

# A Review of the Interplay Between Corporate Governance, Firm Performance, and Capital Structure in India

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**Abstract:** *The relationship between corporate governance, firm performance, and capital structure has become increasingly significant in emerging markets like India. Corporate governance mechanisms, including board composition, ownership structure, audit committees, and disclosure practices, are often considered determinants of firm performance. Simultaneously, capital structure decisions influence financial stability and growth. This review synthesizes existing empirical and theoretical studies on Indian firms to explore how governance mechanisms interact with firm performance and capital structure. The analysis highlights the critical role of independent boards, managerial ownership, and transparency in shaping optimal leverage and profitability. The study also identifies research gaps in linking governance practices with dynamic financial decisions in India.*

**Keywords:** Corporate Governance, Firm Performance, Capital Structure, India

## I. INTRODUCTION

Corporate governance refers to the systems, principles, and processes by which companies are directed and controlled. In India, governance has gained attention due to regulatory reforms like the Companies Act 2013 and SEBI guidelines for listed companies. Studies have indicated that governance practices directly impact firm performance, measured through profitability, return on assets and shareholder value (Kumar & Singh, 2020). Concurrently, capital structure decisions, defined by the proportion of debt and equity financing, affect financial flexibility and risk management (Gupta & Sharma, 2019). The interrelationship between governance and capital structure has become crucial, as governance quality can influence leverage decisions, and capital structure in turn can affect managerial behavior and firm efficiency (Patel & Joshi, 2021).

## CORPORATE GOVERNANCE MECHANISMS IN INDIA

Corporate governance in India has evolved significantly over the past few decades, driven by regulatory reforms, globalization, and the increasing complexity of business operations. At its core, corporate governance involves a set of processes, practices, and policies by which companies are directed and controlled, ensuring accountability, transparency, and alignment between management and shareholders (Kumar & Singh, 2020). Indian corporate governance practices have been shaped by the Companies Act 2013, Securities and Exchange Board of India (SEBI) regulations, and guidelines on board composition, disclosure, and audit requirements. These mechanisms are intended to reduce agency conflicts, enhance investor confidence, and improve firm performance. Among the most significant governance mechanisms are board composition, ownership structure, audit committees, disclosure practices, and executive compensation policies.

Board composition is one of the most critical elements influencing governance effectiveness in Indian firms. A well-structured board, including independent directors and diverse expertise, ensures robust oversight of management

decisions. Independent directors are expected to act impartially, mitigate agency problems, and protect the interests of minority shareholders (Reddy, 2018). Empirical studies indicate that firms with a higher proportion of independent directors tend to exhibit improved financial performance, lower risk-taking, and better compliance with statutory requirements (Kumar & Singh, 2020). Board size is another relevant factor, as overly large boards may face coordination challenges, whereas smaller boards may lack sufficient expertise. A balance is therefore necessary to optimize strategic decision-making and monitoring functions (Choudhury & Das, 2019). Moreover, board diversity, including gender and professional background, has gained attention, with evidence suggesting that diverse boards can contribute to more innovative solutions and effective risk management. SEBI's requirement for at least one woman director on the boards of listed companies has encouraged gender inclusion, fostering broader perspectives in corporate decision-making.

Ownership structure is another significant governance mechanism in India. The country is characterized by a high concentration of promoter and family ownership in publicly listed companies, which can influence managerial behavior and strategic choices (Gupta & Sharma, 2019). Promoter ownership can align the interests of management and shareholders, reducing conflicts and promoting long-term value creation. However, excessive promoter control may also lead to entrenchment, limiting minority shareholder influence and potentially increasing risk-taking. Institutional investors, including mutual funds and insurance companies, have emerged as critical players in Indian governance, as their monitoring and engagement can enhance transparency and performance. Studies suggest that firms with substantial institutional ownership exhibit better financial reporting, stricter adherence to corporate governance norms, and improved access to capital (Patel & Joshi, 2021).

