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Firm Characteristics, Corporate Governance and Financial Leverage: A Critical Literature Review

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Abstract

This study is a critical review of the literature that seeks to establish the effects of firm characteristics, corporate governance (CG), firm performance, and macroeconomic environment on financial leverage. For this review, firm characteristics is assessed as firm size, age of the firm, and ownership structure. Corporate governance is assessed as directors' board size, the audit committee, and the CEO duality. Firm performance which is the intervening variable is determined through Return on Assets (ROA) and Return on Equity (ROE). The moderating variable, macroeconomic environment is determined as Gross Domestic Product (GDP), inflation rate, interest rate and exchange rate. While financial leverage is evaluated using the total debt to total asset ratio. The reviewed literature includes both theoretical and empirical data. The methodology used reviewed various empirical literature, articles, publications, and conceptual studies where descriptive and quantitative analysis were applied. According to various publications reviewed, there are positive, negative, and contradictory outcomes between firm characteristics, CG, firm performance and macroeconomic environment on financial leverage. Disparities in research methodology explain several inconsistent conclusions even in research with very comparable designs. Some studies show positive associations between board size, audit committee, CEO duality, company size, leverage, and profitability. However, other studies show that the level of CG is linked negatively to board size, leverage, and firm age. Other studies suggested that some form of CG mechanism and firm-specific characteristics, predominantly executive compensation, firm performance and firm leverage can impact the bearing and magnitude of the frequency of financial restatement. Nevertheless, in other studies, the timeliness of financial leverage was negatively impacted by the size of the company. Besides, the findings from a different strand of studies in the literature suggest that board ownership and audit quality negatively influence financial leverage. Other research gaps emerging in the literature review include; firm characteristics regarded as a moderating variable between corporate governance and financial leverage. An unspecified possibility of dual causality exists between firm characteristics and corporate governance. The study suggests future research efforts based on the empirical specifications to fill knowledge gaps by taking into account the causality relationships of firm characteristics and corporate governance. The foregoing study is guided by key theories of CG including; stewardship, agency, stakeholder, and resource dependency (RDT) and recommends further research in firm characteristics, CG and financial leverage. Entrenched in research, financial leverage can be enhanced by providing good CG practices, and that macroeconomic environment theoretically moderates the relationship that exists between firm characteristics, CG and financial leverage. It is suggested that a similar study should be done, where future researchers may introduce other variables other than; firm performance and macroeconomic environment to examine the association of firm characteristics, CG and financial leverage.

Keywords: *Firm Characteristics, Corporate Governance, Financial Leverage*

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Introduction

Corporate Governance and Financial Leverage in companies influence financial outcomes. Good CG contributes to shareholder profit maximization and an upsurge in the firm's market value by ensuring that the managers and the shareholders are in good rapport (Wanyama & Olweny, 2013; Chandani & Ahmed, 2021). However, due to the managers' interests, a conflict of interest called an agency problem may exist between them and the shareholders (Wahyuni, 2019). The majority of the research has indicated the existence of a connection between corporate value analysis, CG and ownership structure which is part of firm characteristics, a good CG develops an entity's performance from numerous CG mechanisms (Onguka, Iraya & Nyamute, 2021). Waweru and Riro (2013) contend that a good CG makes both the board and management responsible for meeting their respective obligations to shareholders.

The study will focus on stewardship, agency, resource dependency, and stakeholder theories. Managers and shareholders don't have agency cost according to stewardship theory, consequently, they agree on their interests, reducing supervision of management to enhance shareholder value (Lekaram, 2014). Jensen and Meckling (1976) developed the agency theory, explaining how directors associate with shareholders. The principal expects the agents to maximize their profits. The theory also concentrates on the principal-agent conflict of interest or agency problems. The resource dependency theory (RDT), analyzes the responsibility of directors and their association with the external environment through achieving fundamental resources and leverage. Wanyama and Olweny (2013) described the stakeholder theory as a managerial theory that explains the effect of organizational achievement on any person or group.

Increased profitability and financial resources are crucial for firms to achieve their objectives. The distinctive qualities of a company play an equal role in affecting its performance. Firm characteristics execute a critical function in ascertaining performance and financial leverage since, firms that can successfully match certain features with the environment outperform others (Wakaisuka-Isingoma, Aduda, Wainaina & Mwangi, 2016). Similarly, CG concerns affect many aspects of a company's management, including financial leverage, thus, the managers should effectively apply company resources.

Firm Characteristics

Firm characteristics is defined as elements of a firm viewed as "drivers" of business interactions (Erioti, Vasiliou, & Ventoura Neokosmidi, 2007). They are crucial factors in determining the performance and

success of an organization because they contribute to reducing agency conflicts and informational gaps. They consist of ownership structure, age of firm, and firm size (Abor, 2008; Adeyemi & Fagbemi, 2010; Dean et al., 2000). The size of firms varies, agency costs for large organizations are higher than for smaller firms (Jensen & Meckling, 1976). Larger companies are often more exposed to the public interest since they are more conspicuous than smaller companies (Watts & Zimmerman, 2006). In certain circumstances, Small companies reveal less information than large ones because they are afraid of competition.

