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CORPORATE GOVERNANCE AND THE FIRM'S CAPITAL STRUCTURE (CASE STUDY OF LISTED COMPANIES IN TEXTILE INDUSTRY OF PAKISTAN)

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Abstract
Corporate governance is an evolving area of research in management. Hence, study in hand has observed the relationship of corporate governance with that of the capital structure in listed organizations of Textile Industry in Pakistan Stock Exchange. Related literature is reviewed to extract results of earlier studies regarding corporate governance. Moreover, related variables have been studied and analyzed through the annual reports of selected firms for five years. Corporate governance is explained by board size, independent members on companies' board non-executive members on the companies' board and chairman duality. Capital structure is explained through debt-equity ratio. Correlation of independent variables including size of board (total number of the directors on companies' board), non-executive directors on board and directors independent on board with the dependent variable Debt Equity Ratio was calculated through statistical software SPSS. Significant correlation was observed between percentage of debt equity ratio with independent directors on company's board and non-executive directors on company's board. However, correlation was not found significant in between debt-equity ratio and board size of the listed textile companies in Pakistan Stock Exchange. It is apparent from the said study that corporate governance observance is still at its initial stage in the listed companies of Pakistan and require considerable time and policy implementations to meet the international corporate governance practices.

Keywords: Corporate Governance, The Firm's Capital Structure, Textile Industry of Pakistan, Case Study

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INTRODUCTION

Corporate governance constitutes the framework of rules, practices, and processes by which a company is directed and controlled, balancing the interests of various corporate actors and reducing conflicts among them (OECD, 2023; Shaba, 2024). The specific manifestation of corporate governance differs internationally, shaped by distinct legal, cultural, and economic contexts (Jurist & Jurist, 2023). In Japan, traditional governance practices have emphasized long-term stability, intercorporate relationships, and broader stakeholder engagement, although recent reforms are increasing shareholder influence and transparency (Renou, 2023; Reuters, 2025). In contrast, the Anglo-American corporate governance model foregrounds shareholder primacy, focusing on maximizing shareholder value within a robust legal structure that explicitly outlines the rights and responsibilities of investors and corporate decision-makers (Jurist & Jurist, 2023; OECD, 2023).

A range of factors underpin the economic efficiency of corporate governance within firms, including shareholder monitoring, credit supervision, executive remuneration arrangements, dividend policies, regulatory compliance, and financial performance (Corporate Governance in Pakistan: Practices and Challenges, 2025; Khattak & Ahmad, 2024). Structural adaptation of governance systems is increasingly necessary due to globalization, technological progress, and deregulation, which overall heighten competitive and institutional pressures on national corporate governance frameworks (Does Corporate Governance of Pakistan Meet International Standards?, 2025; Corporate Governance in Pakistan: Practices and Challenges, 2025). In Pakistan, weak investor protection mechanisms have limited the ability of domestic firms to attract foreign capital, motivating regulatory efforts to improve governance structures (Does Corporate Governance of Pakistan Meet International Standards?, 2025).

In response, the Securities and Exchange Commission of Pakistan (SECP) first introduced corporate governance regulations in 2002, followed by the 2012 Code of Corporate Governance, with further revisions in 2014 to strengthen governance practices among listed companies by enhancing board independence and representation (Does Corporate Governance of Pakistan Meet International Standards?, 2025). These reforms aim to enhance transparency, accountability, and shareholder protection, aligning national practice with international norms (Does Corporate Governance of Pakistan Meet International Standards?, 2025; Corporate Governance in Pakistan: Practices and Challenges, 2025).

The textile sector is central to Pakistan's economy, contributing significantly to industrial employment and absorbing a major share of banking credit in the manufacturing sector. Additionally, many textile firms operate as family-owned enterprises, which often presents unique governance challenges requiring improvement to bolster sectoral performance and economic contribution (Hassan Jamal, 2024; Khattak & Ahmad, 2024). Decisions regarding capital structure are influenced by management and board governance mechanisms; optimal capital

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structure is crucial for attracting investors, and governance practices affect how firms balance debt and equity financing (Haque & Shamshir, 2024; Khattak & Ahmad, 2024). Empirical evidence from Pakistan suggests that governance characteristics, including board composition and ownership structure, are significantly related to capital structure outcomes among non-bank firms (Khattak & Ahmad, 2024).

Corporate governance continues to be a dynamic area of management research, with most literature focused on firm performance; however, the interaction between corporate governance and capital structure remains less explored and represents a significant gap in the context of developing economies (Corporate Governance in Pakistan: Practices and Challenges, 2025; Khattak & Ahmad, 2024). In Pakistan, formal corporate governance practices are relatively recent, and SECP codes constitute foundational institutional efforts to improve compliance and governance outcomes in domestic firms (Does Corporate Governance of Pakistan Meet International Standards?, 2025).

