

Capital Structure and Its Effects on Firm Performance and Value: Evidence from Non-Financial Firms in Southeast Asia

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ABSTRACT

This research investigates the impact of capital structure on the performance and value of non-financial firms listed in Southeast Asia. Capital structure is represented by the Debt to Equity Ratio (DER) and the Debt to Asset Ratio (DAR), while performance and value are evaluated through Return on Assets (ROA), Return on Equity (ROE), and Tobin's Q. By utilizing secondary data sourced from the OSIRIS database covering the period from 2019 to 2023, the study employs panel data regression methods to analyze the proposed relationships. The findings reveal that DER significantly negatively affects ROA, suggesting that high levels of debt may impair asset efficiency. Conversely, DER does not have a significant effect on ROE or Tobin's Q. On the other hand, DAR exhibits a positive and significant correlation with ROE, indicating that leverage can be advantageous when managed properly, although its impact on ROA and firm value is not statistically significant.

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INTRODUCTION

Capital structure constitutes one of the most fundamental and enduring issues in corporate finance, as it directly determines how firms allocate financial resources between debt and equity to support their operations and long-term investment strategies (Hossain, 2021; Kruk, 2021). Decisions related to capital structure are not merely technical financing choices; rather, they reflect managerial risk preferences, corporate governance quality, and strategic orientation toward growth and sustainability sustainability (Jensen & Meckling, 1976; Karaca et al., 2025; Kartika et al., 2023). An inappropriate capital structure may expose firms to excessive financial risk, whereas an optimal configuration can enhance efficiency, discipline managerial behavior, and support value creation over time (F. Ahmed et al., 2024).

In theory, capital structure affects firm outcomes through several channels. From the perspective of agency theory, the separation between ownership and control creates conflicts of interest between managers. An inappropriate capital structure may expose firms to excessive financial risk, whereas an optimal configuration can enhance efficiency, discipline managerial behavior, and support value creation over time (Arhinful et al., 2025; Zhou & Lok, 2024).

In theory, capital structure affects firm outcomes through several channels. From the perspective of agency theory, the separation between ownership and control creates conflicts of interest between managers and shareholders. Debt financing can mitigate these conflicts by imposing fixed contractual obligations that restrict managerial discretion and



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reduce free cash flow problems, thereby encouraging managers to operate more efficiently (Chowdhury et al., 2024; Imbierowicz & Streitz, 2024; Jensen & Meckling, 1976). However, excessive leverage may also intensify agency conflicts between shareholders and creditors, increasing monitoring costs and the likelihood of financial distress (Alabdulkarim et al., 2019; Kruk, 2021).

These competing effects are formalized in the trade-off theory, which argues that firms balance the tax advantages of debt against the expected costs of bankruptcy and financial distress when determining their optimal capital structure (Myers, 1984). According to this framework, leverage can improve firm performance up to a certain threshold, beyond which additional debt becomes detrimental. In contrast, the pecking order theory emphasizes information asymmetry between managers and external investors, suggesting that firms prefer internal financing, followed by debt, and issue equity only as a last resort due to higher signaling costs and ownership dilution (Myers & Majluf, 1984). These theories collectively imply that the relationship between capital structure and firm outcomes is unlikely to be uniform across firms, industries, and institutional environments.

Empirical studies investigating the effect of capital structure on financial performance have produced mixed and sometimes contradictory results. Several studies report that leverage enhances profitability by strengthening managerial discipline and improving operational efficiency, particularly in competitive markets where cost control is critical (Ayalew & McMillan, 2021; Mathur et al., 2021). Conversely, other studies document a negative relationship between leverage and performance, attributing this effect to high interest burdens, increased earnings volatility, and reduced flexibility in responding to economic shocks (A. M. Ahmed et al., 2023; El-Sayed Ebaid, 2009; Le & Phan, 2017). These divergent findings suggest that the impact of capital structure on financial performance is context-dependent and influenced by firm-specific as well as institutional factors.

Beyond internal performance, capital structure is also expected to influence firm value, as reflected in market-based measures such as Tobin's Q. According to signaling theory, capital structure decisions convey information to investors regarding management's confidence in future cash flows and growth prospects (Ross, 1977). In this view, higher leverage may be interpreted as a positive signal, leading to higher firm valuation. Nevertheless, empirical evidence from emerging markets frequently shows that the relationship between leverage and firm value is weak or statistically insignificant (Bui et al., 2023; Ferriswara et al., 2022). This indicates that investors may rely more heavily on profitability, growth opportunities, governance quality, and macroeconomic stability rather than leverage ratios alone when valuing firms.

