Corporate Governance Criteria and Capital Structure: A Content Analysis

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1.Corporate Governance
2.Capital Structure
3.Debt – Equity

Abstract
The content analysis by researchers reveals the influence of institutional and firm level criteria of quality of corporate governance on capital structure decisions of the firms. The quality of funding decisions depends on how the governance codes and rules are put to use by the board of directors. The board efficiencies which explain the governance qualities were found to be relevant in deciding the capital structure. The paper observes most significant criteria of corporate governance to be, size of the board, proportion of non-executive directors in the board and the ownership structure. The CEO/ Chairman Duality was however observed to be insignificant in deciding capital structure. It is established that good corporate governance helps in mitigating agency problem and contributes in protecting interests of shareholders. The performance of board related attributes can be enhanced by imparting proper training and providing a strong ethical framework in which the board operates. This in turn will improve the quality of funding decisions.

INTRODUCTION

Funding is a crucial activity for any business. In a capitalist economy, financing is fundamental to the viability of companies and to the persistence of the capitalism itself. The availability of funds depends on the efficient allocation of resources by the economic agents from financial markets to productive investments. The suppliers of funds are interested in getting good returns on their investments. They expect the managers to invest in profit making activity which ensures fair returns on the money invested. They would always want managers to grab every profit making opportunity and do away with bad investments. They trust the companies having good governance qualities, practices and mechanisms. In addition to the financial data depicting the profitability and other quantitative performance indicators, the information about the quality of corporate governance is also a significant determinant for investors while taking the vital decision to invest their money.

The report on the Observance of Standards and Codes (ROSC) jointly prepared by the World Bank and IMF in April 2004 observed that in India, traditionally the financing was debt driven, and Development Finance Institutions (DFIs) were an important source of finance. quity financing had started growing slowly then which resulted in to modifying the ownership structure. It was also observed that the promoters tend to own at least 26 percent of a company, as this threshold gives them veto rights in special resolutions.

The aim of corporate governance reform is to create an enabling environment to ensure that that foreign and domestic long term "patient" capital is available to fund corporate growth and preserve private savings for retirement.

This paper presents the content analysis of the relationship between quality of corporate governance and firm's access to finance. It is based on the review of the empirical literature and is structured as follows; Section 1 discusses the meaning of corporate governance and its relationship with capital structure. Section 2 elaborates on the institutional and firm level criteria of quality of corporate governance. Based on the empirical literature, the authors also try to identify the most significant firm level criteria. The firm level criteria relevant to India are also highlighted in this section. Section 3 reviews the literature on the significance of relationship between various firm level corporate governance criteria and the choice of finance by the firm. Lastly, section 4 concludes the paper.

CORPORATE GOVERNANCE

Meaning

Corporate governance describes how companies ought to be run, directed and controlled. It is about supervising and

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holding to account those who direct and control the management. . Corporate Governance deals with the rights and responsibilities of a company's management, its board, shareholders and various stakeholders. . It is defined by Shleifer & Vishny (1997) as a set of mechanisms relevant to economic efficiency due to its influence over the decision of investors to provide finance, debt or equity, to the firm. The purpose of a governance structure is to assure a significant flow of capital to the financing of firms. Corporate governance includes the structures, processes, cultures and systems that engender the successful operation of the organisations.

Direction and control of corporate bodies are the basic activities of the board. These activities lay the foundation for future progress of business. Corporate governance is the framework that ensures accountability. Once it is in place, companies are free to go about their way in creating shareholder value and registering growth.

Corporate governance is a philosophy and mechanism that involves processes and structure which facilitate the creation of shareholder value through management of the corporate affairs. Corporate governance aims at protecting the individual and collective interest of all the stakeholders. Sound corporate governance principles are the foundation upon which the trust of investors and lenders is built. Good corporate governance practices may have significant influence on the strategic decisions of a company such as external financing that are taken at board level. .

Corporate governance can therefore be described as the process, system, structure and mechanisms used to direct, control and manage the business affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realizing long-term shareholder value. It also focuses on the interests of other stakeholders.

