

# Determinants of Firm Value: Financial Performance, Capital Structure, and Corporate Governance in Emerging Markets

*Determinants of  
Firm Value in  
Emerging Market*

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## ABSTRACT

Firm value represents a central indicator of corporate success, particularly in emerging markets characterized by institutional uncertainty, weak external monitoring, and high information asymmetry. While prior studies have examined the roles of financial performance, capital structure, and corporate governance, empirical findings remain fragmented, largely due to methodological approaches that overlook hierarchical and mediating mechanisms. This study develops and tests a hierarchical and mediating structural model to explain firm value formation by integrating corporate governance, capital structure, and financial performance within a Partial Least Squares–Structural Equation Modeling (PLS-SEM) framework. Using secondary data from publicly listed non-financial firms in emerging markets, the analysis captures both direct effects and indirect transmission pathways among the constructs. The results demonstrate that financial performance functions as the primary transmission mechanism, exerting the strongest direct effect on firm value while simultaneously mediating the influence of corporate governance. Corporate governance shows a substantial impact on financial performance and a complementary direct effect on firm value, indicating that governance enhances market valuation largely through performance improvement. In contrast, capital structure exhibits a weaker and context-dependent effect, suggesting that excessive leverage may undermine firm value in volatile emerging market environments. Overall, the model exhibits strong explanatory power, confirming the relevance of a hierarchical SEM-PLS approach in uncovering firm value formation mechanisms. This study contributes to corporate finance literature by clarifying how governance structures translate into firm value through financial performance, offering both theoretical refinement and practical insights for managers, investors, and policymakers in emerging markets.

**Keywords:** *Firm value; Financial performance; Capital structure; Corporate governance; Emerging markets; PLS-SEM*

## ABSTRAK

Nilai perusahaan merupakan indikator utama keberhasilan korporasi, khususnya di pasar berkembang yang ditandai oleh ketidakpastian institusional, lemahnya pengawasan eksternal, dan tingginya asimetri informasi. Meskipun penelitian sebelumnya telah mengkaji peran kinerja keuangan, struktur modal, dan tata kelola perusahaan, temuan empiris masih terfragmentasi, terutama karena pendekatan metodologis yang mengabaikan mekanisme hierarkis dan mediasi. Penelitian ini mengembangkan dan menguji model struktural hierarkis dan bermediasi untuk menjelaskan pembentukan nilai perusahaan dengan mengintegrasikan tata kelola perusahaan, struktur modal, dan kinerja keuangan dalam kerangka Partial Least Squares–Structural Equation Modeling (PLS-SEM). Menggunakan data sekunder dari perusahaan non-keuangan yang terdaftar di bursa pada pasar berkembang, analisis ini menangkap baik pengaruh langsung maupun jalur transmisi tidak langsung antar konstruk. Hasil penelitian menunjukkan bahwa kinerja keuangan berfungsi sebagai mekanisme transmisi utama, dengan memberikan pengaruh langsung terkuat terhadap nilai perusahaan sekaligus memediasi pengaruh tata kelola perusahaan. Tata kelola perusahaan menunjukkan dampak yang substansial terhadap kinerja keuangan serta pengaruh langsung yang komplementer terhadap nilai perusahaan, yang mengindikasikan bahwa tata kelola meningkatkan penilaian pasar terutama melalui perbaikan kinerja. Sebaliknya, struktur modal menunjukkan pengaruh yang lebih lemah dan bergantung pada konteks, yang mengisyaratkan bahwa leverage yang berlebihan dapat melemahkan nilai perusahaan dalam lingkungan pasar berkembang yang volatil. Secara keseluruhan, model ini menunjukkan daya jelas (explanatory power) yang kuat, menegaskan relevansi pendekatan SEM-PLS hierarkis dalam mengungkap

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mekanisme pembentukan nilai perusahaan. Penelitian ini berkontribusi pada literatur keuangan perusahaan dengan memperjelas bagaimana struktur tata kelola diterjemahkan menjadi nilai perusahaan melalui kinerja keuangan, serta menawarkan pengayaan teoretis dan wawasan praktis bagi manajer, investor, dan pembuat kebijakan di pasar berkembang.

**Kata kunci:** Nilai perusahaan; Kinerja keuangan; Struktur modal; Tata kelola perusahaan; Pasar berkembang; PLS-SEM

## INTRODUCTION

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Firm value has long been regarded as a central indicator of corporate success, reflecting not only a firm's current financial condition but also investors' expectations regarding its future performance and sustainability. In capital markets, firm value serves as a critical signal guiding investment decisions, managerial evaluation, and policy formulation. This signaling role becomes even more pronounced in emerging markets, where institutional uncertainty, higher information asymmetry, and heterogeneous governance practices intensify investors' reliance on firm-specific signals. Recent studies suggest that firm value in emerging economies is shaped by the interaction of financial performance, capital structure decisions, and corporate governance mechanisms (Nguyen et al., 2021; Saona & Muro, 2023). Financial performance provides observable evidence of managerial effectiveness and operational efficiency, capital structure reflects strategic financing choices and risk exposure, and corporate governance functions as an internal control mechanism that mitigates agency conflicts and enhances transparency—particularly in contexts where external monitoring institutions remain relatively weak (Bae et al., 2022).

