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CAPITAL STRUCTURE AND PROFITABILITY IN EMERGING MARKET NEW VENTURES: INSIGHTS FROM TRINIDAD AND TOBAGO

ESTRUCTURA DE CAPITAL Y RENTABILIDAD EN NUEVAS EMPRESAS DE MERCADOS EMERGENTES: PERSPECTIVAS DESDE TRINIDAD Y TOBAGO

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ABSTRACT

New ventures, which are essential in driving economic development, face a universal challenge of accessing finance and deciding on a suitable capital structure. In developing countries such as Trinidad and Tobago, studying the impact of capital structure on profitability levels of new ventures is especially critical, given that current literature has primarily focused on established firms. To fill this gap, this study examined the existing capital structure of 43 new ventures in Trinidad and Tobago, testing the effects of different financing sources on net profit margins. The findings revealed that owners' savings and retained earnings had a positive impact on net profit margins, while short-term loans, long-term loans, and informal investor finance had no significant effect. Moreover, this study expanded upon existing theories, particularly the pecking order theory, by testing it in the context of new ventures, rather than mature firms. The implications of this study are significant to financial managers in charge of decision-making for new ventures. It suggests the importance of owners' savings and retained earnings in financing new ventures. Moreover, the findings suggest that new ventures in Trinidad and Tobago may benefit from pursuing funding options that align with the pecking order theory. Overall, this research emphasizes the need to consider the unique financial challenges facing new ventures when making decisions regarding their capital structure.

KEYWORDS

New ventures, capital structure, Pecking Order theory, Trinidad and Tobago, profitability

RESUMEN

Las nuevas empresas, esenciales para impulsar el desarrollo económico, se enfrentan a un desafío universal: acceder a financiamiento y decidir sobre una estructura de capital adecuada. En países en desarrollo como Trinidad y Tobago, estudiar el impacto de la estructura de capital en los niveles de rentabilidad de las nuevas empresas es especialmente crítico, dado que la literatura actual se ha centrado principalmente en empresas establecidas. Para llenar este vacío, este estudio examinó la estructura de capital existente de 43 nuevas empresas en Trinidad y Tobago, evaluando los efectos de diferentes fuentes de financiamiento en los márgenes de beneficio neto. Los hallazgos revelaron que los ahorros de los propietarios y las utilidades retenidas tenían un impacto positivo en los márgenes de beneficio neto, mientras que los préstamos a corto plazo, los préstamos a largo plazo y la financiación de inversores informales no tenían un efecto significativo. Además, este estudio amplió las teorías existentes, especialmente la teoría del orden jerárquico, al probarla en el contexto de nuevas empresas en lugar de empresas maduras. Las implicaciones de este estudio son significativas para los responsables financieros encargados de la toma de decisiones para las nuevas empresas. Sugiere la importancia

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de los ahorros de los propietarios y las utilidades retenidas en la financiación de nuevas empresas. Además, los hallazgos sugieren que las nuevas empresas en Trinidad y Tobago pueden beneficiarse de la búsqueda de opciones de financiamiento que se alineen con la teoría del orden jerárquico. En general, esta investigación enfatiza la necesidad de considerar los desafíos financieros únicos que enfrentan las nuevas empresas al tomar decisiones sobre su estructura de capital.

PALABRAS CLAVE

Nuevas empresas, estructura de capital, teoría del orden jerárquico, Trinidad y Tobago, rentabilidad.

INTRODUCTION

New ventures play a critical role in economic growth and job creation and this is particularly true in the Caribbean region which is characterized by a diverse range of economies, cultures, and political systems, making it an important area of study for researchers interested in entrepreneurship and economic development (Minto-Coy, Lashley, and Storey, 2018). Within the Caribbean, Trinidad and Tobago stands out as a small island nation having one of the highest rates of entrepreneurial activity in the region (Minto-Coy, Lashley, and Storey, 2018) making it an ideal setting to study new venture financing. It is important to recognize that all mature and stable enterprises started off as new ventures that sought various strategies to achieve survival and growth. Early-stage companies in Trinidad and Tobago, as in other parts of the world, face numerous challenges such as competition, management inexperience, and location problems (Bahaw, 2017). However, financial risks continue to outweigh the many challenges that new venture owners face in today's capital-intensive environment. According to Garcia-Singh (2022), new ventures in Trinidad and Tobago face several challenges in accessing financing, especially from formal financial institutions due to a lack of operational track record, which could potentially affect their profitability levels. In dealing with this challenge, it is important for new venture owners in Trinidad and Tobago to critically think through their financing options and the possible impact they have on business continuity and growth (Ramkissoon-Babwah, 2012). As such, possession of financial management acumen is a prerequisite for new venture success in Trinidad and Tobago. Additionally, owners of newly emerged firms in Trinidad and Tobago must practice caution in deciding the appropriate layers of finance as it has significant implications on cost, risks, ownership, and covenants. New ventures in Trinidad and Tobago are prone to increased costs and decreased performance if a suitable capital structure is not adopted (Brigham, 2004). Moreover, finding an optimal capital structure that ensures profit maximization is a challenge of many new venture owners in Trinidad and Tobago (Jensen, 1986). Understanding the life cycle theory and pecking order theory is crucial in examining how capital structures can affect a business's profitability, as the life cycle theory suggests that companies have different financing needs at different stages of their life cycle whilst the pecking order theory suggests that firms prefer to finance their operations through internal funds first, followed by debt, and then equity (Nguyen et al., 2023). Examining how these theories play out in practice is crucial in understanding how capital structures can affect a business's profitability.

