



The Effect of Earnings Management in Mediating the Role of Corporate Governance, Capital Structure, and Liquidity on Financial Performance (A Study of Conventional Commercial Banks Listed on the Indonesia Stock Exchange)

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ABSTRACT

This study examines the effect of corporate governance, capital structure, and liquidity on financial performance, with earnings management as a mediating variable in conventional commercial banks listed on the Bursa Efek Indonesia during 2021–2025. A quantitative approach was applied using secondary data from annual financial reports of banks consistently listed throughout the observation period. Purposive sampling was used to obtain a balanced panel dataset covering five years. Data were analyzed using Partial Least Squares–Structural Equation Modeling (PLS-SEM) to assess both the measurement and structural models. The results show that corporate governance, capital structure, and liquidity have positive and significant effects on earnings management. In addition, corporate governance, capital structure, liquidity, and earnings management each have a positive and significant direct effect on financial performance. Mediation analysis confirms that earnings management significantly mediates the relationship between corporate governance, capital structure, liquidity, and financial performance. The R-square values indicate strong explanatory power in predicting earnings management and financial performance. These findings suggest that effective governance mechanisms, optimal capital structure decisions, and adequate liquidity management improve financial performance both directly and indirectly through earnings management. This study provides empirical evidence on the mediating role of earnings management in the Indonesian banking sector and offers practical implications for bank management, investors, and regulators in enhancing governance and financial strategies to ensure sustainable performance.

Keywords: *Corporate Governance, Capital Structure, Earnings, Management, Financial Performance Liquidity.*

I. INTRODUCTION

The banking industry has a strategic role in supporting economic growth and maintaining financial stability. Conventional commercial banks listed on the Bursa Efek Indonesia are required to maintain strong financial performance while ensuring transparency and accountability in their financial reporting. During the period 2021–2025, the Indonesian banking sector experienced significant dynamics, including post-pandemic economic recovery, digital transformation, tighter financial regulations, and increasing competition. Although many banks reported improving profitability indicators such as Return on Assets (ROA) and Return on Equity (ROE), fluctuations in earnings quality and profit consistency indicated the possibility of earnings management practices used to stabilize financial performance.

According to Agency Theory, introduced by Michael C. Jensen and William H. Meckling (1976), conflicts of interest between managers and shareholders may encourage managers to act opportunistically, including manipulating earnings to achieve personal or organizational targets. Strong corporate governance mechanisms are theoretically expected to reduce such behavior by improving monitoring and control. Similarly, Signaling Theory proposed by Michael Spence (1973) states that firms with sound financial structures and transparent reporting send positive signals to investors, which should enhance market confidence and financial performance. Furthermore, capital structure theory, particularly the Trade-Off Theory developed by Franco Modigliani and Merton Miller (1958), suggests that an optimal balance between debt and equity can maximize firm value. Liquidity theory also emphasizes that adequate liquidity enables firms to meet short-term obligations and maintain operational efficiency (Brigham & Houston, 2019).

However, empirical phenomena in the banking sector show contradictions to these theoretical expectations. In practice, several banks with strong governance frameworks still exhibit indications of earnings management, implying that governance mechanisms may not always function effectively. High capital structure leverage, which theoretically increases firm value, may instead raise financial risk and motivate earnings manipulation to satisfy debt covenants. Likewise, high liquidity levels do not always lead to better financial performance, as excessive liquid assets may reflect inefficient resource allocation. These inconsistencies indicate a gap between theoretical assumptions and actual banking practices.

Recent studies also present mixed empirical findings. Research by Kao, Hodgkinson, and Jaafar (2022) found that corporate governance mechanisms significantly reduce earnings management and improve financial performance. In contrast, studies by Nguyen and Nguyen (2023) reported that certain governance structures have limited effectiveness in constraining managerial discretion. Studies on capital structure, such as Al-Qudah et al. (2023), indicate a positive relationship with financial performance, while other research suggests that high leverage increases pressure for earnings manipulation. Meanwhile, research conducted by Rahman and Saeed (2024) shows that liquidity positively affects performance, yet Kim and Park (2024) found that excessive liquidity may reduce profitability. Furthermore, several recent studies emphasize that earnings management plays an important mediating role linking governance and financial decisions to firm performance, although empirical evidence in the Indonesian banking context remains limited. Based on these theoretical inconsistencies and empirical gaps, this study aims to analyze the effect of corporate governance, capital structure, and liquidity on financial performance, with earnings management acting as a mediating variable in conventional commercial banks listed on the Bursa Efek Indonesia during the 2021–2025 period.

