The Impact of Capital Structure on the Corporate Governance

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Abstract. The purpose of this paper is to analyze the general characteristics of capital structure and measures to optimize the capital structure of each enterprise under heavy-asset and light-asset industries, the characteristics, differences, and connections of capital structure of each enterprise underdeveloped and developing countries, as well as the similarities and differences between the capital structure of Chinese and Vietnamese enterprises. Meanwhile, it discusses the assumptions and limitations of the classical capital structure theory, the Modigliani-Miller theorem. It concludes that it is difficult for firms to have an optimal debt-to-debt ratio in the actual business environment. Therefore, no matter in different industries or markets, each enterprise should choose the capital structure that best suits its own operating characteristics, objectives, and business conditions according to the macroeconomic environment and relevant national policies, financial market environment, market demand, industry competition, and development trends, as well as its business planning, etc. This will help the enterprise improve its operating ability and ability to cope with economic risks and market changes, realize the enterprise's progress in various aspects, and ultimately benefit the long-term development and sustainable operation of the enterprise.

Keywords: Capital Structure, Optimal Debt Ratio, Industry Differentiation.

1. Introduction

Capital structure refers to the composition and proportionality of various kinds of funds raised by an enterprise and the different kinds of capital used under different financing venues. In financial management, capital structure is divided into broad and narrow sense. Under the broad concept, capital structure refers to the proportion of various types of capital that an enterprise determines according to its actual situation to maximize the market value of the enterprise when given an investment opportunity. In the narrow sense, capital structure refers to the composition and proportion of various long-term capitals of an enterprise, especially the composition and proportion between "long-term debt capital" and "long-term equity capital". With the development and progress of society, as well as the collision and integration of the political, economic, and cultural aspects of various countries, the contemporary environment in which each enterprise is located significantly impacts the choice and development of its own capital structure. In particular, the changes and development of the world economic environment have a multifaceted impact on the enterprise capital structure. Analyzed from the macroeconomic environment: changes in the economic cycle may affect enterprises' profitability and financial position, which in turn affects the choice of their capital structure. Under the economic growth environment, enterprises may choose high-risk and high-return financing methods and adventurous capital structures. In contrast, enterprises will choose conservative capital structures to reduce their operational and financial risks in an environment of economic decline. Analysis from the financial market environment: today's financial market is in continuous maturity and development. Enterprises can choose more diversified financing channels and financing methods, making the enterprise's capital structure a diversified trend. Analysis from the perspective of industry competition: In today's market environment, industry competition is becoming increasingly fierce, and enterprises often need to invest a lot of money to occupy more market share and maintain a competitive advantage. Therefore, the expansion of the enterprise's capital demand and the rise of external financing costs also complicate the choice of enterprise capital structure. From the analysis of the enterprise's business situation, the enterprise's development stage and strategic objectives play an important role in the choice of its capital structure. The capital structure of an enterprise serves the long-term goals and interests of the enterprise. Under different development stages and strategic objectives, the capital structure of an enterprise is also different. In addition, it cannot ignore the serious impact of the COVID-19 pandemic on the world's overall economic level, i.e., under the unstable characteristics of the world economic environment, whether enterprises can choose the most suitable capital structure for their development within a certain period according to the market macro-environment and their operating conditions. Under the most suitable capital structure, it is conducive to improving the enterprise's financing ability, promoting the expansion of the enterprise's market share, reducing the cost of the enterprise's financial crisis, and increasing the value of the enterprise. This is of great significance for enterprises to realize their strategic objectives, improve profitability, cope with the risks of the world economy, and achieve long-term development. Therefore, selecting and constructing an appropriate capital structure has far-reaching significance for an enterprise's daily operation and sustainable business. At the same time, it is also a problem that the management of every enterprise needs to consider and solve.

