to fund operations, investments, and expansion activities.

According to the Organisation for Economic Co-operation and Development (OECD, 2024), retained earnings are the portion of net profits reinvested in the business to support future growth and investment. Similarly, the World Bank (2024) defines retained earnings financing as internally generated financial resources reinvested to finance expansion, innovation, and operational improvements. The International Finance Corporation (IFC, 2025) describes it as the accumulation and reinvestment of after-tax profits to support business expansion and capital investment.

Retained earnings financing is considered a stable and low-risk source of finance because it does not involve repayment obligations, interest costs, or ownership dilution. However, its availability depends largely on the profitability of the business and may be insufficient for large-scale expansion projects.

Within the context of this study, retained earnings financing refers to internally generated profits reinvested into business operations to support growth and expansion. It is examined as an important dimension of capital structure decisions and a determinant of expansion performance among emerging businesses.

4. Theoretical Framework

4.1 Pecking Order Theory

The Pecking Order Theory was developed by Stewart C. Myers in 1984, with significant contributions from Nicholas Majluf in the same year. The theory explains how firms make financing decisions by following a hierarchy of funding sources rather than maintaining a predetermined debt-equity ratio. According to the theory, firms prefer internal financing in the form of retained earnings, followed by debt financing, while equity financing is considered the least preferred option. This preference arises from information asymmetry, where managers possess more information about the firm's true value than external investors.

The central argument of the theory is that firms seek to minimize financing costs and avoid the negative signals that may accompany external financing. Consequently, businesses first utilize retained earnings because they are readily available and do not involve transaction costs, ownership dilution, or repayment obligations. When internal funds become insufficient, firms turn to debt financing, and only resort to equity financing when other sources cannot adequately meet financing needs. As a result, capital structure evolves naturally based on financing requirements rather than adherence to a target debt-equity ratio.

The theory is built on several assumptions. First, managers possess superior information about the firm's prospects compared to external investors. Second, external financing involves higher transaction and information costs. Third, firms prefer financing options that reduce information asymmetry and financial risk. Finally, there is no universally optimal capital structure; financing choices depend on the availability of funds and organizational needs.

The key principles of the theory include the preference hierarchy of internal funds, debt, and equity; the minimization of financing costs; and the influence of information asymmetry on financing behavior. Its major tenets are that retained earnings are the most preferred source of finance, debt is used when internal funds are inadequate, equity financing is the last resort due to ownership dilution, and financing decisions are driven by funding needs rather than target capital structures.

The Pecking Order Theory is highly relevant to this study because it provides a framework for understanding how capital structure decisions influence the expansion performance of emerging businesses. The theory directly relates to the study variables—retained earnings financing, debt financing, equity financing, and financial leverage. Emerging businesses often rely on retained earnings to finance growth due to limited access to external capital. When internal funds are insufficient, they resort to debt financing, while equity financing is generally used as a final option. Therefore, the theory provides a strong foundation for explaining how financing choices affect business expansion,

growth sustainability, and overall expansion performance.

5. Empirical Review

5.1 Related Empirical Studies on Debt Financing and Expansion Performance

Thorsten Beck and Asli Demirgüç-Kunt (2021) conducted a study on access to finance and firm growth in emerging economies. The purpose of the study was to examine the effect of debt financing on firm growth and expansion performance across emerging and developing economies. The study adopted a panel research design using firm-level financial data obtained from the World Bank Enterprise Surveys. The population consisted of firms operating across multiple emerging economies, while several thousand firms constituted the study sample. Firms were selected through stratified sampling procedures embedded within the survey framework. The research instrument comprised standardized enterprise survey questionnaires and audited financial records. Data were collected from secondary databases and firm financial statements over multiple years. Panel regression analysis was employed for data analysis. The findings revealed that access to debt financing significantly enhanced firm expansion by easing liquidity constraints, increasing investment in productive assets, and improving growth opportunities. The study concluded that debt financing is an important driver of business expansion when credit is accessible and efficiently utilized. The authors recommended policies aimed at improving access to formal credit, especially for small and medium-sized enterprises.