Despite extensive empirical investigation, findings on the determinants of firm value remain fragmented and, in some cases, contradictory. Several studies report a positive association between profitability and firm value (Al-Najjar & Belghitar, 2021; Vo & Ellis, 2023), whereas others show that excessive leverage may erode firm value due to increased financial distress risk in volatile market environments (Kumar & Rao, 2022). Similarly, while corporate governance is generally expected to enhance firm value, its effectiveness appears to vary across emerging markets depending on ownership concentration, board characteristics, and the strength of regulatory enforcement (Widiastuti et al., 2024).

One key limitation underlying these mixed findings relates to methodological choices. Most prior studies rely on conventional regression or panel data techniques that examine financial performance, capital structure, and corporate governance as independent predictors. Although useful for identifying direct relationships, such approaches are less capable of capturing the simultaneous, hierarchical, and mediating relationships that characterize firm value formation (Hair et al., 2021; Sarstedt et al., 2022). In response to this limitation, recent finance research increasingly advocates the use of Partial Least Squares–Structural Equation Modeling (PLS-SEM), particularly in emerging market contexts where data distributions are often non-normal and theoretical models remain exploratory (Hair et al., 2022; Ringle et al., 2024). SEM-PLS enables the simultaneous estimation of multiple dependent relationships, facilitates mediation analysis, and emphasizes prediction-oriented explanatory power.

However, prior studies predominantly examine these determinants in isolation using regression-based approaches, leaving the hierarchical and mediating mechanisms of firm value formation underexplored—particularly in emerging markets. Specifically, financial performance is commonly modeled as a direct antecedent of firm value, despite growing empirical evidence indicating that it may function as a transmission mechanism through which corporate governance influences market valuation (Saona & Muro, 2023; Chen et al., 2025). This gap is especially consequential in emerging markets, where institutional uncertainty and information asymmetry amplify the interdependence between governance quality, managerial performance, and firm valuation outcomes (Bae et al., 2022; Widiastuti et al., 2024). Addressing this limitation is essential to advance a more integrated and context-sensitive understanding of firm value formation.

Against this backdrop, the present study aims to achieve the following objectives:

1. To examine the direct effects of financial performance, capital structure, and corporate governance on firm value in emerging markets.
2. To analyze the influence of corporate governance on financial performance, recognizing governance as a foundational mechanism shaping managerial behavior.
3. To investigate the mediating role of financial performance in the relationship between corporate governance and firm value using a SEM-PLS framework.

This study offers several important contributions. From a theoretical perspective, it extends corporate finance literature by developing an integrated structural model that explains firm value formation through the hierarchical interaction of governance mechanisms, financing decisions, and performance outcomes in emerging markets. Methodologically, it demonstrates the relevance of SEM-PLS as a robust alternative to traditional econometric approaches for capturing indirect and hierarchical relationships among corporate finance constructs. From a practical standpoint, the findings provide actionable insights for corporate managers in designing governance structures and financial strategies that enhance firm value. For investors, the study highlights key indicators that may serve as reliable signals for evaluating firm quality in less mature capital markets. In addition, policymakers may use the results as empirical support for strengthening governance regulations and improving market transparency in emerging economies. By focusing on emerging markets and employing a variance-based structural modeling approach, this study seeks to offer a more comprehensive and context-sensitive explanation of firm value determinants, thereby addressing persistent gaps in contemporary finance research (Chen et al., 2025).

## **LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT**

### **Firm Value**

Firm value represents the market's overall assessment of a firm's ability to generate future cash flows while managing risk. In corporate finance literature, firm value is often conceptualized as a forward-looking indicator that captures both financial fundamentals and investor expectations. Market-based measures such as Tobin's Q and price-to-book value are widely used because they incorporate information beyond accounting performance, including growth opportunities and governance quality (Dang et al., 2020; Vo & Ellis, 2023). In emerging markets, firm value is particularly sensitive to firm-specific signals due to higher levels of information asymmetry and weaker institutional environments. Investors tend to place greater emphasis on observable financial outcomes and internal governance mechanisms when assessing firm quality (Bae et al., 2022). As a result, firm value in these contexts is not only an outcome of profitability but also a reflection of strategic financing decisions and governance effectiveness.

