

Islamic Equity Financing as an Alternative of Capital Structure to Improve Business Performance: A Systematic Literature Review

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Abstract: This study presents a systematic literature review of capital structure choices with a particular focus on Islamic equity financing and its impact on business performance. By synthesizing 172 Scopus-indexed articles from 1999 to 2023, the research examines the comparative dynamics of internal financing, trade credit, debt financing, and equity financing—including the Islamic mode of *musharakah*. Key theoretical frameworks, namely the Pecking Order Theory and Trade-Off Theory, are used to analyze how firms navigate capital structure decisions amid considerations such as cost, control, risk, and tax implications. The findings demonstrate a growing academic and practical interest in Islamic equity financing as a profit-and-loss sharing alternative that aligns with ethical finance principles. However, challenges remain in its adoption due to risk asymmetry and limited regulatory and institutional support. This review further highlights technological innovations—such as blockchain and big data analytics—as emerging solutions to mitigate risk and information asymmetry in Islamic equity models. The specific contribution of this study to the international research field lies in its comprehensive mapping of the development and application of *musharakah*-based financing across various contexts and sectors, offering a unique cross-comparison with conventional equity models. It contributes to global discourse by positioning Islamic equity financing not merely as a faith-based solution, but as a viable, ethical, and technologically adaptive alternative to conventional financing models. The study opens new research directions for scholars and practitioners in Islamic finance, fintech, and capital structure optimization.

Keywords: Islamic Equity Financing, Capital Structure, Business Performance, *Musharakah*, systematic literature review

Introduction

Capital structure is an important factor determining business performance, especially in financial terms. Some of the previous studies, such as those conducted by Y J Kim and C H Kim,¹ T Feng and Q Meng,² H T T Hang and others,³ Z Ma and Z Yang,⁴ A Khan, M A Qureshi, and P I Davidsen,⁵ A Ullah and others⁶ revealed that the choice of financing for capital structure influences business performance. Nonetheless, many factors influence entrepreneurs, both company owners and managers, in choosing a financing structure within the company.

Several researchers use the pecking order theory concept in finance to explain how companies prioritize their sources of financing based on the cost and availability of funds. According to the pecking order theory, companies have a preferred order in which they choose to finance their investments. The theory suggests that companies prioritize internal financing, such as retained earnings, over external financing, such as debt or equity. The rationale behind this preference is that internal financing does not require the company to incur additional costs or dilute the ownership of existing shareholders. However, companies will move to external financing options if internal financing is insufficient. The theory further states that companies will prefer debt financing over equity financing.

This preference arises from the notion that debt financing allows the company to maintain control and avoid diluting ownership. Additionally, debt interest payments are tax-deductible, making debt financing relatively cheaper than equity financing, which means that the pecking order theory implies that companies will issue equity as a last resort. It is because issuing new equity shares can lead to a dilution of ownership and may be perceived negatively by existing shareholders. Therefore, it is

¹ Y J Kim and C H Kim, 'The Impact of Capital Structure on the Profitability Efficiency of ICT Firms', in Proceedings - 2021 21st ACIS International Semi-Virtual Winter Conference on Software Engineering, Artificial Intelligence, Networking, and Parallel/Distributed Computing, SNPD-Winter 2021 (Incheon Univ., Graduate School, Dept of Business Administration, Incheon, South Korea, 2021), pp. 127–35, <https://doi.org/10.1109/SNPDWinter52325.2021.00036>.

² T Feng and Q Meng, 'Aligning Investment Strategy with Capital Structure, Transnational Business and Profit on Civil Engineering Companies', in Conference Proceedings of the 10th International Symposium on Project Management, China, ISPM 2022 (Faculty of Business, Department of Financial Management, University of Hohai, Jiangning Campus, Room 602, Building 13, Nanjing, China, 2022), pp. 1286–91, <https://doi.org/10.52202/065147-0174>.

³ H T T Hang and others, 'Impact of Capital Structure on Business Performance of Energy Companies Listed on Vietnam Stock Market', *Proceedings on Engineering Sciences*, 4.4 (2022), 449–56, <https://doi.org/10.24874/PES04.04.006>.

⁴ Z Ma and Z Yang, 'Risk of Marginalization in the Process of Internationalization: A Case Study of Emerging Chinese Multinationals', *Nankai Business Review International*, 3.1 (2012), 52–64, <https://doi.org/10.1108/20408741211201917>.

⁵ A Khan, M A Qureshi, and P I Davidsen, 'A System Dynamics Model of Capital Structure Policy for Firm Value Maximization', *Systems Research and Behavioral Science*, 38.4 (2021), 503–16, <https://doi.org/10.1002/sres.2693>.

⁶ A Ullah and others, 'The Nexus between Capital Structure, Firm-Specific Factors, Macroeconomic Factors and Financial Performance in the Textile Sector of Pakistan', *Heliyon*, 6.8 (2020), <https://doi.org/10.1016/j.heliyon.2020.e04741>.

considered the most expensive source of financing. It is as described by Alexis,⁷ Poutziouris *et al.*,⁸ and Rocha & de Camargos⁹ in their articles.

On the other hand, several researchers specifically use the trade-off theory, which suggests that there is an optimal capital structure that balances the benefits and costs of debt financing. According to the trade-off theory, companies face a trade-off when deciding on their capital structure. On the one hand, debt financing offers certain advantages. It allows companies to benefit from the tax deductibility of interest payments, which reduces the overall tax burden. Debt financing can also provide a fixed cost of capital, as interest rates on debt are typically lower than the cost of equity.

