Research Proposal

(DD/MM/YYYY)

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# Research Title

Impact of Cash Holding on the Relationship between Corporate Governance and Capital Structure in Firms

# Introduction

The relationship between the measures of corporate governance and capital structure, on the one hand, and the level of cash holdings, on the other hand, is an essential concept in corporate finance (Zaid et al., 2020). This research aims to assess the effectiveness of cash holding in moderating the corporate governance-capital structure nexus. Corporate governance is the methods, structures, and relationships that operate in organizations for controlling and directing industry activities on behalf of shareholders about the rights of other stakeholders (Benson, 2022). Capital structure is the total financing a firm uses through debts and equities. Another moderator, cash holding, refers to the liquidity position of firms and has the potential to influence this relationship regarding decision-making influence, financial stability, and its effects on overall firm performance.

There is a marked reason for this project in the evolution of corporate finance, which touches on fiscal changes that firms undergo in light of an optimal capital structure and good governance. Given the existing fiscal environment of uncertainty, it is pertinent to ascertain how these factors intertwine as an informative guide for firms seeking to optimize their performance and manage stakeholders.

This proposal is structured as follows: the introduction gives some information about the context of the issue investigated in the study and the need for the research. The first type of search looks into the existing belief systems about the matter of study to establish the reasons for this project. In the research problem, question(s), and objectives section, researchers define the types of issues or questions that need to be answered to complete the study and the aims of the investigation.

# Initial Literature Review

It is critical to understand that corporate governance is essential for firms by providing a structured approach to the management process to ensure its compliance with shareholders’ and stakeholders’ objectives. The impacts of good governance include eliminating agency costs, low capital costs, and increasing overall firm value (Nguyen et al., 2020). Management control activities include board ownership and regulation that underpins managerial accountability, corporate transparency, and proper management of company affairs.

Over the years, theoretical advancement in capital structure has been dynamic in advance of Charles et al.'s (2021) irrelevance proposition that pointed to the fact that under perfect conditions, a firm’s value ignored the kind of capital structure it possessed. However, it is essential to understand that markets are imperfect, and there are theories regarding how these firms arrive at capital structure decisions. This theory suggests that to optimize the advantageous position of its debt; the firm should make sure that it takes a middle ground between incurring costs of financial pressure and bankruptcy, which act as its disadvantages (Rasulove, 2021). Companies strive to balance their debt to equity, the trade-off value of these benefits and costs.

On the other hand, pecking order theory holds that internal sources of finance are preferred over external sources because managers are better off with internal finance than external fund mobilizers due to information asymmetry, favouring managers (Paul, 2021). In his theory, Miller suggested that firms first use retained earnings, then debt, and issue equity as the last option. This hierarchy also possesses the characteristic that each level represents financing to some extent, with the primary metrics being the cost and risk involved in each tier.

Agency theory was developed by Jensen and Meckling, who pointed out how managerial and shareholder interests differ and impact capital structures (Sdiq, 2020). There is evidence that debt can act as a disciplinary tool that limits managers’ decision-making autonomy and prevents them from engaging in risky endeavours that do not align with shareholders’ interests through fixed debt repayments and tied-up cash flows (Roida, 2020). As a result, firms with high agency costs could decide to increase leverage to address these concerns.

The integration of interactions between corporate governance, capital structure, and cash holdings attracts the attention of scholars of corporate finance, especially in the context of the EMs. Some current issues pulling attention towards CG include demonstrating the significance of corporate governance in a firm's choice of capital structure. For example, Almari and Alfaris (2023) argued that high-quality governance structures assist in achieving desired capital structures and curb agency problems, directing firms into making suboptimal financing choices.

In addition, cash holdings play an essential role of moderating the relationship between corporate governance and capital structure. Li et al., 2022 noted that firms with high cash holdings have the upper hand regarding financial constraints, especially during nasty times. Their study also discovered that such firms are likely to rely less on external financing, thus, low leverage ratios. The study results are also in line with agency theory, which states that cash holdings can prevent shareholders' and debt holders' conflict through internal sources of liquidity instead of external resources.

Further, the relationship between governance and cash holdings has also been discussed in greater detail in the current literature. Oduro and Nyarko (2021), in their study on emerging markets, also discovered that firms with good governance policies are likely to possess more cash to minimize financing risks and oligosensory external financing. These results imply that cash reserves can be used as an effective instrument for managing relations with stakeholders according to the pecking order theory.

Although some contributions have been made in the previous literature, they have not addressed the following questions: How does cash holding affect corporate governance and capital structure in Pakistan? This study intends to fill this research gap by empirically testing the moderating effect of cash holdings in the corporate governance—capital structure relationship in Pakistani firms.