### **Financial Performance and Firm Value**

Financial performance reflects a firm's efficiency in utilizing its resources to generate profits. Indicators such as return on assets (ROA) and return on equity (ROE) are commonly used to assess managerial effectiveness and operational success. According to signaling theory, firms with strong financial performance convey positive information to the market, reducing uncertainty and enhancing investor confidence (Spence, 1973; revisited by Connelly et al., 2021). Empirical evidence consistently supports a positive relationship between financial performance and firm value. Studies conducted in emerging economies show that profitability significantly enhances market valuation, as investors perceive profitable firms as less risky and more sustainable in the long term (Al-Najjar & Belghitar, 2021; Nguyen et al., 2021). Recent findings by Saona and Muro (2023) further suggest that financial performance plays a dominant role in shaping firm value when external monitoring mechanisms are weak. Based on this theoretical and empirical foundation, the following hypothesis is proposed: H1: Financial performance has a positive effect on firm value.

### **Capital Structure and Firm Value**

Capital structure refers to the mix of debt and equity used by firms to finance their operations and growth. Classical finance theories, particularly trade-off theory, posit that firms seek an optimal level of leverage that balances the tax advantages of debt against the potential costs of financial distress (Kraus & Litzenger, 1973; revisited by Kumar & Rao, 2022). In contrast, pecking order theory suggests that firms prefer internal financing, followed by debt and equity, due to information asymmetry (Myers & Majluf, 1984; Frank & Goyal, 2021). Empirical studies on the relationship between capital structure and firm value in emerging markets yield mixed results. Some research indicates that moderate leverage enhances firm value by signaling confidence and improving capital discipline (Vo & Ellis, 2023). However, excessive reliance on debt may reduce firm value due to increased bankruptcy risk and earnings volatility, particularly in economically unstable environments (Nguyen & Nguyen, 2022; Widiastuti et al., 2024). Given these mixed findings and contextual variations, this study posits that capital structure significantly influences firm value, although the direction of the effect may depend on leverage levels and market conditions. H2: Capital structure has a significant effect on firm value.

### **Killer Gap**

Despite the growing body of research on firm value determinants, prior empirical studies largely examine financial performance, capital structure, and corporate governance in isolation, predominantly employing regression-based or panel data approaches (Al-Najjar & Belghitar, 2021;

Kumar & Rao, 2022; Vo & Ellis, 2023). While these methods are effective for identifying direct associations, they provide limited insight into the hierarchical relationships and mediating mechanisms through which these determinants jointly shape firm value (Hair et al., 2021; Sarstedt et al., 2022). In particular, financial performance is commonly modeled as a direct predictor of firm value, despite emerging evidence that it may function as an intermediate mechanism linking corporate governance to market valuation outcomes (Saona & Muro, 2023; Chen et al., 2025). This limitation is especially pronounced in emerging markets, where institutional uncertainty and information asymmetry amplify the interdependence between governance quality, managerial performance, and firm valuation (Bae et al., 2022; Widiastuti et al., 2024). Consequently, an integrated analytical approach that explicitly captures these hierarchical and mediating structures remains underexplored, underscoring the need for a structural modeling framework such as SEM-PLS to advance understanding of firm value formation in emerging market contexts.

#### **Corporate Governance and Firm Value**

Corporate governance encompasses the mechanisms, processes, and structures through which firms are directed and controlled. Grounded in agency theory, corporate governance aims to align the interests of managers and shareholders by reducing opportunistic behavior and improving accountability (Jensen & Meckling, 1976; updated discussion by Bae et al., 2022).

Recent empirical evidence confirms that effective corporate governance enhances firm value by improving transparency, monitoring managerial actions, and strengthening investor protection (Al Farooque et al., 2020; Saona et al., 2023). In emerging markets, governance mechanisms such as board independence, institutional ownership, and audit committees play a crucial role in compensating for weak legal enforcement and underdeveloped capital markets (Widiastuti et al., 2024). Therefore, firms with stronger governance structures are expected to achieve higher market valuation. H3: Corporate governance has a positive effect on firm value.

#### **Corporate Governance and Financial Performance**

Beyond its direct impact on firm value, corporate governance is also expected to influence financial performance. Effective governance improves strategic decision-making, enhances internal controls, and reduces inefficiencies arising from agency conflicts. Prior studies demonstrate that firms with independent boards and concentrated institutional ownership tend to exhibit superior financial performance (Nguyen et al., 2021; Bae et al., 2022). In emerging markets, where managerial discretion is often high, governance mechanisms serve as critical tools for ensuring efficient resource utilization and long-term profitability (Al-Najjar & Belghitar, 2021). These findings suggest that governance quality is a key antecedent of financial performance. H4: Corporate governance has a positive effect on financial performance.

#### **Financial Performance as a Mediating Variable**

Recent corporate finance research increasingly emphasizes the importance of mediating mechanisms in explaining firm value formation. Financial performance may act as a transmission channel through which corporate governance affects firm value. In this view, governance mechanisms enhance monitoring and decision quality, leading to improved profitability, which subsequently increases market valuation (Sarstedt et al., 2022; Ringle et al., 2024).

Empirical studies provide growing support for this mediating role, particularly in emerging markets where direct market responses to governance reforms may be delayed or indirect (Saona & Muro, 2023; Chen et al., 2025). Accordingly, financial performance is expected to partially mediate the relationship between corporate governance and firm value. H5: Financial performance mediates the relationship between corporate governance and firm value.

