BOARD GOVERNANCE PRACTICES AND CAPITAL STRUCTURE DECISIONS WITH THE MODERATING EFFECTS OF GENDER DIVERSITY: EMPIRICAL EVIDENCE FROM DEVELOPING ECONOMY

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ABSTRACT

The purpose of this study is to investigate the impact of board governance practices on capital structure decisions with the moderating effects of gender diversity. The research methodology constitutes panel regression analysis between board governance attributes and capital structure decisions; further moderation is tested with the gender diversity of listed companies in Sri Lanka from 2016 to 2020. 100 listed companies representing food, beverage and tobacco, capital goods, material and consumer services sectors in Sri Lanka were considered as a sample. This study focuses on the five aspects of board governance practices such as board size, board composition, CEO duality, board meeting and audit committee while capital structure decision is measured based on the long-term debt to total assets. The findings demonstrate that the issue of gender diversity has important implications for the capital structure decisions of the listed firms in Sri Lanka. When interacting with a high level of gender diversity, board governance characteristics are more likely to have a significant impact on firms' capital structure decisions. Board composition unveils a negative effect, and interaction between board composition and gender diversity significantly impacts firms' leverage level. A negative effect is observed when the chief executive officer of a company also serves as the chairman of the board of directors. The effect of the audit committee turns from a positive to a negative effect when women participation on the board increases. This study offers evidence to the corporate sector about the inclusion of female representation in boardrooms, which may further increase transparency and attract capital, particularly debt. This study recommends improving monitoring processes and introducing and examining new methods that can help businesses to draw in greater resources and create an optimal capital structure. It would also assist policymakers in determining the sufficiency of available board governance reforms to improve capital structure balancing.

Keywords: Agency theory, Board composition, Board gender diversity, Capital structure decisions, CEO duality

1. INTRODUCTION

In recent years, academics and practitioners have been focused on corporate governance (CG) issues. The effect of CG issues affects managers' primary investment and finance decisions, as well as the performance and valuation of the

firm (Wintoki, Linck et al, 2012). According to Jensen and Meckling (1976), use of debt capital as governance mechanism can reduce agency issues between managers and shareholders. Debt capital can enhance company value by mitigating agency costs of equity since it averts dilution of equity ownership of insiders and offers additional debt holders' monitoring. Agency theory also confirms that leverage can be considered as a crucial CG mechanism for reducing the agency issues between shareholders and managers by disciplining managers (Jensen 1986; Stulz, 1990).

In recent years, Women's participation in the labour force is increasing in developed and developing nations. However, participation by women on board of directors is relatively low (Nazliben, Renneboog, & Uduwalage, 2021). In Sri Lanka, it is a highly debatable area in CG. In investors' view, effective boards and board gender diversity (BGD) are predictors of a firm's future performance (Aman & Nguyen, 2013). In the corporate sector, good CG mechanisms have often led to significant growth and enhanced capital retention in the nations that have implemented CG system (Ahmed, Sheikh & Wang, 2012).

Many academics have recently concentrated on evaluating the systematic relationship between capital structure (CS) decisions and board governance practices (Ji, Mauer, & Zhang, 2019; De Costa & Ajward, 2021). Greater governance reduces top managers' incentives to choose the level of leverage. Furthermore, diversification and CG interactions have an unfavourable effect on financial leverage, suggesting that sophisticated governance reduces the amount of leverage in diversified firms (Ji, Mauer & Zhang, 2019). Azmi et al. (2019) argue that well governed enterprises have a small amount of debt and agency issues are mitigated in the US market. Fosberg (2004) found that organizations with CEO duality were successful in raising the proportion of debt in firm CS. However, the data show a weak positive association (De Costa & Ajward, 2021; Bulathsinhalage & Pathirawasam, 2017; Buvanendra, Sridharan, & Thiyagarajan, 2017; Hewa Wellalage & Locke, 2012; Kajananthan, 2012).