Furthermore, taking on debt can signal a company's confidence in investors and improve its reputation. On the other hand, debt financing comes with costs and risks. Companies that rely heavily on debt financing are obligated to make interest payments and repay the principal amount at maturity, which can strain their cash flows. It is what Bandyopadhyay and Barua,¹⁰ also Levine and Wu¹¹ have shown in their articles. But most researchers prefer to compare these two theories at hand, such as paper from Cahyono and Chawla,¹² Gharaibeh and Al-Tahat,¹³ Indomo and Lubis,¹⁴ Lubis & Paramaanindya,¹⁵ Pestana *et al.*¹⁶

Based on the above background, the researchers are interested in knowing how previous research examines the choice of a company's capital structure, which includes trade payables, debt financing, equity financing, and internal financing, and their impact on business performance. In particular, researchers would like to know developments in the use of Islamic equity financing based on previous studies.

⁷ N B Alexis, 'Understanding the Microfinance's Capital Structure: Does It Alter Its Business Model?', *FIIB Business Review*, 12.1 (2023), 49–57, <https://doi.org/10.1177/2319714520948990>.

⁸ P Poutziouris, D Markou, L Glyptis, and E Hadjielias, 'Capital Structure of UK SMEs: An Integrated Understanding', *International Journal of Entrepreneurship and Small Business*, 46.1 (2022), 64–95, <https://doi.org/10.1504/IJESB.2022.123986>.

⁹ C A C Rocha, and M A de Camargos, 'Preferences, Sources, and Conditionals: A New Approach to Testing Financing Decisions', *Revista Contabilidade e Financas*, 34.91 (2023), <https://doi.org/10.1590/1808-057x20221624.en>

¹⁰ A Bandyopadhyay and N M Barua, 'Factors Determining Capital Structure and Corporate Performance in India: Studying the Business Cycle Effects', *Quarterly Review of Economics and Finance*, 61 (2016), 160–72, <https://doi.org/10.1016/j.qref.2016.01.004>.

¹¹ O Levine, and Y Wu, 'Asset Volatility and Capital Structure: Evidence from Corporate Mergers', *Management Science*, 67.5 (2021), 2773–98, <https://doi.org/10.1287/mnsc.2020.3607>.

¹² S B Cahyono, and A S Chawla, 'Capital Structure among Secondary Sectors of Indonesian Firms: Does Business Scale Matter?', *Indian Journal of Finance*, 15.10 (2021), 8–27, <https://doi.org/10.17010/ijf/2021/v15i10/166509>.

¹³ O K Gharaibeh, and S Al-Tahat, 'Determinants of Capital Structure: Evidence from Jordanian Service Companies', *Investment Management and Financial Innovations*, 17.2 (2020), 364–76, [https://doi.org/10.21511/imfi.17\(2\).2020.28](https://doi.org/10.21511/imfi.17(2).2020.28).

¹⁴ I L Indomo and A W Lubis, 'Capital Structure Behaviour among Indonesian Property Developers during Different Business Cycles', *Journal of Financial Management of Property and Construction*, 28.1 (2023), 91–106, <https://doi.org/10.1108/JFMPC-07-2021-0050>

¹⁵ A W Lubis and D Paramaanindya, 'Determinants of Capital Structure: A Comparison between Sharia-Compliant and Sharia Non-Compliant Firms in Indonesia', in *ACM International Conference Proceeding Series* (Universitas Indonesia, Indonesia, 2020), pp. 39–44, <https://doi.org/10.1145/3409929.3414735>

¹⁶ L J Pestana, L P Gomes, and C Lopes, 'Testing the Capital Structure of Portuguese Family Businesses', *Revista Contabilidade e Financas*, 32.87 (2021), 510–27, <https://doi.org/10.1590/1808-057X202113190>.

Research Method

The research method used in this research is a systematic literature review, which takes the Scopus-indexed article database. The articles sought must meet the following requirements:

1. The keywords "Capital Structure" and "Business" in the keyword search column (found a total of 172 articles from 2000 to 2023).
2. The keyword "Equity Financing" in the keyword search column (found a total of 227 articles from 1999 to 2023)
3. The keyword "*Musyarakah*" or "*Musharaka*" in all search fields (title, abstract, keywords, etc.) has found 88 articles from 1999 to 2023.

After data collection, the articles were filtered again according to the appropriate theme. Article screening looks at the financial variables used, the entities studied, the problems raised, and the theoretical basis used.

Results and Discussion

Capital Structure is one of the factors driving business performance

Several previous studies have revealed that capital structure impacts business performance and firm value.¹⁷ The construction of a civil engineering project is an activity that requires capital, a long construction period, and a long investment recovery period; capital structure has a significant negative correlation with net profit and the conclusion is that multinational business has a significant positive correlation with profit.¹⁸ In some cases, companies with large capital sizes operate less efficiently, whereas companies with large net fixed assets over total assets operate more efficiently.

In several cases, like energy enterprises, it is important to reduce long-term debt, increase short-term debt, and reduce total debt to total assets to maintain optimal capital structure while ensuring liquidity to improve business performance.¹⁹ In other cases, the Kim & Kim article shows that the debt ratio had a positive impact on the efficiency of medium-sized companies, especially in the service industry.²⁰ In several studies, the author uses the pecking order theory approach to explain company behavior in determining capital structure.²¹ In other research, the author

¹⁷ Kim and Kim; Feng and Meng; Hang and others; Ma and Yang; Khan, Qureshi, and Davidsen; Ullah and others.

¹⁸ T Feng and Q Meng, 'Aligning Investment Strategy with Capital Structure, Transnational Business and Profit on Civil Engineering Companies'...

¹⁹ H T T Hang and others, 'Impact of Capital Structure on Business Performance of Energy Companies Listed on Vietnam Stock Market'...