A firm's stage of development and growth may have an impact on its age. Owusu-Ansah (1998) declares that younger companies may suffer from competition and a lack of attractive financial statement reports. In comparison to older firms, startup companies may experience issues like a poor reputation, lack of capital and a poor brand name. Therefore, it is anticipated that successful firms will either reveal more information or will exhibit greater compliance than startups.

Ownership structure is defined as the allocation of equity among several groups of people or entities (Kao, Hodgkinson & Jafaar, 2019). A variety of different types of investors may own companies. In very few instances, these investors buy companies to achieve financial goals. Ownership concentration, state, family, and foreign ownerships are used to gauge the ownership structure. Since the owners' objective is to maximize their returns by addressing governance challenges, ownership structure serves more like a crucial foundation whilst combining CG and value (Onguka et al., 2021).

Corporate Governance

Gompers, Ishii and Metric (2003) define CG as the method in which the board of directors maximizes the shareholders' value through observing the conduct of managers responsible for the daily management of the firm. Cadbury (1992) also defined CG as an instrument used to discipline organizations. CG is also the final aim of accomplishing long-term investors' value while taking their well-being into account when directing and managing the affairs of a firm to enhance corporate accountability and business prosperity (CMA, 2002). Whereas a good CG monitors the activities of a firm and promotes a clear business environment, a poor CG leads to negligence, corruption and waste. Freeman (1994) suggests only excellent governance can generate sustainable good business performance regardless of the type of enterprise. Nonetheless, the impact of CG varies widely in each country.

The directors' board size, the audit committee, and the CEO duality are measures of CG. Directors monitor all decision-making, regardless of board size, as well as controlling and leading the company (Khakwani, SadiqShahid & Hamza, 2016). Coffee (2005) held that auditors similarly play a necessary role in guarding the wealth of investors and preventing dishonest scandals. In the CG structure, the audit committee is involved in monitoring and ensuring the financial reliability and honesty of the company's reporting policies and measures (Chandani & Ahmed, 2021). CEO duality is where the CEO of a company has the same responsibilities as the chairman and it undermines the effectiveness of the management oversight. The CEO and chairman functions in a firm should be separated (Fama & Jensen, 1983).

Due to its significant impact on national economic development and growth, CG is one of the pressing concerns that has lately come up in the corporate world. Many high-performing companies fail for a lack of good governance which is vital and always has a positive effect on organizational performance (Gompers et al, 2003). The success of a country's economy is indicated in the overall performance of its own firms. Thus, the lack of good CG practices is thought to be responsible for the poor level of development achieved by developing countries. Because of this, the absence of a good CG is recognized in current literature as the primary obstacle to the economic development of countries (Wanyama & Olweny, 2013). La Porta et al. (1999) suggest that firms in developing economies are devalued in the financial markets relative to their counterparts in affluent nations because of poor governance.

Firm Performance

Bhunia, Mukhuti and Roy (2011) define financial performance as the general health of a company. Kinyua (2019) opines that financial performance is a breakdown of the review of the development of a firm, in evaluating the success and proper business governance. Today, a company's performance is viewed as its body considering that a strong performance accelerates the growth of a company. The firm's performance may be ascertained in its financial statements which it publishes. If the company is doing well, it will help the management's efforts to provide accurate information about their activities. Performance is determined via ROA and ROE.

The utility or benefits that shareholders obtain from their ownership of a company's shares can be viewed as a measure of the performance or value of the company. Companies with high share prices can be

considered to be financially successful. Such highly valued companies draw a lot of investors, enhancing their chances of continued expansion. Organizations utilize traditional performance indicators, such as profitability, to determine their level of success. These measures can either be historical or comparative (Elly, 2012). Other methods of valuing a company exist. Among the often used measures are weighted average cost of capital, present value, equity cash flow, and discounted cash flow (Urhoghide & Omolaye, 2017).

In the modern world, the efficiency and effectiveness of an organization are determined by its performance. If a company performs well enough, growth can be accelerated. A company's performance may be determined by looking at its financial statements, and a successful company will support the management's efforts to provide accurate information about its operations (Lekaram, 2014). Many analysts use different techniques in determining financial performance, but the focus on measuring financial performance using tools like ROA and ROE is to ascertain the performance of a firm.

Macroeconomic Environment

Macroeconomic environment refers to peripheral aspects in organizations, market place and all the economic spectrum that have an impact on organizational operations, it is a collection of external factors that have an impact on how successfully or unsuccessfully a firm develops (Caballero, 2010). Stable macroeconomic conditions are the prerequisites for sound and healthy performance of the financial sector in a given country. A sound and favorable macroeconomic environment lead to effective and efficient functioning of the financial sector. However, in this era of globalization, the financial sector must be strongly integrated into the global economy, since certain countries still lag behind other developing countries concerning financial deepening and intermediation (Shahbaz, Shamim & Aamir, 2010).