The extensive and in-depth literature on CS and CG indicates the integral part that these practices can play in determining corporate capital structure-related decisions. Most recent studies that have examined the CG and CS relationship have only looked at the direct association and have not considered the "moderating influence" of other dimensions (Zaid, Wang et al, 2020; Altaf, Waseem, & Abbas, 2020). To fill this gap, the present study attempts to establish the moderating effect of BGD on the association between CG and CS decisions.

Several studies have identified that BGD improves corporate board effectiveness. According to Zaid et al. (2020), the effects of board size and board independence are favourable under the condition of high level of BGD while the effect of CEO duality on firm's leverage turns from negative to positive. In other words, BGD moderates the impact of board structure on a company's financing decisions.

Altaf et al. (2021) exert BGD as a moderating variable to investigate the relationship between CG characteristics and financial structures. According to the findings, the presence of BGD has a significant impact on the attributes of CG and financial structures. Amin et al. (2022) investigate the influence of CG on CS along with the moderating role of BGD. The results revealed that a large number of independent directors have a favourable effect on firm leverage, but, the association between CEO duality and leverage was found to be negatively impacted. Additionally, they demonstrated that BGD has a positive influence on firm leverage and is associated with greater CG quality. Wicramasinghe et al. (2021) explore that the moderating effect of BGD is examined in relation to the board attributes and financial performance. According to the findings, board diversity significantly modifies the association between the number of important board features, including board size, independence, and meeting and financial performance. Wijayawardena et al. (2017) studied the specific gendered strategies employed by women engineers to stay in gender-atypical IT firms in Sri Lanka. Respondents perceived the job requirements in Sri Lanka's IT sector as being masculine. In order to align with and fulfil the prevalent expectations for professional roles, respondents compromised four different aspects of their own gender identities. Respondents' link strategies included "using a hybrid style" and "being meek and neutral," whereas their fit strategies included "adopting masculine qualities" and "demonstrating self-confidence."

According to the discussion above, a better dearth study has been undertaken so far on how board governance (BG) practices impact a firm's CS. In addition, the current conclusions are still debatable, and there are still a few inadequately developed disputes. From the Sri Lankan perspective, this study would be the first in the literature, which analyses the moderating effect of gender diversity on the association between BG practices and CS decisions. Thus, the study addresses the research question of "To what extent do BG practices impact CS decisions of listed firms in Sri Lanka?"

2. LITERATURE REVIEW

2.1 Theoretical review

Agency theory

Agency theory involves the contractual linkage between the agent and the principal under which the principal (shareholders) assigns tasks to the agent (manager) to operate the business efficiently. This theory assumes that the agent may behave opportunistically at the expense of the interest of the principal when the two parties want to optimize their utility. Jensen and Meckling (1976) explained this situation, referring to it as an agency relationship in which the principal’s lack of ability to directly observe the agent’s action may result in moral lapses, thus raising the agency cost. To mitigate this adverse effect, managers should possess the firm’s shares is a suggestion made in this case. So that managers’ interest is consistent with shareholders’ wealth maximization. Traditional principal and agent conflicts are immaterial to corporations with high ownership concentration.

Resource Dependency Theory

This theory focuses on the board of directors' roles in obtaining access to resources required for the business. It highlights the board of directors' roles in securing important resources for a firm through their relationship to the external atmosphere (Hillman et al. 2000). Resource dependency theorists focus on hiring independent companies as a means of gaining access to the resources necessary for business success (Johnson et al. 1996). For instance, independent directors who are affiliated with legal organizations provide legal advisory services that could otherwise be more expensive for the organization to get, either in board meetings or in private communications with the firm executives. It has been argued that supplying resources enhances the firm's performance, sustainability, and firm function (Daily et al. 2003).