CORPORATE GOVERNANCE AND CAPITAL STRUCTURE

The corporate governance aims at protecting the interest of shareholders. Better corporate governance structure encourages the investors to supply funds to the company. The capital structure decisions are taken at board level. These decisions are believed to be influenced by the quality of corporate governance. Good corporate governance is essential for companies that want access to capital and for countries that want to stimulate private sector investment. Well run companies are able to attract investors whose support can finance faster growth. Poor corporate governance can pave the way for financial difficulties.

The long term financial strength as well as profitability of the firm is influenced by its financial structure. The financial structure includes both long term and short term sources of funds. The capital structure is that part of financial structure that represents long term sources. It thus consists of shareholders' funds and debts. In a financing decision, a financing manager's job is to come out with the optimum capital structure. It is difficult to define ideal capital structure. It is a function of nature of the company's business and riskiness of the business. It is therefore a matter of judgement. Capital structure should be planned keeping in view, the interest of ordinary shareholders. The interests of other stakeholders such as employees, customers, creditors, society and government should also be considered.

The empirical research unfolds the relationship between corporate governance and capital structure decisions. Some of the contributions are cited below.

Gompers et al (2003), Du and Dai (2005) and Kumar (2005) have analysed the relationship between corporate governance and debt finance.Haquel & Kirkpatrick(2008) study the impact of overall firm-level governance practices on debt financing of non-financial listed companies in Bangladesh. Abor (2007) analyses the effect of corporate governance on financing decisions of Ghanaian firms. Abor & Biekpe (2007) examine the relationship between corporate governance and capital structure decisions of Ghanaian Small and Medium Enterprises by using multivariate regression analysis. The effect of corporate governance attributes such as board size, outside directors, ownership concentration, managerial ownership, director remuneration, and CEO duality on capital structure choices of Pakistani firms listed on the Karachi Stock Exchange, Pakistan, during 2004-2008 is studied by Sheikh & Wang (2012). The relationship between corporate governance and capital structure for Pakistani listed companies has been investigated by Hasan & Butt (2009). They examine the effects of corporate governance and ownership structure on capital structure decisions of Pakistani listed companies since the announcement of Code of Corporate Governance by Securities Exchange Commission of Pakistan in 2002. They argue that corporate governance is generally associated with the existence of agency problem and its roots can be traced back to separation of ownership and control of the firm.According to modern corporate finance theories, agency cost is one of the determinants of capital structure whereas corporate governance is structured to alleviate agency issues; hence corporate governance and capital structure are linked through their association with agency costs. .

It is relevant to understand about three conflicting theories

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of capital structure. They are namely: static trade-off theory, pecking order theory and agency cost theories.

The static trade-off theory or the tax based theory of capital structure states that optimal capital structure is obtained where the net tax advantage of debt financing balances leverage related costs such as financial distress and bankruptcy, holding firm's assets and investment decisions constant. , This theory believes that, issuing equity means moving away from the optimum and should therefore be avoided. According to Myers (1984), firms adopting this theory could be regarded as setting a target debt-to-value ratio with a gradual attempt to achieve it. He suggests that managers will be reluctant to issue equity if they feel it is undervalued in the market. The consequence is that investors perceive equity issues to only occur if equity is either fairly priced or overpriced. As a result investors tend to react negatively to an equity issue and management are reluctant to issue equity.

The Pecking Order Theory (also referred to as the information asymmetry theory) was first suggested by Donaldson in 1961 and was modified by S C Myers and Nicolas Majluf in 1984. This theory assumes that because of asymmetries of information between insiders and outsiders, the company prefers to be financed first by internal resources, then by debt and finally by stockholders' equity , . The theory states that observed leverage reflects the past profitability and investment opportunities of the company.

Pecking order theory states that firms prefer to finance new investment, first internally with retained earnings, then with debt, and finally with an issue of new equity. Myers argues that an optimal capital structure is difficult to define as equity appears at the top and the bottom of the 'pecking order'. Internal funds incur no flotation costs and require no disclosure of the firm's proprietary financial information that may include firm's potential investment opportunities and gains that are expected to accrue as a result of undertaking such investments.

