CORPORATE GOVERNANCE PRACTICES CAN MITIGATE THE INFLUENCE OF CAPITAL STRUCTURE ON FIRM PERFORMANCE: A CROSS-COUNTRY EMPIRICAL STUDY

Muhammad Sadiq Shahid[1], Muhammad Abbas[2] and Muhammad Rizwan[3]

Abstract

We examined whether corporate governance practices can mitigate the effect of capital structure on the performance of a firm in the emerging stock markets of Pakistan and India. Good corporate governance practices play a significant role in eliminating risk for investors, appealing capital investment and hence enhance the performance of the firms. The firms need capital resources to maximize the wealth of shareholders through profit. Therefore, there is a need to focus on the factors affecting profitability and capital structure. The sample of the study is comprised of 208 non-financial firms listed at KSE (Pakistan) and BSE (India) from 2006-2015. We used the panel data techniques, pooled OLS and fixed effect to find out the relationship among corporate governance practices, capital structure and profitability. The outcome of this study indicate that corporate governance practices significantly influence the firm capital structure. Further, results confirmed that corporate governance practices have a distinct effect on the speed of capital structure adjustment. It is suggested that the application of corporate governance rules should be mandatory. Political, social and cultural aspects have to be considered in the corporate governance policy framework. This is the first empirical study examining that corporate governance practices can mitigate the influence of capital structure on a firm's performance (in Pakistan & India) by employing most recent cross-country data. This study contributes in literature by highlighting the relationship between the corporate governance and capital structure choice.

Keywords: Corporate Governance, Capital Structure, OLS, emerging stock market and Firm Performance.

JEL Classification: G300

[1]Associate Professor, Department of Commerce, Bahauddin Zakariya University, Multan, Pakistan. Email: sshahidmalik@bzu.edu.pk

[2]Assistant Professor, Air University Islamabad, Multan Campus, Pakistan. mam@aumc.edu.pk

[3]Associate Professor, IMS, Bahauddin Zakariya University, Multan, Pakistan.Email:mriz@bzu.edu.pk

Introduction

An effective corporate governance system is very important in enhancing the investor confidence regarding corporate investment decisions and improving the financial performance of companies. In the last two decades, there has been a significant debate among researchers regarding corporate governance impact on a firm's performance, and how to establish corporate governance practices because good corporate governance influence stakeholders' decision-making process (Frooman, 1999). In corporate finance, the corporate governance and capital structure are the essential areas of research. Corporate governance signifies the prominent part of corporate finance in risk reduction, attracting capital investment, improving investor confidence and hence increasing the profitability of the firms (Velnampy & Pratheepkanth, 2013). Firms need financial resources and improved profitability to achieve the objective of value maximization. Therefore, it is very important for a firm to know about which factor may influence the capital structure, profitability of firms and corporate investment decisions.

In particular, corporate governance is a mechanism to protect the interests of the all stakeholders. Practices of Corporate governance not only enhance the profitability of firms but also assist in economic development at national level. Those firms which have weaker corporate governance practices, faces additional agency problems and managers get more private benefits because of weak corporate governance (Rais & Saeed, 2005). Chuanrommanee and Swierczek (2007) point out that, the corporate governance practices in the emerging economies like ASEAN are according to the global corporate governance practices. Similarly, in Pakistan, the corporate governance has gained the attention of researhcers after the introduction of Governance Code 2002 by the Securities and Exchange Commission of Pakistan (SECP) for listed firms. In the beginning, there was a lot of criticism and various problems occurred at the time of its enforcement. However, regardless of these criticisms, the corporate governance rules have been a major reason for the start of a new research topic in Pakistan.

Whereas in India, corporate governance initiatives started in 1998 when the Code of Corporate Governance was published as voluntary code and the first monitoring corporate governance framework for listed firm was established by the SEBI. Latter, in February 2000 the Corporate Code was formulated by following the recommendations of the Kumarmangalam Birl.