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Specifically, these theories could provide valuable insights into identifying the optimal mix of financing sources towards achieving profit maximization for new ventures in Trinidad and Tobago which could have implications for other small island nations with similar economic circumstances.

ORIGINALITY AND VALUE OF RESEARCH

This research has academic and practical importance. An extensive review of the literature on capital structure impact on firms' performance provided inconsistent and contradictory findings (Opoku-Asante et al., 2022) particularly for new venture (Salamzadeh and Kirby, 2017). Additionally, Darabjerdi and Joybary (2014) claims that research on capital structure and firms concentrated on: 1) established companies as opposed to new ventures, 2) different measures of firms' financial performance and 3) developed countries. There are limited studies carried out in understanding the capital structure effects on start-up enterprises, particularly in Trinidad and Tobago. Given the significant role that new ventures play in economic development, and the particular importance placed on entrepreneurship in Trinidad and Tobago's push towards greater economic diversification, it's crucial to gain a better understanding of the factors that lead to success for these ventures. An examination of the impact of capital structure on the profitability of new ventures in Trinidad and Tobago is especially relevant in this context, as it can provide valuable insights into how to address the many challenges faced by these businesses, and ultimately contribute towards the country's wider economic goals. The findings of this study would strengthen the literature by providing evidence for the possible impact of capital structure on firms' profitability with a special emphasis on newly emerged ventures in developing countries, thereby closing the gap between the inconsistencies found and contributing to the body of knowledge where there is limited available research. In addition, no research has been found in Trinidad and Tobago that took into consideration life cycle theory and pecking order theory in the conceptual framework of internal and external financing. The study provided a theoretical base to the concept of "Encouraging internal equity finance to drive profitability in new ventures" (Nguyen et al., 2023) . The study provides empirical support to aid new venture owners and financial managers when analysing the opportunity cost of decisions made on the financing mix of their respective companies.

RESEARCH OBJECTIVE

The objective of this study is to investigate how can the life cycle theory and the pecking order theory inform decisions about financing and capital structure to achieve optimal profit maximization. To achieve this objective, the study will address the following overarching research question:

How does capital structure impact the profitability of new ventures in Trinidad and Tobago?

By examining the existing capital structures and their impact on profitability, this research seeks to provide valuable insights into how new ventures in Trinidad and

Tobago can achieve optimal profit maximization and thereby contribute to economic growth and diversification.

LITERATURE REVIEW

The capital structure of a new venture is a key determinant of its financial health, performance, and profitability. In recent years, there has been a growing body of literature exploring the impact of different capital structures on the profitability levels of new ventures. In this literature review, a comprehensive summary of the main findings and insights from both contemporary and earlier studies in the field is presented.

COMPONENTS OF CAPITAL STRUCTURE

The established literature on capital structure identifies it as being a mix of the organisation's financial liabilities which can take the form of short-term, medium-term or long term financing strategies (Kocharr, 1997; Goyal, 2013). These financial liabilities mainly consist of both debt and equity financing each of which have different risks and benefits. A firm's capital structure can be built off debt finance solely, equity finance solely or a combination of both known as layered financing whereby raising start-up capital can be pieced together from multiple sources (Scarborough and Cornwall, 2016). It is important to note that debt and equity finance are the two main forms of capital that entrepreneurs in Trinidad and Tobago often lean towards to first to start and grow their businesses given that the supply of start-up grants in the island is limited and is made accessible to firms who fit the eligibility criteria (Ganger-Singh, 2022). Debt finance refers to borrowed capital whereas equity finance refers to investment capital. Given the difference in the nature of these types of finance, the sources also vary. For instance, debt capital can be sourced from commercial banks and non-bank lenders including small business loan programmes. Scarborough and Cornwall (2016) identified non-bank sources to include social lenders, asset-based lenders, trade creditors, vendor financers, equipment suppliers, finance companies, factors, insurance companies and credit unions. On the other hand, equity finance can be sourced from owners' personal savings, friends and family members, crowd funding networks, angel investors, venture capitalists, accelerator programmes, private placements, employee stock ownership programmes, corporate venture capitalists, mezzanine financers and sale of stock to the public (Scarborough and Cornwall, 2016).