This study's objectives are to examine the relationship between corporate governance practices and capital structure among textile firms listed on the Pakistan Stock Exchange and to provide insights for enhancing governance in this pivotal sector. The findings are expected to guide practitioners in making informed strategic decisions and to contribute to broader academic and policy discussions on governance mechanisms in emerging economies.

LITERATURE REVIEW

A substantial body of empirical research has examined the relationship between corporate governance mechanisms and firm performance, with increasing attention on how governance influences capital structure decisions in developing and emerging markets. Contemporary studies provide evidence that corporate governance characteristics such as board independence, board size, ownership concentration, and governance compliance significantly affect capital structure dynamics and related financial outcomes (Khattak & Ahmad, 2024; Aslam et al., 2024; Farooq et al., 2024). These investigations have broadened the understanding beyond traditional performance measures to include leverage and financing policy implications.

Corporate governance practices and their effects on firm value and financial decisions are shaped by differing economic, regulatory, and institutional environments. Literature suggests that when governance frameworks are stronger, firms tend to make more disciplined financing choices, thereby optimizing their debt–equity mix and reducing agency conflicts (Adams & Jayasekara, 2024). Poor governance, by contrast, often leads to suboptimal capital allocation and increased financial risk (Adams & Jayasekara, 2024).

Empirical evidence from Pakistan also affirms the relevance of governance features in shaping capital structure outcomes. For example, a study on Pakistani non-bank firms reported that various governance attributes have observable effects on debt ratios and leverage adjustments (Khattak & Ahmad, 2024). Specifically, the study found that board composition and ownership structures are statistically linked to capital structure

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ratios, highlighting the importance of governance oversight in financial decision-making (Khattak & Ahmad, 2024). Similarly, research analyzing capital structure dynamics in Pakistan identified that governance quality significantly influences the speed of adjustment toward targeted leverage levels, reflecting governance's role in strategic financing adjustments (Farooq et al., 2024).

Moreover, studies integrating governance compliance with performance metrics indicate that capital structure may mediate the relationship between governance mechanisms and firm outcomes. Evidence from emerging markets shows that higher compliance with corporate governance standards improves performance, though excessive debt can diminish this effect, underscoring the nuanced role of leverage in governance–performance linkages (Does capital structure mediate corporate governance compliance and firm performance? 2025). In addition, research on the moderating effects of leverage in governance–performance relationships confirms that governance variables like board size and independence can have significant interactions with leverage to influence performance outcomes (Ali et al., 2025).

Despite these advances in empirical evidence, gaps remain in understanding how specific governance mechanisms influence capital structure in different industrial contexts and regulatory environments. Nonetheless, the accumulated research consistently highlights the crucial role of corporate governance structures in shaping firms' financing strategies and their implications for financial stability and investor confidence.

STATEMENT OF PROBLEM

The determination behind this effort is to explore the outcomes of corporate governance being observed on the capital structure of organization. Few variables of corporate governance are selected for analysis including size of the board, non-executive member, and composition of BOD on capital structure.

RESEARCH PHILOSOPHY

The two approaches of research philosophies will use in this study.
Realism; objects exist independently to our knowledge
Interpretive; understand the situational differences.

HYPOTHESIS

H1: there is a positive effect of corporate governance on capital structure of listed companies.
H2: there is negative effect of corporate governance on capital structure of listed companies.
H0: there is no effect of corporate governance on capital structure of listed companies.

RESEARCH METHODOLOGY

This study will analyze the relationship between corporate governance and capital structure of listed companies in PSX textile sector. The sample period that is considered for this work is 2014 to 2018 and 10 companies of textile sector are

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selected. Therefore annual reports of selected firms have used as data source. Variables in this study will measure as follows.

Dependent variable
Dependent variable will quantify by using debt equity ratio.

Independent variables
Board size: total members on the firm's board.
Non-executive members on board: Percentage of non-executive directors sitting on the board.
Board composition: the percentage of independent members on board.

