THE EFFECTS OF CORPORATE GOVERNANCE PRACTICES ON CAPITAL STRUCTURE: CRITICAL REVIEW OF LITERATURE

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INTRODUCTION

Capital structure is one of the most contentious issues in corporate finance, and it must be considered in order to enable financial managers to make better investment decisions. Capital structure is mostly made up of debt and equity, and various factors must be considered when deciding on capital structure in order to maximize profitability and worth of a firm. Studies on a firm's capital structure can be traced back to Modigliani and Miller's (1958) seminal work, in which they argued that a firm's capital structure was irrelevant in assessing the firm's value and future performance. Since Modigliani and Miller's declaration in 1958, numerous hypotheses have been formed to justify firm financing decisions. Corporate governance is concerned with how capital providers to enterprises ensure that they will receive a return on their investment (Shleifer and Vishny, 1997). Effective corporate governance standards are required for an economy's long-term development and growth. Countries that have implemented good corporate governance standards, in particular, have seen a robust rise in the corporate sector and a greater ability to attract capital to stimulate the economy. Furthermore, high-quality governance improves a company's performance not just through building and maintaining a corporate culture that inspires management to take measures that maximize shareholder wealth, but also by lowering the cost of funding. The agency theory is one such theory that has received a lot of empirical support and has inspired many contributions to the corporate governance literature and the regulation of listed companies. According to the theory, agency costs resulting from conflicts of interest determine capital structure and the analysis of potential conflicts of interest supports the formulation of rules concerning shareholder rights, investor protection, disclosure and transparency. The purpose of study is to critically look at the existing research to identify what found on the effects of corporate governance practices on capital structure and to bring out research gaps on the relevant topic and this research provides gaps and avenues for future research as contribution to existing empirical evidences.

METHODOLOGY

The empirical evidences taken from twelve journals relevant to the effects of corporate governance practices on capital structure were reviewed, and the indicators measuring corporate governance practice and capital structure, as well as the data type and analysis tools used in the current research related to a specific topic, were identified.

RESULTS AND DISCUSSION

A considerable number of researches on corporate governance and capital structure have been carried out, and theoretical and empirical evidence have been obtained.

Sewpersadh (2019) discovered that CEO duality and director ownership were positively associated with leverage, implying that the presence of CEO duality and manager ownership of equity would increase leverage. The leverage was inversely correlated with board size, suggesting that a larger board would reduce the amount of debt financing.

Ullah et al. (2019) observed that corporate governance has a favorable impact on firm performance but a negative influence on capital structure. A sufficient board size, involvement of institutional ownership, and board independence optimize business performance and reduce the amount of debt in the capital structure. According to the study's findings, good corporate governance procedures in the company improve the profitability of business and minimize the debt-to-equity ratio.

According to the study of Siromi and Chandrapala (2017), the proportion of non-executive directors has a positive impact on the debt ratio of a company. When firms have more outsiders, they increase protection against risks, which increases the ability of the company to raise external debt, while the number of board committees has a negative effect on the leverage position. The negative relationship indicates that due to strong monitoring, the decision of board committees avoids incurring a significant amount of debt. However, the size of the board and the duality of CEO have no major impact on companies' leverage positions. On the other hand, the ownership concentration induces managers to lower gear levels, but this impact is statistically insignificant, except for board composition and board committees.

According to Mudalige and Ekanayake (2015), a higher frequency of board meetings and outside directors are likely to increase debt in the capital structure, whereas managerial and institutional ownerships tend to decrease debt in the capital structure.

Achchuthan et al. (2013) demonstrate empirically that the board committee of corporate governance activities influences the capital structure, whereas the board composition, board size, board meeting, and leadership structure have no effect on the capital structure. When constructing models for corporate governance, the type of country, whether developed or developing, must be considered.

According to Wellalage and Locke (2012), Sri Lankan listed companies have a high debt plan, as well as strong insider ownership and CEO duality. Non-executive directors are less likely to obtain external financing than executive directors. In summary, corporate governance has a significant impact on Sri Lankan listed companies' financing decisions.

The conclusion brought by Sheikh and Wang (2012) points out that when enhancing board size, number of outside directors, the concentration of ownership leads to minimize the proportion of long-term debt in the capital structure while enhancing the remuneration of directors and managerial ownership creates the increase the level of long-term debt in the capital structure, but CEO duality has no effect on the capital structure.

The empirical finding of Abor (2007) indicates that there is a significant and positive correlation between the capital structure and board size, board composition and duality of CEO. Companies with a larger board size, a higher number of outside or non-executive directors, and duality of CEO prefer high debt policies. The findings of this study also show a negative relationship between the CEO's tenure and capital structure, indicating that strengthened CEOs use lower debt to reduce the performance challenges associated with high debt capital. Companies with well-established corporate governance structures are able to attain easier access to lower-cost debt financing, since such companies are able to repay their debt on time.

Wen *et al*. (2002) analyzed the effects of corporate governance characteristics on the mix of debt and equity and found that there are lower rates of leverage when the number of out-of-board directors is higher, or the CEO- 's tenure is longer. Managers facing stronger corporate governance may seek lower rates of debt to avoid additional risks associated with higher leverage. Hence board composition and CEO tenure have significant effects on capital structure and of board size and fixed salaries of the CEOs are statistically insignificant.

Based on these findings, when the CEO serves as a chairman to the board of directors in addition to his position, and the members of the board possess shares in the firm, the proportion of long-term debts to equity is changed. If there are non-executive directors on the board, they will be able to make independent decisions on the capital structure. It is also mentioned in the findings that having board meetings often results in changes in the composition of debt equity, and the length of time the CEO remains in the role also influences debt equity selection. The majority of research concluded that keeping a larger board of directors is one of the drives of capital structure in corporate governance procedures.

CONCLUSIONS

One of the primary goals of capital structure management is to reduce the cost of capital in order to optimize shareholder wealth. Studies on a firm's capital structure can be traced back to Modigliani and Miller's (1958) seminal work, in which they argued that a firm's capital structure was irrelevant in assessing the firm's value and future performance. Since Modigliani and Miller's declaration in 1958, numerous hypotheses have been formed to justify firm financing decisions. Corporate governance, on the other hand, is the framework and principle that includes the processes and arrangements that enhance the creation of shareholder value through the management of an organization's affairs to ensure the protection of all stakeholders' individual and collective interests. Most of the studies used board size, board composition, CEO tenure, CEO compensation, CEO duality, board meetings, managerial ownership and ownership concentration for measuring corporate governance practices and changes in these procedures would make the changes in the level of long-term debt in the capital structure of the companies. The result of most of the studies shows ultimate conclusion that corporate governance practices influence the composition of long-term debt and equity of the company and when developing models for corporate governance, the type of the country that is whether developed country or developing country needs to be considered.

All findings agree on identical corporate governance practices impacting capital structure, although the effects and relationships differ. These variations might be attributed to differences in region, industry, and sample period chosen.

However, most of the studies in relation to the effect of corporate governance practices on capital structure focused on a similar pattern, regardless of whether firms are low or high levered. There is a lack of studies analyzing the persistence of low and high levered capital structure. Several studies have been undertaken to analyze the relationship between corporate governance and capital structure using secondary data obtained from financial reports. Until now, no research on corporate governance and capital structure has been conducted considering both primary and secondary data at a time and analyzed comparatively.

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