Recent literature further emphasizes the importance of institutional and regional context in shaping the capital structure, performance and capital structure–value relationships. Ronoowah and Seetanah (2023) highlight that differences in legal systems, financial market development, and corporate governance frameworks can significantly alter how leverage affects firm outcomes. Similarly, Vargas et al. (2022) show that the effectiveness of capital structure decisions may depend on firms' strategic capabilities and innovation orientation. Despite the growing body of research, much of the existing empirical evidence remains fragmented and heavily concentrated in single-country settings, limiting the generalizability of findings across regions.

Southeast Asia represents a particularly relevant context for examining these issues. The region is characterized by rapid economic growth, increasing integration into global capital markets, and substantial heterogeneity in financial systems and regulatory environments. While firms in Southeast Asia have gained broader access to external financing, particularly debt, questions remain regarding whether increased leverage translates into improved financial performance and higher market valuation. Empirical evidence on this issue, especially for non-financial firms and from a comparative cross-country perspective, remains limited.

Motivated by these gaps, this study investigates the direct impact of capital structure on financial performance and firm value in publicly listed non-financial firms across five Southeast Asian countries, Indonesia, Malaysia, Thailand, Singapore, and the Philippines, over the period 2019-2023. Capital structure is proxied by the Debt to Equity Ratio (DER) and the Debt to Asset Ratio (DAR). Financial performance is measured using Return on Assets (ROA) and Return on Equity (ROE), while firm value is represented by Tobin's Q. By employing a cross-country panel data approach using standardized data from the OSIRIS database, this study aims to provide more robust and generalizable evidence on how capital structure influences firm outcomes in emerging markets.

This research contributes to the corporate finance literature in three important ways. First, it extends prior studies by offering a comparative regional analysis of Southeast Asian firms, a context that remains underexplored. Second, it simultaneously examines the effects of capital structure on both internal performance measures and external market valuation. Third, the findings provide practical insights for corporate managers, investors, and policymakers in designing financing strategies and regulatory frameworks that are better aligned with the characteristics of emerging markets.

Capital Structure and Financial Performance

From a theoretical perspective, the relationship between capital structure and financial performance is primarily explained by agency theory and trade-off theory. Agency theory argues that debt can function as a disciplinary mechanism by limiting managerial discretion through fixed interest obligations, thereby reducing agency costs and improving operational efficiency (Jensen & Meckling, 1976). Similarly, trade-off theory posits that firms benefit from debt financing due to tax advantages and enhanced discipline up to an optimal level, beyond which the costs of financial distress, bankruptcy risk, and agency conflicts with creditors begin to outweigh the benefits (Myers, 1984). These theoretical arguments suggest that leverage may either enhance or impair firm performance depending on how close firms are to their optimal capital structure. Empirical evidence, however, remains inconclusive, particularly in emerging market contexts. Some studies document a positive relationship between leverage and profitability, indicating that debt can improve managerial efficiency and asset utilization (Ayalew & McMillan, 2021; Mathur et al., 2021). In contrast, other studies report negative or insignificant effects of leverage on performance, attributing these outcomes to high interest burdens, earnings volatility, and limited financial flexibility (A. M. Ahmed et al., 2023; El-Sayed Ebaid, 2009; Le & Phan, 2017). These mixed findings highlight the need for further empirical investigation across different institutional settings. Based on these theoretical considerations and prior empirical results, the first hypothesis is formulated as follows:

H₁: Capital structure has a significant effect on financial performance.

Capital Structure and Firm Value

Capital structure is also expected to influence firm value through market perceptions and investor responses. According to signaling theory, financing decisions convey information about a firm's quality, risk profile, and future growth prospects. The use of debt may signal managerial confidence in stable future cash flows, potentially leading to higher market valuation (Ross, 1977). From this perspective, leverage can enhance firm value when investors interpret debt issuance as a credible signal of strength and growth potential. Nevertheless, empirical evidence from emerging markets suggests that the relationship between capital structure and firm value is far from consistent. Several studies find that higher leverage does not necessarily translate into higher market valuation, as investors may focus more on profitability, growth opportunities, corporate governance quality, and macroeconomic stability rather than leverage ratios alone (Bui et al., 2023; Ferriswara et al., 2022). In some cases, excessive debt may even be perceived as a source of financial risk, thereby weakening investor confidence. Given these competing theoretical arguments

and empirical findings, the second hypothesis is proposed as follows:
H₂: Capital structure has a significant effect on firm value.