In contrast, the World Bank (2024), in its *SME finance and development* report, investigated the relationship between debt financing and business growth across developing economies. The study utilized a comparative research design based on cross-country secondary data from SMEs. Data were obtained from national financial databases and enterprise surveys covering thousands of firms. Descriptive and comparative statistical techniques were used for analysis. The findings showed that although moderate debt financing supports expansion, excessive borrowing reduces growth potential by increasing financial obligations and financial distress risk. The report concluded that high debt burdens can constrain business expansion when repayment costs become excessive. It therefore recommended prudent borrowing practices, improved credit risk management, and the provision of affordable financing facilities for SMEs.

5.2 Related Empirical Studies on Equity Financing and Expansion Performance

The Organisation for Economic Co-operation and Development (OECD) (2024) conducted a study on financing SMEs and entrepreneurs 2024: OECD scoreboard. The purpose of the study was to examine how different financing sources, particularly equity financing, influence the growth and expansion of small

and medium-sized enterprises across OECD and partner countries. The study adopted a descriptive and comparative research design using secondary data obtained from government agencies, financial institutions, and SME databases. The population consisted of SMEs operating across participating countries, while the sample comprised firms included in the OECD financing database. Data were collected through official national reports and financial records. The study relied on validated secondary datasets; therefore, reliability was ensured through standardized data collection procedures across countries. Descriptive statistics and comparative analysis were employed for data analysis. The findings revealed that firms with stronger equity financing structures demonstrated higher survival rates, greater investment capacity, and more sustainable expansion outcomes than firms heavily dependent on debt. The study concluded that equity financing strengthens financial resilience and supports long-term business growth. It recommended policies that promote venture capital, private equity investment, and broader access to equity markets for SMEs.

In contrast, Raghuram G. Rajan and Luigi Zingales, in their financial development studies, examined the implications of equity financing for firm growth and performance. The purpose of the study was to assess how ownership structures influence business expansion and corporate efficiency. Using firm-level financial data and econometric analysis, the researchers found that although equity financing improves access to capital and reduces financial distress, excessive equity issuance may dilute ownership concentration and reduce managerial control. This can create agency-related challenges that negatively affect strategic decision-making and expansion efficiency. The study concluded that equity financing is beneficial for growth but may generate governance challenges when ownership becomes highly dispersed. It recommended balancing equity financing with other funding sources to achieve optimal growth and managerial effectiveness.

5.3 Related Empirical Studies on Financial Leverage and Expansion Performance

Giorgio Nocera and M. Hashem Pesaran (2023) conducted a study on financial leverage, external finance and firm growth. The purpose of the study was to examine the influence of financial leverage on firm expansion and investment performance under different macroeconomic conditions. The study adopted a panel research design using firm-level financial data obtained from companies operating across several developed and emerging economies. The population comprised registered firms in the selected countries, while a large sample of firms was drawn from established financial databases. Secondary financial data served as the research instrument, and data were collected from audited financial statements and market databases. Panel regression and econometric estimation techniques were employed for data analysis. The findings revealed that moderate levels of financial leverage improved firms' investment capacity, enhanced access to external

finance, and supported expansion activities. The study concluded that leverage contributes positively to expansion performance when maintained at sustainable levels. It recommended that firms adopt optimal leverage policies and align borrowing decisions with prevailing economic conditions.

In contrast, the World Bank (2024), in its SME finance and development report, examined the implications of leverage for business growth and sustainability in developing economies. The purpose of the study was to assess how varying levels of leverage affect SME expansion performance. A comparative research design was adopted using cross-country secondary data obtained from enterprise surveys and financial databases. Descriptive and comparative statistical analyses were employed. The findings showed that excessive financial leverage increased default risk, reduced financial flexibility, and constrained expansion opportunities. Highly leveraged firms were found to be more vulnerable to economic shocks and repayment pressures. The study concluded that while leverage can support growth, excessive dependence on debt financing undermines long-term expansion performance. The report recommended maintaining prudent leverage ratios, strengthening financial management practices, and improving firms' access to alternative financing sources to support sustainable growth.

