

IMPACT OF CORPORATE GOVERNANCE ON CAPITAL STRUCTURE DECISIONS: EVIDENCE FROM LISTED COMPANIES IN COLOMBO STOCK EXCHANGE

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ABSTRACT

This study examines the impact of corporate governance mechanisms on capital-structure decisions among companies listed on the Colombo Stock Exchange (CSE) in Sri Lanka. Using agency theory as the foundation, the research investigates how ownership and board structure influence firms' leverage choices. A quantitative approach was adopted, analyzing data from 25 listed firms over nine years through regression analysis in SPSS. The findings reveal that managerial ownership, ownership concentration, foreign investor participation, board composition, and board size significantly affect capital-structure decisions, while board meeting frequency does not. Managerial ownership and foreign investors show a positive relationship with leverage, indicating that managerial alignment and external monitoring encourage debt use. Conversely, ownership concentration and larger boards are associated with lower leverage, reflecting more conservative financial policies. Overall, the results highlight that effective corporate governance particularly balanced ownership structures and independent boards plays a vital role in shaping firms' financing behavior. The study contributes to the understanding of governance–finance dynamics in emerging markets and offers practical insights for strengthening governance frameworks to support sound capital-structure decisions.

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1. Background

Capital structure (CS) and corporate governance (CG) have increasingly become central themes in corporate finance and organizational policy, particularly in relation to how firms optimise shareholder wealth, manage risk, and sustain financial stability. Capital structure decisions determine the proportion of debt and equity used to finance a firm's operations, and these decisions directly affect the cost of capital, bankruptcy probability, and market valuation. While the strategic use of debt can increase returns through leverage, excessive borrowing heightens insolvency risk and undermines firm value, especially in volatile or information-asymmetric markets. This is where corporate governance plays a decisive role. Effective governance mechanisms, including board accountability, monitoring structures, and transparent disclosure practices, are designed to minimise agency conflicts between managers

and shareholders. As highlighted by Shleifer and Vishny (1997), governance frameworks align managerial incentives with shareholder objectives, thereby ensuring that financing and investment decisions support long-term value creation. In contrast, weak governance allows managerial discretion to dominate, resulting in inefficient capital allocation, opportunistic behaviour, and higher financing constraints.

Contemporary research further shows that firms with strong governance systems benefit from improved access to external finance, lower capital costs, and greater investor confidence. Investors, including venture capitalists, institutional fund managers, and international lenders demonstrate a clear preference for firms that exhibit transparent reporting systems, independent board structures, and reliable risk-management practices. Such firms are perceived as less exposed to moral hazard and information asymmetry, enabling them to negotiate more favourable borrowing terms and enter capital markets with reduced friction. Recent empirical studies reinforce these arguments, demonstrating that governance quality influences not only the level of leverage but also the speed at which firms adjust towards their target capital structure (Adams et al., 2024; Ezeani et al., 2024). Moreover, emerging evidence suggests that governance effects are context-specific: variables such as board independence, ownership concentration, may strengthen or moderate the governance–leverage relationship depending on institutional settings. As a result, the link between CG and CS is not uniform across countries, firm sizes, or regulatory environments, reinforcing the need for market-specific research, particularly in developing economies where governance frameworks are still evolving.

In Sri Lanka, the growing importance of corporate governance is reflected through revised regulatory reforms, increased stakeholder awareness, and mandatory compliance requirements introduced by the Colombo Stock Exchange (CSE). Yet, despite this progress, academic research in the Sri Lankan context has largely focused on governance and firm performance, leaving the governance capital structure nexus relatively underexplored. Most available studies address isolated governance indicators, such as board size or board independence, rather than examining governance as a multidimensional construct that includes ownership structure. Furthermore, the findings of previous studies are mixed, offering no consensus on whether governance leads to higher or lower leverage in Sri Lankan firms. This gap highlights the need for a comprehensive investigation into how governance mechanisms collectively influence financing policy in listed companies. Therefore, this study seeks to empirically examine the relationship between corporate governance practices and capital structure decisions of firms listed on the CSE, thereby contributing to both the theoretical discourse and practical policy implications for corporate financial management in emerging markets.

2. Review of Literature

For ages, capital structure theories were mostly about the static trade off theory and pecking order theory. Both these theories just assume managers do what's best for shareholders when deciding how to finance stuff. In these views, companies try to either find a sweet spot between the good and bad parts of debt or they like to use their own money first before asking others for cash. But the thing is, these theories basically ignore the fact that managers and owners aren't the same people and might want different things. Jensen and Meckling's (1976) agency

theory actually points out that managers might chase their own goals like building bigger companies, avoiding risks, or getting personal perks instead of just making the company worth more. When lots of different people own small pieces of the company, managers don't fully feel the results of what they decide and might stay away from debt to avoid going bankrupt or having someone look over their shoulder too much.

Recent studies really back up the idea that agency problems affect how companies finance themselves. Research from both developing and rich countries keeps showing that the way companies are governed changes how they choose their capital structure because governance either makes agency problems better or worse (Nguyen et al., 2021; Zeitun & Goaid, 2023; Chowdhury, 2024). For instance, companies with poor monitoring systems tend to use less debt, while those with strong governance are actually better at getting loans and bonds on good terms (Queiri, 2024).