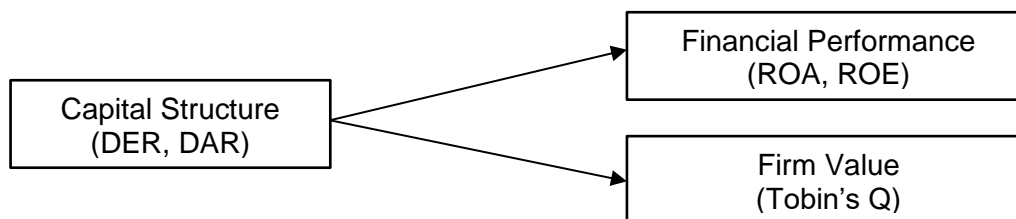


Figure 1. Research framework
Source: Data process by author (2025)

METHODS

This study employs a quantitative causal research design to examine the effect of capital structure on financial performance and firm value in publicly listed non-financial companies across five Southeast Asian countries, Indonesia, Malaysia, Thailand, Singapore, and the Philippines, over the period 2019-2023. A purposive sampling technique is applied based on specific criteria to ensure data consistency and comparability. Firms included in the sample are required to be continuously listed throughout the observation period and to disclose complete and consistent financial data relevant to the variables examined in this study.

Secondary financial and market data are obtained from the OSIRIS database, which provides standardized firm-level information across countries. Capital structure is measured using the Debt to Equity Ratio (DER) and the Debt to Asset Ratio (DAR). Financial performance is proxied by Return on Assets (ROA) and Return on Equity (ROE), while firm value is represented by Tobin's Q. In addition to the main variables, several control variables are incorporated to enhance the robustness of the regression models, namely firm size (FIRM_SIZE), revenue growth (R_GROWTH), asset tangibility (TANGIBILITY), and liquidity (LIQUIDITY).

Panel data regression techniques are employed using Stata software to estimate the proposed empirical models. Model selection is determined through a series of diagnostic tests, including the Chow test, Hausman test, and Lagrange Multiplier test, to identify the most appropriate estimation approach among the common effects, fixed effects, or random effects models. Hypothesis testing is conducted at the 1%, 5%, and 10% significance levels to evaluate the statistical significance and robustness of the estimated relationships.

RESULTS AND DISCUSSION

This study employs panel data regression analysis to examine the impact of capital structure on financial performance and firm value among publicly listed non-financial firms in five Southeast Asian countries over the period 2019-2023. Capital structure is proxied by the Debt to Equity Ratio (DER) and the Debt to Asset Ratio (DAR), while financial performance is measured using Return on Assets (ROA) and Return on Equity (ROE), and firm value is represented by Tobin's Q. The regression results are summarized in Table 1.

Tabel 1. Regression Results of Capital Structure on Financial Performance and Firm Value

	ROA	ROE	Tobin's Q
DER	-7.80e-11 *** (1.48e-11)	4.41e-12 (3.47e-11)	-2.22e-12 (5.24e-12)
DAR	1.33e-11 (1.89e-11)	1.04e-10 ** (4.38e-11)	5.85e-12 (6.80e-12)

Source: data that has been processed by the author (2025)

Notes:

Numbers in parentheses are standard errors.

***p<0.01, **p<0.05, p<0.1

The regression results in Table 1 indicate that the effects of capital structure on firm outcomes vary across different performance and valuation measures. These findings suggest that leverage does not exert a uniform influence on corporate performance or market valuation, but instead produces differentiated effects depending on how debt is structured and which outcome variable is considered.

Focusing first on financial performance measured by ROA, the coefficient of DER is negative and statistically significant at the 1% level. This result indicates that firms with higher debt relative to equity tend to exhibit lower asset profitability. In practical terms, increased reliance on debt appears to constrain firms' ability to generate returns from their asset base, potentially due to higher interest expenses and reduced operational flexibility.