DISCUSSION
Corporate governance is a current issue faced by many Pakistani firms. In particular textile sector also has these issues because of mostly firms are family owned business in textile sector of Pakistan. After introduction of code of corporate governance by SECP all firms follow these codes. Inclusion of non-executive directors, independent members on board and chairman duality are the common draw backs of this sector. Before 2012 the ratio of non-executive directors are low and after that firms tried to maintain a proportion of nonexecutive directors and independent members on board.
Board size is almost constant during sample period of selected firms; all firms in sample size consist of 7 to 9 members. Most firms have constant ratio of non-executive directors some firms have above 50% ratio of NED's during sample period. Average board size of sample firms is 7.3 and with larger board size is 9 and minimum board size is 7. Non-executive director constitute on average 59% which is quite satisfactory representation in board. Independent director's representation is quite diverse in sample firms. Some firms have constant ratio of independent directors however some firms don't have any representation of independent directors on board in sample of this study. After 2012 some firms included independent members in their board composition. Average independent member's proportion is less than 20% of sample firms.
Textile goods are the major export of Pakistan and development of textile sector is the backbone of economic development. In sample of this study all firms have a favorable asset side on their balance sheet. And debt equity ratio is positively related to size of firm more assets in balance sheet has more opportunity for debt financing which provide tax shield to organization.
Representation of non-executive directors on board has a positive impact on leverage of the firm. The firms that have high proportion of NEDs on their board has low debt equity ratio as compare to those have low proportion of NEDs.
Independent nonexecutive directors have significant impact on debt equity ratio the firms that have more independent non-executive director's representation on board have preferred high leverage. However in case of managerial holdings and family owned businesses independent directors handpicked nominees which have less influence in managerial decision making. Most firms of textile industry in Pakistan

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are family owned and with managerial holdings which have a negatively influence of capital structure of the firms.

Debt equity ratio of sample firms is different due to ownership structure and board composition. Capital Structure is significantly affected by size of firm. Firms those have more assets have the opportunity of debt financing and use these assets as collateral. Due to conservative lending policy of Pakistani commercial banks tangible assets on firm's balance sheet create a positive impact and investors also attract by size of firm. Below trend of average asset base of 10 selected textile firms and average debt-equity ratio of the same from 2014 to 2018 are in conformity that except for 2018, leveraged has increased with the enhancement of asset base in all years.

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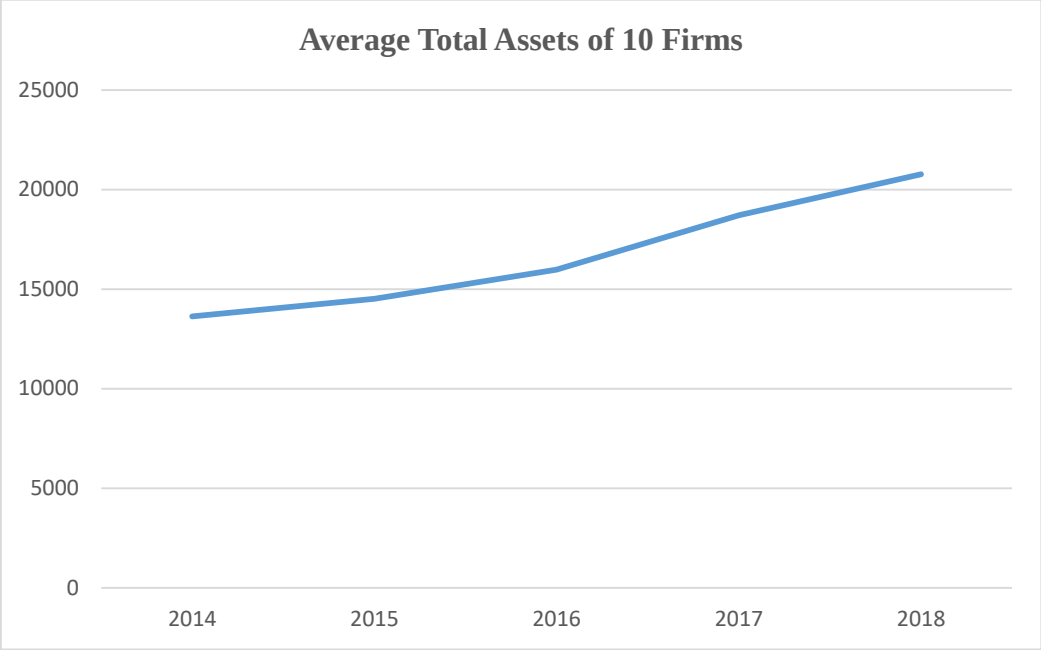