2. Theoretical Basis

Modigliani-Miller theorem (MM theorem) is an acronym for the model of disjointness between a firm's capital structure and its market value developed by Modigliani and Merton Miller. The original MM theorem suggests that a firm's market value is independent of its capital structure when its income tax is not considered and when the firms have the same business risk, but only their capital structure is different. The modified MM theorem suggests that, i.e., after taking into account the income tax factor, a firm's capital structure affects the total value of the firm and that operating in debt will have a tax-saving effect for the firm. In addition, the basic assumptions of the MM theorem include, first, the capital market is perfect. Second, the information is sufficient and complete, with no transaction fees and costs. Third, any one security is infinitely divisible. Fourth, a firm's average expected future operating earnings are expressed as a subjective random variable. Fifth, all debt is risk-free. As a classic theory for studying the corporate capital structure, the MM theorem provides an effective starting point and analytical framework for studying the capital structure problem. It concludes that changing the corporate capital structure only creates value for the firm if income tax is considered.

At the same time, the proposed MM theorem makes the enterprise's financial work from now on with rigorous analytical methods and a mathematical analysis basis. MM's theorem further guides people to grasp the relationship between capital structure, cost of capital, and company value from a dynamic perspective, significantly contributing to world economic development. However, the MM theorem also has major limitations [1]. First, the basic assumptions of the MM theorem need to be harsher and easier to realize in the actual business environment. Secondly, the analysis of the MM theorem lacks dynamism. It is only analyzed from a static point of view, which does not consider the impact of changes in the external economic environment and business conditions on capital structure. Third, the MM theorem has no strong support from empirical tests. This means that at the theoretical level, the assumptions of the MM theorem are limited in the scope of satisfaction. Hence, enterprises' decision-making and capital structure adjustments need to be made according to their actual business objectives and conditions.

3. Differences in Capital Structure by Industry

This paper analyzes the differences in firms' capital structure under asset-heavy and asset-light industries. Firstly, this paper analyzes the capital structure of enterprises in heavy asset industries. Heavy asset industry refers to the industry in which the scale of enterprise investment is expanding, the proportion of working capital is decreasing, and the proportion of fixed assets such as plant and equipment is increasing. Typical asset-heavy industries include the real estate, air transportation, and machinery and equipment industries. In asset-heavy industries, the capital structure of enterprises has general characteristics: first, the equity structure of enterprises is more stable. Under the heavy asset industry, the enterprise has a large investment in assets and a long investment cycle. It needs stable shareholder support to obtain financial support and generate strategic synergies [2]. A stable equity structure can enhance the competitiveness of the enterprise and reduce the financial risk of the enterprise.

Second, the proportion of long-term debt is large. In the asset-heavy industry, enterprises are more inclined to finance with long-term debt. Choosing this financing method provides a more stable source of funds for long-term investment and reduces the cost of frequent borrowing. Thirdly, the match between enterprise assets and liabilities is higher. Enterprises in the asset-heavy industry need to fully consider whether the input of assets and earnings cycle is coordinated in the financing process to ensure that the input of assets and liabilities match the period. A capital structure with a high degree of matching can improve the enterprise's solvency and liquidity and thus reduce financial risks. In addition, optimizing enterprises' capital structure in the asset-heavy industry is also an issue worth exploring. The real estate market is taken as the object of study, and optimization measures are then derived. The real estate market plays an important role in the national economy and is directly related to the financial and monetary markets, construction, and labor markets [3].