In contrast, the coefficient of DAR on ROA is positive but not statistically significant. Although this positive sign suggests that debt-financed assets may contribute to operational efficiency, the magnitude of the effect is insufficient to generate statistically observable improvements in asset profitability. This implies that the mere expansion of assets through debt does not automatically translate into higher returns unless those assets are deployed productively.

When financial performance is measured using ROE, the regression results reveal a different pattern. The coefficient of DER on ROE is positive but statistically insignificant, indicating that higher leverage does not reliably enhance shareholder returns. This finding suggests that the potential leverage effect on equity returns may be offset by increased financing costs or earnings volatility, thereby weakening its observable impact.

Conversely, DAR exhibits a positive and statistically significant relationship with ROE at the 5% level. This result implies that firms with a higher proportion of debt relative to total assets tend to generate higher returns for equity holders. The finding indicates that, under certain conditions, debt financing can magnify returns to shareholders when firms are able to generate returns that exceed the cost of borrowing.

With respect to firm value, neither DER nor DAR demonstrates a statistically significant effect on Tobin's Q. Although the coefficients of both leverage measures are negative for DER and positive for DAR, their lack of significance suggests that variations in capital structure do not systematically influence market valuation in the sampled firms. This implies that investors may not place substantial weight on leverage ratios when assessing firm value.

Taken together, these results indicate that capital structure has a more pronounced effect on internal financial performance than on external market valuation. Moreover, the impact on performance itself is selective, influencing certain profitability measures while leaving others unaffected.

The negative and significant relationship between DER and ROA is consistent with the trade-off theory, which posits that excessive leverage increases the costs of financial distress and reduces operational efficiency once firms surpass their optimal debt level (Myers, 1984). In the context of Southeast Asia, where firms often face volatile economic conditions and uneven access to capital markets, high debt burdens may exacerbate financial risk and limit managerial flexibility.

This finding also aligns with the pecking order theory, which suggests that firms

relying heavily on external debt due to insufficient internal funds may experience weaker performance outcomes (Myers & Majluf, 1984). High DER may reflect financial constraints rather than strategic leverage, thereby explaining its adverse impact on asset profitability.

The insignificant effect of DER on ROE suggests that leverage does not consistently enhance shareholder returns. While financial theory predicts that debt can amplify equity returns when returns on assets exceed borrowing costs, this mechanism may be undermined by rising interest expenses, earnings volatility, and conservative dividend policies. Similar results have been documented in prior studies conducted in emerging markets (El-Sayed Ebaid, 2009; Le & Phan, 2017).

In contrast, the positive and significant effect of DAR on ROE supports the notion of a conditional leverage effect. When debt is effectively used to finance productive assets, it can enhance returns to equity holders. This result is consistent with empirical findings that highlight the importance of asset utilization and capital allocation efficiency in determining the benefits of leverage (Ayalew & McMillan, 2021; Mathur et al., 2021).

The absence of a significant relationship between leverage and Tobin's Q suggests that capital structure decisions do not strongly influence market valuation in the sampled countries. From a signaling theory perspective, this finding implies that debt issuance may not be interpreted as a credible signal of firm quality or growth prospects by investors (Ross, 1977).

Prior research indicates that in emerging markets, investors tend to rely more heavily on profitability indicators, growth opportunities, corporate governance quality, and macroeconomic stability than on leverage ratios alone (Bui et al., 2023; Ferriswara et al., 2022). This may explain why variations in DER and DAR fail to produce significant changes in firm value as measured by Tobin's Q.

The findings also resonate with studies emphasizing the role of institutional context. Ronooowah and Seetanah (2023) argue that differences in regulatory frameworks and financial market development can weaken the transmission of capital structure decisions into firm valuation. In Southeast Asia, heterogeneous institutional environments may dilute the informational content of leverage.

Overall, the results provide partial support for the first hypothesis (H1), indicating that capital structure significantly affects financial performance, albeit in a differentiated manner. However, the findings do not provide strong support for the second hypothesis (H2), as capital structure does not exert a statistically significant influence on firm value.

These outcomes underscore the importance of prudent leverage management. While debt can enhance shareholder returns under certain conditions, excessive reliance on leverage may undermine asset profitability without improving market valuation. Consequently, capital structure decisions should be evaluated in conjunction with firms' operational efficiency, risk management practices, and institutional environment.