The makeup of a company's board is a key governance tool that affects debt decisions. When more board members are independent they usually push for more careful debt policies because these independent boards provide better oversight and help fix managers' tendency to avoid risks too much (Adams & Mehran, 2012; Ezeani et al., 2024). Some new evidence from multiple countries shows that board reforms and governance rules really change how fast companies adjust their debt levels toward what's best for them (Ezeani et al., 2024). Also, having women on boards has been shown to change the relationship between governance and debt, often leading to lower debt levels because of greater concern about risks and more ethical oversight (Amin, 2022).

The degree of ownership concentration is another important driver of capital structure. Managerial ownership typically limits leverage, as managers that have ownership stakes are personally at risk and so managers do not want aggressive financing (Peng & Röell, 2014). In contrast, institutional investors are positively associated with leverage because they will often use debt as a disciplinary mechanism to improve firm value (Akwaa-Sekyi et al., 2024). Recent work in emerging markets also shows that family controlled, or state-led firms have different patterns of leverage also driven by access to political capital, or preference for internal financing (Bawuah et al., 2024; Pahala, 2025).

Capital structure decisions also respond to institutional variables in the broader environment. Firms from countries with stronger investor protection laws and enforcement of governance tend to employ low to moderate debt ratios, since boards can improve the monitoring condition to lower agency costs, thus benefitting from less discipline in financing style (Dodge et al., 2017; Oxford Economics Review, 2024). For example, governance codes have tightened, especially in South Asia, and in the UK, with the outcome of reduced excessive leverage and decision-quality improvements from boards of directors (Ezeani et al., 2024).

The Dynamic Character of Capital Structure

New findings indicate that capital structure is not static; it is shaped by interacting effects between quality of governance, fundamentals at the firm level and constraints in the market. Profitability, future growth opportunities, access to capital markets, and macroeconomic uncertainty affect leverage, but these effects relate to governance quality (Hackbarth et al.,

2021; Zeitun & Goaid, 2023). Evidence from India, Indonesia, and Vietnam suggests firms with good governance make adjustments toward their optimal leverage much faster than firms under weak governance monitoring (Nguyen et al., 2021; Pahala, 2025).

Taken together, recent findings bolster the characterization of corporate governance as not merely an external “control mechanism” but a structural determinant of financing strategy. In firms with strong governance institutional structures, corporations will adopt capital structures that reduces agency costs and improves monitoring efficiency, and align manager incentives with shareholder value. As developing markets like Sri Lanka develop governance reforms, the interactions between board characteristics and ownership flows and regulatory discipline are likely to remain at the forefront of capital-structure research.

Corporate governance is an increasingly important problem, particularly for big, publicly traded corporations on the CSE. Financial resources are necessary for businesses to function and accomplish their goals. Consequently, it is essential to properly take into account the variables affecting capital structure. People in Sri Lanka have become more knowledgeable about corporate governance in recent years. Consequently, corporations are now required to adhere to the corporate governance guidelines that were integrated into the CSE's listing standards.

Few studies have looked at the connection between corporate governance and capital structure in Sri Lanka; most research has focused on the performance of businesses. Furthermore, the scant research that is available has only looked at a few corporate governance facets. The board structure was the main focus of these questions, in contrast to ownership structures. There have been conflicting findings in studies on capital structures and corporate governance.

A few recent studies support the widely held belief that increasing debt levels may cause financial instability and have a detrimental effect on business performance. Companies with high debt levels, for example, were more financially vulnerable during the COVID-19 pandemic, according to a research by Acharya et al. (2020). There may be a more complex relationship between debt levels and firm profitability, according to several recent research that cast doubt on this idea. For instance, a 2021 study by Smith and Warner discovered that the effect of debt on a business's performance varies based on the corporate governance standard and the features of the industry.

3. Hypothesis Development

Ownership structure

Managerial ownership

Managerial ownership refers to the proportion of a firm's equity held by its directors and executives, and is commonly used as a proxy for ownership structure. Although agency theory primarily addresses the separation between ownership and control, managerial shareholding occupies a unique position because managers may act simultaneously as decision-makers and equity holders. The theoretical relationship between managerial ownership and leverage is not straightforward, as it depends on whether ownership aligns or entrenches managerial interests.

According to the Alignment of Interest hypothesis, higher managerial ownership motivates managers to act in the best interest of shareholders, thereby encouraging the use of debt as a disciplinary mechanism and resulting in a positive association between managerial ownership and leverage. In contrast, the Entrenchment theory suggests that when managers hold substantial ownership, they may avoid debt to reduce external monitoring, leading to a negative relationship.

Empirical findings on this relationship remain mixed. Early studies such as Berger et al. (1997) and Short et al. (2002) reported a positive association, supporting the alignment argument. However, research in emerging markets frequently documents negative relationships, consistent with entrenchment effects (Hasan & Butt, 2009; Sheikh & Wang, 2012). More recent evidence continues to show inconsistency: while studies such as Adusei & Obeng (2021) and Li & Islam (2022) find a negative relationship, others report a positive one in similar institutional contexts (Adegboye et al., 2023; Tran & Le, 2024). This divergence suggests that the impact of managerial ownership on leverage is likely contingent on country-specific governance mechanisms, legal environments, and capital-market development.

