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Impact of corporate governance and Ownership Structure on the capital structure of the Investment Banks in Pakistan

Arsal Burhan[1]

*Zohaib Naeem Babar[2]

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Abstract

This research work is tried to find the impact of corporate governance and ownership structure on the capital structure of investment banks. The data is taken from the investment banks' annual reports, which are eight in Pakistan. I collect the data from 2008 to 2022, which is 12 years. For results, I run regression in SPSS. Results show that the general public, non-executive directors, and BFI's (banks, financial companies, and insurance companies) have positive and significant relations with capital structure, while total assets and BOD have negative and non-significant relations with capital structure.

Keywords: corporate governance, ownership structure, capital structure, investment banks

1 Introduction

Corporate governance performs a very important role in any organization. It is a method or a philosophy that tells about the mechanism which makes it easier for shareholders how they can increase their wealth with the help of company management. Corporate governance is the pillar of any organization. It built investor trust in the organization and compelled people to invest in the company. Corporate governance affects the decision-making process which is taken by the higher board. Some corporate governance variables are board size, non-executive directors, CEO duality, etc., which directly impact capital structure or leverage. The agency problem is also associated with corporate governance, created by the company's owners and runners. This problem is shown when managers and shareholders express their interest in the company. Today's advanced technology and theories tell us that agency cost is the big cost affecting the capital structure. Most studies are done on this topic but there has yet to be empirical proof of the relationship between corporate governance, capital structure, and ownership structure till now. Corporate governance

[1]University of quid-e-azam Islamabad, Pakistan
e-mail: arsal.burhan@gmail.com
[2] University of Waikato, New Zealand
e-mail: Corresponding author: Zohaib.uv@gmail.com

has importance in the eyes of researchers it's a growing area where many researchers researched and researched. The impact of corporate governance on firm value and profitability is done but its effect on capital structure still needs to be thoroughly researched. There are very few researchers on this topic in Pakistan's listed companies. For this, I select my research on the investment banks in Pakistan. Agency cost has a high impact on capital structure and corporate governance and becomes the cause of overcoming agency cost on capital structure. So, we can say that corporate governance and capital structure are merged with the help of agency cost or agency problems. In this paper, I found the effect of corporate governance and ownership structure on the capital structure of investment banks in Pakistan. The corporate governance variable set consists of board size, non-executive directors, and ownership structure consisting of associated companies, banks, financial companies, insurance companies, and mutual funds. While the capital structure is calculated with the debt-to-equity ratio.

1.1 Research question

How can corporate governance and ownership structure bring the impact capital structure of the investment banks in Pakistan?

2 Literature review

Cole and Mehran (1998) described the self-interest of managers while making the decision-making. Researchers found that there is a negative relationship between capital structure and managerial shareholding. If managerial shareholding increases, the leverage ratio will decrease. If no one shareholder is picked from the outside and the management holds all the shares, then the debt-equity ratio, or we can say leverage ratio, will decrease, and companies can decrease their loans. Some research which is conducted in Nigeria tells that vice versa results. Chaganti and Damanpour (1991) examine the effect of managerial ownership on capital structure, and the results reveal a negative relation between the outsider shareholders and capital structure and positive relation between the managerial shareholders and the leverage ratio.

Managerial shareholding positively impacts with leverage ratio but the relationship between both of these is insignificant if we compare it with outside shareholders and their impact on capital structure. Daraghma and Alsinawi (2010) stated that the higher board size becomes the cause of low leverage. When the board size is significant, the directors exert pressure on the management to increase their performance, which is why the debts become low. and also, the research in Ghana SME's small medium enterprises reveals that SMEs' large boards and capital structures have negative relation in small and medium enterprises. Haniffa and Hudaib (2006) stated that large boards exert high pressure on the management to increase performance and then with the large boards the leverage will also increase. There is a positive relation between the large board size and the capital structure of the firm. Also, argue that the cost of debt decreases where the board size will increase.

Because the investors think that on larger boards the decision-making looked good and investors invest in the company. Górriz and Fumás (1996) describe that the firms which make a high profit have a log leverage ratio. Some companies think that for high profit they just use internal financing and don't get loans and debts from outside. This research tells that some researches tell that positive relationships and some tell the negative relation between the profit and debt to equity ratio which we can say that the leverage ratio.