²⁰ Y J Kim and C H Kim, 'The Impact of Capital Structure on the Profitability Efficiency of ICT Firms'...

²¹ P Poutziouris and others, 'Capital Structure of UK SMEs: An Integrated Understanding', *International Journal of Entrepreneurship and Small Business*, 46.1 (2022), 64–95, <https://doi.org/10.1504/IJESB.2022.123986>; I L Indomo and A W Lubis, 'Capital Structure Behaviour among Indonesian Property Developers during Different Business Cycles', *Journal of Financial Management of Property and Construction*, 28.1 (2023), 91–106, <https://doi.org/10.1108/JFMPC-07-2021-0050>; N B Alexis, 'Understanding the Microfinance's Capital Structure: Does It Alter Its Business Model?', *FIIB Business Review*, 12.1 (2023), 49–57, <https://doi.org/10.1177/2319714520948990>; C A C Rocha and M A de Camargos, 'Preferences, Sources, and Conditionals: A New Approach to Testing Financing Decisions', *Revista Contabilidade e Financas*, 34.91 (2023), <https://doi.org/10.1590/1808-057x20221624.en>; S B Cahyono and A S Chawla, 'Capital Structure among Secondary Sectors of Indonesian Firms: Does Business Scale Matter?', *Indian Journal of Finance*, 15.10 (2021), 8–27, <https://doi.org/10.17010/ijf/2021/v15i10/166509>; L J Pestana, L P Gomes, and C Lopes, 'Testing the Capital Structure of Portuguese Family Businesses', *Revista Contabilidade e Financas*, 32.87 (2021), 510–27, <https://doi.org/10.1590/1808-057X202113190>; A W Lubis and D Paramaanindya, 'Determinants of Capital Structure: A Comparison between Sharia-Compliant and Sharia Non-Compliant Firms in Indonesia', in *ACM*

uses a trade-off theory approach to explain company behavior in determining capital structure.²²

Factors influencing entrepreneurs to choose a capital structure

The company will always try to determine the optimal capital structure to improve its business performance. Even so, many factors influence companies, business owners, or managers in choosing the company's capital structure. Several factors influence an entrepreneur in deciding the type of financing to choose for his capital structure, which vary widely, including:

1. Bank Connections²³
2. Price of Capital / Cost of Capital²⁴
3. Price of Money²⁵
4. Interest Rate²⁶
5. Spread Rate²⁷
6. Liquidity²⁸
7. Business or Managerial Ownership²⁹
8. Independent Board of Directors³⁰

International Conference Proceeding Series (Universitas Indonesia, Indonesia, 2020), pp. 39–44, <https://doi.org/10.1145/3409929.3414735>; O K Gharaibeh and S AL-Tahat, 'Determinants of Capital Structure: Evidence from Jordanian Service Companies', *Investment Management and Financial Innovations*, 17.2 (2020), 364–76, [https://doi.org/10.21511/imfi.17\(2\).2020.28](https://doi.org/10.21511/imfi.17(2).2020.28).

²² A Bandyopadhyay and N M Barua, 'Factors Determining Capital Structure and Corporate Performance in India: Studying the Business Cycle Effects', *Quarterly Review of Economics and Finance*, 61 (2016), 160–72, <https://doi.org/10.1016/j.qref.2016.01.004>; Indomo and Lubis; Cahyono and Chawla; Pestana, Gomes, and Lopes; O Levine and Y Wu, 'Asset Volatility and Capital Structure: Evidence from Corporate Mergers', *Management Science*, 67.5 (2021), 2773–98, <https://doi.org/10.1287/mnsc.2020.3607>; Lubis and Paramanindya; Gharaibeh and Al-Tahat.

²³ A Gill and C Wilson, 'Bank Connections and Small Business Performance: Evidence from Canadian Survey Data', *International Journal of Finance and Economics*, 26.4 (2021), 5110–34, <https://doi.org/10.1002/ijfe.2057>.

²⁴ E P Peshkova, S P Kyurdzhiev, and A A Martazanov, 'Strategy for Forming Financial Resources in the Context of a Conflict of Interests Between an Economic Entity and Its Creditors', *Smart Innovation, Systems and Technologies* (Russian Presidential Academy of National Economy and Public Administration (RANEPA), 344002, Rostov-on-Don, Russian Federation, 2021), 1257–67, https://doi.org/10.1007/978-981-16-0953-4_119; Gill and Wilson.

²⁵ Pedro Luis Vega-Gutierrez and Juan Antonio Rodriguez-Sanz, 'Interest Rates, Liquidity and the Corporate Financing Decision throughout the Business Cycle: A European Analysis', *Spanish Journal of Finance and Accounting / Revista Española de Financiación y Contabilidad*, 51.2 (2022), 232–62, <https://doi.org/10.1080/02102412.2021.1914388>.

²⁶ Vega-Gutierrez and Rodriguez-Sanz; Gill and Wilson.

²⁷ Vega-Gutierrez and Rodriguez-Sanz.

²⁸ Vega-Gutierrez and Rodriguez-Sanz; Cahyono and Chawla; Bandyopadhyay and Barua; N Wu and others, 'Do Liquidity and Capital Structure Predict Firms' Financial Sustainability? A Panel Data Analysis on Quoted Non-Financial Establishments in Ghana', *Sustainability (Switzerland)*, 15.3 (2023), <https://doi.org/10.3390/su15032240>.