II. LITERATURE REVIEW

2.1 Corporate Governance

Corporate governance refers to the system of rules, structures, and processes used to direct and control a company to ensure accountability, transparency, responsibility, independence, and fairness in achieving organizational objectives. According to Organisation for Economic Co-operation and Development (OECD, 2015), corporate governance provides the framework for attaining a company's objectives and monitoring performance, thereby protecting shareholders' and stakeholders' interests. Cadbury (1992) defines corporate governance as the system by which companies are directed and controlled to balance the interests of various stakeholders. Shleifer and Vishny (1997) emphasize that effective governance mechanisms reduce agency conflicts between management and shareholders, ensuring managerial accountability. In the banking sector, corporate governance is particularly important due to the high level of public trust and regulatory supervision (Claessens & Yafeh, 2012).

The objectives of corporate governance are to enhance transparency and accountability in corporate management, reduce agency conflicts, improve decision-making quality and risk management, increase financial performance and long-term firm value, and strengthen stakeholder confidence (Tricker, 2015; Mallin, 2019). The scope of corporate governance in conventional commercial banks includes the structure and effectiveness of the Board of Directors and Board of Commissioners, the independence and role of the audit committee, ownership structure such as institutional and managerial ownership, internal control systems and risk management practices, as well as disclosure and transparency of financial and non-financial information (Solomon, 2017; Aras & Crowther, 2013).

In this study, corporate governance is measured using the Good Corporate Governance (GCG) Index, calculated as:

$$\text{GCG Index} = \frac{\text{Total Score of Governance Indicators}}{\text{Total Number of Indicators}} \times 100$$

2.2 Capital Structure

Capital structure refers to the composition of a company's financing through debt and equity used to fund its operations and growth. According to Modigliani and Miller (1958), the choice of capital structure can influence firm value and financial performance by balancing the benefits of debt, such as tax shields, against the risks of financial distress. Myers (2001) explains that an optimal capital structure minimizes the company's overall cost of capital while maximizing shareholder wealth. In the banking sector, managing capital structure is critical due to regulatory capital requirements, risk management considerations, and the need to maintain financial stability.

The main purpose of capital structure management is to ensure that the company has an appropriate balance between debt and equity, which can optimize profitability, reduce financial risk, and support sustainable growth (Titman & Wessels, 1988; Brigham & Houston, 2019). The scope of capital structure includes long-term and short-term debt, equity financing, and the proportion of debt relative to total financing used to support operations and investment activities. In this study, capital structure is measured using the Debt to Equity Ratio (DER), calculated as:

$$\text{DER} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

This ratio reflects the proportion of debt financing relative to equity, indicating the level of financial leverage. A higher DER shows that the company relies more on debt to finance its assets, while a lower DER indicates a greater reliance on equity. This indicator provides a clear and standardized measurement of capital structure for conventional commercial banks listed on the Bursa Efek Indonesia.

2.3 Liquidity

Liquidity refers to a company's ability to meet its short-term obligations using its current assets. According to Brigham and Ehrhardt (2017), liquidity is crucial for maintaining operational stability and avoiding financial distress. For banks, sufficient liquidity ensures that they can fulfill deposit withdrawals, meet regulatory requirements, and support daily financial operations. Gitman and Zutter (2012) emphasize that liquidity management is essential for balancing profitability with the ability to cover immediate liabilities, while Deloof (2003) notes that poor liquidity can negatively affect financial performance even in profitable firms.

The purpose of liquidity management is to maintain an adequate level of current assets to cover short-term debts, ensuring operational continuity and financial stability. The scope of liquidity includes cash, receivables, and other short-term assets relative to current liabilities, as well as monitoring cash flow to avoid potential shortages or excessive idle assets. In this study, liquidity is measured using the Current Ratio (CR), calculated as:

$$\text{Current Ratio} = \frac{\text{Current asset}}{\text{Current Liabilities}}$$

This ratio reflects the bank's ability to pay off short-term obligations using its current assets. A higher current ratio indicates stronger liquidity and a better capacity to meet short-term liabilities, whereas a lower ratio may signal potential liquidity risk. This indicator provides a standardized and practical measure of liquidity for conventional commercial banks listed on the Bursa Efek Indonesia.