The rate of inflation, GDP, interest rate, and the exchange rate is used to measure the macroeconomic environment. Ngugi (2001) depicts interest rates as the cost of money that reflect market information about anticipated changes in the purchasing power of the currency. According to economic experts, rates of interest represent the long-term cost of capital allocation; monetarists utilize rates of interest as a significant instrument to promote saving since they drive both saving and the search for alternative investments that would yield higher returns (Egbunike & Okerekeoti, 2018a).

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According to Juraev and Mamatkulova (2017) inflation is the continuous increase in prices or the general level of prices. There are several methods of determining inflation, however, the CPI indicator and the GDP deflator are the two most frequently used measures. The exchange rate according to Egbunike and Okerekeoti (2018) is the value of two currencies to one another. It is the rate used to express the price of one currency against another. Exchange rates are either floating or fixed. GDP is the market rate of all formally acknowledged ultimate services/products manufactured within a country over a given time frame (Desmond, Akunna, Njoku & Ifeyinwa, 2015). GDP is one of the key measures for assessing a nation's economic health.

Financial Leverage

Financial leverage, according to Innocent, Ikechukwu and Nnagbogu (2014), is a measure of how much a corporation uses equity and debt to finance its assets. Both debt and equity may be used by a business to finance its investments. Preference capital is another option available to the business. Despite what the ROA of the business is, the interest rate on the debt is always fixed. Financial leverage is incorporated in a firm when trying to outperform its costs on the fixed charges funds. Financial leverage rises as debt increases and in using financial leverage, a company's main aim is to increase the return to shareholders in favorable economic conditions.

It is viewed as a two-edged sword because it increases profits while also putting them at risk of losing money. High-geared companies rely on debt to support their tasks and procedures compared to other funds. Firms that utilize a low intensity of financial leverage, signal that they rely on retained earnings or equity financing to fund their operations. Financial leverage is measured using the total debt to total assets ratio (Hongli, Ajorsu & Bakpa, 2019).

Managers may implement specified accounting techniques to produce favorable statements of finance regarding creditworthiness to reduce the costs associated with debt covenants (Bowen, DuCharme & Shores, 1995). As Waweru and Riro (2013) explain, there are connections on the choice of policy in accounting and the level of debt since debt agreements are founded on the accounting numbers reported, any disruption of those debt agreements results in costs for the firm. As a result, earnings management may be used to avoid expenses, avoid projecting an overview of the financial distress, and increase the firm's financial leverage (Easton, Eddey & Harris, 1993).

Research Problem

There's a great deal of debate on how CG affects financial leverage. This is because research has shown that many CG procedures have mixed results in terms of projected outcomes showing knowledge gaps. CG has been researched. However, minimal study has been done on how it affects the financial leverage of firms. Wakaisuka-Isingoma et al. (2016) studied the relationship between CG, firm characteristics, external environment, and performance of financial institutions in Uganda, but the research did not take into account the ex-ante or independent influence of firm characteristics and neither was financial leverage considered as the dependent variable. Hasnan, Mohd and Mohamed (2020) investigated the effects of CG and firm-specific characteristics on the incidence of financial restatement, and they discovered that the relationship between CG and firm-specific characteristic variables on the incidence of financial leverage was not significant.

Ben and Chouaibi, (2021) analyzed the impact of the characteristics of two CG mechanisms, namely, board of directors and ownership structure, on the firm value of European financial institutions. Pham & Nguyen (2019) investigated the moderating effects of CG mechanisms on the financial leverage–profitability relation in emerging market companies in Vietnam. Arora and Sharma, (2016) examined CG and performance of firms in developing countries: evidence from India. Sarwar, Al-Faryan and Saeed (2022) explored the relationship between CG, financial leverage, financial performance and CSR as a mediating variable in Thai banks in Thailand. All these studies indicate a contextual gap as they were done in different developing and developed countries.

Widijaya (2022) investigated the effect of CG and company characteristics on accounting conservatism in firms listed on the Indonesia stock exchange. Only Secondary data acquired from the published yearly financial accounts were analyzed indicating a methodological gap. Buvanendra, Sridharan and Thiyagarajan (2017) did a comparative study of listed firms in Sri Lanka and India on firm characteristics, CG and capital structure adjustments. The research found that Sri Lanka and India have different key international factors of capital structure modifications.

In an emerging market in Egypt, the consequences of the relationship between some CG mechanisms, such as board characteristics, ownership structure, and corporate financial leverage were explored (Abobakr & Elgiziry, 2015) but the sample size used was too small, and it was limited to the listed non-

financial companies at the Egyptian Stock Exchange (EGX). Egbunike and Okerekeoti (2018) examined the relation involving macroeconomic factors, firm characteristics and financial performance of manufacturing firms quoted in Nigeria. Taddese and Negash (2013) studied the role of institutions, macroeconomic conditions, industry and firm characteristics on firms' capital structure decisions in nine countries in Africa. This study only focused on listed companies, as is typical in most empirical studies. However, future research on unlisted companies may add to the body of knowledge already included in this study.