The appropriateness of each type of finance must be assessed before new venture owners choose a capital structure that is relevant to their unique funding requirements (Modigliani & Miller,1963; Pouraghajan and Malekian, 2012).The benefits of a capital structure that uses mostly debt sources to finance its assets include ownership preservation (Spinelli and Adams, 2016) and cost effectiveness once interest rates are low (Kerlinger and Lee, 2000). However, debt finance may be difficult to access because lenders require track record and collateral, both of which are lacking for many start-ups in Trinidad and Tobago. Additionally, debt

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financers usually place negative covenants and enforce terms and conditions with numerous restrictions (Kuratko, 2016). Another main drawback of debt capital is that, regardless of profitability, loans must be repaid (Kuratko, 2016). On the contrary, capital structures that favour equity finance does not require owners to repay the capital injection to its provider (Spinelli and Adams, 2016). Rather, shareholders enjoy returns only when profits are made and the risk is shared by all investors. Another advantage of equity centric capital structures is that investors do not base their decisions on track record or collateral but rather on projections. Hence, equity finance is easier to obtain particularly for new ventures. Furthermore, in some cases, equity financers such as venture capitalists provides management support and place fewer restrictions than debt capital providers (Spinelli and Adams, 2016). The main disadvantage of equity finance is ownership dilution where owners give up ownership and control and has a higher cost of capital when compared to debt finance (Scarborough and Cornwall, 2016).

CAPITAL STRUCTURE THEORIES

Previous research has shown that firms' decisions regarding their debt-equity choices cannot be explained by a single, overarching theory (Myers, 2001; Opoku-Asante et al., 2022). However, two main theories popular to the literature domain which gives insights on what drives the capital structure decisions are the Pecking Order theory and the Life Stage theory. These were the chosen theories to apply to this study of new venture capital structures in Trinidad and Tobago for several reasons, with one being the prevalence of family-based or informal sector companies in the country (Sookram and Watson, 2008). The Pecking Order theory aligns with the observed financing preferences of new ventures in Trinidad and Tobago, who tend to prioritize internal funding sources, such as owners' savings and retained earnings, and shy away from external financing sources (Garcia-Singh, 2022). The Life Stage theory, on the other hand, emphasizes the different financing needs of firms in different stages of the business lifecycle, and can provide insights into the financing choices of new venture (Wasilewski and Żurakowska, 2020). Overall, these theories provided a useful framework for analysing the data on capital structures and profitability of new ventures in Trinidad and Tobago. To further understand the application of the Pecking Order theory and the Life Stage theory to the context of new ventures in Trinidad and Tobago, it is helpful to examine literature on these theories and how they have been applied in similar studies.

Pecking Order theory

Pecking Order theory postulates that firms' financial sources are selected based on a preferred hierarchy. Financing choices prioritize internal sources over external sources (Najeeb, Khan and Tayyaba, 2013). Shmidt and Shmidt (2008) identified the pecking order of financial hierarchy as retained profits (internal financing) as first priority, debt issuance as second priority and equity issuance as third priority where the latter two are external financing. The main objective of the pecking order theory is to obtain readily available finance that has minimal objection deferring the need to obtain finance from more difficult sources (Myers and Majluf, 1984). While this theory holds that firms obtain finance from the least resistant source first, there is little consensus on the superiority of the sources. The pecking order theory is not without limitations. According to Brealey, Myers and Allen (2006), the theory does not extend to smaller growth firms. Small new ventures are more likely to rely on equity finance first than their large and mature counterparts where the pecking order theory is most applicable. However, this was not the case for Barbados and Trinidad and Tobago SMEs where external equity was rarely considered as it was not seen feasible and debt sources were reluctantly used due to fear of managerial interference (Estwick, 2013; Ganger-Singh, 2022). It was found that internal equity was the preferred source of finance for Barbadian and Trinidadian SMEs which aligns to the hierarchy in the pecking order theory (Estwick, 2013; Ganger-Singh, 2022). Given that we see the pecking order theory was useful in understanding the financial choices made by business owners in Barbados and Trinidad and Tobago, both of which are Caribbean countries, we rely on this theory to contribute to the conceptual framework of this study.

Life Cycle theory

The life cycle theory postulates that organisations adjust their capital structure composition to suit the life-stage that organisations are in (Wasilewski and Żurakowska, 2020). This is so because different sources of capital, debt and equity, become available to firms depending on the stage of life firms are facing since each life-stage is characterised by different risks and reward profiles. There are typically five stages of a venture life cycle which are the development phase, start-up phase, growth phase, stabilization phase and the swing stage which can either go in the direction of innovation or decline (Kuratko, 2016).

