

CORPORATE GOVERNANCE ON FINANCING POLICY: MEDIATING ROLE OF COST OF CAPITAL

Mian Sajid Nazir

COMSATS Institute of Information Technology, Pakistan
snazir@ciitlahore.edu.pk

Aisha Javaid

The Balochistan University of Information Technology, Pakistan
Aisha.Javaid@buitms.edu.pk

Abstract:

This paper contributes to the existing literature of capital structure by extending the empirical work on the established relationship between the corporate governance and capital structure by analyzing the mediating role of cost of capital. Using five major attributes of corporate governance i.e. board size, board composition, CEO/Chairman duality, managerial ownership and institutional ownership as explanatory variables and weighted average cost of capital as mediator, we analyze the implication of good governance practices on the effectiveness and value relevance of capital structure decisions. The sample for this study is non-financial firms listed on the Pakistan Stock Exchange for the period of 2004-2015. The findings of the study are that board composition, CEO/Chair duality and managerial ownership are significant in determining the capital structure decisions of the firm while; institutional ownership and board size are not significant in the financing decisions of the firm. Our results point out that cost of capital is a decisive factor in determining the financing choices of the firms, and the existence of the indirect effects of corporate governance on capital structure through the mediating role of cost of capital. Moreover, some conventional determinants of capital structure including size of the firm, asset structure of the firm, profitability, business risk and growth are also significant in deciding the optimal financial mix of the non-financial firms of Pakistan stock exchange.

Keyword: corporate governance, cost of capital, capital structure decisions, Pakistan