2.2 Empirical evidence

The board of directors is a crucial CG tool for balancing the interests of shareholders and managers. The large number of directors on the board increases the firm value, mitigates principal-agent issues through an adequate monitoring process and resolves agency conflicts. The larger board size attempts to adopt a high debt strategy through strict monitoring in order to enhance the firm value (Feng et al., 2020). In the views of debt providers, the larger board improves the firms' credibility and financial stability because it is seen as an essential attribute from the viewpoint of creditors (Zaid et al., 2020).

According to agency theory, independence on boards is seen as one of the crucial CG attributes (Fan et al., 2019). Directors' expertise, broad viewpoint, and lack of management ties allow them to assiduously observe top management behaviour and make wise governance decisions. Similarly, independent directors enhance financial transparency, which increases the firm's access to capital because of a higher credit rating (Chen & Hsu, 2009) and ensures that the interests of debt holders will be protected (Zaid et al., 2020).

In general, the company's chief executive officer is in charge of overseeing the firm's operations and managing day-to-day operations whereas the chairman is answerable to drive the board and determine the strategic goals of the business. Contrarily, agency theory emphasizes the separation of both functions in order to establish an efficient CG system and minimize agency issues (Fama & Jensen, 1983). According to the agency hypothesis, we contend that companies with CEO duality experience agency problems and are viewed as riskier by lenders, which leads to a reduction in the amount of loan that is available to these companies. According to several studies, a board that meets frequently is more likely to make choices that are advantageous to shareholders (Sharma et al., 2009). In accordance with this viewpoint, the board will be better able to monitor management through frequent meetings, resulting in outcomes that are advantageous to the firms' shareholders.

Gender diversity in the workplace has recently received a lot of attention in the world (Farrell & Hersch, 2005). The presence of female directors on the board reduces managerial opportunistic behavior and information asymmetry, which, in turn, affects the lenders' perceptions of the borrower's capacity to repay the debt with interest. As a result, companies with greater diversity may have lower costs of debt (Usman et al.,

2019). According to agency theory, a board with female directors is likely to be a better watchdog over managers' activities since diversity boosts board independence (Carter et al., 2003). Therefore, the percentage of women on the board of directors may have an impact on how the board of directors' characteristics affect the CS of the company. Observing top management activities and board strategic decisions based on the aforementioned factors, we hypothesize that the proportion of women on the board has a considerable impact on the effectiveness of the board. Accordingly, firms' debt decisions will be derived. More specifically, when there is equality in the distribution of board members' gender, good board features may aid corporations in managing their financing policies more effectively. With the moderating effects of gender diversity, the following hypotheses are developed:

H_1: The size of the board is positively related to the CS decisions of listed companies in Sri Lanka
H_2: The board composition is positively related to the CS decisions of listed companies in Sri Lanka
H_3: The CEO duality is positively related to the CS decisions of listed companies in Sri Lanka
H_4: The number of board meetings is positively related to the CS decisions of listed companies in Sri Lanka
H_5: The audit committee is positively related to the CS decisions of listed companies in Sri Lanka

We, then, hypothesize that the above relationships would be moderated by BGD.

H_6- BGD moderates the relationship between BG practices and CS decisions of listed companies in Sri Lanka.

3. METHODOLOGY

This section demonstrates the research methodology exerted in this research. The quantitative method and the deductive approach are employed as this study intends to investigate the effect of BG practices on CS decisions with the moderating role of BGD.

3.1 Sample and Data

The Colombo Stock Exchange (CSE) consists of 287 firms representing nineteen different business sectors in 2020 (CSE, 2023). Among 19 sectors, 135 companies under the four sectors such as food, beverage and tobacco, consumer services, capital goods and materials are considered as the population of the study for the period from 2016 to 2020. These four sectors are considered based on the higher number of companies listed under each sector. Random sampling technique has been employed to choose 100 companies as the sample. The audited annual reports of the selected firms are used as the main secondary sources of data. In order to achieve the objectives of the study, panel regression analysis, correlation analysis, and descriptive

statistics are used. Panel regression model estimates the impact of BG practices on CS decisions.