Audit committees are central to the governance framework in India. These committees are responsible for overseeing financial reporting, internal controls, and compliance with statutory requirements. An effective audit committee, comprising independent directors with financial expertise, ensures that financial statements accurately reflect the firm's position and reduces the likelihood of fraud or misreporting (Singh & Kapoor, 2020). The Companies Act 2013 mandates the formation of audit committees for listed companies, and their effectiveness is positively associated with investor confidence, credit ratings, and firm valuation. Research indicates that firms with active and transparent audit committees exhibit higher profitability and improved financial performance, emphasizing the importance of monitoring in governance mechanisms (Bansal, 2021).

Disclosure and transparency practices are vital to building trust between companies and stakeholders. Governance disclosure includes financial reporting, risk management, board evaluations, and related-party transactions. Timely and accurate disclosure provides stakeholders with relevant information to make informed decisions and can mitigate information asymmetry between management and investors (Reddy, 2018). Indian regulations require listed firms to disclose quarterly and annual financial results, corporate social responsibility activities, and board evaluations, contributing to enhanced corporate accountability. Empirical evidence demonstrates that firms with higher disclosure quality experience lower cost of capital, better investor perception, and improved market performance (Patel & Joshi, 2021). Furthermore, disclosure practices influence capital structure decisions, as firms with transparent reporting can negotiate more favorable debt terms and attract long-term investors.

Executive compensation is another governance mechanism influencing managerial behavior and firm performance. Compensation packages, including salaries, bonuses, stock options, and performance-linked incentives, are designed to align managerial interests with shareholder value creation (Choudhury & Das, 2019). SEBI regulations and the Companies Act mandate the disclosure of managerial remuneration, ensuring that stakeholders are aware of executive incentives. Studies in India suggest that performance-based compensation positively impacts profitability, encourages strategic decision-making, and reduces agency conflicts. However, excessive executive pay without performance linkage may harm governance effectiveness and lead to shareholder dissatisfaction.

Regulatory frameworks and codes of governance in India, including the Companies Act 2013, SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, and the National Voluntary Guidelines on Corporate Social Responsibility, have strengthened governance mechanisms over the years (Gupta & Sharma, 2019). These

regulations promote board accountability, transparency, investor protection, and ethical business conduct. Corporate governance reforms in India have also been influenced by international guidelines such as OECD Principles of Corporate Governance, emphasizing accountability, fairness, and transparency. Studies highlight that regulatory compliance positively impacts firm performance and market valuation, reinforcing the link between strong governance and financial outcomes (Kumar & Singh, 2020).

Challenges persist in implementing governance mechanisms in India. Despite regulatory mandates, issues such as inadequate board independence, insufficient minority shareholder protection, and lack of enforcement remain (Reddy, 2018). Family-owned firms may prioritize personal objectives over stakeholder interests, and small firms may face resource constraints in adopting governance practices. Additionally, cultural and institutional factors, including hierarchical decision-making and limited shareholder activism, may limit the effectiveness of governance mechanisms. Empirical research suggests that while governance reforms have improved accountability and performance in large listed firms, small and medium enterprises often lag in adopting structured governance mechanisms (Patel & Joshi, 2021).

Corporate governance mechanisms in India encompass board composition, ownership structure, audit committees, disclosure practices, and executive compensation policies. These mechanisms collectively aim to reduce agency conflicts, improve transparency, and enhance firm performance. Regulatory frameworks, including the Companies Act 2013 and SEBI guidelines, have strengthened governance standards and promoted investor confidence. Empirical evidence suggests that firms with strong governance practices tend to exhibit better financial performance, efficient capital structure decisions, and sustainable growth. However, challenges remain, particularly in promoting board independence, minority shareholder protection, and governance adoption among smaller firms. Future research should focus on longitudinal analyses to assess the long-term impact of governance reforms and sector-specific variations to understand the effectiveness of governance mechanisms across different industries in India.

### **1. Board Composition**

Board composition, especially the proportion of independent directors, is often linked to enhanced monitoring and decision-making. Independent directors help mitigate agency problems and improve firm accountability (Reddy, 2018).