Okiro, Aduda and Omoro (2015) studied the effect of CG and capital structure on the profitability of East African Community (EAC)-listed firms. There was a conceptual gap, the study used the capital structure as the moderating variable. The study period was short. Onguka et al. (2021) analyzed the relationship between CG, capital structure, ownership structure, and firm value for listed firms on the NSE. The research was insignificant as it indicated an insignificant joint effect of CG, capital structure, and ownership structure on corporate value. The linkage between CG and achievement of NSE enterprises was investigated (Lekaram, 2014), but the moderating and intervening effect of macroeconomic environment and firm performance respectively were not assessed. The lack of consistency and adequate empirical literature in the results of the previous studies necessitates further research to be conducted. Therefore, this study aims to undertake a critical literature review to identify research gaps and areas for further studies by asking the research question: What are the effects of firm characteristics, corporate governance, firm performance and macroeconomic environment on financial leverage?

Research Objectives

The study sought to review existing empirical and theoretical literature on the effect of firm characteristics, corporate governance, firm performance and macroeconomic environment on financial leverage. Specific objectives include:

i. To identify previous studies and their knowledge contribution to the effect of firm characteristics, corporate governance, firm performance and macroeconomic environment on financial leverage and in the process identify any existing knowledge gaps.
ii. To recommend approaches for future studies to address existing knowledge gaps and contribute to resolving any conflicting conclusions in the previous studies.

iii. To propose a conceptual framework that could be used in future studies on the relationships between firm characteristics, corporate governance, firm performance, macroeconomic environment and financial leverage.

Literature Review

Theoretical Review

Theories underpinning the study include stewardship theory, agency theory, resource dependency theory and stakeholder theory.

The Stewardship Theory

Donaldson and Davis (1991) advanced this theory. It emphasizes senior management's responsibility as stewards, combining their objectives as a section of the organization, rather than as individuals (Wanyama & Olweny, 2013). Based on this theory, agency cost doesn't exist among shareholders and management. Thus, the shareholders and directors have reached an agreement. As a result, the need for management oversight is reduced, resulting in greater shareholder wealth (Lekaram, 2014). Davis, Schoorman and Donaldson (1997) suggested that to promote more efficient and effective decision-making, the board should comprise a substantial number of executives.

Stewardship theory is a normative alternative to the agency theory of CG. When the adopted values of the company and the enacted values are in alignment, stewardship behavior on the part of managers leads to good CG practices. According to the stewardship theory, performance variations are caused by how easily an executive may act given the structural context in which they are situated. The question then is whether the organizational structure aids the executive in developing and putting into action plans for high corporate performance (Donaldson, 1985). Goals are facilitated alongside structures to the extent that they empower the top management through a clear, consistent role, expectations, and authority. In terms of the CEO's function, structures will help them to improve the operation of their companies to the extent that the CEO has uncontested full control over the organization without any challenges (Donaldson & Davis, 1991).

Stewardship theory is occasionally criticized for giving directors freedom when it comes to using their discretion, even though it must be acknowledged that boards are constrained by some factors, including the availability of a suitable workforce, the demand for the company's products, the cost and availability of

finance (Blair & Stout 2001). Stewardship theory has limitations that arise when managers in certain cases fail to serve as good stewards and occasionally take advantage of their power to act against the interests of their shareholders. In contrast to agency theory, stewardship theory presupposes that managers and board of directors are stewards and their actions are certainly in line together with the goals of their principals upon appointment (Davis et al 1997a; Pastoriza & Ariño, 2008).

Agency Theory

Jensen and Meckling (1976) developed this theory; it is a contractual connection between an agent and a principal. The principal provides duties to the agents for them to provide services for the principal. The theory centers on the issues that evolve due to disputes involving shareholders and managers, it outlines in what manner an unhealthy connection existing amidst them also called agency problems, can lead to inefficiencies in the firm's performance (Wanyama & Olweny, 2013; Lekaram, 2014; Chandani & Ahmed, 2021). This theory is a substantial plan of recommendations in the cash-related discipline of a corporation. Wahyuni (2019) states that it is usual for company executives to have goals and other interests that contradict the company's major objectives because they frequently disregard the interests of principals.

This study and the agency theory suggest that agency costs may cause shareholders to lose value due to conflicts between shareholders' interests and corporate managers' interests. Furthermore, it is impossible to perfectly contract an agent whose actions have an impact on both his welfare and the welfare of the principle because it can be difficult to get them to operate in the principal's best interest. Wakaisuka-Isingoma et al. (2016) point out that the agency theory has an impact on the ability of managers to manage the firm through deploying independent directors for supervision, control, and monitoring while also placing a strong emphasis on board profile, financial transparency, and information disclosure. According to the theory, firm characteristics have an increased influence on financial leverage (Afey & Warui, 2019).

Brudney (1985) challenges agency theory when he states that private negotiation or contract sufficiently restrains managerial wrongdoing, he further draws attention to agency theory criticism in understanding CG processes generally. While acknowledging the value of institutions, he contends that scattered stockholders lack the necessary knowledge and institutional frameworks to either negotiate the conditions in which the management employs or to observe and regulate actions of management (Brudney, 1985). Agency theory has been critiqued in regards to the role of ownership for taking into account the

many formal and informal institutional configurations present in various situations (Van Essen, Van Oosterhout & Carney 2012).