3.2 Model Specification

To examine the impact of BG practices on CS decisions, the following Panel regression model is used:

$LDTA_{it} = \beta_0 + \beta_1 BSIZ_{it} + \beta_2 BCOM_{it} + \beta_3\, CEOD_{it} + \beta_4\, BMEET_{it} + \beta_5 ACOM_{it} + + \beta_6\, FSIZ_{it} + \varepsilon$……………………………………………..………………………..(1)

$LDTA_{it} = \beta_0 + \beta_1 BSIZ_{it} + \beta_2 BCOM_{it} + \beta_3\, CEOD_{it} + \beta_4\, BMEET_{it} + \beta_5 ACOM_{it} + \beta_6\, BSIZ_{it} \times BGD_{it} + \beta_7\, BCOM_{it} \times BGD_{it} + \beta_8\, CEOD_{it} \times BGD_{it} + \beta_9\, BMEET_{it} \times BGD_{it} + + \beta_{10}\, ACOM_{it} \times BGD_{it} + \beta_{11}\, FSIZ_{it} + \varepsilon$…………………………..……………..……(2)

3.3 Measurement of variables

Dependent variable

CS decisions are considered as the dependent variable of the study**.** It is measured based on long-term leverage (LDTA). The long-term debt-to-total-assets ratio is a measure in relation to of the firm's assets that are financed by long-term debt (consisting of loans or other liabilities) for more than one year (Zaid et al., 2020; Bulathsinhalage & Pathirawasam, 2017).

Explanatory variables

BG practices are the explanatory variables which include board size (BSIZ), board composition (BCOM), CEO duality (CEOD), board meeting (BMEET), and audit committee (ACOM). BSIZ denotes the number of directors on the board. BCOM is the proportion of independent non-executive directors to the total number of directors on the board. CEOD is equal to one if the CEO also holds the position of board chair, and zero otherwise. BMEET is evaluated by the number of board meetings held per year. ACOM is evaluated by the number of members of the audit committee (Kajananthan, 2012; Bulathsinhalage & Pathirawasam, 2017; Zaid et al., 2020; Feng et al., 2020).

Moderating variable

Impact of CG practices on CS decisions is measured using both direct and indirect approaches. In this sense, BGD has been introduced as a moderating variable in the analysis. It is measured as the proportion of woman directors on the board (Altaf et al., 2021).

Control variables

Control variables eliminate model misspecification and take into account additional variables that could affect the firm's CS possibilities. Based on the existing literature on the association between CG and CS, firm size is considered as a control variable of the study. It is the natural logarithm of the total assets of firms.

4. FINDINGS AND DISCUSSION

Table 1. Descriptive Statistics

	Mean	Median	Maximum	Minimum	Std. Dev.
BSIZ	8.208	8.000	15.000	3.000	2.231
BCOM	0.395	0.400	1.000	0.182	0.109
BGD	0.082	0.071	0.667	0.000	0.105
CEOD	0.880	1.000	1.000	0.000	0.325
BMEET	5.268	4.000	14.000	2.000	2.797
ACOM	3.186	3.000	6.000	2.000	0.721
FSIZ	8.239	8.617	10.568	5.508	1.380
LDTA	0.061	0.013	0.458	0.000	0.091

Table 1 shows the descriptive statistics of CS decisions (LDTA), and BG practices and firm size. 100 listed companies are drawn from a range of capital goods, food, beverage and tobacco, consumer services, and materials sectors. The average long-term leverage (LDTA) of listed firms is 0.061 within the range between 0.458 and 0.000. BSIZ for the Sri Lankan selected firms averaged 8 members among them 39.5% of directors are independent non-executive directors. BGD ranges from 0 to 0.667 and the mean value is 0.082. CEOD has a mean value of 0.880. Averagely, a firm conducts about five board meeting per year. The mean value of ACOM is 3.186, which ranges from 2 to 6.