### **2. Ownership Structure**

Managerial and institutional ownership can significantly affect performance. High promoter ownership may align management with shareholder interests, while diversified ownership can reduce risk-taking behavior (Choudhury & Das, 2019).

### **3. Audit Committees**

Audit committees are vital for financial oversight. Firms with active audit committees demonstrate higher transparency, lower financial irregularities, and improved investor confidence (Singh & Kapoor, 2020).

### **4. Governance Disclosure**

Transparency through timely disclosure of financial and operational data is linked to market valuation and capital accessibility. Disclosure practices strengthen investor trust and influence leverage decisions (Bansal, 2021).

### **5. Firm Performance**

Firm performance in Indian companies is typically measured through ROA, ROE, Tobin's Q, and profitability ratios. Empirical studies suggest a positive association between good governance practices and firm performance. For instance, firms with independent boards and effective audit committees often achieve higher ROA and market valuation (Kumar & Singh, 2020).

Firm performance is a multidimensional concept encompassing financial outcomes, operational efficiency, market valuation, and long-term sustainability. In the Indian context, firm performance has become an area of intense academic and managerial interest, particularly in light of regulatory reforms, evolving corporate governance practices, and increasing investor scrutiny. Performance is most commonly assessed through financial metrics such as return on assets, return on equity, earnings per share, Tobin's Q, and profitability ratios.

These indicators provide insights into how effectively a firm utilizes its resources, generates shareholder value, and sustains competitive advantage (Kumar & Singh, 2020). The nexus between corporate governance and firm performance has been particularly emphasized in recent literature, as sound governance mechanisms are posited to enhance decision-making, reduce agency costs, and improve accountability (Choudhury & Das, 2019).

The role of board composition is frequently highlighted in studies examining firm performance. Independent directors, board size, and board diversity are considered crucial determinants of organizational success. Independent directors are expected to provide objective oversight, mitigate managerial opportunism, and enhance strategic decision-making. Empirical studies on Indian listed companies indicate that firms with a higher proportion of independent directors generally exhibit superior performance metrics, including higher ROA and ROE, compared to firms with less independent representation (Reddy, 2018).

This is because independent directors contribute to effective monitoring of managerial actions, ensuring that resource allocation and investment decisions align with shareholder interests. Additionally, larger boards with diverse expertise often bring varied perspectives, which enhance innovation, risk management, and operational efficiency. However, excessively large boards may lead to coordination issues, diluting accountability and reducing overall effectiveness.

Ownership structure is another critical determinant of firm performance. In India, promoter ownership, institutional ownership, and managerial ownership play distinct roles in shaping firm outcomes. High promoter or managerial ownership can align the interests of management with those of shareholders, thereby reducing agency conflicts and promoting long-term strategic investments (Choudhury & Das, 2019). Conversely, concentrated ownership may sometimes lead to entrenchment and risk aversion, limiting growth potential.

Institutional ownership, which includes banks, mutual funds, and insurance companies, tends to exert pressure on firms for transparent reporting, prudent capital allocation, and sustainable growth. Empirical studies suggest that firms with balanced ownership structures, combining promoter, institutional, and public shareholders, are more likely to achieve higher profitability and market valuation (Gupta & Sharma, 2019).

Financial leverage also interacts closely with firm performance. Capital structure decisions influence risk-taking, cost of capital, and operational flexibility. Firms with moderate leverage often benefit from tax shields and disciplined financial management, resulting in higher profitability (Patel & Joshi, 2021). However, excessive debt can elevate financial risk, reduce managerial autonomy, and negatively impact firm performance during economic downturns. The literature indicates that Indian firms with strong governance mechanisms are better positioned to manage leverage optimally, translating into stable and sustainable performance outcomes. The interplay between governance, leverage, and performance underscores the importance of integrated corporate strategies that consider both financial and managerial factors (Kumar & Singh, 2020).