Cash holdings act as an essential financial buffer and an avenue to avoid the infirm costs of external financing. Circulating factors, as described in the work of Pozzi et al. (2023), include factors such as the firm's size, the growth prospects of operations, and specific industry traits. This method is helpful to firms with adequate investment opportunities that can tank through difficult economic conditions without having expensive external capital sources. Nevertheless, a high level of cash assets may be costly; negative net operating cash flow can appear due to cash being used for unprofitable projects, or managers may have agency problems that prevent them from taking shareholder-value actions (Harris and Li, 2021)

The literature shows mixed and positive relationships between corporate governance and capital structure. While the appropriateness of the corporate governance system is incontestable, an efficient board of directors and high ownership concentration may result in low leverage because of the mitigation of agency costs and enhanced equity market access (Jaimuk, 2020)). Investors appreciate companies with sound governance systems and receive a lower risk premium, thereby cutting down on funding through debt capital. On the other hand, firms with poor governance structures may use high levels of capital structure leverage to put pressure on management and consequently address agency costs.

Much empirical evidence exists on the issues of corporate governance and capital structure; moreover, there needs to be an adequate analysis of the place of cash holdings to understand the above concepts. Some current scholarly research regarding the relationship between working capital management and corporate governance points out that cash can complement and substitute the governance structures. For instance, Jeenas (2023) posits that while the presence of strong corporate governance means that firms may have more cash on their balance sheets than firms with weak governance, this is beneficial as the firm’s governance structure allows it to guard against overinvestment as well as leverage its cash resources effectively for value-enhancing activities such as funding good investment projects. These cash balances provide financial flexibility and investment in such firms instead of a buffer against future shocks (Batuman et al., 2022).

On the other hand, firms that experience low levels of governance may end up with surplus cash, creating negative value (Habib et al., 2021). Managers of organizations in companies with poor corporate governance can keep money for their usefulness or self-expansion instead of reimbursing shareholders. This often worsens the agency problem and leads to unsound investment decisions.

Consequently, it is evident that although extensive literature exists involving corporate governance and capital structure individually, the moderating effect of cash holdings has yet to be a focus of equal attention. This research endeavour will therefore seek to investigate this relationship in the context of the existing literature to offer a robust and rich account of the dynamics of economic value creation processes within firms and their environments that may enrich the theoretical and practical discourse on strategic management of resources for value and growth.

# Research Problem, Question(s), and Objectives

## Research Problem

This multi-faceted issue interrelates corporate governance capital structure and cash holdings as firms struggle to find the best solution to the balance between them. Prior research primarily focuses on exploring the modulating effect of corporate governance on capital structure decisions, and another stream of research is on utilizing cash holdings as a part of firms’ financial policy. Yet, a few areas need more research, including the interaction between cash holdings and the corporate governance-capital structure nexus. This gap is alarming at the current period, with firms operating under increased risks and limited resources.

## Research Questions

1. To what extent does cash holding alter the interaction between corporate governance structures and capital structure in firms?

2. Which governance mechanisms are most affected in terms of cash holdings in the context of capital structure decisions?

3. Is there evidence that the effect of cash holding on the relationship between corporate governance and capital structure differs between industries and various firm sizes?

4. How do the economic conditions and market volatility influence the relationship between cash reserves, corporate control, and financing strategies?

## Research Objectives

1. To examine how the extent of cash holding affects the governance mechanism of capital structure.
2. To determine the type of governance mechanisms whereby the impact of cash holdings on capital structure decisions is the most felt.
3. To analyze the change in cash holdings' impact on different industrial and firm types.
4. Conducting a comparative study of various industries can reveal various trends belonging to a given sector.
5. To analyze the impact of economic conditions and fluctuations in the share price on the relationship between cash reserves, corporate governance mechanisms, and capital structure decisions.

# Research Methodology

## Research Methodology: Secondary Analysis

### Research Design

Using secondary research approach, this research concentrates on corporate governance, capital structure, and cash holdings. Secondary research therefore uses data that has been collected by other individuals, whether or not they are researchers or organizations. This method is cheap and fast, due to the fact that no original data is collected and the range of analysis is vast. This kind of data is usually collected from authentic and recognized sources that irrespective of pilot data collection make available ample data adequate to answer the identified research questions.

The focus on secondary analysis is specifically suitable for this research, mainly because the examination of different firms and industries’ financial and governance trends can be achieved with this approach. This research will make attempt to establish correlations between corporate governance independent variables, and dependent variables such as capital structure and overall corporate cash management. This method also makes it possible to compare results obtained from different sector and different time, thus gives the researcher a panoramic view of the research topic.

## Data Sources

The secondary data collection for this research will be conducted using select reputable and available sources like Annual reports and or Financial statements amouhg and industry databases. These are excellent sources for obtaining all the necessary financial and governance data for various types of businesses in the manufacturing, telecommunication, finance, and energy industries. It means that through the use of these sources the study can retrieve a lot of information without having to embark on primary research.