Table 2: Correlation Matrix

	BSIZ	BCOM	BGD	CEOD	BMEET	ACOM	FSIZ	LDTA
BSIZ	1.000							

BCOM	-0.203**	1.000						
	0.000	-----						
BGD	-0.022	-0.039	1.000					
	0.629	0.381	-----					
CEOD	0.068	0.101	-0.057	1.000				
	0.126	0.023	0.204	-----				
BMEET	0.265**	0.050	-0.111	0.143**	1.000			
	0.000	0.263	0.013	0.001	-----			
ACOM	0.040	-0.139**	0.063	0.128	0.215**	1.000		
	0.372	0.002	0.161	0.004	0.000	-----		
FSIZ	-0.050	0.096**	0.236**	0.027	0.101**	-0.045	1.000000	
	0.266	0.032	0.000	0.547	0.025	0.317	-----	
LDTA	0.145**	0.046	-0.142**	0.177**	0.292**	-0.114**	0.187**	1.000
	0.001	0.305	0.001	0.000	0.000	0.010	0.000	-----

** statistically significant at 5% level

Table 2 shows the Pearson correlation coefficient between BG practices and CS decisions of listed companies in Sri Lanka. According to the findings, the correlation coefficient between BSIZ and CS decisions is 0.145, which is positive and significant at 5% level. Likewise, BCOM has not shown any significant relationship with CS decision at 5% level. BGD has a weak negative relationship with CS decision at 5% significant level. The correlation coefficient between CEOD and CS decision is positive at 5% levels. BMEET also has a correlation coefficient of 0.292 at a

significant level of 5%. Hence, it represents a weak positive relationship with CS decisions. The correlation coefficient between ACOM and CS decision is -0.114, which is significant at 5% level. FSIZ has a correlation coefficient of 0.187 with a probability of 0.000. Hence, it represents the weak positive relationship between FSIZ and CS decisions.

Table 3: Panel Regression Analysis

	Fixed effect		**Random effect**	
	(1)	**(2)**	**(1)**	**(2)**
Constant	-0.084	-0.117	-0.102**	-0.123**
BSIZ	0.003**	-0.004	0.001	0.001
BCOM	0.085**	0.132**	0.072**	0.119***
CEOD	0.032**	-0.042	-0.037*	-0.037
BMEET	0.003	0.022***	0.004**	0.024***
ACOM	0.011***	0.001	0.017***	0.003
Interactions				
BSIZ × BGD		0.046		0.032
BCOM × BGD		-0.128**		-0.098**
CEOD× BGD		-0.582**		-0.055
BMEET × BGD		0.033		0.052***
ACOM × BGD		-0.171**		-0.133**
Controls				
FSIZ	0.0104	0.009	0.011***	0.011**
R-squared	0.7747	0.7869	0.5669	0.8675
Adjusted R-squared	0.7146	0.7266	0.4327	0.7925
F-statistic	12.902	13.058	4.224	3.8552
Prob(F-statistic)	0.0000	0.0000	0.0001	0.0000
Durbin Watson	1.821	1.896	1.570	1.609

*, **and *** statistically significant at 10%, 5% and 1% levels

Table 3 represents panel data regression analysis for the listed companies in Sri Lanka. According to the Hausman test, the fixed effect model is recommended. Consequently, the results of the fixed effect model were taken into consideration for the following discussion. According to the adjusted R-squared value, the explanatory factors in the empirical model explained approximately 73% of the variation in CS decisions. F-test results show a statistically significant p-value. (13.058; $p < 0.05$). Consequently, the econometric model fits the data well.