The agency cost is observed to be associated with corporate governance which in turn plays a vital role in determining capital structures of the firms.

The agency theory based approach of capital structure decisions has been explained by many researchers in the past. Way back in 1932, it was argued that the gap between ownership and control of large organisations arises from a decrease in equity ownership. This gap encourages managers to pursue their own interests by sacrificing the objective of shareholders' wealth maximisation. . The pivotal works of and put forward the idea of agency theory based explanation of capital structure. Friend & Lang (1988) study managerial self-interest as the motivational factor behind capital structure decisions. Their work addresses the effect of various constraints on management's ability and willingness to reduce the specific risk to them implicit in a higher debt ratio. Harris & Raviv (1991) survey capital structure theories based on agency costs, asymmetric information, product/input market interactions, and corporate control considerations. They argue that conflict of interests causes agency costs, which in turn determine the firm's capital structure decisions. The relationship between managerial entrenchment and capital structure decisions has been explored by Berger et al (1997). They define entrenchment as the extent to which managers fail to experience discipline from the full range of corporate governance and control mechanisms. Wen et al(2002) examine the corporate board structures and decision making processes in Chinese listed firms.

It may be observed that the agency cost arising due to asymmetric information and the strength of control mechanisms such as corporate governance are associated with capital structure decisions.

Some authors argue that the funding strategies can be used as one of the tools to protect interests of shareholders by controlling the management's tendency of chasing their own objectives.

Stulz (1990) studies how financing policies can be used to restrict management's ability to pursue its own objectives when it has the information that the shareholders do not have. The debt financing is considered as an important corporate governance mechanism in mitigating the agency problems between shareholders and managers. . A conflict of interests can occur between large controlling block holders and minority shareholders. The large investors can cause enormous agency problems through direct or indirect expropriation of minority shareholders as well as employee rights. .

The capital structure decisions are thus observed to be related with corporate governance, control and agency costs. It is evident from the above discussion that better corporate governance enhances the accountability of decision makers. The tendency of management to pursue their own objectives can be controlled by robust governance mechanism and strong shareholders rights. This also helps in reducing the agency cost.

Determining the degree or quality of corporate governance is relatively a difficult task as it requires use of various indicators that describe the effectiveness of the governance mechanism. The studies in the past haveused various

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criteria or measures to define the quality of corporate governance. The authors have tried to understand the most commonly used indicators in past studies.

CORPORATE GOVERNANCE CRITERIA

Institutional Criteria

The firm operates within the legal and institutional framework of the respective country. The institutional measures of corporate governance therefore depend on the legislative structure applicable to the firm.

Haque et al present a conceptual framework of corporate governance and capital markets. They observe that the quality of corporate governance represented by various firm level criteria is derived from the insitutional framework of the country in which the firm operates.The institutional framework comprises of the political economy factors, legal and regulatory activism and markets and competition. . The better corporate governance results in to better performance. The legal protection of investor rights is one essential element of corporate governance. . The strong institutional framework is the prerequisite for any firm level governance criteria. The firm level corporate governance provisions partially compensate for ineffective laws and weak legal environment. . Similar observations were recorded by Gugleret al in a study carried out for more than 19000 companies from 61 countries across the world. The origin of a country's legal system proves to be the most impactful factor in improving the return on investment by the firm. Differences in investment performance related to a country's legal system dominate differences related to ownership structure. Strong external capital markets improve the investment performance of companies .

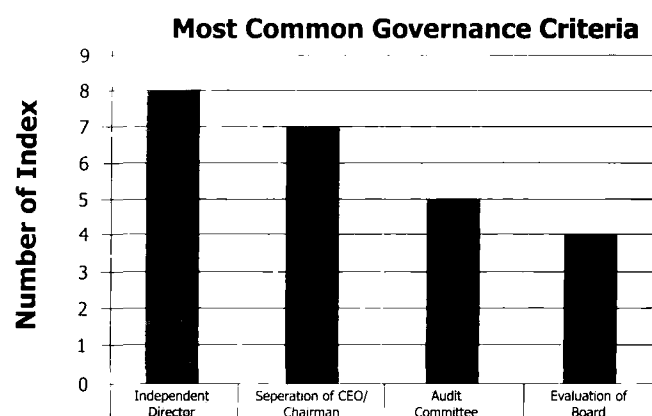
The institutional framework defines the codes and rules but the efficiency of corporate governance depend on the ability, willingness and morality of the people who put them to use. The firm specific factors therefore become more relevant in determining the quality of governance mechanism.