Resource Dependency Theory

In their seminal paper: The External Control of Organizations: A Resource Dependence Perspective, Pfeffer and Salancik (1978) established the RDT. The theory has gained significant traction in strategic management and organizational theory and since its publication (Davis & Cobb, 2010). In elaborating why officially autonomous corporations participate in various inter-organizational pacts such as mergers and acquisitions, joint ventures, board interlocks, in-sourcing, and alliances, the theory cites several inter-organizational interdependencies (Pfeffer & Salancik, 1978). RDT makes an important contribution to the understanding of organizational behavior, structure, stability, and change.

The RDT mirrors the executive and their ability to provide the company with key resources such as skills, information and access to business products to increase the financial performance of the organization (Pfeffer, 1972). This theory emphasizes the function of directors in acquiring leverage and critical resources for an organization through their connections to the outside world. Nienhüser (2008) suggests that a core assumption of RDT is that reliance on critical resources influences behaviors where choices and actions depend on the type of resources.

Despite being a prominent theory for explaining linkages between organizations and their environments, RDT has not been as thoroughly investigated and tested as it could have been. RDT is questioned particularly on both conceptual and empirical grounds, the work of RDT scholars has not always yielded reliable findings (Davis & Cobb, 2010). RDT tends to lead to the establishment of inter-organizational arrangements according to numerous research (Peng, 2004). Other investigations, however, yield insignificant or contrary hypothesized results. RDT has been charged conceptually with combining the theoretically distinct components of power imbalance such as the difference in power between two organizations and mutual dependency (Drees, 2010).

Stakeholder Theory

Freeman (1994) advanced this theory indicating that it implies corporate executives are in charge of a network of ties that includes: - employees, suppliers, and business partners. Wanyama and Olweny (2013)

define the stakeholder theory as any entity affected or has an impact on the organization's goals. Underscoring today's economic circumstances is the essential reality at the heart of stakeholder theory. The theory is managerial in that it mirrors and leads how directors work instead of being limited to management theorists and economists (Freeman, 1994). Managers build relationships with their stakeholders, encourage them, and create communities where everyone tries their hardest to deliver on the company's promise of value (Freeman, Wicks & Parmar, 2004).

Any persons or groups inside an organization that are affected by the operations of a company may be considered as stakeholders. The theory seeks to identify what is in the best interests of various stakeholder groups. Stakeholder theory promotes effective, efficient, moral, and practical management of businesses in highly dynamic and complicated environments. It follows that the theory is crucial to CG and can enable companies to balance the interests of many groups. Stakeholder theory has three crucial components. First and foremost, managers must recognize and monitor all valid stakeholders. They should weigh each stakeholder's interests while making important choices and performing tasks. Secondly, managers should avoid potential confrontations between distinct groups and work to address problems through open communication and debate. Thirdly, managers must keep good relations with other organizations, both public and private, to reduce risks brought on by an uncertain environment. Stakeholders within and those external are often included in the stakeholder theory. Customers, suppliers and competitors are considered as external stakeholders, whereas; managers, employees and owners are considered as internal stakeholders (Chandani & Ahmed, 2021).

Stakeholder theory is descriptive since it emphasizes more on the environmental players and less directly on the corporate-social interaction process. One of Freeman's stated purposes is to provide the management with a useful strategic tool through the display of identifiable characters, however, he does not offer a strong theoretical foundation for explaining a firm behavior or the conduct of individual actors. The four main areas within which Freeman's theory as it is now formulated can be critiqued for its inadequacy in explaining the process, linking internal and external variables, not taking into account the system in which the business functions and the levels of analysis inside the system, and poor environmental evaluation. Stakeholder theory falls short in explaining how a corporation behaves in its environment. Providing an explanatory logic for the relationships under observation is essential to the development of the theory. The

dynamics relating the firm to the stakeholders that are recognized in Freeman's work are not appropriately addressed (Key, 1999).

Empirical Review

Ben and Chouaibi (2021) examined how the effects of ownership structure and the board of directors of two CG systems affected the firm value of European financial institutions. This study used the market-to-book ratio calculated from the Thomson Reuters Eikon ASSET4 database to assess the firm value of 111 financial institutions from 12 European countries listed on the stock exchange from 2007 to 2019. In estimating the link between CG features, multivariate regression analysis on panel data was used. The results of the empirical study indicated that board size and the concentration of ownership have a negative impact on firm value, whereas CEO ownership and board gender diversity are positively associated with company value.

Widijaya (2022) investigated the effect of CG and company characteristics on accounting conservatism. The objective of this research was companies that have annual reports that are registered and published on the Indonesia Stock Exchange. Data was collected from 2016 to 2020. The sample size was only 436 companies that passed the selection to be used in this study. The analysis of data was through a panel regression model. The findings revealed that the independent board of directors, leverage, profitability and sales growth have a positive influence on accounting conservatism. The variable size of the board of directors, type of auditor and firm size did not indicate a significant effect on accounting conservatism.