According to Rais and Saeed (2005), the governance rules have developed the overall firm structure and business environment through transparency and accountability in financial reporting. The global financial crisis draws attention to the importance of good corporate governance practices so that a firm can manage the effects of unexpected crises (fears) that may arise in future business activities. The operating business management decisions regarding assurance of both short and long-term capital, capital structure, maintaining the solvency level are key functions in the formation of competitive gains (Mulili & Wong, 2011).

The importance of capital structure decision is understandable due to its impact on profitability. The fruitful choice of a source of capital is one of the vital components of a firm's financial strategy. Moreover, the debt formation efficiently empowers managers to disburse the forthcoming cash flows. Hence, when firms decide capital financing through debt instead of stock, then firms should have the responsibility to pay the debt cost from the future cash flows. But, due to this increased cost of leverage and as a result, the standard agency costs of debt increase the bankruptcy costs. Thus, the firms should emphasize on the optimal capital structure in such a way that marginal cost of debt is offset by its marginal benefits and resultantly share price is maximized (Jensen, 1986). For that reason, the examination of corporate governance, capital structure relationship gives a wonderful strategic framework on the optimal capital structure decision.

Exiting financial literature, has not fruitfully concentrated on the impact of corporate governance practices on capital structure, so far (Bhagat & Bolton, 2008). The corporate governance is considered as the process of focusing, controlling, and making firms accountable (Australian Standard, 2003). So, it entails that in the process of managing organizations, the corporate governance comprises of accountability, authority, direction, stewardship and control exercises. Further, the corporate governance mechanism controls and protects the rights of all stakeholders (Morin & Jarrell, 2001). The corporate governance is a jointly holistic strategy that should be framed according to the objectives of the firm and the interest of stakeholders.

The researchers find out that corporate governance practices are somehow different from the mandatory issues of firms in Pakistan and India. In this context, our sample consists of 208 non-financial listed firms. Time period for the data analysis is 2006-2015.The reason for choosing this is that it reflects the significance of social and economic conditions that were present during this time. The sample firms have mixed practices in term of audit/remuneration, or nomination committees. Further, in the context, of board size and meeting, these firms have different frequencies of the meeting.

Good corporate governance practices reduce risk for investors, enhance investor confidence about capital investment and improve the firm financial performance. The business organization needs financial resources to meet its objectives related to earning. So, there is a need of exploring factors that may affect the capital structure and financial performance of the firm. Previous literature lacks in this context. There is no consensus, among researchers, on the factors affecting the firm performance. In both developing and developed markets. The objective of this study is to examine the influence of corporate governance practice on capital structure and profitability of firms focusing on emerging stock markets.

The current study examined the following research objectives:

- To examine the association between corporate governance practices and capital structure.

- To examine the association between corporate governance, capital structure and profitability in different industries.
- To examine, that corporate governance can mitigate capital structure impact on profitability in different industries.

The composition of this paper contains the following sections: section II consists of review of literature. Section III consists of methodology of the study. Section IV discusses the outcome of the study that enables value addition through support of this research work and creates coherence with the preceding research. The last section of this study consists of valuable findings and suggestions for investors and stakeholders in Pakistan and India.

Literature Review and Hypothesis Development

In the past two decades, a growing research activity has been observed on the topic of corporate governance due to its importance in enhancing investor confidence regarding corporate investment decisions and improving the financial performance of companies. To achieve corporate objective, firms need financial resources, thus, firms should consider carefully that affect the capital structure and financial performance.

Generally, corporate governance practices have a significant association with economic growth of any country, since good corporate governance practice moderate risks for investors, and attracts capital investment to enhance the financial performance of firms (Spanos, 2005).