Corporate disclosure and transparency are also strongly linked to firm performance. Timely and accurate disclosure of financial statements, strategic decisions, and risk exposures enhances investor confidence and facilitates access to external capital at favorable terms (Bansal, 2021). In India, regulatory requirements such as the SEBI Listing Obligations and Disclosure Requirements have increased the emphasis on transparency, enabling investors to assess firm performance more reliably. Research shows that firms demonstrating high disclosure quality tend to have higher market-to-book ratios, lower cost of capital, and improved operational efficiency. This suggests that transparency not only strengthens investor relations but also incentivizes internal managerial efficiency, ultimately boosting firm performance (Singh & Kapoor, 2020).

Strategic decision-making, including diversification, innovation, and investment in human capital, also significantly influences firm performance. Indian firms adopting technological innovations, diversifying product lines, or investing in employee skill development often experience enhanced profitability and competitive advantage. For example, studies indicate that firms in the IT and pharmaceutical sectors with robust research and development initiatives show higher ROA and market valuation compared to firms with limited strategic investments (Reddy, 2018). Similarly, diversification strategies, when aligned with core competencies, mitigate market risks and provide stable revenue streams, contributing positively to financial performance (Kumar & Singh, 2020).

The macroeconomic and regulatory environment also impacts firm performance. In India, economic reforms, financial liberalization, and corporate governance mandates have created opportunities for improved firm outcomes. Firms that proactively adopt governance reforms, maintain prudent capital structures, and strategically invest in operational efficiency are better positioned to leverage these external changes. Studies suggest that companies adhering to governance best practices demonstrate resilience during economic fluctuations, maintaining profitability and shareholder trust (Patel & Joshi, 2021). Furthermore, sector-specific regulations, such as those in banking, infrastructure, and energy, require firms to maintain strict compliance and risk management practices, directly affecting their performance metrics.

Empirical studies have consistently underscored the positive relationship between corporate governance and firm performance in India. For instance, Kumar and Singh (2020) found that board independence, audit committee effectiveness, and ownership structure significantly improve profitability and market valuation. Similarly, Reddy (2018) reported that larger and more diversified boards enhance operational efficiency and ROA. Choudhury and Das (2019) highlighted the role of managerial ownership in aligning interests and promoting sustainable growth. Patel and Joshi (2021) emphasized that firms with strong governance frameworks manage capital structure efficiently, mitigating financial risks and achieving higher returns on equity. Bansal (2021) demonstrated that firms with transparent disclosure practices maintain investor confidence, leading to improved market performance.

Despite these positive findings, certain challenges persist in measuring firm performance in India. Variations in industry dynamics, firm size, regulatory compliance, and market conditions create heterogeneity in performance outcomes. Additionally, the use of financial ratios alone may not fully capture non-financial aspects of performance, such as corporate reputation, employee satisfaction, and innovation capacity. Therefore, scholars advocate for a holistic assessment that integrates financial and non-financial indicators to comprehensively evaluate firm performance (Gupta & Sharma, 2019).

### **CAPITAL STRUCTURE**

Capital structure decisions in India are influenced by both internal factors (profitability, growth opportunities) and external factors (market conditions, regulatory framework). Studies indicate that firms with strong governance are more likely to maintain optimal leverage, balancing risk and return (Gupta & Sharma, 2019).

### **INTERPLAY BETWEEN GOVERNANCE, PERFORMANCE, AND CAPITAL STRUCTURE**

Corporate governance, firm performance, and capital structure are interrelated dimensions that shape the financial health and strategic direction of firms. In the Indian context, the significance of corporate governance has grown due to regulatory reforms, investor activism, and increasing integration with global financial markets (Kumar & Singh, 2020). Corporate governance encompasses mechanisms, rules, and practices that ensure accountability, transparency, and efficiency in organizational decision-making (Choudhury & Das, 2019).