Lekaram (2014) explored how corporate governance is associated with the profitability of NSE-listed businesses that manufacture. The research design employed was descriptive, panel data regression methodology analyzed secondary data from 2007 to 2012. From the findings, the board size of publicly traded manufacturing firms in Kenya is inversely correlated to firm profitability factors like ROA and ROE.

Arora and Sharma (2016) examined CG and performance in emerging economies a case study of India. The empirical analysis was for the years 2001-2010 and focused on a significant number of enterprises from 20 different businesses in India’s manufacturing sector. The study used system generalized methods of moments (SGMM). On one side, the results suggested that huge boards are linked to higher intellectual

gravity. On the other side, ROE and profitability were found to be unrelated to CG measures. While CEO duality is likewise unrelated to all of the firms' sample performance factors.

Chandani and Ahmed (2021) examined corporate governance, financial leverage, and their effect on the productivity of listed enterprises listed in the Pakistan textile sector. The information was gathered from 2012 to 2017. Panel data and OLS regression models were adopted. The result indicated that financial leverage and performance were negatively related to each other, whereas the size of board, audit committee, and director compensation were strongly related.

Okiro, Aduda and Omoro (2015) studied the effect of CG and capital structure on the profitability of East African Community (EAC) listed firms. Between 2009 and 2013, a census survey was conducted on all 98 listed enterprises, 56 of 98 targeted companies representing 57% of the total were investigated. The results indicated that CG, firm performance and capital structure have a significant positive relation.

From the viewpoint of firm characteristics and CG structures, Thi Hoang, Pham, Thalassinos, Anh Le (2022) investigated the factors influencing the timeliness of financial statements. From 2014 to 2020, the Ho Chi Minh Stock Exchange (HOSE) and Hanoi Stock Exchange (HNX) listed 172 Vietnamese firms, and panel data from their financial statements and annual reports were examined. It was discovered that the size of the company negatively impacted the timeliness of financial statements when profitability positively impacted on it. Further research revealed that audit quality and board ownership both negatively impacted the timeliness of financial statements. The conclusion came from Bayesian analysis, which was initially applied in research on the timeliness of financial statements.

For listed firms on the Nairobi Securities Exchange (NSE), Onguka et al. (2021) analyzed the association of CG, capital structure, ownership structure, and firm value. A census survey was conducted for 64 publicly traded companies, where the sample size was 58 firms. The analysis included 5 years, from 2013 to 2017. The study used a descriptive design and a positivism philosophy. Given that the sample data included both cross-sectional and time-series data, the panel data analysis was considered more appropriate. The association of CG, capital structure, ownership structure, and corporate value was examined using multiple regression analysis. The assessment of the effects of capital structure and ownership structure on the linkage of CG and corporate value was conducted using Baron and Kenny's (1986) approach.

In their study, Egbunike and Okerekeoti (2018) examined the relation of macroeconomic factors, firm characteristics, and the financial performance of listed manufacturing firms in Nigeria. The study focused on the effects of interest rates, inflation, currency, and GDP growth rates on corporations. The size, leverage, and liquidity were among the key firm characteristics. ROA was used to determine financial performance. Ex post facto research design was used in the study and all manufacturing companies listed on the Nigerian Stock Exchange made up the population. The sample was limited to firms in the industry concerned with consumer goods and was obtained using a non-probability sampling technique. Multiple linear regression was applied to validate the hypotheses. The analysis revealed that while exchange and interest rate had no positive impact on ROA, inflation and GDP growth rate had an effect. Second, firm characteristics demonstrated the significance of firm size, leverage, and liquidity.

In Uganda the performance of financial institutions was examined by Wakaisuka-Isingoma et al. (2016) in connection to CG, business characteristics, the external environment, and performance. The research is expected to be valuable for a variety of sectors, including the central bank, and other financial institutions, which are able to compare their opinions alongside those of other researchers. By supporting existing theories, the study is anticipated to significantly contribute to theory development. The study provided policy suggestions meant to improve company performance.

Buvanendra, Sridharan and Thiyagarajan (2017) compared the firm characteristics, CG, and capital structure changes of listed companies in India and Sri Lanka. The research covered the years 2003/04 to 2012/13. Using a dynamic adjustment model, ten independent variables that include CG and firm-specific factors were examined. It was proven that firms in both nations gradually adapted to an ideal capital structure. Additionally, there were global disparities between Sri Lanka and India in the key parameters influencing capital structure modifications.

Conceptual Framework

The association of firm characteristics, CG, firm performance, macroeconomic environment and financial leverage is depicted in Figure 3.1 below. Firm characteristics is the ex-ante variable, CG is the independent variable; the intervening variable is firm performance; macroeconomic environment is the moderating variable; and financial leverage is the dependent variable.