In the context of Sri Lanka, where governance reforms and ownership structures differ significantly from those of developed markets, managerial ownership may act as a mechanism for aligning interests rather than entrenching managerial control. Therefore, based on the alignment hypothesis, this study proposes that managerial ownership positively influences capital-structure decisions. So, therefore this study expects that,

H_{1a}: There is a positive impact of managerial ownership on capital structure decisions

Ownership concentration

Ownership concentration, commonly defined as the percentage of shares held by the top five shareholders, functions as a crucial internal governance mechanism that allows dominant owners to safeguard their control over the firm and influence managerial decisions. However, empirical evidence on the relationship between ownership concentration and capital structure remains inconclusive. For instance, Cespedes et al. (2010) examined Latin American firms from 1996 to 2005 and reported a U-shaped relationship between ownership concentration and leverage. In contrast, Liu et al. (2011) found a negative association between ownership concentration and leverage among Chinese listed firms. More recent studies also continue to show mixed findings. Mbanyele (2020) revealed that the effect of ownership concentration on leverage varies across a firm's life cycle, while a study on firms listed on the Nairobi Securities Exchange identified a positive link between ownership concentration and leverage but a negative association between leverage and stock performance (Njeru & Kariuki, 2023). Based on this theoretical and empirical background, the following hypothesis is proposed:

H_{1b}: There is a negative impact of concentrated ownership on capital structure decisions

Foreign investors

The ratio of shares held by foreign investors to the total number of outstanding shares serves as an indicator of the degree of foreign ownership within a corporation. Emerging empirical evidence suggests that foreign ownership may influence corporate debt policy, particularly under certain institutional conditions (Yahaya, 2025). Nevertheless, the extant literature presents mixed findings. Sunitha and Vijayakumaran (2019) report no statistically significant association between foreign ownership and leverage, whereas Bhabra et al. (2008), in the context of Chinese firms, identify a positive relationship between the two variables. Given these inconsistencies, the present study posits that foreign ownership is likely to have an impact on firms' capital structure decisions. Therefore this study expects that,

H_{1c}: There is a positive impact of foreign investors on capital structure decisions

Board structure

Board composition (independent directors)

A clear distinction exists between non-executive directors and independent directors within corporate governance structures. According to widely accepted corporate governance guidelines, an independent board member is defined as an individual who may hold shares in the company but does not maintain any other financial, managerial, or advisory ties that could compromise their objectivity or create potential conflicts of interest with the firm, its senior management, affiliated entities, or external auditors. In this study, the proportion of independent directors reported in the annual report is used as the measure for board independence.

Prior empirical research has documented a relationship between board composition and capital structure decisions (e.g., Somathilake & Udaya Kumara, 2015). More recent studies further indicate that firms with a higher proportion of independent and diverse board members tend to pursue more conservative leverage strategies (e.g., Ezeani et al., 2024; Amin, 2022). Based on this evidence, the present study anticipates that:

H_{1d}: There is a positive impact of board composition on capital structure decisions

Board size

Board size refers to the total number of directors serving on a company's board. While the numerical size of the board is an important governance indicator, the collective expertise, skills, and experience of its members also play a crucial role in shaping strategic and financial decisions. Accordingly, board size is considered a key internal governance mechanism that may influence a firm's capital structure choices.

Empirical findings on the relationship between board size and leverage remain inconclusive. Siromi and Chandrapala (2017) report no statistically significant association between board size and leverage. In contrast, earlier studies such as Lipton and Lorsch (1992) suggest that board size is significantly related to capital structure decisions. Similarly, Berger, Ofek, and Yermack (1997) find that firms with larger boards tend to maintain lower levels of

leverage, arguing that a higher number of directors enhances monitoring intensity, thereby encouraging management to adopt more conservative financing policies.

Recent empirical evidence offers mixed findings on the effect of board size on leverage. Zeitun et al. (2023) show a non-linear relationship between governance and leverage. Ezeani et al. (2024) report that enhanced board oversight via reform leads to higher debt levels. Conversely, Elmoursy et al. (2025) document that in UK firms, larger boards are linked to higher debt ratios under certain market conditions, while Pahala et al. (2025) find in an Indonesian two-tier board system that board size and composition significantly influence long-term debt when moderated by gender diversity. Based on this, the present study proposes the following hypothesis,

H_{1e}: There is a negative impact of board size on capital structure decisions

Board meetings

It's the quantity of meetings that are held each year. The company's actions may be impacted by meeting frequency, however previous study has shown contradictory findings. That number is represented by the number of board meetings held during a specific fiscal year. Some studies argue that a higher frequency of meetings strengthens board monitoring and reduces information asymmetry, thereby supporting more disciplined financing choices and balanced leverage decisions (Al-Najjar & Clark, 2022). Thus, this study expects that,

H_{1f}: There is a positive impact of board meetings on capital structure decisions

4. Model Specification and Methodology

Conceptualization

In summary, the conceptualization model conveys the researcher's main notion. Three factors are included in the conceptualization model: independent, dependent, and control variables.