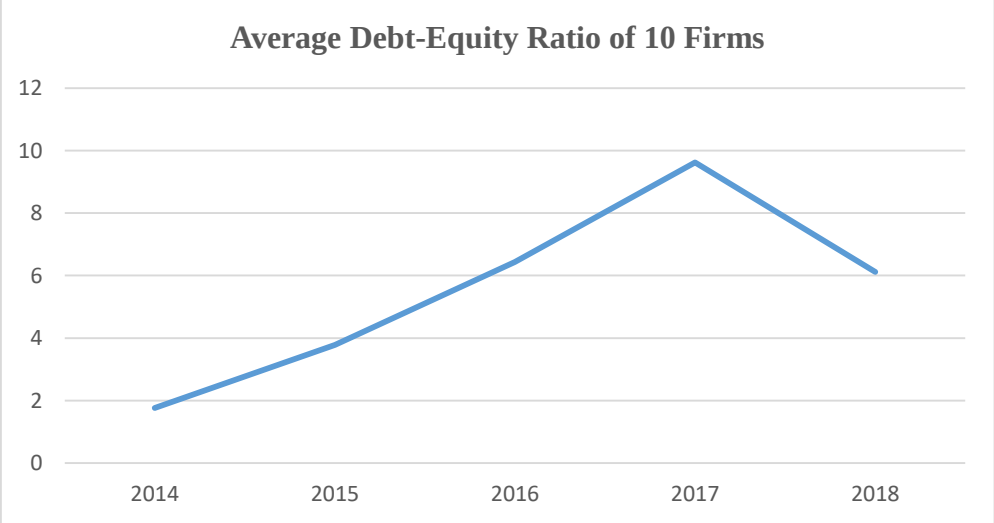

Appended below is the summary figures of the discussion made above and conclusion in the following section.

Debt Equity Ratio										
2014	2.95	0.59	2.08	0.55	4.25	2.22	1.48	0.64	2.12	0.71

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2015	2.48	0.39	1.70	0.51	24.41	2.24	2.01	0.95	2.39	0.71
2016	2.69	0.57	1.63	0.33	50.76	2.22	1.96	1.13	2.17	0.88
2017	2.36	0.64	1.88	0.48	81.12	3.42	1.75	1.50	2.19	0.89
2018	2.43	0.66	1.87	0.53	45.34	3.97	1.82	1.64	1.73	1.20
Total Assets										
2014	24,277.18	7,623.88	25,940.96	3,576.86	20,782.99	6,142.40	16,105.43	22,737.48	3,371.96	5,798.39
2015	24,943.33	7,586.98	26,959.79	3,487.63	18,518.53	5,578.75	20,457.86	28,087.80	3,265.14	6,206.26
2016	32,169.26	8,610.76	28,884.00	4,179.03	18,270.96	5,629.41	19,307.40	31,800.66	3,418.95	7,411.41
2017	36,718.67	9,470.50	34,622.60	4,650.06	18,689.99	7,322.13	20,258.02	42,532.02	3,730.00	9,149.26
2018	43,263.45	10,099.54	39,393.60	5,087.68	19,867.18	8,951.54	23,142.53	42,330.15	4,208.02	11,380.66
BOD										
2014	7	7	8	9	7	7	7	8	7	7
20	7	7	7	9	7	7	7	8	7	7

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2016	7	7	7	9	7	8	8	8	7	7
2017	7	7	7	9	7	7	8	8	7	7
2018	7	7	8	9	8	7	8	8	7	7
NEDs										
2014	71.40%	71.42%	37.50%	66.67%	28.57%	57.14%	57.14%	50.00%	57.14%	85.71%
2015	57.10%	71.42%	71.43%	66.67%	57.14%	57.14%	57.14%	50.00%	57.14%	57.14%
2016	28.57%	71.43%	71.43%	55.56%	14.29%	62.50%	75.00%	50.00%	57.14%	42.86%
2017	71.43%	71.43%	71.43%	66.67%	42.86%	14.29%	75.00%	62.50%	57.14%	71.43%
2018	71.43%	71.43%	75.00%	55.56%	25.00%	71.43%	75.00%	62.50%	42.86%	57.14%
BoC										
2014	42.85%	14.28%	25.00%	11.11%	14.28%	14.28%	14.28%	12.50%	0.00%	0.00%
2015	42.85%	14.28%	14.29%	11.11%	28.57%	14.28%	14.28%	12.50%	0.00%	14.29%

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2016	42.86%	14.29%	14.29%	22.22%	42.86%	12.50%	12.50%	12.50%	14.29%	28.57%
2017	28.57%	14.29%	14.29%	11.11%	42.86%	57.14%	12.50%	12.50%	14.29%	14.29%
2018	28.57%	14.29%	12.50%	22.22%	50.00%	14.29%	12.50%	12.50%	28.57%	14.29%

CONCLUSION

This whole work out is trying to find the relationship of corporate governance practices and capital structure of 10 listed companies of textile sector in Pakistan. It is observed that size of firm is found to be positively related to the debt-equity ratio and more assets on firms balance sheet leads high leverage. Non-executive board members have significant negative correlation with debt-equity ratio whereas independent members have significant positive relationship to debt equity ratio of the firm. More representation of Independent directors force to management for debt financing and get benefit of tax shield. It is concluded that in Pakistan corporate governance practices are still in their beginning stage and the major reason is closely held and family-owned businesses. It takes plenty of time to accept these changes. Code of corporate governance 2002, 2012 and 2014 amendments by SECP is provided the basis to go through on this direction and can compete with the international standards of corporate governance. Further contribution in this study may be made through taking even longer period or the other sectors of the economy. Moreover, another point that is observed related to inverse relation of asset base and leverage in 2018 needs to be investigated in further studies.

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