Effective corporate governance helps in economic growth of any economy. In the last two decades, the research intensity in the corporate governance area has been increased. Those firms which have a weaker corporate governance system face further agency problems and these firm's managers get other private benefits (Core et al., 1999). As said by Chuanrommanee and Swierczek (2007), the corporate governance in ASEAN financial firms are consistent with the international practices. The research on the corporate governance subject becomes very important in emerging stock markets for listed companies, such as, Pakistan and India. After the corporate governance code was published in 2002 by SECP in Pakistan. The major corporate governance initiated with the first voluntary code of corporate governance in 1998. Finally, the Naresh Chandra Committee report of 2002 was revised Clause 49 and implemented by SECI in India.

At the start, the implementation of code was very difficult and faced a lot of criticism. However, eventually the Corporate Governance Code has been implemented successfully and this is a major motive for the start of a new research filed in Pakistan. Ahmed and Wang (2012), examining the data of non-financial firms listed on the KSE, Pakistan from 2004 to 2008, find that board size, outside directors, and ownership concentration are positively associated with capital structure, while director

remuneration managerial ownership have negative association with capital structure. Moreover, they found, the control variables such as profitability and liquidity have negative and firm size has a positive association with capital structure.

According to the agency theory, the scholars found that when an outsider manages than agency cost is greater; and this cost inversely fluctuates with the manager's ownership share. However, agency costs increase when the number of non-managerial shareholders' increases. Moreover, the external bank monitoring creates a positive influence externally in the form of lower agency costs. On the other hand, the Stewardship theory is called a stakeholder theory, which put forward that CEOs and board of directors of a firm performing as Stewards, and to do best for the benefit of the firm instead for own interests (Mulini & Wong, 2011).

In the existing literature of corporate governance, characteristics such as board size, board independence, the frequency of board meetings and audit committee reveal that the corporate governance supports public policy that stimulates firms to assign responsibilities among the external and internal members of the board. In the theoretical context, there are some beliefs about capital structure. In this context, generally Barges (1963) point out; the debt is a cheaper capital source of finance as compared to equity. The implication viewed of M & M theory (1958); where they distinguished, the financial instruments issued by the firm have no impact on productivity and value of the firm. However, the trade off- theory indicated that financing assets from debt increases the tax benefits because interest payments are tax deductible. Though, the proportion of debt increase equally the possibility of default, therefore, the expected bankruptcy cost increased (Olayinka, 2011). Further, in relation to the theory, the firm prefers internal source of finance for their investment such as, cash flows (Myers & Majluf, 1984).

According to the signalling effect theory (Ross, 1977), the investors have a higher level of confidence, the debt will entail higher quality and expected cash flows. In addition, there is no common theory of debt-equity choice, however, there are few conditional theories, and each expedites to comprehend the financial structure and choices of the firm (Olayinka, 2011).

The board members are accountable for overall performance and play an important role in financing decision. Similarly, Rehman et al. (2010) point out that capital structure is associated with corporate governance.

Pfeffer and Salancick (2003) pointed out, the presence of non-executive members' moderates' reservations about the firm and support in borrowing of capital. Similarly, Berger et al. (1997) found, those firms having additional external directors, relatively keeping high leverage levels. In the same way, Salim and Yadav (2012) also observed the negative association between capital structure and performance in Malaysian firms but Saeedi and Mahmoodi (2011) found positive relation in Iran. Likewise, Wen et al. (2002) determined a negative (significant) association between the external

directors of the board and leverage of the firm, because the existence of external board members leads to low level of leverage.

In Pakistan, Javed et al. (2014) found direct impact of capital structure and governance on firm value. In India, Kumar (2006) found the same result. The findings indicate that those firms having weaker corporate governance mechanisms, relatively having higher leverage. Further, Kumar point out those firms having greater foreign ownership (low institutional ownership) tends to have low leverage. Moreover, Abor (2007) analyzed the governance influence on the capital structure decision of SMEs. He establishes a negative association between board size and capital structure, while a positive association of board composition, board skills, CEO duality and capital structure. These results advocate that SMEs follow low leverage policy with larger board size. There is a notion that large board size can enhance the value of firms due to a range of board member skill for better decisions and harder for an authoritative CEO to dominate. However, some researchers supported the small board size because larger boards are less effective (Jensen, 1993). When a board size increase than it is hard to harmonize, while the small size of the board, possibility reduces free riding, and upsurge the responsibility of individual directors. Therefore, board size may have positive as well as negative impact on firm value.