BGY Corporation greatly influences China and the world's real estate industry. Therefore, it is of great significance to analyze the capital structure of BGY, a typical heavy-asset enterprise, to optimize the capital structure of the enterprise and to improve its operation ability. First, analyze the capital structure of BGY. Through the annual report of BGN 2022 and its notes, as of the end of 2022, BGN's total borrowing balance decreased by 14.7% year-on-year, the gearing ratio decreased to 69.4%, and the net borrowing ratio decreased to 40%. Then, check the shareholding ratio of BGI shareholders; the shareholding ratio of the top ten shareholders is about 40%, and the shareholding structure is relatively decentralized. Second, the way to optimize the capital structure of enterprises under the heavy asset industry. Enterprises can broaden financing channels and explore new ways of financing. In addition to traditional bank loans and commercial bond issuance, each enterprise can also carry out diversified financing through equity financing, trusts, funds, etc.; as well as new financing methods such as asset securitization, lease financing, etc. are also good choices [4]. At the same time, enterprises also need to determine the appropriate proportion and term of liabilities. Each enterprise should choose the appropriate proportion of liabilities to reduce its capital cost according to its own operating conditions and industry characteristics and adopt a combination of long- and short-term liabilities to match. Among them, short-term liabilities are suitable for solving the capital needs of daily operation of enterprises, while long-term liabilities are mainly used for projects with longer investment cycles.

In addition, this paper analyzes the capital structure of enterprises in asset-light industries. Asset-light industries usually refer to industries that emphasize the core competitiveness of enterprises and use intangible assets such as brand value, patented technology, corporate experience, human resources, customer resources, and governance systems as the main assets to obtain higher returns with relatively low capital investment and operating costs. Typical asset-light industries include the Internet service industry, creative industry, retail industry, etc. The characteristics of enterprise capital structure under the asset-light industry include: first, the lightweight of enterprise assets. In asset-light industries, the main assets of enterprises are intangible assets, such as brands and intellectual property rights. These assets are usually lightweight, do not require large capital investment, and are easy to manage and operate. The lightweight of enterprise assets helps enterprises adjust and optimize their capital structure more flexibly in operation to adapt to industry and market changes [5]. Second, the enterprise debt ratio is lower. Under the asset-light industry, each enterprise's own operation risk is usually higher, and it needs to maintain higher liquidity to cope with market changes and uncertainties. Debt management may increase the enterprise's financial risk and operational instability, so there are better choices than this. Third, diversification of enterprise equity structure. Enterprises in the asset-light industry usually have a diversified equity structure, such as venture capital funds, private equity funds, and corporate shareholders. This is conducive to diversifying business risks, increasing shareholder returns, and bringing more strategic resources and business opportunities to the enterprise. In addition, it is essential to analyze typical cases and measures to optimize the capital structure of enterprises under asset-light industries. Due to the increasing influence of Internet technology, the retail industry has gradually transformed from the traditional offline single sale to the digital retail industry, which is one of the backbones of the economic development of various countries.

In China, Jingdong Group is actively building a new retail business model and is a leader in the Chinese retail industry. Therefore, analyzing the capital structure of Jingdong, a typical asset-light enterprise, is more representative. First, analyze the capital structure of Jingdong Group. Based on Jingdong's annual report, Jingdong emphasizes a financing model combining debt financing and equity financing. As far as equity financing is concerned, Jingdong Group has successfully listed in mainland China, the Hong Kong Special Administrative Region, and the United States in the past two decades, attracting more investors and increasing the market capitalization of the enterprise through the issuance of shares. At the same time, Jingdong has developed a "dual shareholding structure" model, which realizes the separation of voting rights and cash flow rights of the company's shareholders. In terms of debt financing, Jingdong mainly obtains funds through bank loans and the issuance of corporate bonds. Jingdong has established cooperative relationships with several banks, including the Bank of China and the Industrial and Commercial Bank of China. It has issued bonds several times to support its expansion and development. Second, how to optimize enterprises' capital structure under the asset-light industry. Enterprises should rationally configure their asset and liability structure. Each light-asset enterprise needs to configure a reasonable asset and liability structure according to its operation situation and external market environment to reduce operational and financial risks. At the same time, enterprises need to strengthen cooperation with financial institutions. By establishing long-term and stable cooperative relationships with financial institutions, sharing financial market information, and improving capital supervision, enterprises can obtain better financial services and financing support, thus improving the efficiency of capital utilization and risk management.