In evaluating the model based on the fixed effect regression model's findings, the result shows that the BSIZ has a positive and statistically significant impact on CS decision (ß=-0.003, $p< 0.05$). The finding implies that a greater BSIZ resulted in a higher level of debt supporting H_1. Firms with large boards have a better chance of obtaining funding from outside sources to increase the firm's worth. The results are consistent with previous research undertaken by Zaid et al. (2020) and Usman et al. (2019). BCOM variable has a positive and statistically significant impact on CS

decisions supporting H_2. It indicates that debt funding for businesses increases in proportion to the number of independent non-executive directors present in the boardroom. This finding is consistent with the prior studies conducted by Zaid et al. (2020) and Amin et al. (2022). When exploring the impact of CEOD on CS decisions, it has a positive and significant coefficient (ß = 0.032; $p < 0.05$) of the CEO duality variable. Therefore, H_3 is supported. This finding is in line with the prior studies conducted by Bajagai et al. (2019). ACOM has a significant positive impact on CS decisions (ß =-0.011, $p< 0.05$). Hence, H_5 is supported by finding. It is also in accordance with previous finding of Meah (2019). As seen in table 4, H_4 is not supported by findings as BMEET have no significant impact on CS decisions.

Moving to the moderating effect, the results expose no significant effect of the interaction between gender diversity and BSIZ (ß=-0.046, $p> 0.05$). This indicates that when the percentage of females in the boardroom increases the effect of the board size on the firm's debt level will not be changed. BCOM unveils a negative coefficient, and significant influence of the interaction between BCOM and gender diversity on firm leverage level (ß =-0.128, $p< 0.05$). The impact of BCOM was turned from positive to negative. Likewise, CEOD has a significant negative impact on the interaction between CEOD and gender diversity on firm leverage level (ß = -0.582, $p< 0.05$). The impact of CEOD was turned from positive to negative. It points out that the tenure of the CEO is adversely linked to leverage, as rooted CEOs desire little leverage to cut performance pressures. Furthermore, ACOM has a significant negative impact on the interaction between ACOM and gender diversity on firm leverage level (ß = -0.582, $p< 0.05$). The impact of ACOM was turned from positive to negative. Moreover, the results expose no significant effect of the interaction between gender diversity and BMEET (ß=-0.033, $p> 0.05$). H_6 is supported by finding as BGD moderates the relationship between BG practices and CS decisions of listed companies in Sri Lanka in terms of BOM, CEOD and ACOM.

5. CONCLUSION

This research study aspires to assess the impact of board governance practices on capital structure decisions of the listed companies in Sri Lanka and how it is moderated by gender diversity. The panel regression analysis that was run between board governance practices with capital structure decisions has been discussed; further moderation was tested with gender diversity. The direct effect was converted into an indirect effect between the board size and capital structure decisions, which shows that board diversity moderates its relation. The board composition on debt creates a moderating effect and it can be concluded that the firm will be affected by the gender diversity of the board members, which would affect the financial decisions of the company. The positive impact was converted into a negative effect between the separation of duties between the CEO and chairman of a company, which demonstrates that the relationship is moderated by the participation of women on the board. The impact of the audit committee changes from a significant positive to a negative effect when the proportion of women on the board increases.

The assertion of this study, which is consistent with previous research and supported by the agency theoretical framework, is that gender diversity has significant consequences for the financing decisions of the listed companies in Sri Lanka. Board governance attributes are more likely to significantly influence firms' capital structure when interacting with a high level of gender diversity. The study's conclusions include recommendations for improving monitoring processes and introducing and examining new methods that can help businesses to draw in greater resources and create an optimal capital structure. It would also assist policymakers in various aspects in determining the adequacy of corporate governance reforms to improve capital structure management.

The study contains a few limitations that could guide various future studies. The sample of 100 companies was selected from only four sectors. Future studies may use other sectors for their study and make comparisons. Moreover, the research should use many other attributes of corporate governance, which may be more useful in future research. Furthermore, an analysis for a longer period may provide more valid results. It is better to apply mixed method techniques for future studies.

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