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Corporate Governance and its Effect on Decision Making of the Firm

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Abstract
This study has been done to investigate the effect on the performance of an organization decisions and here we discuss some factors such as ownership concentration, board size, and managerial ownership, outside directors, director remuneration and CEO duality affect capital stricture choices with in the firm. Corporate governance is a system in which we can give proper rights to the departments of the firm with an equal and the requirement of that individual department and the division of resources is according to their responsibilities through which the effectiveness and productivity is also increase.
The result suggested that outside directors and board size and ownership concentration have a positive impact on the total debt ratio and long term ratio but have negative effect upon director remuneration and managerial ownership on the long term debt ratio. Variables such as profitability and liquidity are negative impact at long-term debt ratio, where the size of an organization has positive effect on it. Tangible asset has positive impact on long-term debt ratio and negatively related to the total debt ratio. We know that developing countries have week internal and external corporate governance implementations as compare to developed countries
Keywords: CG, Capital Structure, CEO Duality, Managerial Ownership

1. Introduction

Corporate governance is linked with process & tactics through which the supplier of the capital of the firm ensure themselves to the beneficial return on their investment as we know the investment is a very important thing for any business and organizations in corporate financial management of the firm because through this the a firm growth will increase and generation of wealth will also increase and this growth leads to improve the economic growth of the country and economic development provide the employment in the society and hence the poverty will be decreased. Corporate governance's essential in development and growth of economy of the organization in which the corporate governance are working very effectively and experiencing a speedy growth of corporation and ability in attracting capital flow. The economy is increasing very fast and a high quality governance augment the performance of a company not only by establishing an monitoring a corporate culture through which the firm motivate to took these actions by which the shareholders' value increase as well as the cost of funds are also decreased. Some principals of corporate governance are as follow:

1.1 Rights of shareholders

Organizations provide the safety to the shareholders that their rights are must be exercise and all related information must be providing to them.

1.2 Interests of other stakeholders
Organizations must ensure that the organization will very effectively and also focus on increase in the interest of shareholder.
1.3 Responsibilities of the board
They will also ensure that the board members of the company are skilled and have enough experience to run the organization efficiently.
1.4 Ethical behavior
They are also ethical in behavior and not performing any illegal activity in their system and have a proper rule and regulations and promote ethical and responsible decision making.
1.5 Transparency
Organizations should clarify that they are very clear in their functions and there is no any illegal activity in their accounting and finance through which a shareholder effect.

2. Literature Review

Corporate governance is linked with the process with the supplies of capital to the organization and assures us to get back our investment with the healthy profit. Many studies are conducted about corporate governance on capital structure in the developed countries like US. In some of the developing countries are also following the corporate governance. And through this they are getting success with better and successful capital structure.
Many empirical researches are conducted to find the impact of corporate governance on some variables for example

- Board size of the firm
- Outside directors,
- Ownership concentration,
- Managerial ownership,
- CEO duality.

2.1 History about Corporate Governance (C.G) in Pakistan
The companies which are serving in Pakistan are having very low internal and external governance mechanisms as compare to the other developed countries. The Pakistani government is taking actions to improve the corporate governance, particularly after opening the secondary market in foreign investment on an equal basis with the local investor. The initiative taken by the government by Pakistan is the establishment of Securities and Exchange Commission of Pakistan (S.E.C.P) which helps us to link with developed modern and efficient corporate sector and a capital market which is based on sound regulation and principals to promote the economic growth
Securities and Exchange Commission of Pakistan (S.E.C.P) has started its operation on January1st, 1999 and makes the rules of corporate governance (C.G) on March 28th 2002. In order to establish a system for trading in a well-organized manner in secondary market where the organizations which are listed are directed and controlled by the direction of Securities and Exchange Commission of Pakistan (S.E.C.P) incompliance with the best practices to secure the interest of diversified stake-holders. The rule and regulations which are established by (S.E.C.P) are based on internationally recognized principals and emphasized on openness, transparency and accountability of the companies which are listed in (S.E.C.P).
In this research paper we focus on board size, outside directors, qualification of directors, CEO duality, functions of directors and reporting frame work to increase the accountability and efficiency to optimized the interest of a boarder group of stake-holders rather than only maximizing the interest of share-holders.
2.2 Relationship between Corporate Governance and Capital Structure
Many studies about corporate governance show the influence of financial decision that causes the corporate governance like board size, managerial ownership and concentration and CEOs duality.
The attributes of above factors in linking are as follows:
2.2.1 Board size of the firm
An effective board size of the firm is very necessary to accomplish their goals and for the success of an organization. The board members which are be selected are the supreme body of an organization which makes the top level decisions of the company and their responsibility is to provide the superior strategic path to ensure the growth of the firm and increase the return on the investors investment and it is also duty of the board to monitor and create as explained by “the disciplining the senior management. According to Adams and Mehran (2003)”it is explained that Better board can effectively check the actions of management and give us better experiences. Conversely, Lipton and Lorsch (1992) asserts that large boards are less effective compared to small boards because some directors may free-ride on the efforts of others. Capital structure has a negative correlation with board size and companies leverage but according to statistical analysis it shows as insignificant. Costs of debt financing and board size have negative relation between them. Some of the researcher suggested that large board have less effective power then lower boards so we can say that lower board are more efficient in their