²⁹ A S L Lindawati and others, 'The Impact of Internal Factors on Risk Management Disclosure in Retail Industry', in *ACM International Conference Proceeding Series* (Bina Nusantara University, Indonesia, 2021), pp. 199–205, <https://doi.org/10.1145/3457640.3457643>; Pestana, Gomes, and Lopes; H Y Baek, D D Cho, and P L Fazio, 'Family Ownership, Control and Corporate Capital Structure: An Examination of Small Capitalization Public Firms', *Journal of Family Business Management*, 6.2 (2016), 169–85, <https://doi.org/10.1108/JFBM-02-2015-0006>; Indomo and Lubis; Sudip; Adhikari and Aditya R. Khanal, 'Business Risk, Financial Risk and Savings: Does Perceived Higher Business Risk Induce Savings among Small Agricultural Operations in the USA?', *Agricultural Finance Review*, 83.1 (2023), 107–23, <https://doi.org/10.1108/AFR-01-2022-0006>.

³⁰ Lindawati and others, 'The Impact of Internal Factors on Risk Management Disclosure in Retail Industry' ...

9. Audit Committee³¹
10. Firm or Company Size³²
11. Growth Opportunity³³
12. Profitability³⁴
13. Tangibility³⁵
14. Business Risks³⁶
15. Monetary Policy³⁷
16. Macroeconomic Conditions³⁸
17. Asymmetric Information³⁹
18. Agency Cost⁴⁰
19. Signaling⁴¹
20. Age and Education of the Operator⁴²
21. Land Acreage⁴³
22. Adoption of Alternative on-farm Enterprises and Farmers' Continuation Plan⁴⁴
23. Asset volatility/Merger⁴⁵
24. Non-debt Tax⁴⁶
25. Personality Traits include optimism, risk tolerance, sense of control (external and internal), attitude towards debt, and gender constructs of entrepreneurs.⁴⁷

Alternative capital sources to optimize the cost of capital structure

In general, companies can choose capital structure choices, including trade credit, debt financing, equity financing, or their own capital. Each choice of capital structure has different characteristics. Trade credit is generally given by suppliers to

³¹ Lindawati and others Lindawati and others, 'The Impact of Internal Factors on Risk Management Disclosure in Retail Industry'.

³² Lindawati and others; Cahyono and Chawla; Poutziouris and others; Indomo and Lubis; Lubis and Paramaanindya; Gharaibeh and Al-Tahat.

³³ Cahyono and Chawla; Poutziouris and others; Indomo and Lubis.

³⁴ Cahyono and Chawla; Indomo and Lubis; Adhikari and Khanal; Peshkova, Kyurdzhiev, and Martazanov; Lubis and Paramaanindya; Gharaibeh and Al-Tahat.

³⁵ Cahyono and Chawla; Indomo and Lubis; Lubis and Paramaanindya.

³⁶ Cahyono and Chawla; J Nwachukwu and D Mohammed, 'Business Risk, Industry Affiliation, and Corporate Capital Structure: Evidence from Publicly Listed Nigerian Companies', *Journal of African Business*, 13.1 (2012), 5–15, <https://doi.org/10.1080/15228916.2012.657918>; Adhikari and Khanal; Lubis and Paramaanindya; Gharaibeh and Al-Tahat.

³⁷ O V Campos and W M Lamounier, 'The Effects of Monetary Policies on the Capital Structures of the Firms', *Brazilian Business Review*, 19.6 (2022), 584–606, <https://doi.org/10.15728/BBR.2021.19.6.1.EN>.

³⁸ Poutziouris and others.

³⁹ Bandyopadhyay and Barua, 'Factors Determining Capital Structure and Corporate Performance in India: Studying the Business Cycle Effects'

⁴⁰ Bandyopadhyay and Barua.

⁴¹ Bandyopadhyay and Barua.

⁴² Adhikari and Khanal, 'Business Risk, Financial Risk and Savings: Does Perceived Higher Business Risk Induce Savings

⁴³ Adhikari and Khanal.

⁴⁴ Adhikari and Khanal.

⁴⁵ Levine and Wu, 'Asset Volatility and Capital Structure: Evidence from Corporate Mergers...

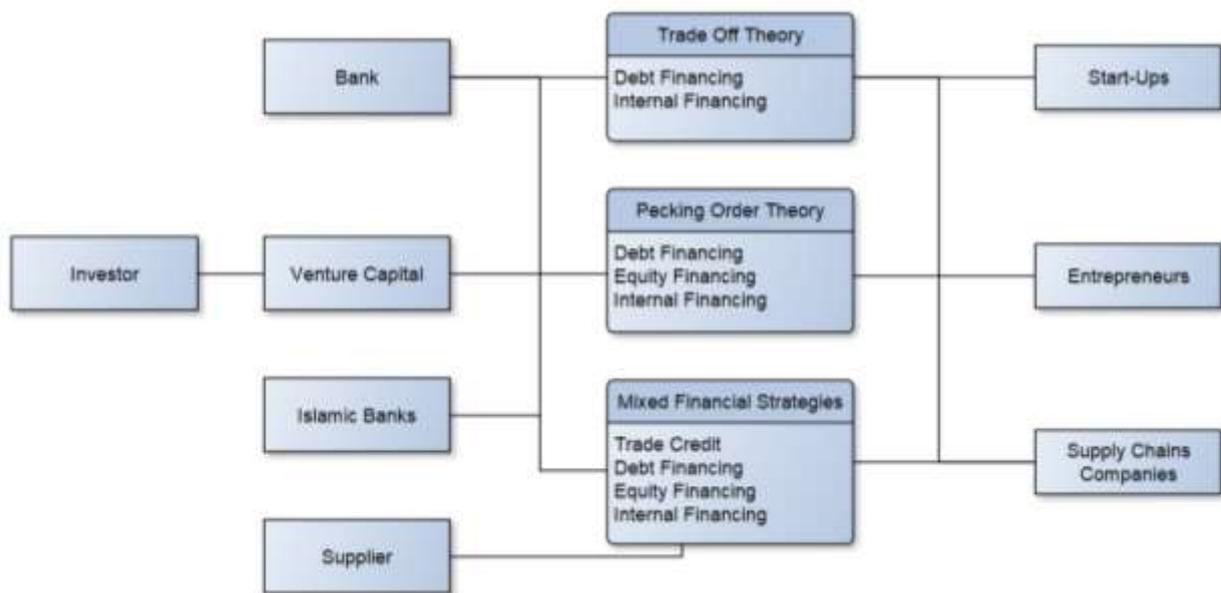
⁴⁶ Gharaibeh and Al-Tahat.