Beyond the main findings, the differentiated effects of DER and DAR underscore the importance of how leverage is structured rather than the mere presence of debt itself. DER captures the relative balance between debt and equity financing, which directly reflects financial risk borne by shareholders. A high DER may signal overdependence on external financing and heightened vulnerability to interest rate fluctuations and refinancing risk. In contrast, DAR reflects the extent to which total assets are financed by debt, which may better capture the productive deployment of borrowed funds. The divergent effects observed in this study suggest that leverage contributes positively to performance only when debt financing is closely aligned with asset expansion and efficient capital utilization.

These findings also provide insight into agency theory dynamics within Southeast Asian firms. While debt can serve as a disciplinary mechanism by reducing free cash flow and constraining managerial discretion, excessive reliance on leverage, particularly when measured relative to equity, may intensify agency conflicts between shareholders and creditors. High DER levels may encourage risk-shifting behavior or underinvestment problems, prompting creditors to impose stricter monitoring and covenants, which in turn

increase agency costs and reduce operational efficiency. This mechanism helps explain the negative association between DER and ROA, as managerial focus may shift from value creation toward meeting short-term debt obligations.

The contrasting impact of DAR on ROE further highlights the conditional nature of leverage benefits. When firms are able to generate returns on debt-financed assets that exceed borrowing costs, leverage can magnify equity returns and enhance shareholder wealth. This outcome is particularly relevant for firms operating in growth-oriented sectors, where access to debt enables expansion and economies of scale. However, the absence of a significant effect on ROA suggests that such benefits are not uniformly distributed across operational performance metrics, reinforcing the argument that leverage effectiveness depends heavily on asset productivity and managerial capability.

From a broader perspective, the insignificant relationship between capital structure and firm value points to the limited signaling role of leverage in Southeast Asian capital markets. Unlike in more developed markets, where debt issuance may be interpreted as a credible signal of managerial confidence, investors in emerging markets appear to discount leverage information due to concerns over market inefficiencies, governance quality, and macroeconomic volatility. This weak market response implies that capital structure decisions alone are insufficient to influence firm valuation unless accompanied by strong fundamentals, transparent governance, and stable institutional conditions.

Based on the above discussion, the heterogeneous results across performance and value measures emphasize the need for nuanced capital structure policies at the firm level. A uniform leverage strategy may not be optimal across different firms or institutional environments. Instead, managers should tailor financing decisions to firm-specific characteristics, such as profitability, asset structure, and growth opportunities, while considering external factors including regulatory frameworks and financial market development. These considerations reinforce the study's contribution to the literature by demonstrating that the impact of capital structure in emerging markets is complex, context-dependent, and mediated by both internal efficiency and external institutional factors.

CONCLUSION

This study examines the effect of capital structure on financial performance and firm value among publicly listed non-financial firms in five Southeast Asian countries over the period 2019–2023. Using panel data regression and leverage proxies in the form of the Debt to Equity Ratio (DER) and Debt to Asset Ratio (DAR), the findings indicate that capital structure exerts a differentiated impact on firm outcomes. Specifically, DER is found to have a significant negative effect on Return on Assets (ROA), suggesting that excessive reliance on debt relative to equity can reduce asset efficiency and intensify financial burdens. In contrast, DAR shows a positive and significant relationship with Return on Equity (ROE), indicating that debt can enhance shareholder returns when it is used to finance productive assets. However, neither DER nor DAR has a statistically significant effect on firm value as measured by Tobin's Q, implying that leverage decisions do not systematically influence market valuation in the sampled firms. Overall, the results confirm that capital structure affects internal financial performance in a selective manner but does not translate directly into higher firm value in Southeast Asian markets.

The findings of this study carry several important implications. For corporate managers, the results underscore the importance of adopting a prudent and balanced capital structure, as excessive leverage may undermine operational efficiency without improving market valuation. Managers should therefore focus not only on increasing leverage but also on ensuring that debt is allocated toward productive investments that enhance returns. For investors, the insignificant relationship between leverage and firm

value suggests that profitability, asset utilization, and institutional factors may be more informative indicators than leverage ratios alone when evaluating firms in emerging markets. From a policy perspective, the results highlight the role of institutional and financial market development in shaping the effectiveness of capital structure decisions.

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