5.4 Related Empirical Studies on Retained Earnings Financing and Expansion Performance

The Organisation for Economic Co-operation and Development (OECD) (2024) conducted a study on financing SMEs and entrepreneurs 2024: OECD scoreboard. The purpose of the study was to examine the major sources of finance available to SMEs and their implications for business growth and expansion. The study adopted a descriptive and comparative research design using secondary data collected from government agencies, financial institutions, and SME databases across OECD member and partner countries. The population consisted of SMEs operating within participating countries, while firms included in the OECD database constituted the sample. Data were collected through official financial reports and enterprise statistics. Standardized OECD datasets served as the research instrument, ensuring data reliability and consistency across countries. Descriptive statistics and comparative analyses were employed for data analysis. The findings revealed that retained earnings remained the most widely utilized source of financing among SMEs and contributed significantly to business expansion by enhancing financial independence and reducing dependence on external financing. The study concluded that internally generated funds provide a stable foundation for sustainable growth and long-term expansion. It recommended policies that support SME profitability and encourage the reinvestment of earnings into productive business activities.

In contrast, the World Bank (2024), in its SME finance and development report, examined the adequacy of retained earnings as a source of finance for business expansion. The study adopted a comparative research design using cross-country secondary data obtained from enterprise surveys and financial databases. The population comprised SMEs across developing economies, while firms included in the database formed the sample. Data were analyzed using descriptive and comparative statistical techniques. The findings indicated that although retained earnings support business growth, they are often insufficient to finance large-scale expansion, particularly in capital-intensive industries. The study concluded that reliance on retained earnings alone may constrain growth opportunities when profitability is low or investment requirements are substantial. The report therefore recommended combining retained earnings with external financing sources such as debt and equity to achieve sustainable expansion and long-term competitiveness.

5.5. Position Statement

This paper takes the position that capital structure decisions significantly influence the expansion performance of emerging businesses. Specifically, the study argues that a balanced combination of debt financing, equity financing, financial leverage, and retained earnings financing provides the financial capacity required for sustainable business growth. While each financing source possesses unique advantages and limitations, no single source is sufficient to support long-term expansion independently. Excessive reliance on debt may increase financial risk, whereas overdependence on equity may dilute ownership and control. Similarly, retained earnings may be inadequate for large-scale expansion despite their stability and low cost. Therefore, emerging businesses are more likely to achieve sustained increases in sales, assets, market coverage, and operational capacity when financing decisions are strategically aligned with organizational needs and growth objectives. Consequently, this paper supports the adoption of an optimal and balanced capital structure as a critical driver of expansion performance.

5.6 Argument with Empirical Evidence

The position of this paper is that capital structure decisions positively influence the expansion performance of emerging businesses when financing sources are appropriately combined and managed. Empirical evidence provides substantial support for this position.

First, debt financing has been shown to enhance expansion performance by providing firms with access to additional capital required for investment and growth. Thorsten Beck and Asli Demirgüç-Kunt (2021) found that access to credit significantly improves firm growth by reducing liquidity constraints and enabling investment in productive assets. Similarly, the World Bank (2024) reported that moderate debt financing supports business expansion by increasing firms' capacity to undertake growth-oriented projects.

Second, equity financing contributes to long-term expansion by strengthening the capital base of firms and reducing dependence on borrowed funds. The OECD (2024) found that firms with stronger equity financing structures recorded higher survival rates and better expansion outcomes than firms relying heavily on debt. Equity financing provides stable funding that enables businesses to pursue strategic investments and market expansion without facing repayment pressures.

Third, financial leverage can improve expansion performance when maintained at optimal levels. Nocera and Pesaran (2023) reported that moderate leverage enhances investment capacity and facilitates business growth by increasing access to external finance. Likewise, the World Bank (2024) observed that appropriately managed leverage supports expansion by enabling firms to exploit profitable investment opportunities.

Finally, retained earnings financing provides internally generated funds that support sustainable growth. The OECD (2024) found that firms relying on retained earnings demonstrate greater financial independence and consistent expansion performance. Retained earnings allow businesses to reinvest profits in productive activities without incurring debt obligations or ownership dilution.