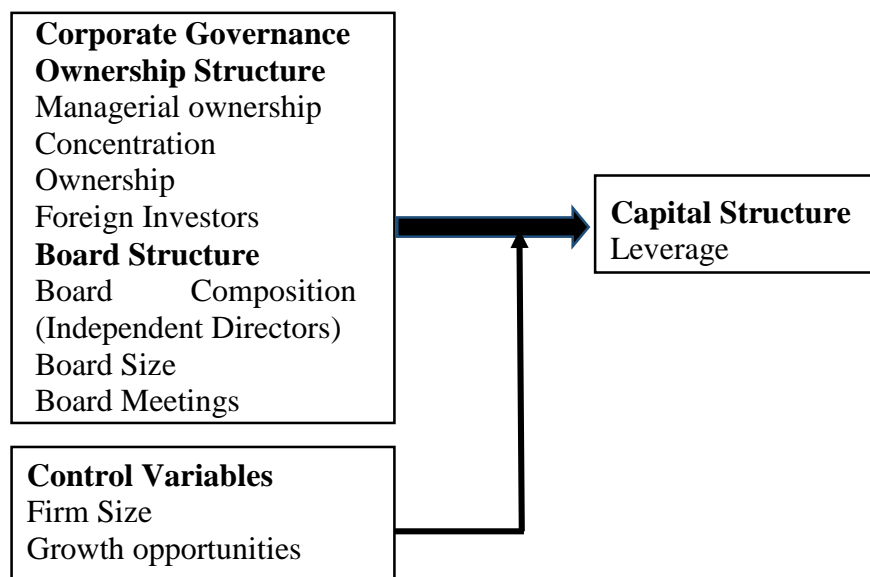


Figure 1: Conceptual Framework

Source: Developed by Researchers

Model Specification

To test our hypothesis, we can construct the following new research model for the study.

$$LEV = \beta_0 + \beta_1 MO + \beta_2 CO + \beta_3 FI + \beta_4 BC + \beta_5 BS + \beta_6 BM + \beta_7 FS + \beta_8 GRO + \beta_9 FA + \epsilon_i$$

ϵ_i = error term

Operationalization

Definition of Variables

Table 1: Operationalization		
Variables	Measurement	Abbreviation
Capital structure variables		
Leverage	Total Debt / Total Assets	LEV
Corporate governance variables		
Ownership structure		
Managerial Ownership	Shares owned directly by directors, supervisors and top management / total number of outstanding shares	MO
Concentration Ownership	Concentration = Amount of the shares owned by the major 5 shareholders/Total of shares	CO
Foreign Investors	Foreign investor-owned shares/ total of shares	FI
Board structure		
Board Composition (Independent Directors)	Percentage of independent directors on the board	BC
Board Size	Natural logarithm of the total number of directors on the board	BS
Board Meetings	Number of Meeting	BM
Control variables		
Firm Size	Natural logarithm of total real assets	FS
Growth opportunities	Ratio of the sum of the market value of equity and the book value of debt to the book value of total assets Non-tradable share price is used to calculate the market value of the tradable equity.	GRO

Source: Developed by Researchers

By examining data from businesses listed on the Colombo Stock Exchange (CSE), this study seeks to investigate the connection between capital structure choices and corporate governance. "What is the relationship between corporate governance and capital structure decisions, and to what extent does the corporate governance structure influence the capital structure of companies listed in Sri Lanka?" is the main research question that drives this quantitative study.

All companies listed on the CSE make up the study's population, while a sample of 25 companies was chosen based on their market value. The study uses the Statistical Package for Social Sciences (SPSS) to analyze data over a nine-year period. Several analytical methods, such as regression analysis, correlation testing, and descriptive statistics, were used to accomplish the study's goals and test the hypotheses.

4. Results and Discussion

Most often, descriptive statistics are used to summarize data. These statistics include the mean, median, maximum, minimum, and standard deviation of the independent and dependent variables. Many descriptive statistics measures are used to characterize the basic characteristics of the independent and dependent variables. The use of descriptive statistics is useful for making generalizations about the collected data. Descriptive statistics give basic descriptions of the sample and the measurements. It displays the computed mean, median, standard deviation, minimum, and maximum in the table below.

Table 2 presents the mean, standard deviation, and summary descriptive statistics for both the independent and dependent variables. The mean values serve as the average metrics for the variables they denote. Leverage exhibits an average value of .3725, with a standard deviation of .263 and a range from 0.01 to 1.75.

Table 2: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
LEV	225	.01070	1.75640	.3724919	.26295957
MO	225	.00000	.77618	.1098936	.20900778
CO	225	.31153	.99984	.7832824	.14809161
FI	225	.00370	.97472	.2939484	.25722535
BC	225	.14286	3.00000	.3997939	.21320981
BS	225	5.00000	13.00000	8.6177778	2.10349294
BM	225	1.00000	14.00000	5.4755556	2.63739891
FS	225	11.50305	19.28991	16.8602571	1.38117181
GRO	225	.00075	3.77439	.6341931	.71473518
Valid N (listwise)	225				

Source: Survey data

Managerial ownership (MO) has a mean of 0.0109, with a range from 0.00 to 0.77. This led to a standard deviation of 0.209. For concentrated ownership (OC), the average value stands at 0.2939. A standard deviation of 0.148 was observed, with a range from 0.31 to 0.99. The average value of foreign investors (FI) for the selected companies is 0.294, and it has a standard deviation of 0.257, with values ranging from 0.03 to 0.974.

