CORPORATE GOVERNANCE, OWNERSHIP STRUCTURE AND CAPITAL STRUCTURE: AN EMPIRICAL STUDY ON NON-FINANCIAL FIRMS LISTED IN PAKISTAN

By

KHAN Shoaib

March 2016

Doctoral Dissertation Submitted to the Higher Degree Committee

Ritsumeikan Asia Pacific University

in Partial Fulfillment of the Requirements for the Degree of

Doctor of Philosophy

Abstract

The collapse of corporations, corporate scandals and financial crises certainly prove that corporate governance is a highly relevant topic in the field of corporate finance. These factors made market regulators, policy makers and governments around the globe establish and reform the principles of corporate governance. For the enhancement of the corporate governance mechanism, countries around the globe have introduced the Code of Corporate Governance (CCG). Similarly, as a part of financial liberalization and market reforms, the Securities and Exchange Commission of Pakistan (SECP) implemented the first CCG in 2002 and revised it in 2012. It is evident that SECP adopted the OECD Principles of Corporate Governance to the Pakistani CCG and its revision.

Nevertheless, SECP may have naively adopted the OECD Principles without adequate consideration of *de facto* realities of the unique practices of corporate finance in Pakistan. How should the SECP have done it? The OECD expects the policy makers in each country to improve and enhance the corporate governance mechanism through issuance and revision of CCG under a regulatory framework, where active cooperation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises are encouraged (OECD 2004). However, the separation of ownership and control of financing in modern corporations makes it very difficult for us to identify the balanced role of stakeholders in corporate governance. Therefore, this study aims to explore the unique features of corporate finance which should be reflected in the CCG. Such as, (i) the firm-specific factors that affect the capital structure choices of firms, which are influenced by the availability of financing sources; (ii) the impact of ownership patterns, under the separation of ownership and control mechanism on capital structure, specifically by analyzing the effects of managerial ownership, institutional shareholdings, and

block-holders on capital structure decisions; and (iii) the impact of internal attributes of corporate governance on the selection of capital structure.

The empirical findings show that the firm-specific factors affect the debt ratios in the similar way to those in developed economies; however, with some anomalies. It further show that the overall leverage level for Pakistani firms has declined. However, the proportion of short-term debt has slightly increased and suggest that many Pakistani firms rely on short-term debt, which is the drain of long-term capital for investment. In fact, their reliance on short-term borrowings has ironically become even more intense. This may predict that many Pakistani firms are exposed to higher liquidity risk even though they are reducing the overall leveraging. Moreover, the heavy reliance upon short-term debt is partly due to the under development of capital markets in the country.

The investigation result on the effects of ownership structure patterns on capitals structure indicates that managerial ownership and block-holders tend to encourage leveraging. This phenomenon predicts the exploitation of minority groups or other external stakeholders and signals the less prudent corporate governance mechanism. Furthermore, the results suggest prudent monitoring by institutional shareholders to reduce agency conflicts by diminishing managerial opportunism. However, contrary to this, the limited role of institutional shareholders in CCG reveals the limitations of CCG, and suggests an improvement and enhancement of the code with the active participation of other relevant stakeholders.

The study on effects of internal attributes of corporate governance on the selection of capital structure suggests that certain internal attributes have the explanatory power to affect a firms' capital structure. For example, things such as board size, independent/outside directors, CEO duality, managerial equity ownership and block-holders are positively related to leverage.

Moreover, excess reliance on board size, board composition and CEO duality for the enhancement of governance mechanism would be futile without the participation of other stakeholders.

Based on the findings related to the firms’ financing sources and ownership patterns, the shortcomings which this dissertation found in the evolution of CCG in Pakistan include: (i) the failure by the CCG to take into account unique financing features, i.e. the heavy reliance of Pakistani firms on short-term debt, that is, the drain of capital for long-term investment; (ii) the ownership patterns suggest that the prudent monitors’ role of institutional shareholders, which is expected to minimize the agency conflict in firms’ choice of capital structure and corporate governance; (iii) the limited guidance in the current code, which does not adequately take into consideration the unique nexus in the Pakistani firms' selection of capital structure to mitigate the agency conflict. This dissertation provides empirical grounds for further discussions on the improvement of the current CCG by establishing an adequate *ex post* evaluation and governance mechanism.

Key words: Corporate governance, Capital structure; Ownership structure; Code of corporate governance; Non-financial firms; Karachi Stock Exchange; Pakistan.