### Annual Reports

Public company annual reports are the major secondary data source for this study. These reports include financial statements, details on the corporate governance systems that were in place at the time and the company’s explanation of the management of capital within the business. Annual reports provide information about organisational performance for the period under consideration and decisions of the board of directors on the capital structure and cash management. These reports facilitate the research to assess broad trends of governance and firms’ financial performance.

### Financial Databases

Secondary data will also be drawn from financial databases including; Bloomberg, Thomson Reuters, and Compustat. Many of these databases contain data on companies that are listed in World’s Stock Exchanges and include information on their capital structure, their cash reserves, and their governance structures. The use of these databases provides an access to the good and relevant information about the firms’ financial performance to analyze the research questions.

## Data Collection

Secondary data collection will still involve data collection with less emphasis in undertaking new surveys or interviews in order to get the data. The following types of data will be collected:

### Quantitative Data:

The principal form of data to be collected in this study will be quantitative data collected from financial databases and other relevant reports of the firms under study. That on the quantitative aspect of the research that put figures on corporate governance, capital structure and cash holdings. Financial data for the study shall entail, the debt-equity ratio, liquidity ratios, and profitability ratios since they help to determine the effects of the firm’s governance structure on capital management. Changes in the governance practices will be identified from the financial reports of the organization of the last ten fiscal years.

### Corporate Governance Information

This research will also gather information on the corporate governance practices, including board of directors, remuneration policies and governance mechanisms. This information will be extracted from corporate governance section particularised in annual reports and from special databases containing information on governance. Thus, analysing this information, the research can study how certain forms of governance influence firms’ finance decisions, especially as regards capital structure and cash holdings.

## Data Analysis

After data has been gathered from secondary sources the analysis will involve a process of making meanings and understanding the data in the context of the research questions. The data for the research study will be obtained from annual reports of the sampled firms along with the data from financial databases, in an effort to find correlations between corporate governance, capital structure and cash holdings.

### Corporate Governance and Capital Structure:

The information generated on corporate governance will be used to determine its influence on the structure of a firm’s capital. This will explore the relationship between governance structures including the board composition, independent directors as well as the pay structure for the firm executives with regards to the manner that the firms deal with debts and equities. Some of the governance features that foster transparency can impact on firms to maintain better capital structure policies and engagements than firms with lower governance standards whom we expect to have higher leverage policies and riskier finance structures.

### Cash Holdings and Financial Strategy:

The research will also seek to establish the correlation between corporate governance and cash holdings. In simpler terms, companies with good governance can keep larger amounts of cash on their balance sheet for buffer against more risky operations while, the firms with poor governance can experiment graduated usage unused cash balances. The analysis of the quantitative data derived from financial reports enables the research to establish trends regarding the relationship between various structural governance systems and the management of cash at a particular firm.

### Industry Comparisons

In order to compare the results obtained from the analysis, a cross sectional study will be performed across the different industries in an attempt to discover any sectorial characteristics of governance structures and financial management. For instance, the practices of governance in industries that invest a lot of capital such as telecommunication, energy industries will be different from practices of industries that offer services like finance, retail among others. By so doing, this comparison will go a long way in explaining the differences in governance and capital structure across sectors.

## Ethical Considerations

In secondary analysis the key ethical issues are concerned more with the proper usage of the data. In this case since the analyzed data is common to the public and has already been published, concerns on consent and privacy are not very exigent. However, the research has to ensure that data is used appropriately and that it is acknowledged where such data was sourced from.

Particular attention will be paid to the fact that a wrong interpretation of the data or mistaken implication can also be made when developing the conclusion (Lobe et al., 2020). Nonetheless, because secondary data is secondary to this study in most of the cases meaning that it was collected for another purpose other than this research, it requires further evaluation as to its relevance, reliability and accuracy to the objectives of the study.

# Conclusion

Thus, the research approach of the given study is based on the secondary analysis of the secondary data sources including annual reports and registration documents, financial databases, and records of good governance. This approach facilitate the study of corporate governance, capital structure and cash holdings in an efficient and exhaustive manner. Through an exploratory analysis of the data available within the current literature, the research seeks to make sensible inferences about the firms’ style of coping with their financial risks and their corporate governance systems. As its name suggests, there are certain weaknesses associated with the use of secondary data but with reference to the research questions posed in this study, the use of a secondary data approach is both methodologically effective and efficient..

# Time Scale

The timeline below outlines the phases of the project, which span eight months.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| PHASES | JAN | FEB | MARCH | APRIL | MAY | JUN | JUL | AUG |
| Project planning and literature review |  |  |  |  |  |  |  |  |
| data collection preparation |  |  |  |  |  |  |  |  |
| data collection |  |  |  |  |  |  |  |  |
| data analysis |  |  |  |  |  |  |  |  |
| finding and validation |  |  |  |  |  |  |  |  |
| report writing |  |  |  |  |  |  |  |  |
| Final review and submission |  |  |  |  |  |  |  |  |

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