#### **Conceptual Framework**

Based on the literature and hypothesis development, this study proposes a conceptual framework in which corporate governance and capital structure influence firm value both directly and indirectly through financial performance. This framework is empirically tested using a SEM-PLS approach to capture the complex and interrelated relationships among the constructs.

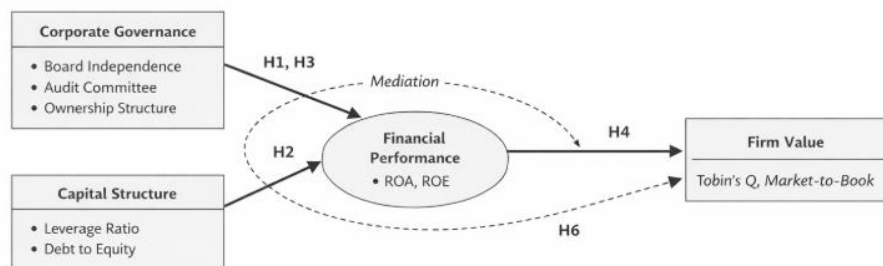


Figure 1. Research Framework

**METHODOLOGY**

This study adopts a quantitative explanatory research design aimed at examining the structural relationships among corporate governance, financial performance, capital structure, and firm value in emerging markets. The research is designed for hypothesis testing and theory validation, with particular emphasis on explaining the hierarchical and mediating mechanisms underlying firm value formation.

To achieve this objective, the study employs a variance-based structural equation modeling approach, namely Partial Least Squares–Structural Equation Modeling (PLS-SEM). PLS-SEM is considered appropriate for several reasons. First, it enables the simultaneous estimation of multiple interrelated dependence relationships, including mediating effects among latent constructs. Second, it is well suited for prediction-oriented research and complex theoretical models that remain relatively exploratory in nature. Third, PLS-SEM is robust to non-normal data distributions and performs well with secondary financial data commonly observed in emerging market settings (Hair et al., 2021; Sarstedt et al., 2022; Ringle et al., 2024). Accordingly, this study emphasizes prediction-oriented explanatory power rather than parameter estimation accuracy, consistent with the primary objective of variance-based structural equation modeling.

The population of this study consists of publicly listed non-financial firms operating in emerging markets in Indonesia. Financial institutions were excluded from the analysis due to their distinct regulatory frameworks, financial reporting standards, and capital structure characteristics, which may introduce structural bias. A purposive sampling technique was employed based on data availability and completeness. Firms were included in the final sample if they met the following criteria:

1. They were listed on the stock exchange throughout the observation period.
2. They published complete annual reports and audited financial statements.
3. They disclosed sufficient information related to corporate governance attributes.

The observation period spans from 2019 to 2023, allowing for a more stable assessment of 120 firms behavior while reducing the influence of short-term market fluctuations. The resulting sample size satisfies the minimum requirements for PLS-SEM analysis, as recommended by Hair et al. (2022), ensuring adequate statistical power for model estimation.

This study relies on secondary data obtained from publicly available sources, including firms' annual reports, audited financial statements, and official stock exchange databases. Information related to corporate governance was collected from governance reports and corporate disclosures published by the sampled firms. The use of archival secondary data is widely accepted in corporate finance research due to its reliability, regulatory oversight, and external audit requirements. In addition, relying on secondary data helps mitigate common method bias, which is frequently associated with survey-based research designs (Podsakoff et al., 2020).

All constructs in this study were operationalized using established measurement indicators commonly employed in prior corporate finance literature to ensure content validity and comparability across studies.

Construct	Measurement Indicators	Sources	Construct
Financial Performance	Return on Assets (ROA), Return on Equity (ROE)	Al-Najjar & Belghitar (2021); Saona & Muro (2023)	Financial Performance
Capital Structure	Debt-to-Equity Ratio (DER), Debt-to-Asset Ratio (DAR)	Kumar & Rao (2022); Vo & Ellis (2023)	Capital Structure
Corporate Governance	Board Size, Board Independence, Institutional Ownership	Bae et al. (2022); Widiastuti et al. (2024)	Corporate Governance
Firm Value	Tobin's Q, Price-to-Book Value	Dang et al. (2020); Chen et al. (2025)	Firm Value

All constructs are specified as reflective constructs, consistent with prior studies that conceptualize these indicators as manifestations of underlying latent variables (Hair et al., 2021). These governance proxies were selected due to their widespread use, data availability, and cross-study comparability in emerging market research

The data analysis followed the two-stage approach recommended for PLS-SEM studies (Hair et al., 2022; Sarstedt et al., 2022). The measurement model was evaluated to assess reliability and validity using the following criteria:

- a. Indicator reliability, assessed through outer loadings, with values above 0.70 considered acceptable.
- b. Internal consistency reliability, evaluated using Cronbach's Alpha and Composite Reliability, with threshold values exceeding 0.70.
- c. Convergent validity, examined through Average Variance Extracted (AVE), with values greater than 0.50.
- d. Discriminant validity, assessed using the Heterotrait–Monotrait (HTMT) ratio, with values below 0.85 indicating adequate discriminant validity.