Green (1992) provide evidence that there is a negative relation between the firm size (total assets) and capital structure. The big firms probably, understand the fact that the reason behind the low leverage is low debts. Some big companies issue their equity at valid prices and make money and invest money into the company. Many companies prove negative relation between the firm size and the capital structure. (Kroll et al., 2007), tells about the relationship between the non-executive directors and the capital structure. The researcher revealed the negative relation between both of them. Non-executive directors always pull pressure on the management to rely on equity financing.

A company with a higher strength of non-executive directors can run on low-debt financing. Pedersen and Thomsen (2003) find that companies that have large boards and boards have a large amount of non-executive directors. They stated that companies with large non-executive directors have a higher amount of leverage. To show the company's strongest position to the shareholders, nonexecutive puts pressure on managers to do the debt financing and make to increase their tangible and intangible assets. When the size of the firm becomes broad then investors attract to the company and this is the reason for putting pressure on management by the non-executive directors. (Ruan et al., 2011), also stated that higher nonexecutives become the reason for higher debt financing. The company with higher equity financing is admitted as a high-performance company. Dividend policy also impacts positive relations with the capital structure. Wei et al. (2005) stated that when manager shareholding in the company increases then there is the creation of self-interest by the managers. For their funds and valuation of their shares, they make high debt financing which can give dangerous results and company shareholders can get out from the shareholding. In many companies where self-interest is here, there are eighty percent chances of high debt financing.

Zahra et al. (2000) talked about the agency cost. Agency conflict is created by the owners and managers and this impact on profitability is very negative. all are thinking about their benefit and everyone wants to make money. Many recent types of research, explain that agency costs highly negative impact on company profitability and shareholder wealth. Managers become mean and don't convey information to the other shareholders which is very risky for both the company and the shareholders. Nimalathasan (2010) stated that institutional shareholding impact positively on the capital structure. How much the institutional shareholding will be high the leverage will also be high and the company will run on a debt basis. In this condition, agency conflicts come over again because managers have no shares and they will not work as they should because there is no self-interest taken by the managers. In this condition, most of the companies take high financing of debts.

2.1 Hypothesis

H1: there is a relationship between corporate governance and capital structure.
H0: there is no relation between corporate governance and capital structure.
H2: there is a relation between the ownership structure and capital structure.
H0: there is no relation between ownership structure and capital structure.

3 Methodology

The main aim was to find the relation between the independent and dependent variables which are used in this study. Regression analysis is used to find the relation of the study in SPSS. During my research, I find data from the eight investment banks which are working in Pakistan. The variables which are used to express corporate governance are board size and the extent of non-executive directors. In the ownership structure blog, associated companies, the board of directors, and their spouses, (banks, financial companies, and insurance companies), are used as one variable. Mutual fund holding is also the part of ownership structure. These were the independent variables. I take capital structure as the dependent variable and to calculate this variable I use the debt/equity ratio. Equity and debts are taken from the balance sheet in the annual reports of different investment banks. And ownership structure variables are taken from the shareholding pattern in annual reports. Non-executive directors are calculated in the sense of total non-executive directors by board size.

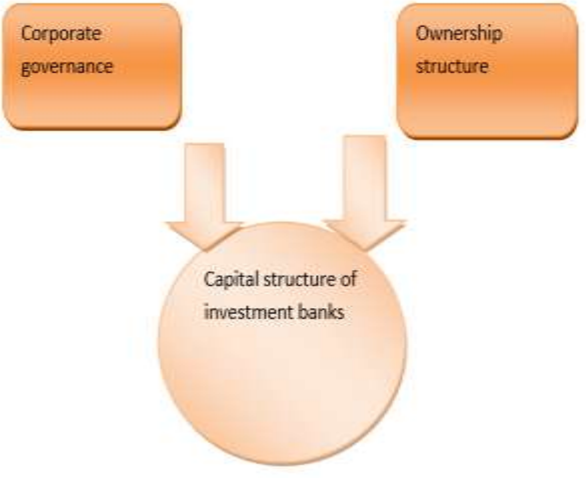
3.1 Type of research

The study is based on exploratory research and data is collected from secondary sources. The main motive was to use exploratory is to find or know about the previous research results and findings. All the data is taken from the annual reports of investment banks in Pakistan. Secondary data is used to check the relation between the dependent and independent variables. I use board size, and non-executive directors as corporate governance variables and ownership structure consist of associated companies, bank, financial, and insurance companies, the general public, and mutual funds. I find the capital structure with the help of debt to equity. We can also say the leverage to capital structure. Capital structure is consisting of two kinds of financing which are debt financing and equity financing.