The quality of governance is particularly crucial in emerging markets like India, where firms face agency problems due to concentrated ownership and managerial discretion (Reddy, 2018). Studies suggest that firms with strong governance mechanisms, including independent boards, audit committees, and effective disclosure practices, tend to exhibit better operational and financial performance (Patel & Joshi, 2021). These governance structures influence managerial behavior, mitigate agency conflicts, and enhance decision-making processes, which in turn impact profitability and strategic choices regarding capital structure.

Board composition is a critical component of corporate governance that affects both performance and financial policies. Independent directors provide external oversight and reduce the likelihood of managerial opportunism, leading to improved firm performance (Kumar & Singh, 2020). Reddy (2018) found that firms with a higher proportion of independent directors demonstrated higher return on assets and return on equity suggesting that effective monitoring enhances operational efficiency. Moreover, independent boards are more likely to adopt conservative debt policies, ensuring that firms maintain optimal leverage while avoiding excessive financial risk. Board size also matters; larger

boards bring diverse expertise but may suffer from slower decision-making, whereas smaller boards can act more efficiently but may lack sufficient oversight (Singh & Kapoor, 2020). Therefore, board composition influences both performance metrics and capital structure decisions, creating a direct interplay between governance and financial strategy.

Ownership structure, including promoter, institutional, and managerial ownership, plays a complementary role in this interplay. Concentrated ownership by promoters often aligns management's interests with those of shareholders, reducing agency costs and improving performance (Choudhury & Das, 2019). Institutional ownership, by contrast, may impose external monitoring pressures, encouraging transparency and prudent financial management (Gupta & Sharma, 2019). Studies indicate that firms with strong promoter or managerial ownership often adopt moderate leverage to balance growth opportunities with financial risk (Patel & Joshi, 2021). Conversely, dispersed ownership can lead to higher agency costs, potentially increasing reliance on debt financing as a mechanism for external monitoring. Thus, ownership patterns influence capital structure choices while simultaneously affecting firm profitability and market valuation.

Audit committees and governance disclosure are additional mechanisms that bridge governance and financial performance. Audit committees ensure the accuracy of financial reporting and internal controls, reducing the likelihood of fraud and enhancing investor confidence (Singh & Kapoor, 2020). High-quality financial disclosure not only strengthens stakeholder trust but also improves access to external financing at favorable terms (Bansal, 2021). For example, firms with transparent governance practices are better positioned to raise debt without incurring excessive costs, illustrating the direct influence of governance quality on capital structure. Furthermore, disclosure practices often correlate with market performance, as investors reward firms demonstrating accountability and effective risk management (Patel & Joshi, 2021).

The relationship between corporate governance and capital structure is bidirectional. On one hand, strong governance can influence leverage decisions by promoting prudent debt management and reducing risk exposure (Reddy, 2018). On the other hand, a firm's capital structure can affect governance behavior. Highly leveraged firms face stricter monitoring from creditors, which may compel managers and boards to enhance transparency and adopt disciplined operational strategies (Choudhury & Das, 2019). This bidirectional relationship highlights the dynamic interplay between financial and organizational decision-making, emphasizing that governance and capital structure cannot be examined in isolation when analyzing firm performance.

Empirical studies in India provide substantial evidence supporting this interplay. Kumar and Singh (2020) reported that independent boards positively impact ROA and ROE while moderating leverage decisions. Gupta and Sharma (2019) observed that firms with higher promoter ownership maintain stable capital structures and achieve higher market valuation, indicating that ownership concentration strengthens financial stability. Similarly, Patel and Joshi (2021) highlighted that firms with robust disclosure practices and active audit committees demonstrate better performance and greater ability to manage debt efficiently. Reddy (2018) further emphasized that board size and independence significantly influence profitability and debt levels, reinforcing the notion that governance structures guide capital allocation and financial strategy.

While the positive impact of governance on performance and capital structure is widely documented, certain contextual factors in India moderate this relationship. Sectoral differences, firm size, regulatory environment, and market conditions can all influence how governance mechanisms affect leverage and profitability (Bansal, 2021). For instance, capital-intensive sectors may require higher leverage, even with strong governance, whereas service-oriented firms might rely more on internal financing. Moreover, governance reforms under the Companies Act 2013 and SEBI regulations have enhanced transparency and board accountability, but their implementation varies across firms, creating heterogeneity in performance outcomes (Patel & Joshi, 2021).