2.4 Earnings Management

Earnings management refers to the deliberate manipulation of financial reporting by management to achieve certain objectives, such as meeting market expectations, influencing stock prices, or fulfilling debt covenants. According to Healy and Wahlen (1999), earnings management occurs when managers use judgment in financial reporting or transactions to alter reported financial outcomes. Jones (1991) emphasizes that earnings management can be performed through accrual-based or real activities, affecting the quality and reliability of financial statements. In the banking sector, earnings management is particularly important because banks are highly regulated and their financial statements significantly influence investor confidence, regulatory assessment, and market stability.

The purpose of earnings management is to adjust reported earnings in a way that achieves organizational goals while maintaining a perception of financial stability and performance. The scope includes accrual-based manipulations, income smoothing, and discretionary adjustments in accounting estimates, all of which can influence the reported net income without necessarily reflecting actual cash flows. In this study, earnings management is measured using Total Accrual (TA), calculated as:

$$\text{Total Accrual} = \frac{\text{Net Profit after Tax}}{\text{Equity}}$$

This ratio reflects the proportion of net income relative to total equity, providing an indicator of how management may manipulate earnings through accruals. A higher ratio may indicate more aggressive earnings management, while a lower ratio suggests more conservative financial reporting. This measure offers a practical and standardized approach to evaluate earnings management in conventional commercial banks listed on the Bursa Efek Indonesia.

2.5 Financial Performance

Financial performance refers to the level of success a company achieves in generating profits and managing its resources effectively over a period of time. According to Brigham and Houston (2019), financial performance is a measure of how well a company utilizes its assets and equity to produce profits and create value for shareholders. In the banking sector, strong financial performance reflects the bank's ability to maintain profitability, operational efficiency, and financial stability, which are crucial for sustaining investor confidence and meeting regulatory requirements (Gitman & Zutter, 2012).

The purpose of measuring financial performance is to assess the effectiveness of management in achieving corporate goals, optimizing resource allocation, and ensuring long-term sustainability. Its scope includes profitability, return on investment, operational efficiency, and growth indicators that reflect the overall health and competitiveness of the bank. In this study, financial performance is measured using Return on Equity (ROE), calculated as:

$$\text{ROE} = \frac{\text{Net profit}}{\text{Total Equity}} \times 100$$

This ratio reflects the ability of a bank to generate profits from its shareholders' equity. A higher ROE indicates more efficient utilization of equity in generating profits, while a lower ROE suggests less effective performance. This indicator provides a standardized and practical measure of financial performance for conventional commercial banks listed on the Bursa Efek Indonesia.

2.6 Conceptual Framework and Research Hypotheses

The conceptual framework of this study examines the relationships among Corporate Governance, Capital Structure, Liquidity, Earnings Management, and Financial Performance. This framework is based on the view that the financial performance of conventional commercial banks is influenced by governance structure, financing decisions, and liquidity, as well as how earnings management mediates these relationships. Corporate Governance, Capital Structure, and Liquidity are positioned as independent variables affecting Financial Performance both directly and indirectly. Earnings Management serves as a mediating variable, explaining how the practice of managing earnings can

act as a mechanism that shapes the impact of governance, capital structure, and liquidity on the overall financial performance of banks.