Firm Level Criteria

The firm level criteria of corporate governance vary from company to company. Therefore the firms operating within the common legal framework may show dissimilarities in the quality of corporate governance.

The Cadbury Committee Report on the financial aspects of corporate governance focuses on the control and reporting functions of boards, and on the role of auditors. It states that boards of directors are responsible for the governance of their companies. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The report further argues that the financial reporting should be honest and should present a balanced picture of the state of the company's affairs. The integrity of reports depends on the integrity of those who prepare and present them. Tests of board effectiveness include the way in which the members of the board as a whole work together under the Chairman, whose role in corporate governance is fundamental, and their collective ability to provide both the leadership and the checks and balances which effective governance demands. The structures and rules are important because they provide a framework which will encourage and support good governance, but what counts is the way in which they are put to use. The responsibility for putting the code into practice lies directly with the boards of directors of listed companies.

It has been observed in the report published by World Bank in June 2013that with respect to governance criteria; issues addressing the role of the board of directors overwhelmingly dominate the criteria. However, the composition and role of the board is often addressed only in the voluntary framework of corporate governance codes. Board composition and qualification is thus an effective target with which to differentiate companies from the rest of the market. Following graph depicts the most commonly used governance criteria as per the World Bank Report, 2013.



Source: World Bank Report: 'Raising the bar of Corporate Governance, 2013'

The authors reviewed literature on the relationship between corporate governance and capital structure to understand various firm level criteria/ measures used for describing corporate governance qualities. The table below lists the criteria that are most commonly used by researchers to represent the quality of corporate

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Table 1: Summary of the literature on the corporate governance criteria used in various studies.

Author(s)	Sample (Period)	Corporate Governance criteria used	Focus of study
(Wen, Rwegasira, & Bilderbeek, 2002)	60 Chinese firms (1996-1998)	Board size, board composition, CEO tenure and CEO fixed compensation	CG with debt to total asset ratios
(Gompers, Ishii, & Metrick, 2003)	1500 US firms per year	24 CG[1] provisions to form CGI[2]	Balance of power between managers and shareholders
(Abor, 2007) (Haquel & Kirkpatrick, 2008)	Ghanaian firms 101 Firms from Bangladesh (2004-05)	Board size, board composition, and CEO duality, Tenure of the CEO CGI consisting of five components: The ownership pattern, shareholders' rights, Independence and responsibilities of the board and management, Financial reporting and disclosures, Responsibility towards the stakeholders.	CG and capital structure decisions CG and capital structure in developing countries.
(Hasan & Butt, 2009)	59 firms from Pakistan (2002-05)	Board Size, Composition of Board and CEO/Chair Duality.	CG and capital structure (Bertus, JR, & YOST)
(Chung & Zhang, 2011)	Listed firms from USA (2001-06)	Standard provided in ISS[3]Corporate Governance : Best Practices User Guide and Glossary(2003)	CG and proportion of Institutional holding
(Brown & Caylor, 2006)	2363 firms from USA (2003)	Governance index using 51 out of 61 standards includedin ISS database.	CG and firm operating performance
(Berger, Ofek, & Yermack, 1997)	452 companies from USA (1984-91) 374 firms from	CEO tenure, Board composition, Board size. CEO Stock ownership, CEO option holding Managerial ownership, managerial	Managerial Entrenchment and Capital Structure Decisions CG and investor
(Klapper &Love, 2002)	14 countries	compensation, board structure, disclosure, minority shareholder protections	protection and performance

governance.