⁴⁷ K M Vieira and others, 'My Business and I: Entrepreneur Personality Traits and Capital Structure Choice', *Revista de Administracao Mackenzie*, 21.6 (2020), <https://doi.org/10.1590/1678-6971/ERAMD200300>.

retailers (entrepreneurs). Trade credit has no capital cost, but companies that choose to use trade credit will miss out on the opportunity cost. Debt financing is provided by financial institutions such as banks, Islamic banks, and venture capitalists. Debt-based financing uses interest instruments to measure the rate of return on debt principal. From the company side, debt financing has various advantages. However, at a certain level, debt financing has risks and costs that may be detrimental to the company.

Equity Financing is a source of financing provided by venture capital, angel investors, and Islamic Banks. This type of funding source is profit-and-loss sharing, that is, the funder and the company share profits from the results of operations on the issued capital. In other words, these two parties also share the risk of the business results carried out by the company. Figure 1 below provides an overview of the choice of capital structure and the entities involved in it.

Figure 1. The Choice of Capital Structure and The Entities



Several previous studies have used different theoretical approaches to explore the factors that influence entrepreneurs in choosing their capital structure. Based on the theoretical approach, the research articles are similar, as shown in Table 1.

Table 1. Articles Based on Theory Approach

Author	Theory Approach and Findings
Bandyopadhyay and Barua Indomo and Lubis Cahyono and Chawla Pestana, Gomes, and Lopes Levine and Wu Lubis and Paramaanindya Gharaibeh and Al-Tahat ⁴⁸	The trade-off theory approach is used as a basis for analysis of considerations for the selection of capital structure.
Poutziouris and others Indomo and Lubis Alexis	The Pecking Order theory approach is used as a basis for analysis of

⁴⁸ Bandyopadhyay and Barua; Indomo and Lubis; Cahyono and Chawla; Pestana, Gomes, and Lopes; Levine and Wu; Lubis and Paramaanindya; Gharaibeh and AL-Tahat.

Rocha and de Camargos Cahyono and Chawla Pestana, Gomes, and Lopes Lubis and Paramaanindya Gharaibeh and Al-Tahat ⁴⁹	considerations when choosing a capital structure.
Indomo and Lubis; Cahyono and Chawla Pestana, Gomes, and Lopes Lubis and Paramaanindya Gharaibeh and Al-Tahat ⁵⁰	Cahyono and Chawla (2021), Gharaibeh & Al-Tahat (2020), Indomo & Lubis (2023), Lubis & Paramaanindya (2020), Pestana et al. (2021) made a comparison between the pecking order theory and the trade-off theory.
Wenyan Zhuo and others Chuanxin Xia and others Xiaoli Zhang and others ⁵¹	Xia (2020) and Zhuo (2022) proposed mixed financing modes: (a) bank credit and equity financing and (b) trade credit and equity financing.

When grouped based on sources of financing, some previous studies can be summarized as follows:

Table 2. Articles based on capital structure funding sources

Source of Fund/Capital	Findings
External Financing (Debt Financing and Equity Financing) compared with Internal Financing. ⁵²	Wang et al. (2023) focus on impact of financing structure (Debt and Equity Financing) and cash holding to enterprise innovation. Audretsch et al (2023) find that CEO gender is important as it moderates the relationship between

⁴⁹ Poutziouris and others; Indomo and Lubis; Alexis; Rocha and de Camargos; Cahyono and Chawla; Pestana, Gomes, and Lopes; Lubis and Paramaanindya; Gharaibeh and AL-Tahat.

⁵⁰ Indomo and Lubis; Cahyono and Chawla; Pestana, Gomes, and Lopes; Lubis and Paramaanindya; Gharaibeh and AL-Tahat.

⁵¹ Wenyan Zhuo and others, 'Mixed Financing Modes for Capital-Constrained Supply Chain with Risk-Averse Members', *RAIRO - Operations Research*, 56.3 (2022), 1223–58, <https://doi.org/10.1051/ro/2022054>; Chuanxin Xia and others, 'Mixed Financing Strategies for Capital-Constrained Retailer in the Chinese Financial Market', *Pacific Basin Finance Journal*, 63 (2020), <https://doi.org/10.1016/j.pacfin.2020.101395>; Xiaoli Zhang and others, 'The Impact of Equity Financing on the Performance of Capital-Constrained Supply Chain under Consumers' Low-Carbon Preference', *International Journal of Environmental Research and Public Health*, 18.5 (2021), 1–22, <https://doi.org/10.3390/ijerph18052329>.