Collectively, these empirical findings suggest that debt financing, equity financing, financial leverage, and retained earnings financing each contribute to expansion performance. Therefore, emerging businesses are more likely to achieve sustainable growth when they adopt a balanced capital structure that effectively integrates both internal and external sources of finance.

5.7 Counterargument with Empirical Evidence

Despite the evidence supporting the positive influence of capital structure decisions on expansion performance, several empirical studies present contrary findings. Critics argue that certain financing choices may hinder rather than promote business expansion, particularly when improperly utilized.

With respect to debt financing, the World Bank (2024) reported that excessive borrowing increases financial obligations, reduces cash flow availability, and exposes firms to financial distress. The report found that highly indebted firms often experience slower growth because substantial resources are devoted to debt servicing rather than productive investments. Similarly, firms operating in volatile economic environments may face significant difficulties in sustaining expansion when borrowing costs rise.

Regarding equity financing, studies by Raghuram G. Rajan and Luigi Zingales indicate that while equity financing improves access to capital, it may dilute ownership and reduce managerial control. As ownership becomes more dispersed, agency conflicts

may emerge, potentially slowing decision-making processes and reducing expansion efficiency. Consequently, equity financing may not always produce the expected growth outcomes.

Financial leverage has also been criticized for increasing organizational risk. The World Bank (2024) found that highly leveraged firms are more vulnerable to economic shocks, interest rate fluctuations, and default risk. Excessive leverage may therefore undermine long-term expansion by reducing financial flexibility and increasing insolvency risk.

Similarly, retained earnings financing has limitations. The World Bank (2024) reported that internally generated funds are often insufficient to finance large-scale expansion projects, particularly in capital-intensive industries. Firms relying solely on retained earnings may therefore experience slower growth and miss strategic investment opportunities.

These empirical findings suggest that capital structure decisions do not automatically guarantee expansion performance. Rather, inappropriate financing choices, excessive dependence on a particular source of finance, or unfavorable economic conditions may negatively affect business growth and sustainability.

5.8 Rebuttal

Although the counterarguments highlight the potential risks associated with debt financing, equity financing, financial leverage, and retained earnings financing, these limitations do not invalidate the importance of capital structure decisions in promoting expansion performance. Rather, they reinforce the need for firms to adopt appropriate financing strategies and maintain an optimal balance among available financing sources.

The negative effects associated with debt financing and financial leverage are largely a consequence of excessive borrowing rather than debt itself. Empirical evidence from Beck and Demirgüç-Kunt (2021) and the OECD (2024) demonstrates that moderate and well-managed debt financing provides firms with the resources necessary for investment, innovation, and expansion. Similarly, concerns regarding ownership dilution under equity financing can be mitigated through effective corporate governance structures and strategic equity issuance. Equity financing continues to provide stable long-term capital that supports business growth and resilience.

Furthermore, while retained earnings may be insufficient for large-scale expansion, they remain a reliable and low-cost source of finance that strengthens financial independence and reduces reliance on external funding. The limitations of retained earnings therefore suggest the need for complementary financing sources rather than their abandonment.

Consequently, the issue is not whether capital structure decisions influence expansion performance, but how

effectively firms combine and manage financing sources. A balanced capital structure that integrates retained earnings, debt, equity, and leverage remains the most viable approach for achieving sustainable expansion performance among emerging businesses.

6. Appraisal of Literature

The literature reviewed provides substantial evidence that capital structure decisions play a significant role in influencing the expansion performance of businesses. Conceptually, the reviewed studies establish that debt financing, equity financing, financial leverage, and retained earnings financing are major components of capital structure and are critical determinants of organizational growth. The reviewed concepts also reveal that expansion performance is a multidimensional construct encompassing growth in sales, assets, market share, production capacity, and employment.

The theoretical review, anchored on the Pecking Order Theory, provides a sound explanation for financing behavior among firms. The theory suggests that businesses prefer retained earnings as the primary source of finance, followed by debt financing and, lastly, equity financing. This theoretical position aligns closely with the financing patterns observed among emerging businesses, particularly in environments characterized by limited access to external capital.