The capital market food chain typology refers to the sources of equity finance available to ventures based on their level of development (Spinelli and Adams, 2016). During the introduction phase in firms where sales are normally low, early stage investors are the typical financers. These early stage investors include founders, friends and family members and angels. When ventures are launched and therefore increase in value, venture capital and private equity become available. As ventures progress into the growth phase, private equity, public equity and strategic acquisitions are additional sources of external finance that are typically used (Spinelli and Adams, 2016). According to Spinelli and Adams (2016), firms access equity finance alternatives based on their availability, suitability and cost which is dependent on which stage firms' are facing, the amount of capital required, the level of tolerable equity preservation and the extremity of risks perceived. Spinelli and Adams (2016) further stated that debt capital is difficult for firms to obtain in their start-up phases because of lack of track record and assets to be used for collateral.

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However, as firms become more established, debt finance sources become more accessible (Kuratko, 2016). Frielinghaus, Mostert and Firer (2005) stated that the anticipated level of debt capital utilized by firms is low during the early stage and late stages of ventures but high during their prime stage which is characterized by efficiency and maturity. A similar pattern was observed in a later study where firms continue to change their capital structures following a leverage pattern of low-high-low during growth, stabilization and decline stages (Ashan, Wang, and Muhammad, 2016). In summary, the aforementioned studies suggest that firms' financing needs and capital structure change as they move through different stages of development. As such, the life cycle theory provides a useful framework for analysing new venture firms' financial strategies as in the case of this study where we look closely at the financial choices made by these firms in their earlier stages of development.

CAPITAL STRUCTURE AND FINANCIAL PERFORMANCE

The literature revealed some mixed findings on the relationship of firms' capital structure and financial performance (Opoku-Asante et al., 2022; Nguyen et al., 2023). According to a study by Tamayo-Torres et al. (2021), there is a significant relationship between capital structure and profitability levels of new ventures in emerging economies. The study revealed that companies that rely on debt financing had lower profitability levels compared to those that rely more heavily on equity financing. The authors suggest that this is because debt financing can limit the ability of new ventures to invest in growth opportunities, while equity financing allows for greater flexibility in resource allocation. Similarly, a study by Singh and Upneja (2020) found that capital structure has a significant impact on the profitability of new ventures in India. The study revealed that companies with a higher debt-to-equity ratio had significantly lower profitability levels compared to those with a lower debt-to-equity ratio. The authors suggest that this is because a high debt-to-equity ratio can lead to financial distress and higher interest expenses, which can negatively impact profitability levels. However, in a study by Chanda and Sharma (2015) on Indian manufacturing firms revealed that these firms return on assets was not determined by their capital structures. What is more is that return on equity was negatively correlated with the firms' capital structure with other independent factors including size, sales growth and age had a significant effect on financial performance. In another study by Lim and Ang (2020) on new ventures in Singapore, the authors found that there was no significant relationship between capital structure and profitability levels. The study revealed that new ventures with different capital structures had similar profitability levels, suggesting that other factors, such as management and strategy, may have a greater impact on profitability. Similarly, three studies, Olokoyo (2013), Quang and Xin (2014) and Opoku-Asante et al., (2022) found a negative relationship between capital structure and financial performance. Conversely, Fama and French (2002) and Abdullah and Tursoy (2021), found that high levered firms had high profitability. A positive relationship was also found by Gill, Biger and Mathur (2011) between leverage and profitability. Likewise, Goyal (2013) espoused a positive association between debt centric capital structures and profitability.

Overall, these studies revealed inconsistent findings on the impact of capital structure on firms' financial performance suggesting a need to probe this area of study further. It was clear that the impact of capital structure on the profitability of new ventures can vary based on factors such as the country or region of operation, the type of financing used, and the specific context of the venture. This makes a case for why this study targets new ventures in Trinidad and Tobago as their capital markets are limited when compared to the developed world (Ganger-Singh, 2022) and providing evidence for the impact of capital structure on profitability performance will certainly narrow the gap between the inconsistencies found so new venture owners in Trinidad and Tobago can make more informed financial decisions.

MEASURES OF PROFITABILITY

There are various accounting based indicators of firms' financial performance (Nassar, 2016). Variables that are found in the conventional financial statements such as firms' profit and loss statements, balance sheets and cash flow statements are converted into ratios to calculate financial performance. These include net profit margins, return on equity, dividend revenue, and return on assets (Nassar, 2016). Shareholders use these indicators to determine if wealth is made and weather there was any financial improvement at the end of the investment period (Berger & Patti, 2002). Moreover, net profit margin is a commonly used measure of a firm's profitability and can be a reliable marker of success for new ventures. According to Van Horne and Wachowicz (2008), "net profit margin represents the percentage of each dollar of sales that a firm actually keeps after accounting for all of its expenses" (p. 262). As such, a higher net profit margin indicates that the firm is generating more profit per dollar of sales, which can be an important consideration for new ventures with limited resources. Additionally, a high net profit margin is often a key consideration for investors and creditors when evaluating a firm's financial performance and creditworthiness. Therefore, by maintaining a high net profit margin, new ventures can establish themselves as financially viable and attractive to potential investors and creditors.