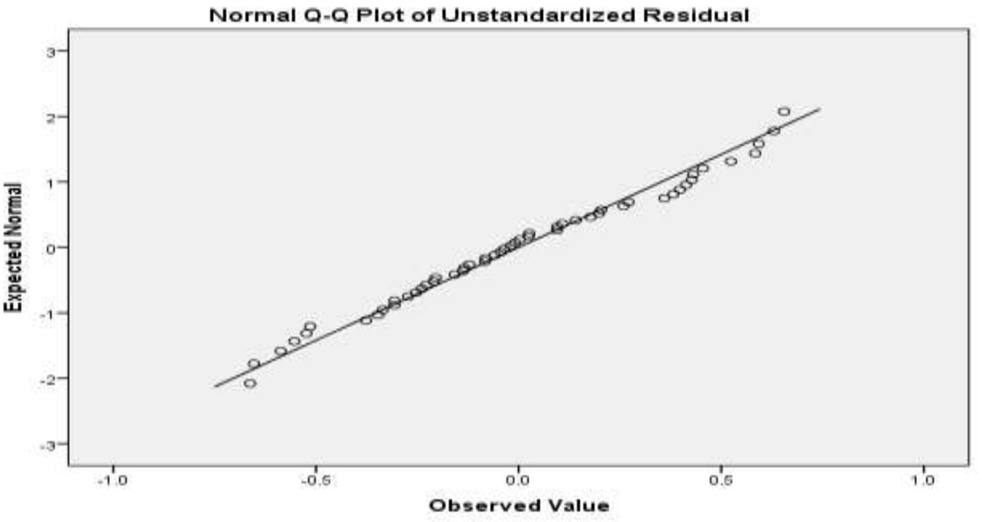
3.2 Source of data

A secondary source is used for the data collection purpose and data is collected from the annual reports of the banks. In my research, 8 investment banks are used and data is collected from 2008 to 2015 which is 8 years.

3.3 Schematic diagram



3.4 Normality curve



This diagram tells about the normality of the data. Scatter plots are near their origin which tells that the data is normal. After the normality test then the next step is to run regression on this normal data.

4 Results

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1.441	.781		-1.846	.072
	boardsize	-.128	.093	-.205	-1.383	.174
	Associated companies	.018	.008	1.124	2.296	.027
	Directors CEO Stockholdings	.025	.009	.964	2.894	.006
	bfIcompanies	.015	.005	.995	3.128	.003
	MF	.051	.027	.279	1.885	.066
	ROA	.005	.004	.174	1.417	.164
	Total assets	-2.526E-009	.000	-.072	-.567	.573
	Non-executive directors	1.033	.363	.388	2.845	.007
	Public	.022	.007	1.349	3.263	.002

a. Dependent Variable: capital structure

After running the regressions on SPSS, there are different results about the variables which are used in this study. Results show that board size has negative and non-significant relation with capital structure. If board size will increase then the debt will decrease. The companies which are associated with investment banks are positive and significant relations with capital structure. It means that, if associated companies get more shares of investment banks then the debt also becomes high. Banks, financial companies, and insurance companies have a significant and positive relationship with investment banks. If the share held by these increases then the debt will be increased. Like these non-executive directors, the general public and approximately mutual funds have a positive and significant relationship with the capital structure. If these will be high then debts become high. ROA has a positive, but non-significant relation with capital structure. In the overall result, just total assets and BOD are negatively related to capital structure. The relation between both of these is non-significant. Total assets increase then debts decrease.

5 Conclusion

After the results, the conclusion is that if the banks increase their board size then debt becomes decreases. Banks should hire more qualified directors. Total assets also tell that more assets decrease debts. But both have a non-significant relationship. The general public, non-executive directors, and BFI have positive and significant relationships. Banks should not issue more shares to these. If more shares are issued to them then the danger of debts will increase. The company which is running on its equity is admitted profitable and successful company. Shareholding by mutual funds should also decrease because if the shares taken by them increase then leverage will also increase.

5.1 Recommendation

This topic is very important and more research can be done on that. My research is on investment banks but we can research more on mutual funds corporations, leasing companies, mod area companies, and other banks or companies. This area is very vast and a very low amount of work is done on that. To take this topic we can research in other countries banks and companies and also we can comparison of different companies and banks.

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