work performance.

2.2.2 Outside directors of the firm

Outside directors are very important asset of an organization due to their vast experience and knowledge and their broad vision of thinking and self-determination from management high degree of independence gives the authority to outside directors to check the actions of management more closely and take appropriate governance actions and in also in the case of bad results they have right to fire the managers of that particular managers he is not performing well. Manager performance is more than the board member as manager has effective control and coordination with the coworkers as compare to the board of directors. Firms with outsider board of directors have better access to the capital market. And rational organizations are more effected by external environment. If we want greater share of capital market in our organization then percentage of our board of directors from outsider of firm should be greater. From some of the evidences we conclude that relationship of board size and leverage are very effective. If significant leverage of organization is lower than its fractions of outsider board directors will be low. Outside directors work effectively due to expertise in their field. But they are unaware abo internal control and coworker's performance as manger has good control on internal working environment so their performance is better and efficient in firm's progress.

2.2.3 Ownership concentration of the firm

The ownership concentration factor is very crucial factor with in the organizations. The ownership of block-holders helps us to improve the agency problem between the manager and the share-holder of an organization. The block-holders move much more powers as compare to other share-holders to influence the management decisions such as block –holders can force the management that make such type of decisions through which the wealth of share-holder will be maximized. Due to low cost as compare to new equity issue they can demand higher debt as apart from tax shield factor block holders may put pressure on management that they will use more debts because of reduction in management discretionary control at the firm cash flow and also stop the process in which resource are engage in inefficient activities we know that the use of debt will increase the risk of bankruptcy but an investor who owned a well-diversified portfolio of investment can afford the risk easily. According to research it is seen that organizations with greater number of shareholder have greater debt ratios but the small amount of shareholders have less debt ratio that is not a good scenario of organization. It's seen that there is positive relationship between leverage and shareholders. External shareholder in organization shows positive relationship that shows good and efficient performance due to outsider shareholders. Organizations debt amount depends on its shareholders so if the firm contains large no of outsider shareholders they will get large amount of debt that debt investing in business will show higher performance of organization. But have inverse relationship if shareholders are worker of organization.

2.2.4 Managerial ownership of the firm

The agency problem is very difficult to face it because a manager I only focusing on their own interest more than overall organizations hence the productivity is also decrease due to this. This problem among a manager and a shareholder has been started when a manager will allocate the resources of an organization towards that projects through there is maximum benefits of the manager not of the shareholder there for it is beneficial to the organization to give the shared ownership to the organizations manager though this he will also become a shareholder of the firm and also focus on the interest of organization rather than his personal interest because he is also a part of the profits and his personal interest is also linked with organizational interest. According to some authors if increase in manager ownership stock of firm will also increase due to common interest of shareholder and manager and outsider shareholder benefits will more close to each other. Agency cost will be reduced if the managers share in firm increase. Debt ratio will reduce if manager increase in organization. Owner ratio of manager and debt ratio are negatively correlated with each other.in the organization that have less managers share will less effective on debt ratio of organization.

2.2.5 Duality of the firm CEO

As we know that the CEO of the firm has an executive responsibility to manage the firm business activities where the chairman has authorized for the responsibility to handle the issues of the board of directors. The problem of CEO duality started when the organizations CEO of that particular firm performing the both duties and offering his services as the chairman in the board of directors. Agency theory suggested that the conflict will started between shareholders and management when both of the duets are performing by the same person because both have different prospective among their duties. Duality increases the discrimination of CEO by providing a broader power base CEO responsibility is to initiating and implementing the strategic decisions for the organization. Dual leadership in which same person is performing dual tasks at the same time he work as a board member and will also perform deities of chairman in an organization. Through some studied shows that the if board of directors work as chairman then their decision are more closely to the personal interest and he prefer his personal interest and very less focus on organization and his decision are very biased the relationship between CEO duality.