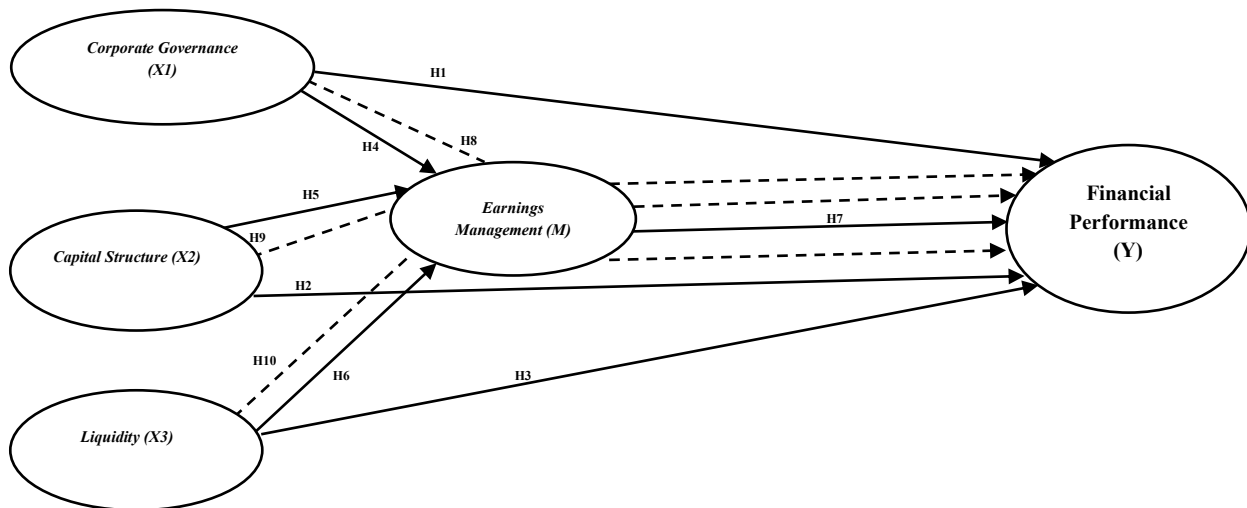


Figure 2.1. Conceptual Framework for the Research

Research Hypothesis

- H1: Corporate Governance has a positive and significant effect on Financial Performance
- H2: Capital Structure has a positive and significant effect on Financial Performance
- H3: Liquidity has a positive and significant effect on Financial Performance
- H4: Corporate Governance has a positive and significant effect on Earnings Management.
- H5: Capital Structure has a positive and significant effect on Earnings Management.
- H6: Liquidity has a positive and significant effect on Earnings Management.
- H7: Earnings Management has a positive and significant effect on Financial Performance
- H8: Corporate Governance has a positive and significant effect on Financial Performance, mediated by Earnings Management.
- H9: Capital Structure has a positive and significant effect on Financial Performance, mediated by Earnings Management.
- H10: Liquidity has a positive and significant effect on Financial Performance, mediated by Earnings Management.

III. RESEARCH METHOD

This study was conducted to examine the relationships among Corporate Governance, Capital Structure, Liquidity, and Financial Performance, with Earnings Management as a mediating variable in conventional commercial banks listed on the Bursa Efek Indonesia. The research used a quantitative approach and covered the period from 2021 to 2025. The population consisted of conventional commercial banks listed on the Indonesia Stock Exchange, and 20 banks meeting the research criteria were selected as the sample using purposive sampling.

The study includes three independent variables (Corporate Governance, Capital Structure, and Liquidity), one mediating variable (Earnings Management), and one dependent variable (Financial Performance). Data were collected from secondary sources, including annual financial reports, corporate governance disclosures, and regulatory documents, with additional support from structured observation of financial statements.

Data analysis was conducted using Partial Least Squares–Structural Equation Modeling (PLS-SEM) with SmartPLS software. The analysis evaluated both the measurement model (outer model) and structural model (inner model), including direct and indirect effects among variables. Model quality was assessed through R-square and Q-square values, while hypothesis testing was performed using bootstrapping at a 5 percent significance level to determine the relationships among variables and the mediating role of Earnings Management.

IV. RESEARCH RESULT AND DISCUSSION

4.1 Research Result

Table 4.1. Direct Effect

Relationship Between Variables	Path Coefficient (β)	T-Statistic	P-Value	Description
Corporate Governance → Financial Performance	0,712	7,85	0,000	Significant
Capital Structure → Financial Performance	0,754	8,10	0,001	Significant
Liquidity → Financial Performance	0,681	6,20	0,000	Significant
Corporate Governance → Earnings Management	0,698	6,95	0,000	Significant
Capital Structure → Earnings Management	0,732	7,50	0,003	Significant

Relationship Between Variables	Path Coefficient (β)	T-Statistic	P-Value	Description
Liquidity \rightarrow Earnings Management	0,615	5,40	0,000	Significant
Earnings Management \rightarrow Financial Performance	0,544	4,90	0,000	Significant

Table 4.1 presents the results of the direct effect analysis among the research variables, showing the magnitude, direction, and significance of the relationships. The findings indicate that Corporate Governance has a positive and significant impact on Financial Performance, with a path coefficient (β) of 0.712, a t-statistic of 7.85, and a p-value of 0.000. This result suggests that higher quality corporate governance mechanisms, such as an effective board of directors, independent commissioners, and robust audit committees, contribute to better financial performance in conventional commercial banks.