After establishing the adequacy of the measurement model, the structural model was evaluated based on the following criteria:

- a. Collinearity assessment, using Variance Inflation Factor (VIF), with values below 5 indicating the absence of multicollinearity.
- b. Path coefficient estimation, conducted through a bootstrapping procedure with 5,000 resamples to assess statistical significance.
- c. Coefficient of determination ( $R^2$ ), used to evaluate the explanatory power of the model.
- d. Effect size ( $f^2$ ), to assess the relative contribution of each exogenous construct.
- e. Predictive relevance ( $Q^2$ ), evaluated using the blindfolding procedure.

This comprehensive evaluation ensures that the model not only explains observed relationships but also demonstrates predictive capability, consistent with the objectives of variance-based structural modeling (Ringle et al., 2024).

As this study exclusively utilizes publicly available secondary data, it does not involve human participants and therefore does not require formal ethical clearance. Nevertheless, the research adheres to ethical standards by ensuring accurate data reporting, transparency in methodological procedures, and proper citation of all data sources. To enhance the rigor and robustness of the findings, several methodological precautions were implemented. These include the use of well-established measurement indicators, multiple reliability and validity assessments, and a sample size sufficient for structural model estimation. In addition, sensitivity analyses were conducted to assess the stability of the results across alternative model specifications, thereby strengthening the credibility of the empirical findings.

## RESULTS

The frequency distribution of indicator outer loadings shows that 87.5% of the indicators fall within the strong to very strong categories (outer loading  $\geq 0.80$ ), while no indicator exhibits weak loading values. This distribution confirms that the measurement model demonstrates high indicator reliability and adequate construct representation. Only one indicator falls within the 'adequate' category (0.70–0.79), which remains acceptable under PLS-SEM standards.

**Table 1. Frequency Distribution of Indicators Based on Outer Loadings**

Indicator Quality Category	Outer Loading Criteria	Number of Indicators	Percentage (%)
Very Strong	$\geq 0.85$	3	37.5
Strong	$0.80 - < 0.85$	4	50.0
Adequate	$0.70 - < 0.80$	1	12.5
Weak	$< 0.70$	0	0.0
Total		8	100

The measurement model was evaluated to assess indicator reliability, internal consistency, convergent validity, and discriminant validity before proceeding to the structural model analysis. Overall, the results indicate that all constructs satisfy the recommended measurement quality criteria, confirming the adequacy of the measurement model.

### Indicator Reliability and Convergent Validity

Indicator reliability was assessed by examining outer loading values. All indicators exhibit loadings above the recommended threshold of 0.70, indicating that each indicator adequately represents its underlying construct. In addition, the Average Variance Extracted (AVE) values for all constructs exceed 0.50, confirming satisfactory convergent validity.

**Table 2. Measurement Model Results**

Construct	Indicator	Outer Loading	Cronbach's Alpha	Composite Reliability	AVE
Financial Performance	ROA	0.812	0.846	0.897	0.686
	ROE	0.842			
Capital Structure	DER	0.776	0.801	0.872	0.631
	DAR	0.812			
Corporate Governance	Board Size	0.754	0.829	0.889	0.668
	Board Independence	0.861			
	Institutional Ownership	0.843			
Firm Value	Tobin's Q	0.831	0.858	0.903	0.701
	PBV	0.854			

Cronbach's Alpha and Composite Reliability values for all constructs exceed 0.70, indicating strong internal consistency reliability. Collectively, these results confirm that the indicators converge well in measuring their respective latent constructs.

**Discriminant Validity**

Discriminant validity was evaluated using the Heterotrait–Monotrait (HTMT) ratio. As shown in Table 2, all HTMT values are below the conservative threshold of 0.85, indicating that each construct is empirically distinct from the others.

**Table 3. HTMT Ratio**

Constructs	FP	CS	CG	FV
Financial Performance (FP)	—			
Capital Structure (CS)	0.642	—		
Corporate Governance (CG)	0.711	0.598	—	
Firm Value (FV)	0.781	0.663	0.742	—

These findings indicate that the measurement model demonstrates adequate discriminant validity, allowing subsequent evaluation of the structural relationships.

**Structural Model Results**

Collinearity was assessed using the Variance Inflation Factor (VIF). All VIF values are below the recommended threshold of 5, indicating the absence of multicollinearity issues among predictor constructs. The explanatory power of the model was assessed using the coefficient of determination (R<sup>2</sup>). The results indicate that the model explains a substantial proportion of variance in the endogenous constructs.