There is a general assumption that the board composition has a significant impact on a firm's performance. However, there are mixed empirical evidence regarding associations between board structure and firm performance, and few studies discovered the positive association between board composition and firm performance. Weir and Laing (2001) state that, "higher numbers of non-executive directors have a greater return on equity". Similarly, Ezzamel and Watson (1993) examined that non-executive on the board had a positive association with firm profitability.

Brown and Caylor (2006) find out, firms with larger board size generate high ROE. According to Jackling and Johl (2009) point of view, the larger board size impacts performance positively. In the same way, Baysinger and Butler (1985) find out that outside directors performed well as compared to other firms. Although, Rosenstein and Wyatt (1990) stated that increase in outside director leads to increase in stock return. While conducting a study on the US firms by Agrawal and Knoeber (1996) point out, there is an adverse association between performance of firms and proportion of external directors in board size.

There is an assumption that independent director energetic participation can help in better functioning of the board within the organization (Roberts et al., 2005). In support of the above assumption, Chan and Li (2008) point out the value of the firm is increased through the existence of expert-independent directors. Moreover, Jackling and Johl (2009) find out, a large number of outsider board member positively influences the firm performance. Kang and Zardkoohi (2005) concluded about relationship between CEO duality and performance that if such duality exists as a reward, it enhances the firm performance.

Uzun et al. (2004) found that the chances of fraud reduced due to higher audit committee independence and also audit committee diminishes the agency cost and enhance financial performance. Likewise, Brown and Caylor (2006) investigated a positive association between firm return and audit committees' autonomy. Although, Chan and Li (2008) described that the value of the firm boosted through independent directors in audit committee.

According to Lipton and Lorsch (1992) point of view, the better performance of firms is a result of the frequent meetings of the board. A constructive relationship exists between frequency of board meetings and financial performance of companies (Brown & Caylor, 2006).

Yasser et al. (2011) confirmed that the corporate governance has negative influence on debt ratio and positive influence on return on assets. Corporate managers and boards of directors, may possibly ensure corporate transparency (Jensen & Meckling, 1976) however, the agency theory point out that the external investor pressures motivate managers to maximize the firm value (Allen, Bernardo, & Welch, 2001).

The following hypotheses are operationalized in relation to existing literature for analyzing the association between corporate governance practices, the capital structure and financial performance of Pakistani and Indian listed firms:

H1: Corporate governance positively affects the firm profitability

H2: Corporate governance has a significant impact on capital structure.

H3: Corporate governance significantly mitigates the impact of the capital structure on profitability.

Data and Methodology

In the existing literature, the board composition (ratio of non-executive directors), board size, and board committees are the key dimensions of corporate governance (Bhagat & Bolton, 2008), among others. Similarly, the debt ratio is considered as a key ratio to define the capital structure within the organization (Bhagat & Bolton, 2008). Profitability is measured by return on assets (ROA) and share return (RT). Table 1 describes the measurements of the variables that are employed in this study.

Table 1
Measurement of the variables

Variables	Measures
Board Size (BODSIZE)	The total number of members in board
Board Composition (BCP)	Number of outside directors in board divided by the total directors
Board committees (BC)	This is measured as, two or more committees have been represented as 1; otherwise 0
The frequency of the board meeting [FOBM]	This proxy is measured as, the number of board meetings in a year.
CEO Duality[CD]	The dummy variable; 1 if CEO chair of the board, 0 otherwise
Ownership Concentration(OC)	This proxy is measured as, Top 15 Share / Total Share.
Diversification[SEGDIV]	Dummy; 1 if a firm deals in multiple segments, 0 otherwise.
Capital structure (LEV)	Leverage ratio = total debt / (total debt + equity)
Profitability (ROA)	Return on assets measured as (NI/net total assets)
Share return (Rt)	Return of share measured by (Pt-Pt-1/Pt-1)
Firm size (SIZE)	Log of total assets
Firm age (AGE)	Age is measured as number of years the firm is operating