Outside directors (BC) constitute approximately one-third of all independent, non-executive directors on the board, with a standard deviation of 0.213. The research revealed that the mean board size (BS) of the 25 organizations was 8.61, accompanied by a standard deviation of 2.638. A total of five to thirteen board meetings took place, with an average of 5.47.

Additionally, the average size of the firm and the percentage of growth opportunities related to the company's total assets are 16.86 and 0.634, respectively. N also represents the overall count of observations gathered.

Correlation Analysis

In order to determine the degree and direction of the linear relationship between two variables, the correlation analysis is first conducted on the variables. In order to test the pairwise correlation, SPSS is used. The degree and direction of the linear link between two variables, as determined by the covariance, are measured by the correlation coefficient, sometimes referred to as r or R^2 .

Table 3 presents the Pearson correlation coefficient between the independent and dependent variables.

The relationship between leverage and managerial ownership is 0.088. Thus, there is a positive correlation between leverage and managerial ownership. Managerial ownership and leverage are not significant at the 0.05 level ($0.189 > 0.05$). The correlation between leverage and concentrated ownership is -0.187 at the 0.05 ($0.005 < 0.05$) significance level. Therefore, leverage and concentrated ownership are negatively correlated. Leverage and foreign investors have a 0.285 correlation. Thus, there is a substantial positive correlation between leverage and foreign investors at the 0.05 level ($0.000 < 0.05$).

A positive relationship between leverage and board composition is indicated by the correlation coefficient of 0.213 between the two variables and significant differences in the dependent variable at the 0.05 ($0.01 < 0.05$) levels; a negative relationship between board size and leverage is indicated by the correlation coefficient of -0.059, which is not significant at the 0.05 level ($0.381 > 0.05$); and a correlation value between board meetings and leverage.

This illustrates how effectively board meetings and leverage may complement one another. Leverage, business size, and growth potential had respective connection values of -0.415 and 0.145. This illustrates how capital structure and growth prospects are negatively correlated with business size, but positively correlated with the latter. There is a substantial correlation between the two variables at the 0.05 levels ($0.030, 0.000 < 0.05$).

Table 3: Correlations

	LEV	MO	CO	FI	BC	BS	BM	FS	GRO
LEV								
MO	.088							
	.189								
CO	-.187**	-.113						
	.005	.090							
FI	.285**	-.322**	.097					
	.000	.000	.147						
BC	.213**	.005	.030	-.071				
	.001	.941	.656	.292					
BS	-.059	-.017	-.019	-.061	.003			
	.381	.802	.774	.366	.959				
BM	.140*	.049	-.228**	-.112	-.014	.361**		
	.035	.469	.001	.095	.836	.000			
FS	.145*	.187**	-.278**	-.003	-.140*	-.077	-.121	
	.030	.005	.000	.961	.035	.247	.070		
GRO	-.415**	-.078	.223**	.153*	-.018	.223**	-.112	-.336**
	.000	.242	.001	.022	.784	.001	.094	.000	

****. Correlation is significant at the 0.01 level (2-tailed).**

***. Correlation is significant at the 0.05 level (2-tailed).**

Source: Survey data

Regression Analysis

The purpose of regression analysis is to determine if an independent variable has a significant effect on a dependent variable. The association between corporate governance and capital structure was determined using regression analysis. The analysis's conclusions are listed below.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.627 ^a	.393	.371	.20859308

a. Predictors: (Constant), GRO, BC, MO, BM, CO, FI, BS, FS

Source: Survey data

In this case, ownership and board composition are independent factors, and leverage is the dependent variable. With a 62.7% connection, the table demonstrates the favorable relationship between leverage and corporate governance, namely ownership and board structure. To evaluate the model's performance, two statistics are extracted from the regression equation: adjusted R-squared and R-squared multiples. The coefficient of determination, or R square, is

the square of R. The percentage of the dependent variable's variance that can be ascribed to the independent variables is indicated.

As indicated by the table's R square value of 39.3%, the direction of the connection has 39.3% strength or fitness compared to the 62.7% leverage from ownership and board setup. According to this, 62.7% of leverage can be attributed to ownership and board structure. In addition to ownership and board composition, a number of other factors also influence the others. R square for the population in the sample is most accurately estimated by the Adjusted R Square. A modified R square of 0.371 is found in the table.

Table 5: ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	6.091	8	.761	17.498	.000 ^b
	Residual	9.398	216	.044		
	Total	15.489	224			

a. Dependent Variable: LEV

b. Predictors: (Constant), GRO, BC, MO, BM, CO, FI, BS, FS

Source: Survey data

ANOVA table 5 indicates that the significant P value is 0.000, which is less than the 0.05 threshold for significance. Consequently, the ownership and board structure (corporate governance) has a major influence on leverage and capital structure. It is feasible to draw the conclusion that this significant level encompasses 62.7% of the influence.