The above mentioned observations reveal that the board related criteria such as board size, composition of the board and CEO/Chair Duality are most frequently used criteria. The shareholding pattern including managerial shareholding is also observed to be one of the significant criteria. The World Bank Report also highlights the importance of board related measures in representing the quality of corporate governance. Many researchers have used a composite index for corporate governance which depends on various institutional and firm level factors.

The paperalso tries to understand the corporate governance criteria relevant for India.

The report on the Observance of Standards and Codes (ROSC) assesses India's compliance with each OECD Principle of Corporate Governance. The report offers high priority policy recommendations for two of the recommended corporate governance principles. The first recommendation talks about sanctions and enforcements and suggests certain amendments in the law and regulatory framework. The report recommends with high priority and endorses the creation of a credible director training institution. The report desires that the boards should move away from simply "rubber stamping" the decisions of management or promoters. They should know their duties of care and loyalty to the company and all shareholders. The report observed the key missing ingredient to be a strong focus on director professionalism. It is recommended to float the Director training institutes that can play a key capacity building role and expand the pool of competent candidates. This categorically underlines the importance of the role of board in observing the corporate governance principles.

The report also recommends encouraging institutional investors who act as fiduciaries to attend shareholder meetings and vote. This might encourage shareholder activism across the board, which is an important engine of change in corporate governance reform. This recommendation holds the medium priority as per the report.

It is evident from the above discussion that the following criteria of corporate governance are most relevant and significant of the various other measures.

1.Composition of the board / Proportion of independent directors

2.Separation of CEO and Chairman

3.Board working together as a team

4.Trained and qualified board members

5.Institutional investors supporting shareholders' activism

It is evident from the above that the qualification of board, proportion of independent directors and spirit of working together as a team are relevant and significant criteria for Indian companies. The proportion of shares held by the institutional investors also plays a crucial role in determining quality of corporate governance.

RELATIONSHIP BETWEEN FIRM LEVEL CRITERIA AND CAPITAL STRUCTURE

Ownership Structure And Capital Structure

The ownership structure of firm explains the proportion of shares held by various categories of shareholders. The major categories are promoters, managers, institutions and retail investors. It is observed that the ownership structure plays a substantial role in taking capital structure decisions.

Managerial Holding

Many researchers have observed that the proportion of shares held by managers determine the extent to which major decisions can be controlled by the management and thus influence the capital structure.

The term 'ownership structure 'has been used in place of 'capital structure' by Jensen and Meckling (1976) to highlight the fact that along with the variables, equity and debt, the third variable , fraction of equity held by the manager is also crucial. They argue that managerial shareholding reduces managerial incentives to consume perquisites and expropriate shareholders' wealth and results in alignment of the interests of management and shareholders. It also reduces the propensity to involve in non-maximizing behaviour.

Management is assumed to know more about the firm's value than potential investors. Myers & Majluf (1984) studied the impact of this superior information on firm's financing and investment decisions. They observed that when managers have superior information, and stock is issued to finance investment, stock price will fall, other things equal. This action is nevertheless in the (existing) stockholders' interest. If the firm issues safe (default-risk free) debt to finance investment, stock price will not fall.

The firm's debt equity ratio depends critically on the probability distribution of cash flow and on the firm's investment opportunities. Shareholders of a firm with negative expected free cash flow but poor investment opportunities may want the management to issue debt so that management will control even fewer resources, whereas shareholders of a firm with positive expected free

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cash flow but good investment opportunities may want the management to raise funds to explore the opportunities. Agency costs exist when management values investments more than shareholders do and has information that shareholders do not have. The financing policy reduces the agency cost of managerial discretion.

The evidence for the relationship between managerial holding and leverage of the firm is mixed.

The higher than optimum debt can be used by the management for their own benefit. This implies that higher the managerial ownership, greater is the ability and desire of managers to adjust debt ratio by their own interest. .

Fama & Jensen (1983) argue that managerial shareholding may have adverse effects on agency conflicts and it may entrench the present management leading to an increase in managerial opportunism. The managers of a firm may make efforts to expand the firm beyond its optimal size for their personal gains and this may result in increase in gearing levels. These efforts may lead to greater power and status for managers but it will have a negative impact on firm efficiency.