⁵² Zhuo and others; Xia and others; Zhang and others; Cheng-Ben Wang, Jie-Ru Rong, and Jia-Ming Zhu, 'Algorithm Research on the Influence of Financing Structure and Cash Holding on Enterprise Innovation Based on System GMM Model Function Theory', *Journal of Combinatorial Optimization*, 45.2 (2023), <https://doi.org/10.1007/s10878-023-00991-1>; David Audretsch, Maksim Belitski, and Candida Brush, 'How to Secure an Innovation Grant for Firms in New Industries? Gender and Resource Perspectives', *International Journal of Entrepreneurial Behaviour and Research*, 2023, <https://doi.org/10.1108/IJEBr-02-2022-0183>; Phuong Bui and others, 'External Financing and Earnings Management: Evidence in Vietnam', *Cogent Economics and Finance*, 10.1 (2022), <https://doi.org/10.1080/23322039.2022.2147703>; Zafrin Rahman and Wanying Shi, 'How Does Frugal Innovation Help Young Firms in the US? The Moderating Roles of Venture Capital Investment and Debt Financing', *Journal of General Management*, 2022, 030630702211364, <https://doi.org/10.1177/03063070221136407>; Jun Chu, 'Risk Mechanism and Architecture of Investment and Financing Based on DEA-Malmquist Index', ed. by Yaxiang Fan, *Journal of Sensors*, 2022 (2022), 1–10, <https://doi.org/10.1155/2022/3613624>; Bayu Arie Fianto and others, 'Equity Financing and Debt-Based

	<p>the sources of funding and the likelihood of accessing grant funding.</p> <p>Rahman and Shi (2022) put debt financing, venture capital equity financing, and owner equity financing as moderator variables that interact with frugal innovation and firm performance.</p> <p>Bui et al. (2022) state that firms issuing equity have stronger incentives to manage earnings than debt issuers and call for thorough monitoring and scrutiny of stakeholders towards this type of issuance.</p> <p>Chu (2022) found that most companies prefer debt financing because equity financing costs can be deducted before taxes, and investment costs are lower than equity financing. Enterprises face certain risks when choosing debt financing; in addition, they also face the risk of future repayment.</p> <p>Xia (2020) and Zhuo et al. (2022) put mixed financing modes (a) bank credit and equity financing (b) trade credit and equity financing in simple-supply chain equilibrium.</p> <p>Zhang et al. (2021) put hybrid financing (Bank Loan Financing and Equity Financing) in Low Carbon Supply Chain Companies.</p> <p>Fianto et al. (2018) found that equity and debt-based financing groups exhibit a positive and significant impact on rural households' income, but equity financing performed better than debt-based financing.</p>
Trade Credit and Equity Financing ⁵³	<p>Xia (2020) and Zhuo (2022) proposed mixed financing modes: (a) bank credit and equity financing, and (b) trade credit and equity financing.</p>
Equity Finance ⁵⁴	<p>Xia (2020) and Zhuo (2022) put mixed financing modes (a) bank credit and equity financing (b) trade credit and equity financing.</p> <p>Deias and Magrini (2023) investors point the view that equity financing is an exit scenario to sell their shares.</p>

Financing: Evidence from Islamic Microfinance Institutions in Indonesia', *Pacific Basin Finance Journal*, 52 (2018), 163–72, <https://doi.org/10.1016/j.pacfin.2017.09.010>.

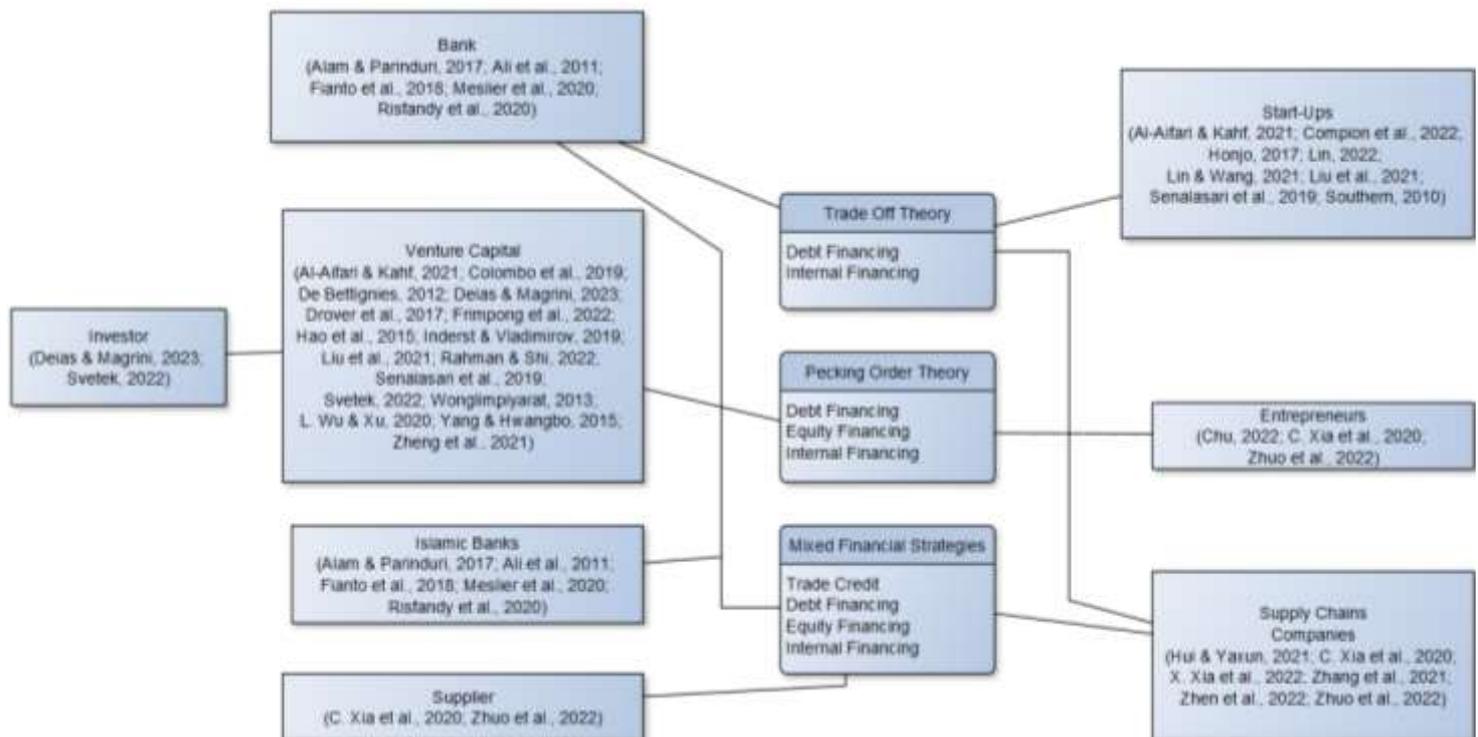
⁵³ Zhuo and others; Xia and others; Zhang and others.