Table 6: Coefficients^a

Model	Unstandardized		Standardized	t	Sig.	
	Coefficients		Coefficients			
	B	Std. Error	Beta			
	(Constant)	-.853	.250		-3.419	.001
1	MO	.201	.072	.159	2.782	.006
	CO	-.305	.103	-.172	2.973	.003
	FI	.238	.059	.232	4.054	.000
	BC	.184	.066	.149	-2.768	.006
	BS	-.018	.007	-.146	-2.440	.015
	BM	.006	.006	.059	.970	.333
	FS	.058	.012	.305	4.962	.000
	GRO	-.181	.022	-.493	8.102	.000

Dependent Variable: LEV

Source: Survey data

Coefficient values for the regression model are given in the column of unstandardized coefficients. The other b values represent the slope, X represents the independent variables of ownership and board structure, Y represents leverage, and the constant (-.853) represents the intercept. Since it indicates how much the dependent scores change when the independent score changes by one unit, the coefficient's slope offers the most crucial information.

Managerial ownership has a considerable effect on leverage, as shown by the P value of 0.001, which is significant at the 0.05 level (0.001<0.05). The P value of 0.003 indicates that concentrated ownership lowers leverage, which is significant at the 0.05 level (0.003<0.05). The table's P value of 0.000, which is less than 0.05, indicates that foreign investors obviously have a major impact on leverage.

At the 0.05 level, the P value of 0.006 for board composition is significant (0.006<0.05). Consequently, the makeup of the board has a significant influence on leverage. The data indicates that leverage is strongly impacted by board size; in this case, the significant value is 0.015, which is below the 0.05 criterion. From this, it would seem that leverage is negatively impacted by board size. A P value of 0.333 over the 0.05 significant threshold indicates that board meetings had no discernible effect on leverage. Business size and growth potential directly affect leverage. The fact that both of their P values (0.000, 0.000<0.05) fall below 0.05 demonstrates this.

$$\text{LEV} = (-0.853) + 0.201\text{MO} + (-0.305)\text{CO} + 0.238\text{FI} + 0.184\text{BC} + (-0.018)\text{BS} + 0.006\text{BM} + 0.058\text{FS} + (-0.181)\text{GRO} + \epsilon_i$$

5. Discussion

The study aimed to examine the influence of corporate governance mechanisms on capital structure decisions among listed firms, focusing on ownership and board structure variables. The regression analysis revealed that managerial ownership, ownership concentration, foreign investors, board composition, and board size significantly affect firms' capital structure decisions, while board meetings did not exhibit a significant effect. The findings revealed a positive and significant relationship between managerial ownership and capital structure decisions, supporting the Alignment of Interest hypothesis. This suggests that as managerial shareholding increases, managers' interests align more closely with those of shareholders, leading to a greater reliance on debt as a disciplinary mechanism to enhance firm performance and shareholder value. This result is consistent with the findings of Berger et al. (1997) and Short et al. (2002), who reported a positive association between leverage and managerial ownership. However, it contradicts the findings of Sheikh and Wang (2012) and Hasan and Butt (2009), who observed a negative relationship, possibly due to differences in institutional and regulatory contexts.

The results also indicated a negative relationship between ownership concentration and leverage, implying that firms with highly concentrated ownership tend to rely less on external debt financing. This aligns with Liu et al. (2011), who found a similar negative relationship in Chinese firms, and suggests that dominant shareholders may prefer to maintain tighter control and minimize external monitoring. Although Cespedes et al. (2010) reported a non-linear U-

shaped relationship between ownership concentration and leverage, the current finding indicates that concentrated shareholders in the observed firms adopt a more conservative financing approach. Furthermore, the study found a positive and significant impact of foreign investor ownership on capital structure, implying that the presence of foreign shareholders encourages firms to adopt higher leverage. This finding supports Bhabra et al. (2008), who found a positive relationship between foreign ownership and leverage in Chinese firms, highlighting the monitoring and governance-enhancing role of foreign investors. In contrast, Sunitha and Vijayakumaran (2019) found no significant relationship, suggesting that the influence of foreign investors may depend on the maturity of financial markets and the strength of institutional governance frameworks.

With regard to board structure, the study found a positive and significant relationship between board composition and capital structure, suggesting that a higher proportion of independent directors contributes to more prudent and effective capital structure decisions. This finding supports Somathilake and Udaya Kumara (2015), indicating that independent directors enhance transparency, reduce managerial opportunism, and ensure financial decisions align with shareholder interests. The study also revealed a negative and significant association between board size and leverage, confirming that larger boards tend to pursue more conservative financial policies. This finding is consistent with Berger, Ofek, and Yermack (1997) and Lipton and Lorsch (1992), who argued that larger boards increase oversight and pressure on management to reduce leverage. However, it differs from Siromi and Chandrapala (2017), who found no significant relationship, likely due to contextual differences in governance efficiency.