The secondary data of 208 non-financial firms have been extracted between 2006-2015 from Data Stream and the annual reports of firms in Pakistan and Indian stock exchanges. The quantitative pooled OLS analysis with fixed effects is employed to observe the impact of corporate governance on the capital structure and firm performance. Corporate governance practices dimensions such as, board size, board composition, the number of board committees and the frequency of board meetings are used in this study. Following econometric model is proposed

$$ROA_{it} = \beta o+\beta 1\ FOBM_{it} +\beta 2\ BCP_{it} +\beta 3BC_{it}+\beta 4BODSIZE_{it}+\beta 5LEV_{it}+\beta 6RT_{it}+\beta 7CD_{it} + \beta 8OC_{it}+ \beta 9AGE_{+it}\varepsilon i \quad \ldots\ldots (1)$$

$$Rt_{it} = \beta o+\beta 1\ FOBM_{it} +\beta 2\ BCP_{it} +\beta 3\ BC_{it}+\beta 4BODSIZE_{it}+\beta 5LEV_{it}+\beta 6ROA_{it}+ \beta 7CD_{it}+ \beta 8OC_{it} + \beta 9AGE+ _{it}\varepsilon i \quad \ldots\ldots (2)$$

$$LEV_{it}=\beta o+\beta 1FOBM_{it}+\beta 2BCP_{it} +\beta 3BC_{it}+\beta 4BODSIZE_{it}+\beta 5ROA_{it}+\beta 6RT_{it} + \beta 7CD_{it} + \beta 8OC_{it} + \beta 9AGE_{+} + _{it}\varepsilon i \quad \ldots\ldots (3)$$

Further, this model can be modified to analyse the interaction impact of corporate governance and capital structure and firm performance.

$ROA_{it} = \beta o + \beta 1\ FOBM_{it} + \beta 2 BCP_{it} + \beta 3 BC_{it} + \beta 4 BODSIZE_{it} + \beta 5 SIZE_{it} + \beta 6 RT_{it} + \beta 7 OC_{it} + \beta 8 CD_{it} + \beta 9 LEV_{it} * BODSIZE_{it} + \beta 10 AGE_{it} + {}_{it}\varepsilon i$ ……..... (4)

$Rt_{it} = \beta o + \beta 1\ FOBM_{it} + \beta 2\ BCP_{it} + \beta 3\ BC_{it} + \beta 4 BODSIZE_{it} + \beta 5 SIZE_{it} + \beta 6 ROA_{it} + \beta 7 OC_{it} + \beta 8 CD_{it} + \beta 9 LEV_{it} * BODSIZE_{it} + \beta 10 AGE_{it} + {}_{it}\varepsilon i$ ……..... (5)

Where: βo = Intercept; β1, 2,,,,, N = Population slope; Rt_{it}= share return of firm i in time t LEV_{it} = Debt Ratio of firm i in time t; BCP_{it} = Board composition of firm i in time t; BC = Board committees of firm i in time t; $BODSIZE_{it}$ = Board Size of firm i in time t; $FOBM_{it}$ = Frequencey of Board meeting of firm i in time t; OC_{it} = Ownership Concentration of firm i in time t; CD_{it} = CEO duality of firm i in time t; Age= Age of firm i in time t; $SIZE_{it}$ = Size of firm i in time t; ROA_{it}= Return on Assets of firm i in time t; RT_{it}= Share return of firm i in time t; and ε_{it} = error term.

Result and Discussion

While examining the possible differences between the Pakistani and Indian firms, capital structure and governance elements of the firms are compared. The descriptive results such as, means, medians and standard deviation are presented in the table 2. According to the results, corporate governance characteristics are on average higher in Indian firms in contrast to Pakistani firms. Larger firms are more leveraged and profitable as compared to small size firms in both Pakistan and India. The results also indicate that the capital structure as the debt maintained by non-financial firms is, on average, 37.9% for Pakistan and 41.9% for India respectively.