In conclusion, this literature review has provided a comprehensive overview of the research on capital structure and its impact on profitability. While many studies have examined the relationship between these two variables, there are still several gaps in the literature that warrant further investigation. For example, there is a need for more research to explore the relationship between capital structure and profitability in other countries in the Caribbean region as it is an under researched issue within this context. Additionally, more research is needed to examine the impact of specific types of financing, such as debt, equity, and hybrid securities, on a firm's profitability. Overall, by addressing these gaps in the literature, future research has the potential

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to shed further light on the complex relationship between capital structure and profitability, and provide valuable insights for firms and investors alike.

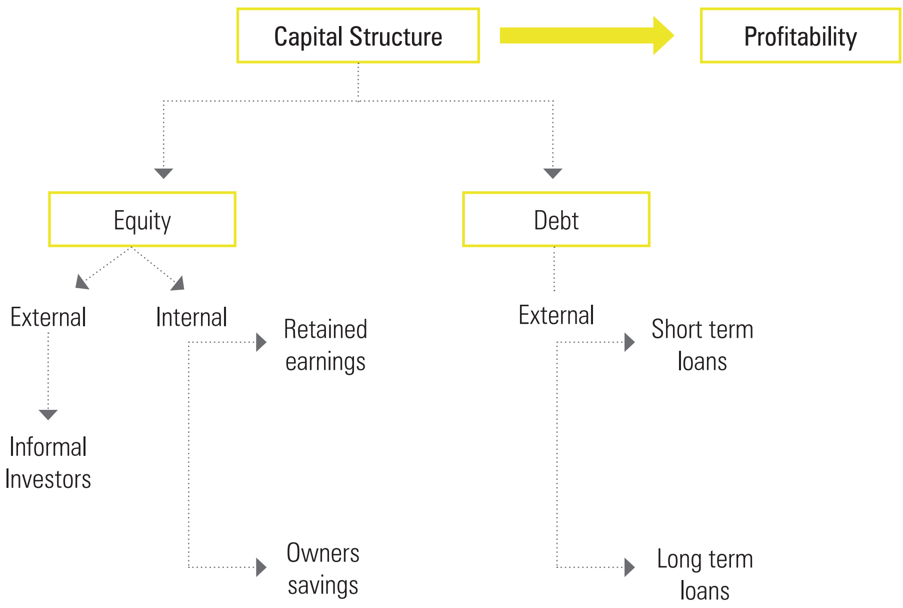
RESEARCH METHODOLOGY

The research aims to find out if capital structure, made up of various types of financing, used by new ventures in Trinidad and Tobago has an impact on their profitability levels.

EMPIRICAL MODEL

The Pecking Order theory and the Life Stage theory were used to create a conceptual model for the study. The Pecking Order theory provided the framework for the independent variables, which include internal equity, external equity, and debt sources. Additionally, the Life Stage theory was incorporated to determine which sources of financing are most likely available for new ventures that have recently emerged. By combining these two theories, the researcher was able to create a conceptual model that can analyse the relationship between capital structure and net profit margins for new ventures. Overall, the conceptual model provides a useful framework for examining the financial strategies of new ventures and could potentially shed light on the factors that contribute to their success or failure. The conceptual model and measured variables used in this research is depicted in figure 1.

Figure 1: Conceptual framework



Source: Developed for this study

RESEARCH VARIABLES

Dependent variable- Net profit margin is used as the dependent variable in this study. It is the percentage of revenue remaining after expenses are deducted from total revenue.Net profit margin is one of the most closely monitored measures of finance by new venture owners as it is a simple to understand, used for comparisons, and is an indicator of profit in relation to revenue made. Financers of both debt and equity also use this margin when making financial decisions. Net profit margin is calculated as Net profit (total revenue minus total expenses) divided by Total Revenue.

Independent variables- Various sources of internal and external finance were used as the independent variables of the study. These equity and debt sources are components of firms' capital structure.

Owners' savings- This is an internal source of equity finance also known as personal savings. According to the pecking order theory, internal finance is a prioritized source of finance. Based on the life cycle theory, owners' savings are seen as the most convenient and frequent source of finance for new ventures (Wasilewski and Żurakowska, 2020).

Retained earnings- This is accumulated surpluses made by firms' overtime that are not paid out as dividends but are retained. As seen in the pecking order theory, this is a preferred source of finance for firms as it offers least resistance, a situation favoured by several new ventures, and is readily available (Nguyen and Rugman, 2015).