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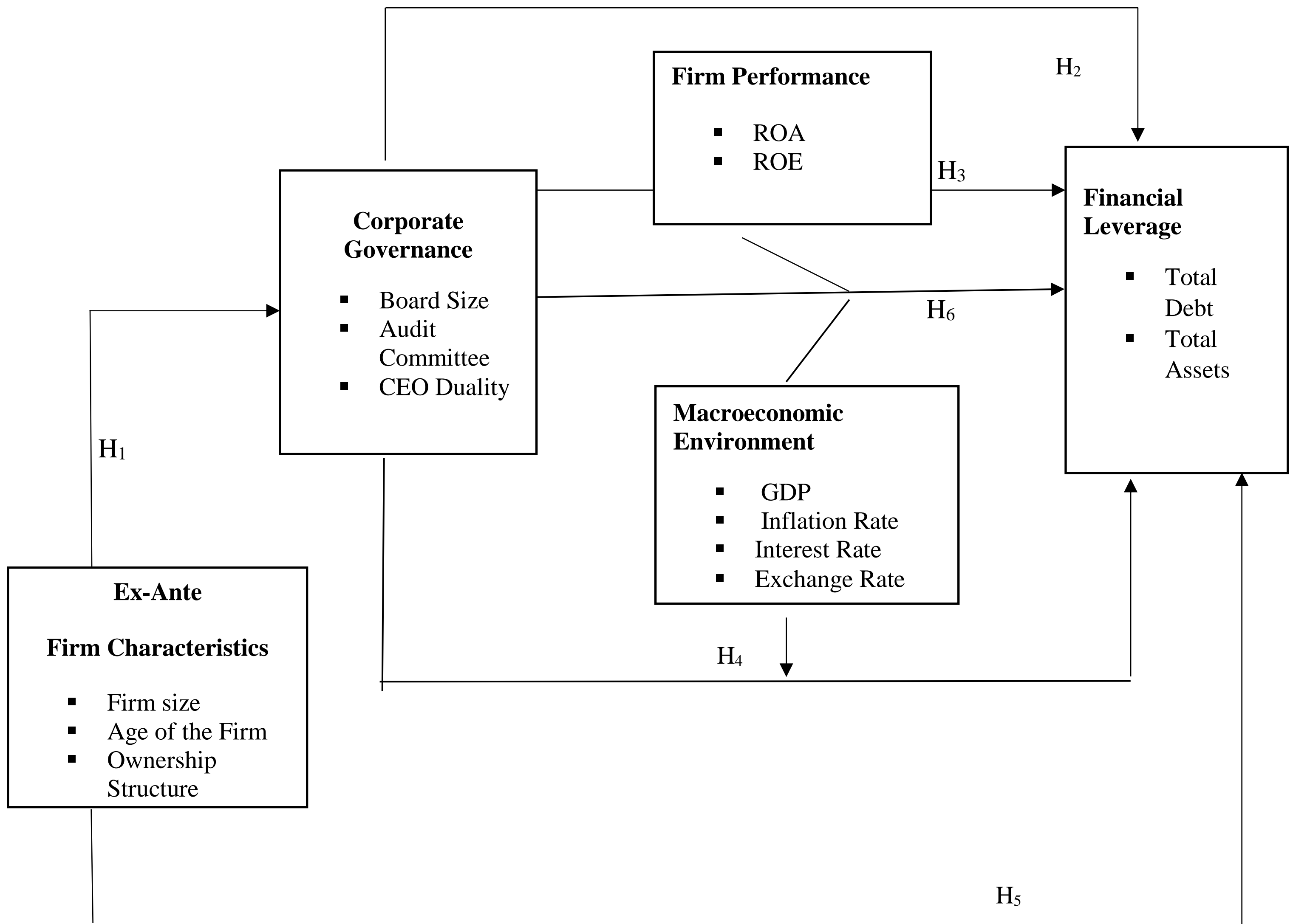

Figure 1: Conceptual Framework

Summary

This study reviewed the theoretical and empirical literature based on firm characteristics, CG, firm performance, macroeconomic environment and financial leverage. According to the study, financial leverage is associated with many positive externalities in the form of total assets and total debts. The study observed that the effect of firm characteristics studies thus the firm size, age of the firm and ownership structure and CG studies that is the board size, audit committee and CEO duality on financial leverage gives mixed results in terms of projected outcomes showing knowledge gaps. However, most of the studies indicated that both firm characteristics and CG positively influences financial leverage. There was a

moderating effect of macroeconomic environment on the association involving firm characteristics, CG and financial leverage.

The theoretical review of the study included the stewardship theory which suggests that senior management should act as stewards, combining their objectives as a section of the organization, rather than as individuals. Based on this theory, agency cost doesn't exist among shareholders and management because they have reached an agreement. The theory further suggests that to promote more efficient and effective decision-making, the board should comprise a substantial number of executives. The agency theory centers on the issues that evolve due to disputes involving shareholders and managers, it outlines in what manner an unhealthy connection existing amidst them also called agency problems, can lead to inefficiencies in the firm's performance. The RDT successfully mirrors the executive and their ability to provide the company with key resources such as skills, information, and access to business products to enhance the financial performance of the organization. This theory emphasizes the function of directors in acquiring leverage and critical resources for an organization through their connections to the outside world. Stakeholder theory holds that corporate executives are in charge of a network of ties that includes employees, suppliers, and business partners. The theory is managerial in that it mirrors and leads how directors work instead of being limited to management theorists and economists. Managers build relationships with their stakeholders, encourage them, and create communities where everyone tries their hardest to deliver on the company's promise of value.