Contrary to expectations, the relationship between board meeting frequency and capital structure decisions was insignificant, indicating that the number of meetings alone does not necessarily enhance the board's influence on financial policy. This suggests that the effectiveness of board monitoring depends more on the quality of deliberations and expertise than on meeting frequency. Overall, the results demonstrate that corporate governance mechanisms, particularly ownership structure and board composition, play a critical role in shaping capital structure decisions. These findings support the agency theory perspective, emphasizing that good governance practices help mitigate agency conflicts and align managerial behavior with shareholder interests. From a practical standpoint, the results highlight the need for policymakers and regulators to strengthen governance frameworks by promoting transparency in ownership, encouraging foreign investor participation, and ensuring effective board independence to foster sound financial decision-making and sustainable firm performance.

6. Implications

Theoretical Implications

The empirical results—and the pattern of accepted and rejected hypotheses—add several targeted refinements to existing capital-structure theory (static trade-off, pecking-order) and to agency/monitoring explanations of governance. Below I present the principal theoretical implications in a concise, integrated narrative.

First, the results confirm that corporate governance mechanisms are not peripheral but central determinants of how firms trade off the benefits and costs of debt. The positive effect of managerial ownership on capital-structure decisions (H_{1a} accepted) suggests that when managers hold meaningful equity stakes they do not uniformly shun leverage out of risk aversion. Instead, managerial ownership can align incentives so that managers are willing to accept debt-financing that disciplines free cash flow, preserves control without diluting equity, or signals confidence to outside capital providers. Theoretically, this nuance modifies the simple managerial-risk-aversion story: managerial ownership simultaneously reduces classic agency costs of equity (supporting leverage) and may reduce managers' incentive to underinvest, which makes debt a workable tool within the static trade-off logic.

Second, the negative effect of concentrated ownership (H_{1b} accepted) highlights a cross-cutting agency effect that is distinct from managerial alignment. Large, controlling shareholders appear to be associated with *lower* leverage in this sample—suggesting that concentration introduces risks of expropriation or control preservation strategies that discourage using external debt. In theoretical terms, concentrated ownership creates an agency-of-controlling-shareholders problem that can invert predictions from models focused solely on manager–shareholder conflicts. Thus, models of capital structure must account for distinct agency channels: (a) manager–minority principal–agent problems that may favor debt as discipline, and (b) controller–minority conflicts that may lead controllers to reduce leverage to protect private benefits of control or to avoid external scrutiny.

Third, the positive association with foreign investors (H_{1c} accepted) emphasizes the role of external monitoring and capital-market integration in shaping leverage choices. Foreign investors often bring stronger monitoring, different risk preferences, and better access to cross-border capital markets; their presence makes firms more likely to use debt. Theoretically, this supports an information-asymmetry/pecking-order complement: foreign ownership reduces information frictions and agency costs, lowering the effective cost of debt and making externally supplied debt more attractive within both static trade-off and dynamic financing hierarchies.

Fourth, board-related findings require a two-part reinterpretation. The positive impact of board composition (H_{1d} accepted) and the negative impact of board size (H_{1e} accepted) together indicate that *quality and structure* of the board matter more than mere size or activity counts. A board that is better structured (for example, a higher proportion of effective, independent, or expert directors) seems to enable or tolerate higher leverage—perhaps because it reduces monitoring costs and increases creditors' confidence—whereas larger boards are associated with lower leverage, likely due to coordination problems, diluted oversight, or conservative decision-making. This nuance refines governance arguments in capital-structure theory: board composition (a qualitative feature) can facilitate the use of debt by lowering agency and information costs, while larger boards (a quantitative feature) may impede decisive financing choices and bias firms toward safer, less-levered positions.

Fifth, the insignificance of board meeting frequency (H_{1f} rejected) demonstrates that governance *activity* is not a reliable substitute for *governance effectiveness*. Frequency of meetings alone does not translate into better monitoring or improved capital-structure

outcomes. Theoretically, this cautions against models that treat governance variables as interchangeable proxies for monitoring; governance must be measured in terms of effectiveness, authority, independence, and the quality of oversight—not merely formal activity.

Taken together, these findings suggest a more contingent, multi-channel theoretical framework for capital-structure choice:

- Capital-structure models should explicitly separate (and model) multiple agency problems—manager–shareholder, controller–minority, and investor–manager—because each implies different leverage responses to governance variables.
- Governance variables operate by changing both (a) the perceived net benefit of debt (tax/shield, discipline) and (b) the perceived cost of debt (distress, expropriation, information asymmetry). Therefore, any theory that predicts leverage must incorporate how governance shifts these two sides of the trade-off.
- Information asymmetry and external monitoring (e.g., foreign investors, high-quality boards) reduce the cost of external finance and can make debt more attractive—so pecking-order predictions (preference for internal finance) are conditional on governance quality and investor composition.
- Governance effectiveness is multidimensional: qualitative composition matters more than frequency-based proxies. Theories and empirical designs should use nuanced governance measures (independence, expertise, minority protection) rather than activity counts alone.