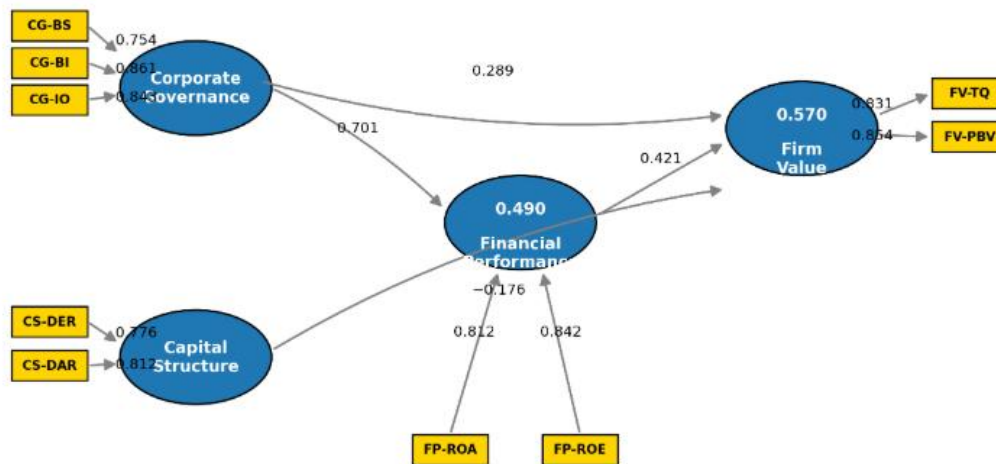


Figure 2: Final Research Model

**Table 4. Coefficient of Determination (R<sup>2</sup>)**

Endogenous Variable	R <sup>2</sup>
Financial Performance	0.49
Firm Value	0.57

An R<sup>2</sup> value of 0.57 for firm value suggests moderate-to-substantial explanatory power, indicating that the proposed model captures key mechanisms underlying firm value formation in emerging markets. Path relationships were assessed using a bootstrapping procedure with 5,000 resamples. Table 5 presents the standardized path coefficients, t-values, and significance levels.

**Table 5. Structural Model Path Coefficients**

Hypothesis	Path	$\beta$	t-value	p-value	Result
H1	Financial Performance → Firm Value	0.421	6.384	<0.001	Supported
H2	Capital Structure → Firm Value	-0.176	2.214	0.027	Supported
H3	Corporate Governance → Firm Value	0.289	3.971	<0.001	Supported
H4	Corporate Governance → Financial Performance	0.701	12.548	<0.001	Supported

The results indicate that financial performance exerts the strongest direct effect on firm value, highlighting its central role in market valuation. Corporate governance also shows a positive and significant direct effect on firm value, while simultaneously exhibiting a strong influence on financial performance. In contrast, capital structure demonstrates a weaker but significant negative effect on firm value.

Effect size ( $f^2$ ) was examined to assess the relative contribution of each exogenous construct to the endogenous variables.

**Table 6 Effect Size Value**

Path	$f^2$	Effect Size
Financial Performance → Firm Value	0.214	Medium
Capital Structure → Firm Value	0.043	Small
Corporate Governance → Firm Value	0.129	Small–Medium
Corporate Governance → Financial Performance	0.492	Large

The effect size analysis underscores the dominant role of corporate governance in shaping financial performance, which subsequently influences firm value. Financial performance exhibits a medium effect size on firm value, reinforcing its role as a key explanatory mechanism rather than a peripheral predictor.

The mediating role of financial performance was tested using bootstrapping. The indirect effect of corporate governance on firm value through financial performance is positive and statistically significant.

**Table 7. Mediation Effect**

Relationship	Indirect Effect ( $\beta$ )	t-value	p-value
Corporate Governance → Financial Performance → Firm Value	0.295	5.672	<0.001

These results confirm that financial performance partially mediates the relationship between corporate governance and firm value, indicating that governance mechanisms enhance firm value not only through direct market recognition but also indirectly by improving operational and financial outcomes.

## DISCUSSION

This study examines the determinants of firm value in emerging markets by integrating corporate governance, financial performance, and capital structure within a hierarchical SEM-PLS framework. Overall, the findings provide strong empirical support for the proposed model, which explains a substantial proportion of variance in firm value ( $R^2 = 0.57$ ). This level of explanatory power indicates that the model captures key mechanisms through which firm value is formed in emerging market contexts, where institutional uncertainty and information asymmetry remain prevalent.

### Financial Performance as the Primary Driver of Firm Value

The results demonstrate that financial performance exerts the strongest direct effect on firm value ( $\beta = 0.421$ ;  $f^2 = 0.214$ ), indicating a medium effect size relative to other structural paths. This finding underscores the central role of profitability in shaping market valuation, particularly in emerging markets where investors tend to rely heavily on observable financial outcomes as credible signals of firm quality. From a signaling theory perspective, strong financial performance reduces information asymmetry by conveying managerial competence and operational efficiency to the market (Connelly et al., 2021). This result is consistent with recent empirical evidence showing that profitability remains a dominant determinant of firm value in emerging economies (Al-Najjar & Belghitar, 2021; Vo & Ellis, 2023). Unlike developed markets—where intangible assets and reputational factors may play a stronger role—emerging market investors appear to prioritize financial fundamentals when forming valuation judgments. The medium effect size observed in this study confirms that financial performance functions not merely as a supporting variable, but as a core explanatory mechanism in firm value formation.