Informal investors- Informal investors are also known as angel investors. According to the life cycle theory, firms in their early stages are more successful in accessing external equity finance from informal investors rather than venture capitalists. For new firms, normal capital market seldom applies (Kuratko, 2016).

Short term loan: This refers to borrowed finance that does not cross a loan term of one year typically used to finance stock and cash requirements (Darabjerdi and Joybary, 2014)

Long term loan: This is debt finance for a longer period. Typically, long term loans are provided by commercial banks in terms of greater than one year up to ten years payable (Darabjerdi and Joybary, 2014). It is recognised that although new ventures have difficulty in accessing debt finance, it is possible if bankable securities and personal guarantees are used (Darabjerdi and Joybary, 2014). According to the pecking order theory, debt issuance is the preferred external source of finance

HYPOTHESIS:

The research primary postulation is as follows:

Hypothesis 1: H_{01}: Capital structure has no impact on net profit margins of new ventures in Trinidad and Tobago.

The research subsidiary postulations are as follows:

Hypothesis 2: H_{02}: There is no significant relationship between retained earnings source of finance and net profit margin of new ventures in Trinidad and Tobago.

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Hypothesis 3: H_{03}: There is no significant relationship between owners' savings source of finance and net profit margin of new ventures in Trinidad and Tobago.

Hypothesis 4: H_{04}: There is no significant relationship between informal investors' source of finance and net profit margin of new ventures in Trinidad and Tobago.

Hypothesis 5: H_{05}: There is no significant relationship between short term debt finance and net profit margin of new ventures in Trinidad and Tobago.

Hypothesis 6: H_{06}: There is no significant relationship between long term debt finance and net profit margin of new ventures in Trinidad and Tobago.

SAMPLING

The population of interest for this study focused on newly emerged ventures in Trinidad and Tobago. The following criteria were used in the selection of the sample:

- Firms were in their fourth year of operation and active since they were launched
- Firms that maintained and archived proper financial records in the form of balance sheets, income statements and cash flow statements for the first three years of their business life
- Firms that had a qualified financial manager

A list of randomly selected new ventures generated from the Trinidad and Tobago companies' registry online search facility was used to select the sample. Telephone calls were made to the businesses to ensure all criterions for sample selection were satisfied and permission was granted to conduct the study. These conditions produced a sample size of 43 firms that were utilized in the study.

DATA COLLECTION

Primary data was used in this study which was collected from survey questionnaires administered to financial representatives at the new ventures. However, secondary data in the form of financial statements for the first three years of operation were reviewed by the respondents to provide information to fill out the questionnaires.

SURVEY DESIGN, SURVEY ADMINISTRATION AND RESPONDENTS

Capital structure theory was used to guide the design of the structured questionnaire used for data collection in this study. Given that this theory suggests that the overall financial performance of a business is influenced by the its mix of debt and equity financing used to fund the business, it provided a framework for identifying the key variables to be included in the questionnaire such as the amount and timing of finance invested, the sources of finance, and the balance between debt and equity financing over the first three years of the business life-cycle. The questionnaires were emailed directly to the financial manager of each firm. The financial managers were asked to review the annual balance sheets, cash flow statements and income statements for the period to extract the data to complete the questionnaires. Questionnaires were used for convenience, and allowed for confidential data to be collected without the researcher themselves having to review the ventures closely held financial documents which is a privacy concern. This method increased cooperation of subjects to participate in the study.

DATA ANALYSIS

Pearson Correlation coefficients were used to test the study hypothesises by assessing correlations between the sources of finance variables and profitability of the new ventures. This method was chosen due to its wide recognition, simplicity, and assumption of normal distribution of variables, making it a widely accepted method of measuring the degree of linear relationship between two variables. Regression analysis was used to estimate the impact of the predictors (debt and equity finance sources) on the dependent variable which was net profit margin. The regression model equation was formulated as:

$$NPM_{xy} = \alpha + \beta_1 OS_{xy} + \beta_2 RE_{xy} + \beta_3 II_{xy} + \beta_4 STL_{xy} + \beta_5 LTL_{xy} + \varepsilon$$

Where:

NPM = the net profit margin;

OS = the amount of owners savings invested;

RE= the amount of retained earnings invested;

II = the amount of informal investment;

STL = the amount of short term loan borrowed;

LTL = the amount of amount of long term loan borrowed;

ε= error term;

x= venture 1........... venture43;

y= 1 year ....3 year;

α , β_2, β_2, β_3, β_4, β_5 =Coefficients of the model

This regression model presented aims to find the relationships between the net profit margin and capital structure factors such as the amount of savings and investment, retained earnings, informal investment, short term loans, and long term loans for each of the 43 ventures over a period of three years. The coefficients in the model represent the strength and direction of these relationships, and the error term represents the variation in the net profit margin that is not explained by these factors.