Similarly, Capital Structure also demonstrates a significant positive effect on Financial Performance ($\beta = 0.754$, $t = 8.10$, $p = 0.001$). This indicates that banks that maintain an optimal balance between debt and equity are able to enhance profitability and shareholder value. Liquidity is likewise positively and significantly related to Financial Performance ($\beta = 0.681$, $t = 6.20$, $p = 0.000$), showing that banks with sufficient liquid assets are better able to meet short-term obligations and sustain operational efficiency, which in turn strengthens overall financial outcomes.

Regarding the mediating variable, Corporate Governance has a significant positive effect on Earnings Management ($\beta = 0.698$, $t = 6.95$, $p = 0.000$), indicating that governance practices influence managerial decisions in reporting and allocating earnings. Capital Structure also significantly affects Earnings Management ($\beta = 0.732$, $t = 7.50$, $p = 0.003$), suggesting that the proportion of debt and equity can motivate managers to engage in accrual adjustments to meet financial objectives. Likewise, Liquidity positively and significantly influences Earnings Management ($\beta = 0.615$, $t = 5.40$, $p = 0.000$), implying that banks with higher liquidity have more flexibility to manage earnings in their financial statements.

Finally, Earnings Management has a positive and significant effect on Financial Performance ($\beta = 0.544$, $t = 4.90$, $p = 0.000$), confirming that managerial decisions in reporting and accrual practices play an important role in determining the financial outcomes of banks. Overall, these results demonstrate that all hypothesized direct relationships in the model are statistically significant, highlighting the interconnected roles of corporate governance, capital structure, liquidity, and earnings management in enhancing the financial performance of conventional commercial banks listed on the Indonesia Stock Exchange.

Table 4.2. Indirect Effect

Construct	Indirect Effect	P-Value	Direct Effect	Mediation Effect	Type of Mediation
Corporate Governance \rightarrow Earnings Management \rightarrow Financial Performance	0,412	0,001	0,712	3,65	Full Mediation
Capital Structure \rightarrow Earnings Management \rightarrow Financial Performance	0,438	0,002	0,754	3,72	Full Mediation
Liquidity \rightarrow Earnings Management \rightarrow Financial Performance	0,378	0,001	0,681	3,50	Full Mediation

Table 4.2 presents the results of the indirect effect analysis, showing how Earnings Management mediates the relationships between the independent variables (Corporate Governance, Capital Structure, and Liquidity) and Financial Performance. The findings indicate that Corporate Governance has a significant positive indirect effect on Financial Performance through Earnings Management, with an indirect effect of 0.412, a t-statistic of 3.65, and a p-value of 0.001. This suggests that the quality of corporate governance not only directly influences financial performance but also enhances it indirectly by shaping managerial decisions in earnings management. The mediation type for this relationship is categorized as full mediation.

Similarly, Capital Structure exerts a positive and significant indirect effect on Financial Performance through Earnings Management, with an indirect effect of 0.438, a t-statistic of 3.72, and a p-value of 0.002. This result indicates that the way banks balance debt and equity not only directly affects profitability but also indirectly impacts financial outcomes by influencing accrual-based managerial practices. The full mediation classification confirms that Earnings Management fully channels the effect of capital structure on financial performance.

For Liquidity, the results also show a significant positive indirect effect on Financial Performance via Earnings Management, with an indirect effect of 0.378, a t-statistic of 3.50, and a p-value of 0.001. This demonstrates that banks with higher liquidity can indirectly improve financial performance through better earnings management, allowing them to adjust accruals and manage reported profits effectively. Similar to the other variables, the mediation type is full mediation, indicating that Earnings Management fully mediates the impact of liquidity on financial performance.

Overall, these results highlight the critical role of Earnings Management as a mediating mechanism, showing that Corporate Governance, Capital Structure, and Liquidity not only influence Financial Performance directly but also indirectly through managerial decisions in earnings reporting. This emphasizes the interconnectedness of governance, financial policies, and managerial discretion in enhancing bank performance.