The empirical review of the study entailed a review of various studies among them Hasnan, Mohd and Mohamed (2020) examined how CG and firm-specific characteristics influenced the frequency of financial restatement across publicly traded Malaysian companies. Egbunike and Okerekeoti (2018) examined the connections among macroeconomic factors, firm characteristics, and the financial performance of manufacturing companies listed in Nigeria. Onguka et al. (2021) analyzed the relationship surrounding CG, capital structure, ownership structure, and firm value of listed companies at the NSE. Ben and Chouaibi (2021) analyzed the impact of the CG mechanisms on the characteristics of board of directors and ownership structure on the company value of European financial institutions. Wakaisuka-Isingoma et al. (2016) studied in Uganda the relationship between CG, firm characteristics, external environment, and performance of financial institutions. The reviewed studies indicate that several factors including board size, CEO duality and audit committee influence or do not influence financial leverage. However, the

studies have not explicitly identified the association of firm characteristics, CG, firm performance, macroeconomic environment and financial leverage.

Conclusions and Recommendations

This research provides a framework for future discussion involving literature, theory, practice and policy concerning firm characteristics, CG, firm performance, macroeconomic environment and financial leverage. Research on the relationship between these study variables has been ongoing with inconclusive findings on the actual nature of the relationship between them. Based on the study, firm characteristics and good CG increases financial leverage, which supports the existing literature. The positive significant link of firm characteristics, CG, and financial leverage was changed by addition of an intervening variable denoted as firm performance. By examining empirically interrelationships of the research variables, this study also contributes to the theories on CG. Following the reviewed research, there is a correlation of board size, the fraction of audit committee membership in relation to the overall board number, family control, CEO duality, and firm characteristics such as firm size along with ROA as a firm performance indicator.

From the findings on the effect of CG and company characteristics on accounting conservatism, it was established that board of directors, leverage, profitability and sales growth have significantly influenced accounting conservatism. The variable board size of directors, type of auditor and firm size was incapable of significantly influencing accounting conservatism. The study found that CG practices enhance the level of leverage and the auditing quality, thereby advancing firm performance. This conclusion was drawn from the results of the connection of CG, firm characteristics, external environment, and performance of financial institutions. The outcome indicated a significantly negative linkage of executive compensation, firm performance, and the incidence of financial restatement when looking at the effects of CG and firm-specific characteristics on the incidence of financial restatement among public companies.

The relationship between macroeconomic conditions, firm characteristics, and financial performance of listed manufacturing firms led the study to find that while inflation rate and GDP growth rate had a considerable impact on ROA, interest rate and exchange rate had no significant influence. Furthermore, firm characteristics demonstrated the significance of company size, leverage, and liquidity. This literature review promotes future research through testing empirically the interrelationships among firm characteristics, CG, firm performance, macroeconomic environment and financial leverage. The study thus

concludes that firm characteristics, CG, firm performance and macroeconomic environment jointly influence financial leverage.

Given the conflicting findings on linkage of firm characteristics, CG and financial leverage, further studies should attempt to establish the association of the three variables. This study advances knowledge by empirically examining the linkage of firm characteristics, CG, firm performance, macroeconomic environment and financial leverage. The study findings leave potential for more in-depth investigation of the concepts. Future studies could include other financial leverage measures apart from total debts and total assets. Distinct concepts apart from firm characteristics, CG, firm performance and macroeconomic environment can also be studied in future to largely enhance CG studies.

From this research, the study findings will promote the theory of the agency which tries to describe the kind of association between agents and principals. The board size and audit committee which are corporate governance variables are part of the agents who are expected to have a good relationship with the principal. In this regard, firms will achieve high financial performance due to a good relationship between agents and principals. Since the executive in firms serves the employees, suppliers, and business partners; the outcome in handling the challenge contributed to stakeholder theory. This is because it guides managers the right way, making this theory managerial. The essential reality at the heart of stakeholder theory is underscored in today's economic circumstances. Freeman (1994) indicates that managers build relationships with their stakeholders, and inspire them, for the profitability of the company. The identified problem further contributes to stewardship theory, which asserts that managers are motivated to do a good job by maximizing company profits and increasing financial leverage.

In contribution to policy and practice, CG is a set of rules and procedures designed to keep a firm together. Its goal is to hold a company accountable while also helping them avoid legal, financial, and ethical problems. Governance guarantees that every member in a company adheres to ethical and open decision-making procedures such that all concerns of investors are protected through further contributions to policies and practices such as allowing shareholders to elect a board of directors who will always be seeking the best interests of shareholders (Wahyuni, 2019).

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