The relationship between CEO stock ownership and leverage was also found to be significant by Berger et al (1997). They observe significant positive relationship between leverage and CEO direct stock ownership. The results of their study indicate that entrenched CEOs make efforts to remain away from debt and gearing ratios remain lower in the absence of demand from owners. A critical examination of changes in leverage levels reveals that gearing levels move upward when steps to reduce entrenchment are taken. They observe a significant positive relationship between leverage and CEO vested option holding. The option variables show greater economic significance than the variables for direct stock ownership.

Some studies however observe negative relationship between managerial holding and leverage.

Lang (1987) discusses a theory and argues that if management loses its stake at bankruptcy, it may desire to use an amount of debt that is less than optimum to reduce its bankruptcy risk implicit in a higher debt level. Keeping debts at less than optimum level also maximises firm value. The role of managerial self-interest as a motivating factor in making capital structure decisions has been discussed by Friend & Lang in 1988. They find that there exists a negative relationship between debt ratio and management's shareholding. This indicates that in the absence of any non-managerial principal stockholder the tendency of low debt to equity ratio will continue. The non –diversifiable risk of debt to management is greater than that to public investors. . Hasan & Butt (2009) and Sheikh & Wang (2012)find that the managerial ownership is negatively related with leverage.

Berger, Ofek, & Yermack (1997) find that the CEO's tenure in the office has a negative association with leverage.

It was observed for American firms from 1988 to 2003, that managers sell shares when a firm's stock is performing well, large contemporaneous decreases in managerial ownership are associated with increases in Tobin's q.

Large Block Holding

The proportion of shares held by a block of shareholders which may comprise of promoters and / or founding families affect the capital structure decisions of the firm. These shareholders have the controlling powers due to higher proportion of shares held by them and use the leverage for their benefit.

Shleifer & Vishny (1997) submit that a conflict of interests can occur between large controlling block holders and minority shareholders. The large investors can cause massive agency problems through direct or indirect expropriation of minority shareholders as well as employee rights.

In the study carried out by Sheikh & Wang (2012) for Pakistani firms, the ownership concentration is found to be positively related to the total debt ratio and the long-term debt ratio.

A direct relationship is found between block holder share ownership and debt/equity ratio by Fosberg (2004). This suggests that monitoring by block holders is effective in controlling the suboptimal debt usage agency problem.

The capital structure pattern in many developing economies like Bangladesh seems to suffer most from the agency problems created by the founding family or controlling shareholders. . The controlling shareholders of poorly governed family-controlled firms tend to exercise direct or indirect influence in the firm's financing decisions. This is in their interest and results in reduced rights for minority shareholder. These controlling shareholders want to preserve authority and informational advantage by choosing readily available bank debt toward meeting the firm's financing needs. This helps in retaining or increasing ownership or control. The positive association found by Haquel & Kirkpatrick (2008) between ownership concentration and financial leverage supports this argument. The ownership concentration - which is measured by the presence of a controlling shareholder and the presence of large block holdings - and leverage are

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observed to be the significant governance mechanisms for the firms in Spain.

Institutional Holding

The institutional investors consider the quality of corporate governance to be an important factor while taking the decision of investing in the firm. McKinsey & Company (2000) surveyed more than 200 institutional investors from 31 countries and it was observed that the institutional investors put corporate governance quality at par with the other financial indicators while evaluating the investment decision

Chung & Zhang (2011) observe that the institutional shareholding proportion increases with the improvement in quality of corporate governance and good governance structure.

This observation held well across all types of institutional investors. This relationship was observed to be economically significant. The study revealed the most attractive governance provisions to be, the composition/ operation of the board of directors or the provisions that are designed to strengthen shareholders' rights. Corporate Governance was studied as a means to attract the institutional shareholders. The study also tested if the positive relation between governance quality and institutional ownership is driven by reverse causality. (I.e. institutional investor activism causes the firm to adopt better governance practices). It indicates that the positive relation between institutional holding and corporate governance is driven at least in part. However, positive but insignificant relationship was observed between institutional ownership and leverage by Hasan& Butt (2009).