RESULTS AND DISCUSSION

This section of the study presents and compares the results to past empirical findings, drawing implications from the comparison.

CORRELATION ANALYSIS

Pearson correlation was used to test the subsidiary hypothesises of the study, thereby, determining if a relationship existed between net profit margin and the variables that

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make up the new ventures capital structure. The results of the data analysis depicted in Table 1 reveal a strong relationship between net profit margin and the components of firms' capital structure. Specifically, a positive relationship was found between net profit margin and internal equity sources of finance such as owner's savings and retained earnings. This finding contradicts that of Darabjerdi and Joybary (2014) who found that the profitability level of food industry companies is not impacted by their retained earnings. Despite this, there was alignment of our results with previous research. For instance, a study by Ugwu, Francica, and Onyekwelu (2021) found that retained earnings have a positive relationship with the operational performance indicators of oil and gas firms in Nigeria. Similarly, Nguyen and Rugman (2015) findings showed that internal equity financing positively affects the performance of multinational subsidiaries in emerging economies. The findings suggest that new ventures in Trinidad and Tobago should consider relying on internal equity sources of finance to support their growth and maximize profitability. On the other hand, external sources of finance such as informal investors, short-term loans, and long-term loans were found to have a negative relationship with net profit margins in new ventures in Trinidad and Tobago. This was also the case for firms in the automobile sector of Pakistan where an increase in debt capital had an inverse relationship with profitability (Sadiq and Sher, 2016). Likewise, in a similar study that looked at the relation of internal and external financing on innovation of European firms, it was found that capital structures that emphasized debt reduced the focus on innovation as profitability was negatively affected (Nylund et al., 2019). Such is the case for Vietnamese firms whereby long-term debt was negatively associated with profit maximization (Nguyen et al., 2023). Interestingly a recent study by Zhang and Azman (2023) found that bank financing has an adverse impact on start-ups profitability whilst business credit has a positive impact. Overall, the results indicate that new ventures should be cautious when considering these types of financing options. Instead, they may want to focus on building up their internal equity sources of finance before seeking external financing options. These findings have implications for policymakers in Trinidad and Tobago who may need to consider promoting and facilitating the use of internal equity sources of finance among new ventures to support their growth and development. As an additional recommendation, financial institutions in Trinidad and Tobago could explore the potential of modifying its debt financing services that has the potential to lead to favourable profitability outcomes for emerging ventures.

Table 1: Relationship between net profit and components of the capital structure

Null Hypothesis	Pearson`s correlation coefficient	Significance level	Decision	Observation
H_{02}: There is no significant relationship between retained earnings source of finance and net profit margin of new ventures in Trinidad and Tobago.	.583	.003	Reject	Positive relationship
H_{03}: There is no significant relationship between owners' savings source of finance and net profit margin of new ventures in Trinidad and Tobago.	.789	.000	Reject	Positive relationship
H_{04}: There is no significant relationship between informal investors source of finance and net profit margin of new ventures in Trinidad and Tobago.	-.484	.017	Reject	Negative relationship
H_{05}: There is no significant relationship between short term debt finance and net profit margin of new ventures in Trinidad and Tobago. .	-.544	.006	Reject	Negative relationship
H_{06}: There is no significant relationship between long term debt finance and net profit margin of new ventures in Trinidad and Tobago	-.498	.013	Reject	Negative relationship

REGRESSION ANALYSIS

The study's primary hypothesis was tested firstly by using simple regression analysis followed by step-wise regression analysis to estimate the value of the impact that the independent variables had on the dependent variables. All regression assumptions for the quality of the data were tested and were found satisfactory. The first regression model is given in table 2.

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Table 2: Model 1 Regression Output

Model		B	Std. Error	Beta	t	Sig.
1	(Constant)	-2.260	4.319		-.523	.607
	II	-.090	.060	-.228	-1.502	.150
	RE	.089	.040	.327	2.231	.039
	STL	.013	.200	.012	.066	.948
	LTL	.052	.055	.164	.950	.355
	OS	1.257	.384	.640	3.274	.004
R .855[a]		R Square .731	Adjusted R Square .656		Std. Error of the Estimate 3.14819	
a. Dependent Variable: NPM		b. Predictors: (Constant), OS, II, RE, LTL, STL				

As seen in table 2, at a 95% confidence interval, there were only two significant predictors of net profit margin which were owners' savings (p-value = .004) and retained earnings (p-value= 0.39). Informal investors, short term loans and long term loans were not significant predictors of the dependent variable. An adjusted R^2 of .656 showed that approximately 66% of the model is explained by the variables. To further confirm the model, step wise regression analysis was performed and all of the insignificant variables were excluded from the model. The final model is shown in table 3