Empirically, the literature presents both convergent and divergent findings. Supporting studies indicate that access to debt financing, equity capital, moderate leverage, and retained earnings contributes positively to expansion performance by increasing investment capacity and financial flexibility. However, contradictory studies reveal that excessive debt, high leverage, ownership dilution associated with equity financing, and inadequate retained earnings may constrain growth. These inconsistencies suggest that the relationship between capital structure decisions and expansion performance is complex and context-dependent.

Overall, the literature demonstrates that no single financing source guarantees sustainable expansion. Instead, expansion performance depends on the effective combination and management of various financing options. The review therefore supports the position that a balanced capital structure, integrating both internal and external financing sources, provides the most effective pathway for achieving sustainable growth and expansion among emerging businesses.

7. Knowledge Gap

Despite extensive literature on capital structure and firm performance, several important gaps remain that justify further empirical investigation, particularly in emerging business contexts.

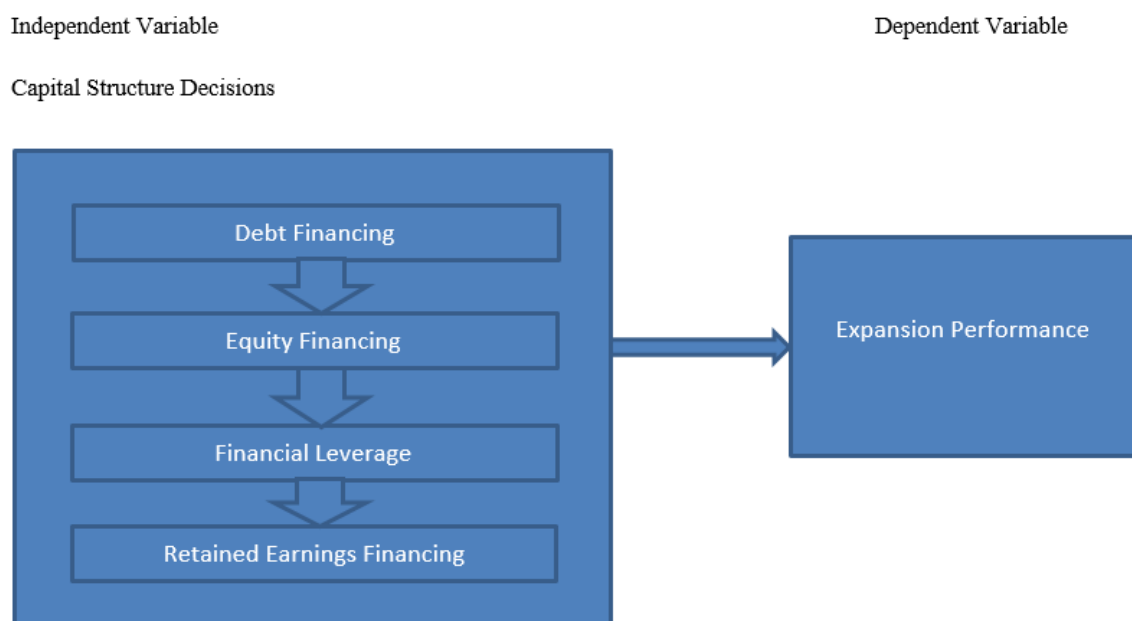


Figure 1: Interaction between the independent (debt financing, equity financing, financial leverage, and retained earnings) variable and dependent (expansion performance) variable.

Source: Author's conceptual formulation (2026), based on the propositions of the Pecking Order Theory (Myers, 1984) and reviewed empirical literature.

First, existing studies largely examine debt financing, equity financing, financial leverage, and retained earnings separately. This fragmented approach fails to capture the real-world situation where firms combine multiple financing sources, making it difficult to understand their joint effect on expansion performance.

Second, most studies focus on financial performance indicators such as profitability, return on assets, and firm value. However, expansion performance—which includes sales growth, asset growth, market expansion, employment growth, and operational scaling—has received limited attention. This creates a gap in understanding how financing decisions influence actual business expansion.