### **The Context-Dependent Role of Capital Structure**

Capital structure exhibits a statistically significant but relatively weak effect on firm value ( $\beta = -0.176$ ;  $f^2 = 0.043$ ). The small effect size suggests that leverage decisions play a secondary role compared to financial performance and governance mechanisms. The negative coefficient indicates that higher leverage tends to reduce firm value in emerging markets, likely due to increased financial risk and limited debt management capacity. This finding aligns with studies reporting that excessive leverage erodes firm value in volatile and institutionally weak environments (Kumar & Rao, 2022; Nguyen & Nguyen, 2022). While trade-off theory predicts potential value enhancement through tax shields, the results of this study suggest that, in emerging markets, the costs associated with financial distress, weak creditor protection, and macroeconomic instability may outweigh such benefits. Importantly, the small effect size indicates that capital structure should be interpreted as a context-dependent factor, rather than a dominant driver of firm value.

### **Corporate Governance and Firm Value: Direct and Indirect Pathways**

Corporate governance shows a positive and significant direct effect on firm value ( $\beta = 0.289$ ;  $f^2 = 0.129$ ), indicating a small-to-medium effect size. This finding supports agency theory, which posits that effective governance mechanisms enhance transparency, strengthen monitoring, and reduce opportunistic managerial behavior, thereby improving market valuation (Bae et al., 2022; Saona et al., 2023). More importantly, corporate governance demonstrates the strongest effect in the model on financial performance ( $\beta = 0.701$ ;  $f^2 = 0.492$ ), representing a large effect size. This result highlights governance as a foundational mechanism that shapes managerial behavior and operational efficiency rather than acting solely as a direct market signal. In emerging markets, where external governance institutions are often weak, internal governance structures—such as board effectiveness and institutional ownership—play a critical role in ensuring disciplined decision-making and efficient resource utilization (Widiastuti et al., 2024).

### **Financial Performance as a Mediating Mechanism**

The mediation analysis reveals that financial performance partially mediates the relationship between corporate governance and firm value (indirect  $\beta = 0.295$ ;  $p < 0.001$ ). This finding provides empirical evidence that governance enhances firm value not only through direct market recognition but also—more importantly—through improvements in financial outcomes. This result extends prior studies that report mixed or inconsistent effects of corporate governance on firm value. When governance mechanisms are modeled solely as direct predictors, their indirect influence through financial performance remains unobserved, leading to an underestimation of their true impact (Saona & Muro, 2023; Chen et al., 2025). By explicitly modeling this mediating pathway, the present study clarifies that governance primarily operates as a performance-enhancing mechanism, which subsequently translates into higher firm value.

### **Comparison with Prior Empirical Models**

Compared to regression-based empirical models commonly used in prior research, this study offers a more nuanced explanation of firm value formation by explicitly capturing hierarchical relationships and indirect effects. While earlier studies often report fragmented findings regarding capital structure and corporate governance, the SEM-PLS approach employed here demonstrates that financial performance functions as a key transmission channel—particularly for governance-related effects. This hierarchical perspective helps reconcile inconsistencies in prior empirical evidence and highlights why governance effects may appear weak or unstable when mediation mechanisms are ignored. By focusing on effect sizes and explanatory power rather than isolated coefficients, the study advances a more integrated and context-sensitive understanding of firm value formation in emerging markets.

### **Theoretical Implications**

The findings contribute to corporate finance theory in several ways. First, they reinforce signaling theory by confirming the dominant role of financial performance in firm valuation under conditions of high information asymmetry. Second, they extend agency theory by demonstrating that corporate governance exerts its strongest influence indirectly through financial performance rather than solely through direct market effects. Third, the study provides methodological support for the use of SEM-PLS in finance research involving complex and interrelated constructs, particularly in emerging market contexts.

### **Managerial and Policy Implications**

The findings of this study offer several important managerial and policy implications that are directly grounded in the empirical results of the SEM-PLS analysis. Rather than providing normative recommendations, the implications are derived from the relative explanatory power

( $R^2$ ) and effect sizes ( $f^2$ ) observed in the structural model, thereby ensuring practical relevance and analytical consistency.

The structural model demonstrates that firm value is explained to a substantial extent ( $R^2 = 0.57$ ) by the combined effects of financial performance, corporate governance, and capital structure. Among these determinants, financial performance exhibits the strongest direct influence on firm value ( $f^2 = 0.214$ ), while corporate governance exerts a large effect on financial performance ( $f^2 = 0.492$ ). These results suggest several important managerial insights.

First, managers should recognize that governance mechanisms primarily create value indirectly through performance improvement, rather than through immediate market recognition. The large effect size of corporate governance on financial performance indicates that governance reforms—such as enhancing board effectiveness and strengthening ownership monitoring—are most impactful when they translate into operational efficiency and profitability. Consequently, governance initiatives should be evaluated based on their ability to improve financial outcomes, not merely their formal compliance with governance codes.