⁵⁴ Zhuo and others; Xia and others; Anna Deias and Alessandro Magrini, 'The Impact of Equity Funding Dynamics on Venture Success: An Empirical Analysis Based on Crunchbase Data', *Economies*, 11.1 (2023), <https://doi.org/10.3390/economies11010019>; Xiaole Wan and others, 'Equity Financing Risk Assessment Based on PLTS-ER Approach in Marine Ranching from the Ecological and Circular Economy Perspectives', *Annals of Operations Research*, 2023, <https://doi.org/10.1007/s10479-023-05222-8>.

	Wan et al. (2023) assess the risk of equity financing in sustainable business management.
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The entities that were the subject of discussion in previous literature, related to determining the capital structure to improve business performance, we described in Figure 2 below:

Figure 2. The capital structure to improve business performance



Equity Financing As An Option In The Capital Structure To Improve Business Performance.

Xia et al. study compares mixed financing of a bank and equity credit and mixed financing of trade and equity credit and found that the mixed financing of trade and equity credit exhibits the only financing equilibrium.⁵⁵ A model such as the Pareto interval theory of the wholesale price exists such that both the supplier and retailer can obtain higher profits with the mixed financing of trade and equity credit than with the mixed financing of bank and equity credit.⁵⁶ In the manufacturer of the low-carbon supply chain cases which provide in Zhang et al. article, equity financing ratio have positive impacts on supply chain equilibrium. This result was the opposite of the impact of the interest rate of bank loan financing.⁵⁷

At Wang et al. article found that the higher the proportion of equity financing, the more cash companies hold, and the more R&D expenses companies put on.⁵⁸ In

⁵⁵ Chuanxin Xia, Yujie Xiao, Wenyan Zhuo, and Yu Jen Hsiao, 'Mixed Financing Strategies for Capital-Constrained Retailer in the Chinese Financial Market', *Pacific Basin Finance Journal*, 63 (2020), <https://doi.org/10.1016/j.pacfin.2020.101395>

⁵⁶ Xia and others.

⁵⁷ Zhang and others.

⁵⁸ Wang, Rong, and Zhu.

this case, cash holdings are used as an intermediary channel between the financing structure and enterprise innovation.⁵⁹ Wang said that when the financial marketization degree is low, the effect of equity financing in external financing through cash holding channels to promote the growth of R&D expenses is more significant than when the financial marketization degree is high.⁶⁰ In some cases, Chu found that after the outbreak of the epidemic, most companies preferred debt financing because equity financing costs can be deducted before taxes, and investment costs are lower than equity financing.⁶¹

In several previous studies, the choice of debt or equity financing is only sometimes a trade-off. In Rahman and Shi article that interaction effects on firm performance was tested; it finds that between frugal innovation and venture capital (VC) equity financing and frugal innovation and debt financing are found to be significant. Both moderators (equity financing and debt financing) weaken the positive effects on firm performance.⁶² In Fianto et al.'s article, which compares debt financing and equity financing as capital structure options for rural households, they find that both financing groups exhibit a positive and significant impact on rural households' income, although equity financing performed better than debt-based financing.⁶³ In this article said that clients with equity financing contracts improved their annual income more than clients with debt-based financing.⁶⁴

Development of Islamic Equity Financing (*Mushārah*)

Equity financing is well known by Islamic Banks, where it is more often called *mushārah* financing based on profit-sharing. Even though it is a product that is quite unique in Islamic banks, this product is not very attractive to financial institutions, especially banks, because it has a fairly high-risk profile.⁶⁵ Even so, efforts continue to be made to improve *mushārah* financing (Islamic equity financing) so that it can still be carried out by mitigating risks for both the donor and the entrepreneur.⁶⁶ The development carried out includes product development,⁶⁷ and also on the development of methods of providing financing itself.

⁵⁹ Wang, Rong, and Zhu.

⁶⁰ Wang, Rong, and Zhu.

⁶¹ Chu.

⁶² Rahman and Shi.

⁶³ Fianto and others.

⁶⁴ Fianto and others.

⁶⁵ M Mutamimah and I Kartika, 'Blockchain Technology and Financing Risk in Profit Loss Sharing Financing of Indonesian Islamic Bank', *Lecture Notes on Data Engineering and Communications Technologies* (Department of Management, Faculty of Economics, Universitas Islam Sultan Agung, Semarang, Indonesia, 2023), 171–79, https://doi.org/10.1007/978-3-031-26281-4_17; E E Hasna, E Abdelaziz, and S Mohamed, 'Platform for the Social and Solidarity Economy Based on Islamic Finance-Derived Crowdfunding: A Blockchain Infrastructure', in *Proceedings - 16th International Conference on Signal-Image Technology and Internet-Based Systems, SITIS 2022* (Cadi Ayyad University, Computer Systems Engineering Laboratory, Faculty of Sciences Semlalia, Marrakesh, Morocco, 2022), pp. 457–64, <https://doi.org/10.1109/SITIS57111.2022.00076>; Yasushi Suzuki and Mohammad Dulal Miah, 'Lender's Position in the Profit and Loss Sharing Islamic Finance: An Analytical Perspective of Izutsu's Hypotheses on "Islam" and "Hilm"', *International Journal of Islamic and Middle Eastern Finance and Management*, 2022, <https://doi.org/10.1108/IMEFM-12-2021-0496>.