Table 2
Descriptive Statistics of the study

Measurement	Pakistan			Indian		
Overall	**Mean**	**Median**	**St. Deviation**	**Mean**	**Median**	**St. Deviation**
BODSIZE	7.8924	6.7340	1.6980	9.4546	6.6485	1.9340
BCP	2.9375	2.2350	1.9502	3.1901	2.6049	0.8743
BC	1.5618	0.9038	0.9018	2.8279	1.6256	0.5970
FOBM	1.3809	0.9802	1.0378	2.4328	1.3750	1.4510
CD	0.3029	0.2189	1.4782	0.4384	0.3649	0.8157
OC	0.5648	0.4913	0.9485	0.6740	0.6048	0.3719
LEV	0.3984	0.2817	0.8963	0.5019	0.4382	1.6354
ROA	0.0895	0.0670	0.5849	0.0985	0.0864	0.5831
RT	0.0685	0.0394	1.090	0.1182	0.7984	1.4980
SIZE	12.9463	9.1470	1.0945	16.9841	12.8760	1.5329

Table 3 shows the correlation results of individual relationship between the variables. All the variables except ownership concentration are associated with the capital structure. The results validate the association between corporate governance and capital structure. Although the mixed association (both positive and negative) were found to all variables. Correlation values indicate that board size and ROA are negatively associated. It is consistent with previous studies related to emerging stock markets.

Table 3
Correlation between Corporate governance, Capital structure and Performance

Variables	BODSIZE	BCP	BC	FOBM	CD	OC
PAKISTAN						
LEV	0.0546**	0.2034**	0.3983*	0.1851*	0.0687**	-0.0970
ROA	-0.1358*	0.1496*	-0.0109	0.0187*	-0.1972*	-0.3157
RT	0.1948*	-0.1094*	-0.1847	0.1546*	0.1826*	0.2936
INDIA						
LEV	0.1439*	0.3059	0.4602**	0.348**	0.2078*	-0.2694
ROA	-0.2093**	0.3629*	0.0948*	0.2684*	0.1948*	-0.1690
RT	0.3064**	0.2842**	0.1738**	0.3489*	-0.1904*	0.1502

Note: **= Significant at 1%, & * significant at 5 %

The pooled OLS, Fixed Effect and Random Effect regression models has been applied in to find out the impact of corporate governance on profitability (ROA), return (Rt) and capital structure, separately for Indian and Pakistani dataset. The results of pooled OLS models are provided in table 4, 5 and 6. The corporate governance dimension, Board size, FOBM, Board Composition contributes significantly to ROA, while Board committee, CEO duality, and OC factors are not contributing significantly to ROA. Moreover, leverage and firm diversification also significantly contributes to ROA. While in case of share return as dependent variable, only board committee, board committee, board size, board composition, and ownership concentration significantly associated with share return.

Table 4
Pooled OLS and Fixed Effect Results: firm performance (ROA)

	Pakistan		**India**	
Variables	**OLS**	**FE**	**OLS**	**FE**
Constant	0.1249	0.1409	-0.2596*	-0.3048**
BODSIZE	0.1438**	0.1876*	0.1638	0.1479*
FOBM	0.0298*	0.0358*	0.08648	0.06974*
BCP	0.1385	-0.1974*	0. 2048*	0.2019*
BC	0.0087	0.0093	0.0109	0.0206
CD	0.1638	0.1492	0.1940	0.2038
OC	0.1047	0.1693	0.1876	0.1974
LEV	-0.1786*	-0.1864*	-0.2908*	-0.1796*
RT	0.1058*	-0.0974*	0.1578*	-0.1629*
DIV	0.0167*	0.0085*	0.0196*	0.0179*
SIZE	0.0826*	0.0924	0.0494	0.0618*
AGE	0.0674	0.0906*	0.1098	0.1040
R-Square	0.5150	0.5341	0.5068	0.5395
F-value	1.459*	1.538*	1.639*	2.210*