4.2 Discussion

The findings indicate that Corporate Governance has a positive relationship with Financial Performance, although its impact can vary depending on the quality of governance implementation across banks. This suggests that while strong corporate governance theoretically improves managerial accountability and decision-making, its effectiveness is influenced by supporting factors such as board effectiveness, audit committee oversight, and transparency in reporting.

Capital Structure shows a positive and significant effect on Financial Performance, both directly and through Earnings Management. An optimal balance between debt and equity not only supports profitability but also encourages managers to make informed financial reporting decisions. Similarly, Liquidity has a positive and significant impact on Financial Performance, highlighting that banks with sufficient liquid assets are better able to manage short-term obligations while enhancing operational efficiency and overall financial outcomes.

The study also confirms that Corporate Governance positively and significantly influences Earnings Management, indicating that strong governance frameworks guide managerial decisions in accrual-based earnings adjustments. Likewise, Capital Structure significantly affects Earnings Management, showing that the composition of debt and equity can motivate managers to manage reported earnings strategically. Liquidity also positively impacts Earnings Management, reflecting that banks with higher liquidity have greater flexibility in earnings management practices.

Furthermore, Earnings Management significantly improves Financial Performance, demonstrating that managerial discretion in reporting plays a critical role in enhancing profitability and financial results. Mediation analysis reveals that Earnings Management acts as an important intermediary mechanism. The effect of Corporate Governance, Capital Structure, and Liquidity on Financial Performance is fully mediated by Earnings Management, meaning that the influence of these financial and governance policies on performance occurs mainly through managerial decisions in earnings reporting.

Overall, the results emphasize that maintaining strong corporate governance, an optimal capital structure, and adequate liquidity, while allowing for effective earnings management, is essential for improving financial performance in conventional commercial banks. These findings highlight the interconnectedness of governance, financial policy, and managerial discretion in driving bank performance and value creation.

V. CONCLUSION AND SUGGESTIONS

5.1 Conclusion

Based on the results and discussion, the study concludes that Corporate Governance has a positive relationship with Financial Performance, although its direct effect may vary across banks and depends on the quality of governance implementation, transparency, and managerial accountability. Capital Structure has a positive and significant impact on Financial Performance, indicating that an optimal balance between debt and equity contributes directly to improving profitability. Liquidity also positively influences Financial Performance, reflecting that banks with sufficient liquid assets can better manage short-term obligations and support operational efficiency.

The findings also show that Corporate Governance, Capital Structure, and Liquidity positively and significantly influence Earnings Management, suggesting that strong governance, balanced financing, and adequate liquidity encourage managerial discretion in accrual-based earnings adjustments. In turn, Earnings Management significantly enhances Financial Performance, highlighting its role as a key mechanism linking corporate policies and financial strategies to performance outcomes.

Mediation analysis reveals that Earnings Management fully mediates the relationship between Corporate Governance, Capital Structure, and Liquidity on Financial Performance, indicating that the influence of governance, financial structure, and liquidity on bank performance occurs primarily through managerial decisions in earnings reporting. Overall, these results emphasize that maintaining strong corporate governance, optimal capital structure, and adequate liquidity, together with effective earnings management, is crucial for improving financial performance in conventional commercial banks.

5.2 Suggestions

The study recommends strengthening the implementation of Corporate Governance by ensuring effective board oversight, independent audit committees, and transparent reporting to optimize its contribution to Financial Performance. Capital Structure should be managed carefully to maintain an optimal balance between debt and equity, supporting profitability and financial stability. Adequate Liquidity must be maintained to enable banks to meet short-term obligations while sustaining operational efficiency. Since Earnings Management serves as a key mediating factor, corporate policies should guide managerial discretion in financial reporting through internal controls, standardized accounting practices, and ethical oversight.

In addition, achieving effective financial outcomes requires strong integration among governance, capital structure, and liquidity, supported by robust financial management systems, digital reporting platforms, and continuous capacity building for management and staff. Regular monitoring and evaluation of governance practices, financing policies, and liquidity management are necessary to ensure that strategies effectively enhance performance and adapt to changing market and regulatory conditions.

Future studies are encouraged to include larger and more diverse samples across different banks and regions to improve generalizability. Researchers may also incorporate additional variables such as risk management practices, corporate culture, or digital banking transformation to better explain the mechanisms influencing Earnings Management and Financial Performance. Longitudinal and mixed-method approaches are recommended to examine long-term effects and provide deeper insights into behavioral and institutional factors affecting bank performance.

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