The interplay between governance, performance, and capital structure has significant implications for strategic management. Firms that integrate governance best practices into their financial strategy are better positioned to optimize resource allocation, manage risk, and enhance shareholder value (Kumar & Singh, 2020). Strong governance

reduces information asymmetry, enables efficient monitoring, and fosters a culture of accountability, which supports both operational excellence and prudent leverage decisions (Choudhury & Das, 2019). Consequently, understanding the interconnections among these dimensions is crucial for policymakers, regulators, investors, and managers aiming to strengthen the Indian corporate sector.

Despite considerable progress in research, gaps remain. Few longitudinal studies examine how governance reforms influence capital structure decisions over time, and sector-specific analyses are limited, particularly in IT, pharmaceuticals, and service sectors (Bansal, 2021). Moreover, the causal links between governance mechanisms, performance, and leverage require further investigation using advanced econometric models. Future research should also explore the role of emerging governance practices, such as ESG (Environmental, Social, and Governance) factors, in shaping financial performance and capital structure decisions in India.

Corporate governance, firm performance, and capital structure in India are closely intertwined. Strong governance mechanisms such as independent boards, effective audit committees, and transparent disclosure practices enhance firm performance while enabling prudent capital structure decisions (Kumar & Singh, 2020; Patel & Joshi, 2021). Ownership concentration and board composition further influence both profitability and leverage, demonstrating the multidimensional impact of governance. The dynamic interplay between these factors underscores the importance of integrating governance practices into strategic financial management to ensure sustainable growth, financial stability, and enhanced investor confidence. Strengthening this interplay through regulatory support, investor activism, and sector-specific initiatives will contribute to the overall development of India's corporate sector.

The literature indicates a complex interplay among these three factors:

**Governance → Performance → Capital Structure:** Strong governance leads to higher performance, enabling firms to access cheaper debt or equity financing (Patel & Joshi, 2021).

**Governance → Capital Structure → Performance:** Governance quality influences leverage choices, which in turn affects profitability and risk (Reddy, 2018).

**Bidirectional Influence:** Capital structure may also affect governance behavior; highly leveraged firms may require stronger oversight to manage creditor expectations (Choudhury & Das, 2019).

**Table 1: Studies on Governance, Performance, and Capital Structure in India**

Study	Sample	Governance Variables	Capital Structure Measure	Performance Measure	Key Findings
Kumar & Singh (2020)	120 listed firms	Board independence, audit committee	Debt-to-equity ratio	ROA, ROE	Independent boards positively influence performance and moderate leverage decisions
Gupta & Sharma (2019)	100 manufacturing firms	Ownership concentration	Debt ratio	Tobin's Q	Firms with higher promoter ownership have stable leverage and higher market valuation
Reddy (2018)	80 companies	Board size, independent directors	Total debt/total assets	ROA	Larger boards with independent directors improve profitability and reduce agency costs
Patel & Joshi (2021)	150 firms	Disclosure quality, audit	Long-term debt ratio	ROE, EPS	Strong disclosure practices improve

		committee			performance and facilitate better financing choices
Choudhury & Das (2019)	90 firms	Managerial ownership, board diversity	Leverage ratio	ROA	Managerial ownership aligns interests and impacts capital structure decisions positively
Bansal (2021)	60 NSE-listed firms	Governance disclosure index	Debt-equity ratio	Market-to-book ratio	Firms with transparent disclosure maintain optimal leverage and investor confidence

## II. CONCLUSION

This review highlights that corporate governance mechanisms significantly impact firm performance and capital structure in Indian firms. Independent boards, managerial ownership, audit committees, and disclosure practices positively influence both profitability and leverage management. Integrating governance with strategic financial decisions enhances firm stability, market confidence, and long-term growth. Future research should focus on causal relationships and sector-specific nuances to deepen understanding.

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