Note: **= Significant at 1%, & * significant at 5 %

However, few corporate governance practices dimension contributes significantly to leverage. The significant results indicate a positive association of board size with return on assets. It means that bigger board size is better, because constituted with members from different knowledge, diversified expertise and skills facilitate better decision making and play a good role to monitor the activities of the firm. Although a there are few studies which describe negative relationship between board size and profitability, the results of current studies are consistent with some other studies (Eisenhardt and Yawson, 2006) pointing out that larger board size may have positive impact of profitability of firms especially in the developing countries where members of board of directors usually have

social networking with the other stake holders including bankers, auditors, regulators and investors. Therefore, a firm with large and diverse board may earn higher profits due to social capital of directors. According to Yawson (2006), in the firms with larger board size, access to external factors is better, risk is reduced and critical resources are easily accessible.

Table 5
Pooled OLS and Fixed Effect Results: firm performance (Share return)

	Pakistan		India	
Variables	**OLS**	**FE**	**OLS**	**FE**
Constant	-1.0649*	-1.3678*	-1.3589*	0.7348
BODSIZE	0.1683*	0.1940*	0.2198*	0.2085*
FOBM	0.0568	0.0903**	0.1842*	0.1099*
BCP	0.0283	0.0547*	0.0902	0.0629*
BC	0.1756**	0.2083	0. 2382*	0.1940**
CD	0.2048	0.1864*	0.2831	0.2068
OC	0.1643*	0.1028**	0.2058*	0.2438
LEV	-0.1680*	-0.1239*	-0.1842*	-0.2364*
ROA	0.1089**	0.2785*	0.1942**	0.2076**
SIZE	0.0694	0.0428**	0.0984**	0.1018**
DIV	0.0104	0.0198*	0.0146**	0.0138*
AGE	0.0128*	0.0190	0.1048**	0.1260*
R-Square	0.5430	0.5106	0.4938	0.5283
F-value	2.849*	2.698*	2.760*	3.421*

Note: **= Significant at 1%, & * significant at 5 %

Further, we documented that board size and board compositions have a strong influence on capital structure among non-financial listed firms in Pakistan and India. The industry dummy and time dummy are also used in this analysis. The results of time effects show that the variation in firm performance is different across the firm and over the time period. We also documented that the CEO duality insignificantly contributes to firm performance, but contribute significantly to the capital structure of the firm in Pakistan and India.

Table 6

Pooled OLS and Fixed Effect Results of leverage

	Pakistan		India	
Variables	**OLS**	**FE**	**OLS**	**FE**
Constant	-1.1394*	-1.3680*	-2.3347	0.4178*
BODSIZE	0.1275**	-0.3248	0.4834	0.3542
FOBM	0.0341*	0.2483	-0.5808	-0.3140
BCP	0.1749*	-0.5745*	0.4248*	0.4294*
BC	0.0098	0.0142	0.0748*	0.0648
CD	0.1259	-0.1875*	-0.268*	-0.3694*
OC	-0.0158	-0.0241	-0.0349	-0.0485*
ROA	-0.348*	0.3745*	-0.2468	-0.2594*
RT	-0.1426*	-0.0285*	-0.1389*	-0.5249*
DIV	-0.1446	-0.1462	-0.0151	-0.0141
SIZE	0.2342	-0.134*	0.2941*	-0.1948*
AGE	0.0341*	0.0266	0.1242	0.1169
R-Square	0.4805	0.4976	0.5374	0.5039
F-value	0.506	1.530*	1.519*	2.016*

*Note: **= Significant at 1%, & * significant at 5 %*

The results of all OLS models for firm performance are summarized in the above table. Overall findings indicate that the corporate Governance Practices contributes significantly to firm performance (both measures) and capital Structure.