Second, given the medium effect size of financial performance on firm value, managerial strategies that enhance sustainable profitability are likely to yield more substantial valuation gains than strategies focused on short-term signaling. Investments in efficiency improvement, performance-based incentive systems, and disciplined resource allocation appear to be more effective pathways to firm value creation than aggressive financing or cosmetic governance adjustments.

Third, the relatively small effect size of capital structure on firm value ( $f^2 = 0.043$ ), combined with its negative coefficient, suggests that leverage decisions should be approached cautiously in emerging market contexts. Managers may benefit more from maintaining financial flexibility and managing risk exposure than from pursuing higher leverage in pursuit of potential tax advantages. This implication is particularly relevant in environments characterized by macroeconomic volatility and limited creditor protection.

For investors operating in emerging markets, the findings highlight the importance of adopting an integrated evaluation framework. While financial performance remains the most influential direct driver of firm value, the results indicate that governance quality plays a critical role in sustaining that performance over time. The strong explanatory power of governance on financial performance suggests that investors should incorporate governance indicators—such as board independence and institutional ownership—into their firm assessment processes, particularly as forward-looking signals of performance sustainability. Firms with strong governance structures are more likely to maintain stable financial performance, which, in turn, supports higher firm valuation. This insight may help investors reduce exposure to firms whose short-term profitability is not supported by sound governance foundations.

From a policy perspective, the results provide empirical support for strengthening corporate governance frameworks in emerging economies. The large effect size of corporate governance on financial performance implies that governance reforms can generate tangible economic benefits, rather than serving merely symbolic or compliance-oriented purposes.

Regulatory initiatives aimed at improving board accountability, transparency, and shareholder protection may indirectly enhance firm value by fostering better managerial performance. In addition, the weak and negative effect of capital structure on firm value suggests that policies discouraging excessive corporate leverage—such as enhanced disclosure of debt risk and improved creditor protection—may contribute to market stability and investor confidence.

Taken together, these implications indicate that firm value creation in emerging markets is driven less by isolated financial decisions and more by the interaction between governance quality and financial performance. By focusing on governance mechanisms that demonstrably improve performance, managers, investors, and policymakers can more effectively enhance firm valuation in environments characterized by institutional constraints and information asymmetry.

## **CONCLUSION**

This study investigates the determinants of firm value in emerging markets by integrating corporate governance, financial performance, and capital structure within a hierarchical SEM-PLS framework. The findings provide clear evidence that firm value is shaped not by isolated financial decisions, but by the interaction between governance mechanisms and financial performance outcomes. Financial performance emerges as the most influential direct driver of firm value, confirming its central role in market valuation under conditions of high information asymmetry. Corporate governance, in turn, exerts its strongest influence indirectly by significantly enhancing financial performance, highlighting governance as a foundational mechanism rather than a purely

symbolic market signal. In contrast, capital structure demonstrates a weaker and context-dependent effect, suggesting that leverage decisions play a secondary role in firm value creation in emerging market environments.

Methodologically, this study demonstrates the usefulness of SEM-PLS in capturing hierarchical and mediating relationships that are often overlooked in regression-based models. By emphasizing explanatory power and indirect pathways, the study offers a more integrated and context-sensitive understanding of firm value formation in emerging markets.

Despite its contributions, this study is subject to several limitations. First, the analysis relies on secondary data from publicly listed non-financial firms, which may limit the generalizability of the findings to privately held firms or financial institutions with different regulatory and financial characteristics. Second, corporate governance is measured using a limited set of observable proxies, which may not fully capture qualitative dimensions such as board dynamics, managerial expertise, or governance culture. Third, the cross-sectional nature of the analysis restricts the ability to draw strong causal inferences over time. Although SEM-PLS allows for the examination of structural relationships, it does not fully address dynamic changes in governance practices, financial performance, or market valuation. Finally, the focus on emerging markets as a broad category may obscure country-specific institutional differences that could moderate the observed relationships.

Future research may extend this study in several important ways. First, longitudinal or panel-based SEM approaches could be employed to examine how changes in corporate governance and financial performance influence firm value over time. Second, future studies may incorporate additional constructs—such as environmental, social, and governance (ESG) performance, innovation capability, or risk management practices—to provide a more comprehensive explanation of firm value creation.

Third, comparative cross-country analyses could offer deeper insights into how institutional quality moderates the governance–performance–value relationship across different emerging economies. Finally, qualitative or mixed-method approaches may complement quantitative findings by exploring the organizational processes through which governance mechanisms translate into improved financial performance and market valuation.

In conclusion, this study underscores that firm value creation in emerging markets is fundamentally driven by the strategic alignment between corporate governance quality and financial performance. By adopting an integrated structural modeling approach, the study contributes to contemporary corporate finance literature and provides a robust foundation for future research on firm value determinants in developing economies.

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