⁶⁶ Prasetyo Utomo and Novriana Sumarti, 'The Application of Simulated Annealing Method in Optimizing Profit-Loss Sharing Ratio with Vasicek Model', *AIP Conference Proceedings*, 2021, <https://doi.org/10.1063/5.0075344>; Hasna, Abdelaziz, and Mohamed.

⁶⁷ A Abozaid, 'Economic and Shariah Considerations in Debt Financing', *Journal of King Abdulaziz University, Islamic Economics*, 35.3 (2022), <https://doi.org/10.4197/Islec.35-3.8>; Oussama Gafrej and Mouna Boujelbéne, 'An Alternative Model for Islamic Venture Capital Firms', *International Journal of Islamic and Middle Eastern Finance and Management*, 15.6 (2022), 1009–18, <https://doi.org/10.1108/IMEFM-04-2021-0145>; Mamoru Nagano, 'Does Islamic Finance Follow Financial Hierarchy? Evidence from the Malaysian Firms', *Singapore*

Mushārahah product development is growing quite rapidly, both for financing consumptive needs and productive purposes. Abozaid proposes a possibility of developing a practical financing structure that avoids the adverse effects of debt-based financing and distinguishes Islamic financing, in its essence and effects, from conventional financing. This structure can be found in the mode of diminishing *mushārahah*, as this method of financing is supposed not to lead to the creation of debt.⁶⁸ Several studies like the combination of “*Ijārah*” contract and “Diminishing *Mushārahah*”,⁶⁹ Profit-and-loss sharing-based *Mushārahah* Sukūk,⁷⁰ *Mushārahah-Qard Hasan* based credit card⁷¹ and Financing Homes by *Ijārah*-based diminishing *Mushārahah* (IDM)⁷² show that product development in *mushārahah* keeps growing to meet community needs.

Utomo and Sumarti try to develop mathematical models based on a few data of sales profits of traders in a traditional market in Indonesia. They try to generate more data using the Bootstrap method for the simulation of models of usurer and PLS.⁷³ Arshed and Kalim try to model the macro-equilibrium *mushārahah* demand and supply model.⁷⁴ They try to conduct *mushārahah* equilibrium to accommodate policymakers to predict the movement of the Islamic stock market index (the price of *Mushārahah* financing) and the incidence of *Mushārahah* financing.⁷⁵ Research that use technology approaches to delivering *Mushārahah* financing also developed by Mutamimah and Kartika and Hasna et al. They try to use blockchain technology to reduce asymmetric information and financing risk in Islamic Equity Financing.⁷⁶

Conclusion

The capital structure is one of the vital roles in the company to improve business performance. However, the choice of the capital structure itself is highly dependent on the decisions of the business owner or manager, business conditions, limitations in accessing funds, costs incurred from sources of funds, and business risks that will be exposed to the company by selecting these sources of capital. Based on our literature review, we have mapped out the factors that influence companies in choosing a capital structure. We have also mapped out previous studies that tried to combine capital sources to create efficiency and improve company business performance. Fund source options that are often considered include trade payables, debt financing, equity financing, and internal financing. Previous studies have proven that the choice of a combination of capital structures that is successful in one business sector may not necessarily be successful in another business sector. Equity financing has proven to be the choice of capital structure for many business sectors. However, equity financing

Economic Review, 67.1 (2022), 511–40, <https://doi.org/10.1142/S0217590821420030>; Mohammad Selim, ‘Financing Homes by Employing *Ijara* Based Diminishing *Musharaka*’, *International Journal of Islamic and Middle Eastern Finance and Management*, 13.5 (2020), 787–802, <https://doi.org/10.1108/IMEFM-05-2019-0217>.

⁶⁸ Abozaid.

⁶⁹ Gafrej and Boujelbéne.

⁷⁰ Nagano.

⁷¹ Mohammad Selim, ‘Issuing Credit Cards based on *Musharaka* and *Qard Hasan* and Its Effects on the Earnings of the Card Holders’, *2021 International Conference on Sustainable Islamic Business and Finance, SIBF 2021*, 2021, pp. 71–74, <https://doi.org/10.1109/IEEECONF53626.2021.9686327>.

⁷² Selim, ‘Financing Homes by Employing *Ijara* Based Diminishing *Musharaka*’.

⁷³ Utomo and Sumarti.

⁷⁴ Noman Arshed and Rukhsana Kalim, ‘Exploration of the Equilibrium Level of *Musharaka* Financing in Full-Fledged Islamic Banks’, *Journal of Islamic Accounting and Business Research*, 12.3 (2021), 340–61, <https://doi.org/10.1108/JIABR-02-2020-0048>.

⁷⁵ Arshed and Kalim.

⁷⁶ Mutamimah and Kartika; Hasna, Abdelaziz, and Mohamed.

has also been proven to have a higher risk profile for investors and companies. Equity Financing and Islamic Equity Financing (*Mushārakah*), which have identical risk profiles, have encouraged studies to develop risk mitigation concepts for this source of financing. Admit it or not, the complexity of developing financing models, optimizing financing results, and using technology to mitigate asymmetric information and financing risks in equity financing are the main ideas of previous studies. We feel that these things will be the direction for future research related to equity financing.

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