Third, there is a contextual limitation, as many studies are based on large, listed firms in developed economies. Emerging businesses in developing countries are underrepresented, even though they face different financial constraints and play a key role in economic development.

Fourth, methodological inconsistencies across studies, including differences in research design, measurement, and analysis techniques, make findings difficult to compare and limit general conclusions.

Finally, empirical findings remain inconsistent, with studies reporting positive, negative, or insignificant relationships between financing decisions and expansion outcomes. This suggests the influence of moderating factors such as firm size, industry type, and economic conditions.

Therefore, there is a need for an integrated study that jointly examines debt financing, equity financing, financial leverage, and retained earnings in relation to expansion performance in emerging businesses.

7. Conceptual Framework

The conceptual framework shows the relationship between capital structure decisions and expansion performance of emerging businesses. The independent variables are debt financing, equity financing, financial leverage, and retained earnings financing, while the dependent variable is expansion performance.

Debt financing provides external funds for investment and business expansion but may create repayment pressure if not well managed. Equity financing strengthens the capital base and supports long-term growth without repayment obligations. Financial leverage reflects the proportion of debt used and influences expansion depending on its optimal level. Retained earnings financing provides internal funds that enhance reinvestment and financial independence.

Collectively, these financing sources interact to determine expansion performance, which is measured through sales growth, asset expansion, market share, employment growth, and operational scale. The framework assumes that appropriate capital structure decisions enhance expansion performance, while poor financing decisions may limit business growth and sustainability.

8. Summary

The literature shows that capital structure decisions significantly influence expansion performance in emerging businesses. Expansion performance is reflected in sales growth, asset growth, market share, employment, and operational scale. Debt financing enhances expansion by providing external funds for investment, but excessive debt can cause financial distress, indicating a nonlinear effect. Equity financing strengthens capital structure and supports long-term growth, though it may lead to ownership dilution and governance challenges. Financial leverage improves expansion when maintained at optimal levels but increases financial risk when excessive. Retained earnings support expansion through internal funding and financial stability, but are often limited by profitability.

Overall, the findings reveal that no single financing source is sufficient on its own. Instead, expansion performance is best achieved through a balanced mix of debt, equity, leverage, and retained earnings. Effective capital structure management is therefore essential for sustainable growth and business expansion in emerging firms.

9. Conclusion

This study examined the relationship between capital structure decisions and the expansion performance of emerging businesses, focusing on debt financing, equity financing, financial leverage, and retained earnings financing. It established that expansion performance is a multidimensional concept reflected in growth in sales, assets, market share, employment, and operational capacity, all of which depend heavily on effective financial resource management.

The study concludes that capital structure decisions significantly influence expansion performance, though the relationship is complex and context-dependent. Debt financing supports expansion by providing external capital for investment and operational growth, but excessive debt can hinder expansion due to repayment obligations and financial distress. Equity financing enhances expansion by strengthening the capital base and supporting long-term investment, although it may lead to ownership dilution and governance concerns.

Financial leverage shows a nonlinear relationship with expansion performance, where moderate leverage enhances growth potential, while excessive leverage increases financial risk and restricts expansion. Retained earnings financing provides stable internal funding that supports gradual expansion, but its effectiveness is limited by profitability and may be insufficient for large-scale growth.

Overall, the study concludes that sustainable expansion is best achieved through a balanced mix of debt, equity, leverage, and retained earnings, rather than reliance on a single financing source.

10. Recommendations

1. Emerging businesses should maintain a balanced capital structure combining debt, equity, leverage, and retained earnings.
2. Excessive debt should be avoided to reduce financial distress and liquidity problems.
3. Equity financing should be used strategically for long-term expansion while managing ownership dilution.
4. Financial leverage should be kept at an optimal level to balance risk and return.
5. Retained earnings should be reinvested into productive assets to support internal growth.
6. Firms should strengthen financial planning and forecasting to guide financing decisions.
7. Policymakers and financial institutions should improve access to affordable credit and equity funding.
8. Training should be provided to entrepreneurs on capital structure management.
9. Firms should regularly review their financing mix based on economic conditions.
10. Financial decisions should be data-driven rather than based on intuition.

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