Practical theoretical extensions recommended by these results include formalizing a *contingency model* of capital structure in which governance variables interact with firm-level characteristics (profitability, growth opportunities) and external conditions (market access, investor mix) to produce context-dependent leverage rules. Finally, researchers should refine agency-based predictions by distinguishing which governance mechanisms mitigate which agency costs—only then can theory generate precise, testable predictions consistent with the mixed empirical patterns observed here.

Practical Implications

The findings of this study offer several important managerial implications for corporate executives, board members, and policymakers, particularly within emerging markets such as Sri Lanka. The positive association between managerial ownership and capital-structure decisions suggests that when managers hold a meaningful equity stake in the firm, their interests align more closely with those of shareholders, leading to more prudent and performance-oriented financing choices. Therefore, firms should design incentive systems that enhance managerial ownership to encourage the optimal use of debt while minimizing agency conflicts. Conversely, the negative effect of concentrated ownership on leverage indicates that excessive control by a few large shareholders may lead to conservative financial policies that limit a firm’s growth potential. Managers and regulators should thus promote greater ownership dispersion and ensure mechanisms are in place to protect minority shareholders and improve transparency. The significant positive impact of foreign investors underscores the importance of attracting and maintaining foreign participation, as such investors bring not only capital but

also stronger monitoring, international expertise, and credibility in financial markets. Managers should therefore prioritize transparent reporting and adherence to global governance standards to appeal to these investors and secure favorable financing conditions.

Furthermore, the findings emphasize that the quality of board composition plays a more decisive role in capital-structure decisions than the size of the board. Smaller, more independent, and financially skilled boards are better positioned to make effective and timely financing decisions, whereas larger boards may suffer from coordination inefficiencies and conservative decision-making. As such, firms should prioritize the appointment of directors with relevant expertise in finance and risk management rather than merely expanding board size. The insignificance of board meeting frequency reveals that governance effectiveness depends on the quality and focus of board deliberations rather than the number of meetings held. Boards should therefore ensure that discussions are data-driven and focused on strategic issues related to financing, leverage, and investment policy.

Overall, the results highlight the need for an integrated governance–finance approach in corporate decision-making. Managers should view corporate governance not merely as a compliance requirement but as a strategic tool for optimizing capital-structure choices, improving investor confidence, and enhancing access to external financing. In emerging market contexts, where regulatory frameworks are evolving, adopting strong governance practices—such as increasing transparency, ensuring board independence, and safeguarding minority shareholder rights—can significantly improve firms’ financial flexibility and resilience. Ultimately, managers are encouraged to strike a balance between risk-taking and control, using debt as a strategic instrument to discipline management and enhance firm value while maintaining robust governance mechanisms to mitigate financial and agency risks.

Limitation and Future Research Direction

This study has certain limitations that provide useful directions for future research. First, the analysis focuses only on listed companies in Sri Lanka, which may limit the generalizability of the findings to unlisted firms or those in different institutional settings. The unique governance practices, regulatory framework, and market dynamics in Sri Lanka may influence financing behavior differently compared to other emerging or developed economies. Therefore, future studies could adopt a cross-country or regional comparative approach to examine whether similar patterns exist under varying legal and governance environments.

Second, the study employs a cross-sectional design, capturing relationships at a single point in time. However, capital-structure decisions are inherently dynamic and may evolve with changes in firm performance, economic conditions, and governance reforms. Future research could use longitudinal or panel-data methods to observe how these relationships develop over time and to identify causal effects more accurately. Moreover, incorporating macroeconomic factors and firm life-cycle stages would provide a more comprehensive understanding of the determinants of capital-structure decisions.

Finally, the study focuses on a limited set of governance variables—such as ownership structure and board characteristics—while other critical aspects, including audit committee effectiveness, board diversity, CEO duality, and institutional investor influence, were not considered. Future studies should broaden the governance framework and employ advanced

econometric models, such as structural equation modeling or instrumental variable techniques, to address potential endogeneity concerns. Expanding the scope in these ways would strengthen theoretical development and offer deeper insights into how corporate governance mechanisms shape capital-structure decisions across different contexts.

7. Conclusions

Using an experimental technique, this study looked at how ownership and board composition affect a company's capital structure using a sample of Sri Lankan listed businesses. The results of this investigation are in agreement with those of earlier research. Conclusions on the effects of ownership and board composition on capital structure can be made by the researcher based on the empirical results of the study. Among these, this analysis found positive and statistically significant relationships with foreign investors, concentrated ownership, board composition, and capital structure. A statistically significant inverse relationship exists between capital structure and growth opportunities. Additional analysis in this study indicates that board size, managerial ownership, and board meetings have no effect on capital structure. Thus, the study disproves H_{1a} , H_{1e} , and H_{2f} . There are several plausible reasons. According to Bhabra et al. (2008), there is a positive correlation between foreign ownership and leverage in the case of China. There is no discernible link between the two, according to Vijayakumaran, R., and Sunitha, V. (2019). Siromi and Chandrapala (2017) contend that there is no discernible relationship between board size and leverage. However, there is a considerable correlation between board size and capital structure, according to Lipton and Lorsch (1992). Companies with more board members typically have lower leverage or debt ratios (Berger, Ofek, & Yermack, 1997).

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