BOARD OF DIRECTORS AND CAPITAL STRUCTURE

Board Size And Capital Structure

The board of directors is the highest body of a company that is responsible for managing the firm and its operations. It plays vital role in strategic decisions regarding choice of funding source.

The evidence regarding the relationship between board size and capital structure is diverse.

Berger et al (1997) find that board size is negatively associated with leverage.The CEOs with small board are being monitored closely and therefore are less entrenched and issue more debts.

The negative relationshipbetween board size and leverage ratios is observed for Ghanaian small and medium enterprises (SMEs). The SMEs with larger boards generally have low level of gearing. .

Hasan & Butt(2009)find that the size of board is negatively correlated with debt to equity ratio indicating larger boards may exert pressure on managers to follow lower gearing levels and enhance firm performance.

Some studies support the positive relationship between board size and leverage.

The companies with high gearing level rather have larger boards. Wen (2002) also finds positive relationship between board size and capital structure. He argues that large boards follow a policy of higher levels of gearing to enhance firm value especially when these are entrenched due to greater monitoring by regulatory authorities. It is also argued that larger board may find difficulty in arriving at a consensus in decision which can ultimately affect the quality of corporate governance and will translate into higher financial leverage levels.

Abor (2007) observes significant and positive associations between capital structure and board size.

Hasan & Butt (2009) used multivariate analysis and established the significant positive relationship between board size and capital structure for Pakistani listed companies. This observation was reinforced in 2012 and it was observed that the board size is positively related to the total debt ratio and the long-term debt ratio of firms listed in Karachi Stock Exchange.

However, for the companies in Spain, the board independence, and board size or CEO Chairman Duality did not show a significant impact on the valuation of the firms.

NON-EXECUTIVE DIRECTORS AND CAPITAL STRUCTURE

The ratio of number of Non-Executive Directors to Board Size determines the extent of external control on the functions carried out by the board.

The literature reviewed gives mixed evidence about the relationship between board composition and capital structure of the company.

Bergeret al (1997)emphasized the fact that stronger monitoring by outside directors has positive relationship with leverage. The companies with relatively more non-executive directors control the CEOs more closely which results in to adopting capital structure with more leverage.

Abor and Biekpe (2007) accentuate the presence of positiverelationship between gearing levels and board composition. Ghanaian SMEs that have more outside directors and a diversified set of skills at board found to have higher level of gearing. Abor (2007) observes the

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similar relationship for Ghanaian listed firms. He emphasizes that Ghanaian listed firms with larger board size, higher percentage of non-executive directors pursue high debt policy.

Sheikh & Wang (2012) highlight the positive relationship between proportion of outside directors with the total debt ratio and the long-term debt ratio,

The negative relationship between board composition and leverage was witnessed by some of the researchers.

Wen (2002) confirms the existence of significantly negative relationship between gearing level and representation of non-executive directors on the board.

Hasan & Butt (2009)observes insignificant but negative relationship between board composition and shareholding. He argues that concentration of ownership leads toreduce the presence of non-executive directors on boards. This results in establishment of stronger control on firms. This phenomenon is common in family owned companies which dominate the Pakistani equity market.

CEO/Chair Duality And Capital Structure

Another important feature of modern corporate governance is CEO/Chair duality. CEO is the decision management authority, whereas Chairman is decision control authority. If CEO is the Chairman of the company, the decision making and execution gets rigid and there is limited scope for flexibility, adaptability and participative decision making. The corporate management where the CEO also serves as chairman of the board suffers from inflexibility and has a direct impact on the financing decision of the company.

It is argued that in a firm, decision management and decision control functions should be separate. Decision management function comprises of initiation and implementation while decision control function comprises of ratification and monitoring. . This separation is ensured through a set of internal checks and internal controls. This system facilitates the judicious utilization of firm's resources. Therefore the same system should be implemented at the premier level. The role of chief decision management authority (CEO) should also be separated from role of chief decision control authority (Chairman). Board of directors is the seat of premier level of decision control mechanism in the corporate structure so it must not be controlled by CEO. If CEO is working as Chairman of the company, there is no separation of decision management and decision control and it ultimately leads to agency problems.