3. Research Methodology

This study employed panel data methodology because sample contained data across firms and over time. Moreover, panel data sets are better able to identify and estimate effects that simply are not detectable in pure cross-sections or pure time series data. The basic regression model can be specified as follows:

Y it = α+Xitβ +Uit
itb þ uit

3.1 Variable Definition

3.1.1 Dependent Variable

Total Debt Ratio

3.1.2 Explanatory Variables

- Board size
- Outside directors
- Ownership concentration
- Managerial ownership
- Director remuneration
- CEO duality

3.1.3 Control Variables

- Profitability
- Size
- Liquidity

4. Results and Discussion

TDR = β0+ β1PROFit+ β2SIZEit+β3LIQit+ Uit
LTDR= β0+ β1PROFit+ β2SIZEit+β3LIQit+ Uit

4.1 Empirical Results

Percentage of shares held by

Title	2004	2005	2006	2007	2008	Mean ¼5
a)- CEO	2.67	3.00	4.08	4.09	4.82	3.73
b)- Directors	7.18	7.97	8.46	8.76	8.55	8.18
c)-Directors family members	1.34	1.58	1.38	1.36	1.20	1.37
d)-Total(a-c)	11.19	12.55	13.92	14.21	14.57	13.28
e)-Banks	9.27	7.84	6.60	6.67	8.60	7.82
f)-Insurance Companies	1.90	2.01	2.06	1.96	1.85	1.96
g)-Modarba Companies	1.05	0.80	1.17	1.15	1.25	1.08
h)-Investment Companies	3.70	4.60	3.94	3.75	3.50	3.90
i)-Total (e-h)	15.92	15.25	13.77	13.63	15.20	14.76
j)-Other Companies	42.47	42.90	42.51	43.21	42.85	42.79
k)-General Public	0.42	29.30	29.80	28.95	27.38	29.17
l)-Grand Total	100	100	100	100	100	100

Notes: a Grand total is the summation of (d, i, j, and k); N ¼ 155

4.2 Discussion

This above data describes us the overview of the structure of non-financial organization in Pakistan and the source is Karachi stock exchange. A large amount of shareholders of Pakistani companies which are listed in Pakistan are the other companies which capture an average 42.79% of outstanding shares and the financial institutions have only 0.019% share which is very low. Banks have 0.078% share and insurance companies have 0.0196% of total market share. Publically peoples are holding an average of 29.17%of outstanding shares and second largest shareholder holders Modaraba companies have also very less amount of market share only 0.108% and investment companies also have average 14.76 percent of the total market-share. Shares occupied by CEOs, directors, and the family members which are very close to the top level management are 13.28 % which is also a greater market shared captured by them.

5. Conclusion

This study was conducted to determine the impact of corporate governance on the capital structure of non-financial companies and through the analysis of some of the companies that we can study the size of the board of

directors and outside directors and the concentration of ownership associated positively with each scale of the capital structure. Managerial ownership management or negatively associated with each of the company measure of corporate governance and CEO duality is the same as the relevant negatively with both measures of capital structure and this relationship is not statistically significant .
This positive relationship b / w the size of the Board of Directors and the capital structure is consistent with resource dependence theory which suggested that the size of a large plate will serve the Mediterranean in order to get support with external factors. positive Relationship directors abroad and capital structure indicates that the board of directors with more independence can take more debt on favorable terms because of effective monitoring and the relationship between the concentration positive relationship b/w ownership and capital structure refers to the mass holders which monitors the effective and increase the ability to shareholders detached by force to administration to take those actions that will be from which to maximize the wealth of shareholders. If there is a negative relationship between ownership interest along with the administrative director with the interests of outside shareholders, which will reduce the debt as a tool to solve the agencies problem. Negative relationship with the director of the wage and capital structure shows managers try to use less debt in order to avoid extra pressure and the risks associated with high leverage, and maintain proper positions for good salary. The positive relationship between profitability and liquidity with capital structure consistent with the hypothesis of the pecking order shows that the companies have profits and promising and promising liquid resources borrow less as compare with companies that have fewer profits. Positive relationship size of the capital structure is consistent with the constant trade-off model, which suggests that large companies will borrow amount because massive problem of its ability to manage risk. The positive relationship between tangibility of assets and long-term debt ratio indicates that a company that has a promising guaranteed asset tends to borrow more from companies with intangible risky assets.

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