Table 3: Model 2 Regression Output

Dependent variable	Regression test	Model
Net Profit Margin	Step-Wise	= -2.431+ 1.297 Owners Savings + 0.079 Retained Earnings
		$R^2 = 0.691$, R^2 adj $=0.662$

The results indicate that new ventures in Trinidad and Tobago can benefit significantly from relying on internal equity sources of finance, such as owners' savings and retained earnings. Owners' savings is the most impactful predictor in the model and is consistent with a prior study that suggest owner's equity contributes positively to profitability (Muriithi, 2014). Furthermore, the regression equation results make it clear that every dollar invested from owners' savings holds the potential to increase net profit margin by approximately \$1.30. Similarly, every dollar invested from retained earnings can boost net profit margin by about \$0.08. signifying the need for policymakers to support measures for new ventures to encourage the retention and reinvestment of profits. The research findings provided evidence that capital structure has an impact on net profit margins of new ventures in Trinidad and Tobago and is supported by prior studies (Dao and Ta, 2020; Abdullah and Tursoy, 2021; Nguyen et al., 2023). On this basis, the study's main null hypothesis is rejected demonstrating that capital structure choice is key to optimizing profitability among new ventures in Trinidad and Tobago.

CONCLUSION

In conclusion, the study provides valuable insights into the relationship between capital structure and net profit margins in new ventures in Trinidad and Tobago. By carefully managing their financing options and balancing internal and external sources of finance, new ventures can maximize their profitability and ensure long-term success and growth. The study's main objective was to investigate the impact of new ventures in Trinidad and Tobago capital structure on net profit margins. The study accomplished its main objective and provided empirical support that capital structure influenced net profit margins of new ventures in Trinidad and Tobago. This was consistent to previous research conducted by Nassar (2016) and Nguyen et al., (2023). The results of the study further indicated that that internal equity component of new ventures capital structure is positively and significantly associated with net profit margins. However, external components of new ventures capital structure (both debt and equity) is negatively and significantly associated with net profit margins.

The study provides a more nuanced understanding of the capital structure factors affecting net profit margins in new ventures in Trinidad and Tobago by expanding and modifying a prior model from Darabjerdi and Joybary (2014) and testing new predictors. While inconsistent to the findings of Darabjrdi and Joybary (2014) whereby owners' savings and retained earnings were the only predictors of net profit margins in this study, it is safe to conclude that newly emerged firms operate differently to that of their larger mature counter parts explaining the discrepancies found. This finding has important implications for capital structure theory whereby it supports the notion that internal equity sources of finance are crucial in optimizing new venture profitability and is consistent with the pecking order theory, which emphasizes the need for firms to prioritize the use of retaining earnings and internal funds for investment before relying on external financing options such as debt or equity (Myers and Majluf, 1984).This study went on to reveal that the pecking order theory is more applicable to early stage firms in the case of Trinidad and Tobago and advances the literature by challenging the traditional belief that this theory is only relevant to established firms (Brealey, Myers and Allen, 2006).

This study contributed to the literature providing information on the effect of different types of internal and external debt and equity financing options and has provided a basis for further research in capital structure theories, focusing on newly emerged ventures. Based on the results of the study, it is recommended that new venture owners give preference to owners' savings and retained earnings rather than to rely on loans and informal investment to finance their businesses during the earlier stages of the venture life cycle as these internal sources of equity finance are seen to positively affect profitability in new ventures. This finding sheds light on the intricacies of the capital structure theories and their application to different types of firms particularly

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those that are located in Trinidad and Tobago where there is an underdeveloped capital market and a large informal business sector (Sookram and Watson, 2008). It also suggests that early stage firms face unique challenges and opportunities that require different financing strategies compared to established firms.

While this study narrowed the three highlighted gaps in the literature by: 1) testing early stage ventures who were understudied ,2) using different measures of profitability and 3) focusing on developing countries such as Trinidad and Tobago, there were two limitations that can be addressed in future research. Firstly, the study only focused on early-stage ventures in Trinidad and Tobago, which may limit the generalizability of the findings to other countries or to firms in different stages of development. Future research could examine the applicability of the pecking order theory to small firms in other developing countries, or compare the financing practices of early-stage ventures to those of more established firms. Secondly, the study used secondary data sources to measure profitability, which may not capture all aspects of firm performance. Future research could incorporate primary data sources such as interviews to gather more comprehensive information about the financial and operational performance of new ventures. Additionally, the study did not explore other factors that may influence capital structure decisions such as market conditions, legal and regulatory frameworks, and cultural norms, which could also be considered in future research. Overall, while this study made important contributions to the literature on new venture financing practices in Trinidad and Tobago, there is still much room for further research to explore the complexities and subtleties of capital structure decisions in various contexts.

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