4. Differences and Links Between the Capital Structure of Firms in Different Markets

This paper focuses on comparing the capital structure of enterprises in developing countries with that of enterprises in developed countries, as well as comparing the capital structure of Chinese enterprises with that of Vietnamese enterprises. Firstly, it describes the general characteristics of enterprise capital structure in developing and developed countries. In developing countries, the common characteristics of enterprise capital structure are: first, single financing channel and irrational equity structure [6]. In developing countries, the capital structure of enterprises is single, and banks usually play a dominant role in enterprise financing activities. Due to the relative immaturity of the capital market, equity financing is a high-risk factor for most enterprises in developing countries. In addition, the equity of enterprises in developing countries is usually more concentrated, held by a small number of major shareholders, and the equity structure needs to be revised, which is not conducive to the enterprise's business decisions. Second, short-term debt is high, and the transparency of enterprises needs to be improved. Developing country firms generally have more short-term debt to maintain their daily operations better. However, more short-term debt may increase the liquidity risk of the enterprise, so the enterprise may have a broken capital chain when facing changes or risks in the economic environment.

In addition, the transparency of the capital structure of enterprises in developing countries needs to be improved, which may expose them to greater information asymmetry risks in the capital market [7]. In developed countries, the capital structure of enterprises is generally characterized by, first, higher debt ratios. In developed countries, firms prefer debt financing to support their operations and expansion. Higher debt ratios imply a greater focus on using financial leverage to increase shareholder value and ensure smooth implementation of projects as firms implement restructuring programs, innovative projects, and acquisitions of other firms. Second, the capital structure is flexible and adapted to the characteristics of the business. These enterprises flexibly adjust their capital structure to achieve optimal financing cost and risk control through the enterprise's macroeconomic environment and strategic needs, etc. They also attach great importance to the compatibility of their capital structure with their characteristics. They attach great importance to the compatibility between their capital structure and operating characteristics. For high-growth enterprises, they are more inclined to use debt financing to support their rapid expansion. For mature enterprises, they pay more attention to equity financing to stabilize their capital structure and maintain their business status quo. Third, implement a high dividend policy and emphasize protecting shareholders' rights. Implementing a high dividend policy and the payment of stable cash dividends to shareholders are conducive to improving shareholders' return on investment and enhancing enterprises' financing ability. At the same time, it focuses on establishing a sound corporate governance structure and internal control system to ensure that shareholders' rights and interests are not infringed upon.

Secondly, this paper analyzes the difference and connection between the capital structure of enterprises in developing and developed countries. Regarding the difference there are differences between the two in terms of financing methods and equity structure. In terms of financing methods, enterprises in developing countries usually rely on external financing, especially bank loans, and have a single financing method. On the other hand, the relative maturity of financial markets in developed countries has led to more diversified financing methods, including bond issuance, stock issuance, asset securitization, and so on [8]. In terms of shareholding structure, the shareholding structure of enterprises in developing countries tends to be relatively concentrated and controlled by a small number of major shareholders, which, to a certain extent, may threaten the sustained operation of the enterprise. On the other hand, the equity structure of enterprises in developed countries is more decentralized and jointly held by many minority shareholders, reducing the degree of control of a single major shareholder over the enterprise. As far as the linkage is concerned, the two have common points in terms of capital structure theory and business objectives. For the capital structure theory, both in developing and developed countries, the capital structure of enterprises is influenced by the capital structure theory. It provides guidelines for enterprises to choose appropriate financing methods. As for business objectives, enterprises in both developing and developed countries aim to maximize profits. Therefore, enterprises need to choose the financing method that best suits their business characteristics and development objectives to optimize their capital structure and achieve their business objectives.