Very few authors support the positive and significant relationship between CEO/ Chair duality and capital structure decisions. Many of the researchers however conclude the insignificant relationship between the two variables.

Abor (2007) observes significant and positive associations between capital structure and CEO duality. The positive relationship between high debt policy and CEO duality is apparent in Ghanaian listed firms. Abor and Biekpe (2007) also provide evidence about the presence of positive relationship between gearing levels and CEO duality.

A weak and statistically insignificant relationship between CEO duality and capital structure was observed by .An insignificant relationship of CEO/Chair Duality with capital structure is observed by Hasan & Butt (2009) for the listed firms in Pakistan. It is commented that in Pakistan non-executive directors are not independent in true sense. However correlation analysis suggests that CEO/Chair Duality and manager ownership are negatively correlated with profitability. .This insignificant relationship is highlighted by one more study of Pakistani firms carried out in 2012.

The insignificance observed by researchers suggests that the separation of two functions does not really affect the capital structure choice by the firm.

Corporate Governance Index (CGI) And Capital Structure

The study of literature reveals the use of Corporate Governance Index by many researchers. The use of predefined indexes was found to be very common. However, some of the authors have tried to construct the index of their own.

Haquel & Kirkpatrick (2008)used CGI consisting of five governance components. It is shown that the regression coefficient of the CGI is significant and negative. The poor corporate governance and associated weak shareholder rights are linked with higher debt finance.

Gompers et al (2003) use 24 corporate governance provisions to form a CGI and observe that weaker shareholders' rights are associated with lower profis, lower sales growth, higher capital expenditures and more number of acquisitions.

Chenet al (2003) use CG criteria given by CLSA and S& P and suggest that in emerging markets where infrastructural factors such as the legal protection of investors and the overall level of corporate governance are not well established, strengthening overall corporate governance reduces the expropriation risk resulting in to reducing the cost of equity capital than adopting a more forthright

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disclosure policy.

Brown & Caylor (2006) construct a governance index using 51 out of 61 standards included in ISS database. They observe for 2363 firms from USA that barring 9 of the provisions, other are positively and significantly related with the operating performance.

Chung & Zhang (2011) use standard provided in ISS Corporate Governance: Best Practices User Guide and Glossary (2003) and observe that for American companies, the fraction of a company's shares that are held by institutional investors increases with the quality of its governance structure.

Jiraporn & Gleason (2007) used CGI prepared by Investor Responsibility Research Centre(IRRC) and observed that the companies with restricted shareholder rights show higher leverage. It is also argued that higher leverage alleviates agency problems.

Toledo constructed a governance index (GOV-I) for a sample of 97 Spanish non-financial public companies. Using simple and multiple OLS regressions, he finds a significant relationship between governance and performance, future growth opportunities and size, demonstrating that Spanish firms adopt better standards of governance to compensate for the low level of investor protection holding in the country.

CONCLUSIONS

The paper summaries the association of various institutional and firm level criteria describing the quality of corporate governance and capital structure decisions of the firm. The firm level criteria for better corporate governance are derived from the institutional and legal framework of the country in which the firm operates. Assuming that the firms in one country are governed by the same institutional framework, firm level criteria play a significant role in determining the quality of corporate governance. The ability and willingness of putting the codes and rules in practice determines the efficiency of the corporate governance system. The composition, qualification and role of board of directors play a major role in improving board efficiency. This efficiency finally decides the quality of decisions taken by the board. The paper observes most significant criteria of corporate governance to be, ownership structure, size of the board and the proportion of non-executive directors in the board. The CEO/ Chairman Duality was however found to be insignificant in taking the capital structure decisions. The performance of board related attributes can be enhanced by imparting proper training and providing a strong ethical framework in which the board operates. Enhancing the quality of board will improve the worth of strategic decisions like choice of capital structure and will certainly give the winning edge to the firm.

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