Further, it has been analysed that does corporate governance mitigates the adverse impact of capital structure on firm performance. For this purpose, we used the interaction term between corporate governance and capital structure (BODSIZE*LEV and FOBM*LEV), and the results of pooled OS models are provided in table 08.

Table 7
Pooled OLS Results of firm performance (ROA & RT)

	Pakistan		India	
Variables	**ROA**	**RT**	**ROA**	**RT**
Constant	0.1868	-0.1085	-2.3849	-1.5032
BODSIZE	0.2035**	0.1958**	0.3482	0.2085*
FOBM	0.0819	0.1854*	-0.2069	0.2638*
BCP	0.0984*	0.1079*	0.3049*	0.2664*
BC	-0.2848*	-0.2451*	-0.1874*	-0.2630*
CD	0.1014*	0.1329*	0.2958	0.2864*
OC	0.1869**	0.1374	0.0176	0.0196**
DIV	0.0139	0.0104**	-0.0184	0.0120
BODSIZE*LEV	-0.0960*	-0.0846*	-0.0285**	-0.0340**
FOBM*LEV	0.1438	0.1098	0.1942	0.1784
SIZE	0.0998*	0.1009*	0.1680	0.1090**
AGE	0.1049**	0.0908	0.0908*	0.1340**
R-Square	0.5609	0.5218	0.4840	0.5809
F-value	1.849*	2.736*	1.958*	2.469*

*Note: **= Significant at 1%, & * significant at 5 %*

In table 08 results indicate that the interaction term BODSIZE*LEV and FOBM*LEV has positive and significant impact on profitability and share return as firm performance measures. It means that the adverse effect of higher leverage on performance of the firm is dampened and through good corporate governance practices of board structure and audit committees, because these are considered as protection tools for shareholders. Overall, we can conclude that corporate governance practice can reduce the negative impact of capital structure on performance. Further, the results reveal that, the composition of executive and non-executive directors in a board make sure that the optimal level of debt ratio is maintained in capital financing decision. In previous studies such as Belkhir (2009), Masulis et al. (2012) etc., similar results were found. With regard to above findings, it is concluded that, the influence of capital structure has been moderate by the best corporate governance practices.

Conclusion

This study is an attempt to validate that transparency and overall firm performance is enhanced through the implementation of good corporate governance practices. Moreover, it also enhances transparency and protects the interest of the shareholders through managers. The objective of the study is to examine that the corporate governance can mitigate the impact of the capital structure on the performance of non-financial firms in Pakistan and India. The capital financing decision is one of the major issues that managers have to face. The corporate governance is a major factor that affects the investment and financing decision. Moreover, the corporate governance significantly assists firms by imparting good management practices, operational control and accounting systems. Rigorous and operational regulatory mechanism and efficient utilization of capital resources result in improved performance.

Overall, results indicate that corporate governance practices are significantly associated with the capital financing choices. The Board composition and number of committees contribute to mitigate the significant influence of capital structure on firm performance, and results are consistent with Belkhir (2009), Masulis et al. (2012), etc. However, ownership concentration does not contribute significantly to the capital structure decisions. These findings are consistent with the existing literature. The larger board size and its composition ensure lower debt ratio, because the larger corporate board and good composition put a strong pressure to make managers pursue a lower debt ratio (Belkhir, 2009). These outcomes have important implications for policy makers, researchers and corporate boards, particularly.

Corporate governance should focus on board members, because it is positively associated with future operating performance. Although, the researchers have acknowledged the transformations between practices and mandatory corporate governance issues in the listed firms in both emerging and developed stock markets, corporate governance regulations should be rigorously directed by the SECs of Pakistan and India. Furthermore, the political, economic and social & cultural characteristics of Pakistan and India should be reflected in the corporate governance policy framework. According to our judgment, the narrow role of independent boards and committees be enhanced, the identical requirements for increasing composition of non-executive directors be implemented to improve governance and monitoring effectiveness of firms. Hence, there is a need to establish a corporate governance model that considers the conditions of both emerging stock markets.

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