Then, the capital structure characteristics of Chinese and Vietnamese enterprises are described. In China, enterprises are characterized by complex equity structures. Chinese enterprises have high equity concentration and a low proportion of institutional investors. Major shareholders have strong control over enterprises, which, to some extent, affects enterprises' governance structure and decision-making efficiency. Meanwhile, the proportion of institutional investors in China's capital market is relatively low, which makes institutional investors play a limited role in participating in corporate governance and supervising management. Second, financing is skewed towards external financing. For a long time, the financial management level of Chinese enterprises has been relatively low, and enterprises have less retained earnings for internal financing and rely heavily on external financing. At the same time, short-term liabilities of Chinese enterprises account for a relatively high proportion, and a high debt ratio also means that enterprises face higher credit risk and liquidity risk and are more sensitive to changes in the economic environment. Third, the capital structure is influenced by the market. Changes in market factors such as the stock market, bond market, and bank credit market impact enterprises' choice of financing methods and capital structure adjustment. In Vietnam, the capital structure of enterprises is characterized by foreign investment preference [9]. As an emerging market country and since the Trans-Pacific Partnership Comprehensive and Progressive Agreement came into effect on January 14, 2019, Vietnam's enterprises are more inclined to actively seek foreign expansion, access to technological resources, and capture international market share, with more and more international capital flowing into the country. Second, financing methods need more diversification [10]. Bank loans play an important role in financing Vietnamese enterprises, and their financing channels and methods are relatively single, which also reflects the limited nature of Vietnam's financial market.

In addition, Vietnamese enterprises tend to increase long-term debt ratios to enhance profitability. Finally, it analyzes the differences and links between the capital structure of Chinese and Vietnamese enterprises. As far as the differences are concerned, they are mainly manifested in two aspects. In terms of shareholding structure, Chinese firms have relatively complex shareholding structures with high shareholding concentration and strong control over the firm by a few major shareholders. Vietnamese firms have a relatively simple shareholding structure, with lower equity concentration and weaker control of the firm by the majority shareholders. In terms of debt structure, Chinese enterprises have a relatively diversified debt structure, including corporate bonds, equity financing, and other financing methods. On the other hand, Vietnamese enterprises have a relatively homogeneous debt structure, relying mainly on bank loans. As far as linkages are concerned, they are also mainly manifested in two aspects. First, the market environment. Both Chinese and Vietnamese enterprises are in a market economy environment. Therefore, each enterprise needs to adjust its financing strategy and capital structure according to the changes in the market environment to adapt to the market demand and competitive environment. The second is financing methods. Whether in China or Vietnam, enterprises' financing methods are affected by the market environment and their operating conditions. Whether the market environment is favorable or not and the business condition of the enterprise are the main influencing factors for the enterprise in choosing the appropriate financing method.

5. Conclusion

The choice of capital structure is increasingly becoming an important influence on the long-term development of an enterprise. At the same time, capital structure is also an important indicator of an enterprise's operating capacity and development status. An appropriate capital structure helps enterprises to develop business, improve operating ability, and take more market share. However, the assumptions of MM theory are limited, so it is difficult for enterprises to accurately derive the optimal debt-to-debt ratio under the actual market environment and operation situation. Therefore, it may be impractical for enterprises in different industries and markets to find the optimal capital structure, but it is very important to find a capital structure that is suitable for their own operating characteristics, business development objectives, and industry trends. Each enterprise should make a rational analysis based on the market environment, judge the supply and demand situation, and respond to consumer demand promptly. According to the economic environment, each enterprise should adjust its corporate strategy to expand in a favorable economic environment and to be conservative in a declining economic environment. Depending on the nature of the enterprise's own business, growth-oriented, mature, labor-intensive, and capital-intensive enterprises, etc., the enterprise should choose a capital structure that suits its business characteristics. According to the business objectives of the enterprise, whether it is the implementation of corporate mergers and acquisitions and reorganization, or the implementation of research and innovation projects with long cycles and large capital requirements, etc., the enterprise should choose the appropriate capital structure. In general, the choice of capital structure is different in different countries and industries. And it is difficult for enterprises to get the optimal debt ratio. Instead, they should build a capital structure suitable for their own development according to the market environment, economic environment, the nature of their business objectives, and industry characteristics.

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