CORPORATE GOVERNANCE AND BANK CAPITAL STRUCTURE: Evidence from a cross-country analysis.

A thesis submitted for the degree of Master of Philosophy (M.Phil) in Finance

By

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Declaration

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ABSTRACT

The objective of this study is to provide empirical evidence on how owners of family managed firms affect bank leverage in family owned and managed firms. In addition, to assess the effect when a control right of the controlling owner exceeds cash flow rights which give rise to the agency problem in a bank with ownership concentration on bank leverage. Using cross-country bank-level data from Caprio et.al (2007) the study revealed that family-owner managed firms tend to have lower debt and this supports the hypothesis that bank leverage is likely to be lower in owner managed family firms. Furthermore, using equity ratio as an alternative indicator of bank leverage, the result indicates that family owner managed firms have a positively significant impact on bank leverage. This suggests that in a family-owner managed firm there is always a higher level of equity to finance the asset of banks in order to make sure the asset base of the bank is strong. This further strengthen the position of our result when using liability ratio in term of leverage where the inverse relationship between leverage and family-owner managed firms is interpreted as dependence on equity rather debt. Therefore, this implies that family owner managed firms prefer lower bank leverage.

Moreover, higher control rights than cash flow rights give rise to a serious agency problem, as a result the control rights of the controlling owner exceeds cash flow rights has a significant positive relationship on bank leverage in term of liability ratio, and a significant negative relationship on bank leverage in term of equity ratio. This finding which uses the liability ratio in term of leverage further explained that bank leverage is higher when control rights of the controlling owner exceeds cash flow rights. The result also suggests that for firms where control rights of the controlling owners exceed cash flow rights, the equity is lower so they will prefer debt financing because of the fear of losing control. Situations like this are associated with an over- reliance on debt due to large shareholders being unwilling to dilute their ownership, generally this known as non-dilution of entrenchment. This implies that bank leverage is higher if control exceeds cash flow rights. However, this study recommends that there should be more dilution of ownership in family-owner managed firms so those minority owners are not exploited. In addition, controlling shareholder should not allow excessive building up of bank leverage because too much debt may lower bank valuation. Consequently, banks need to be better regulated furthermore excessive leverage has been identified as one of the reasons for the current financial crisis.

CHAPTER ONE

INTRODUCTION

1.1 Background of the study

The current financial crisis has highlighted the risks of unregulated privatisation. During the sustained period of high growth over the past decade or so, unfettered risk-taking by banks has been one major factor contributing to the outbreak of the financial crisis (e.g., see Coricelli et al, 2009; de Haas and van Horen, 2009), necessitating huge government bail-outs of banks. Accordingly, capital management of banks has come under increasing scrutiny in recent times. But it is only recently that the question of optimal bank capital structure has begun to be addressed (e.g., see Diamond and Rajan (2000)). Following the recent surge of literature for corporate governance of non-financial firms (La port et al, 1999) some researchers (e.g. Caprio et al., 2007) have also highlighted the potential role of governance on bank valuation. In particular the paper examines whether strong shareholder's protection laws could improve bank governance and therefore bank valuation. More recently Mehran and Thakor (2009) examine the link between bank capital and bank valuation. Researchers are however not aware of any research exploring the possible role of corporate governance of banks on a bank's capital management. Using cross-country bank-level data, this study aims to bridge this gap in the literature. The analysis of bank leverage is very important because there is a need to understand the relationship between leverage decisions and the ownership structures of banks which have been emphasised in the wake of the current financial crisis that shows the risk of lending booms which result in the downturns of the global economy.

Caprio et.al (2007) claimed that ownership structure is an important mechanism for governing banks and the same most important aspect of corporate control mechanisms that determine the governance of non-financial firms also determine bank operations. Laeven and Levine (2008) revealed that ownership structure and shareholder protection laws have an impact on the ability of owners to influence risk. The authors argue further that shareholders with higher voting rights than cash flow rights have the greater power and incentives to change corporate behaviour than minority shareholders. Theory also suggests that how much a bank will deleverage will surely depend on how much leverage bank equity owners are willing to tolerate in future time and the level of leverage that will be profitable in the business with an increase in cost of capital. Based on this perspective, ownership structure determines the ability of owners to change bank risk in response to standard risk shifting

incentives and to incentives from official regulations. Consequently, the importance of banks to national economies is emphasized by the fact that banking is universally a regulated industry and banks have access to government safety nets. In addition, the activities of banks have a number of intrinsic risks that can pull down the whole financial system of a nation's economy. The intrinsic risks include, among others, operating with high leverage which can cause financial distress and bankruptcy. It is therefore very important that banks have strong corporate governance in order to protect the interests of all the stakeholders and thus to better align the interests of bank managers, shareholders and customers.

Furthermore, sizeable corporate governance literature on non-financial firms focuses heavily on firms' ownership structure (e.g., Claessens et al. 2000, 2002). The question is whether banks are different from these non-financial firms. Following Caprio et al. (2007), This analysis focuses on two key ownership variables, namely, when a family is a controlling owner and also whether control rights of the controlling owner exceeds the corresponding cash flow rights. This analysis however differs from Caprio et al. (2007) in that it considers the role of bank ownership structure on capital structure.

Moreover, conflicts of interests between managers and shareholders as well as those between controlling and minority shareholders lie at the heart of the corporate governance literature. With the exception of the US and the UK, ownership concentration is commonly high in all parts of the world. One important characteristic of the prevalent ownership structure around the world is the dominance of family ownership. Often in family controlled firms the controlling owner and the manager belong to the same family, which helps to align the interests of the manager with the controlling owner. It is also argued that owner-managed family firms tend to be more risk-averse than others, even at the highest level of concentration, which in turn may generate a negative relationship between family ownership and leverage structure and may be a contrast to the conventional wisdom of a positive relationship. The conflict between the controlling owner and the minority owners however continues to persist, thus generating some negative impacts on bank valuations. Second, as control rights of the controlling owner often exceeds his/her cash flow rights. Higher control rights may give rise to serious agency problems and are often associated with pyramid ownership structures and crossholding. Such situations are associated with an over-reliance on debt due to large shareholders being unwilling to dilute their ownership, generally known as non-dilution of entrenchment. Claessens et.al (2002). Against this background, this study

examines how family owner-managed firms affect bank leverage. In addition, to assesses how excessive control rights in relation to cash flow rights may influence bank leverage.

The banking crisis has highlighted the adverse effects of much capital. In this context, the present study empirically examines if there is a link between ownership and bank capital. Our analysis particularly focuses on two ownership variables, namely, incidence of family ownership and also if control rights exceeds cash flow rights. This is because these two ownership variables have important implication for corporate governance of bank. Firstly, one can argue that family bank is more risk averse than others and therefore are less likely to have lower loan and lower capital structure than non-family banks. Secondly, the management of bank where control exceeds cash flow rights is more likely to take riskier decision since financial risks involved for them would be less than when cash flow rights are higher. We use bank-level cross-country data available from Caprio et al. (2007). Our results provide support to the two hypotheses not only for the full sample but also in some sub-samples. In particular, importance of control exceeds for cash is upheld in the OECD countries while importance of family ownership for capital structure is particularly pronounced in the non-OECD countries. This is because incidence of family ownership is less pronounced OECD countries.

In particular, estimates suggest that family- owner managed firms tend to have a lower liability. This result is consistent with Daly and Dollinger (1992) and Anderson et al. (2002). In addition, with equity ratio the result indicates that family- owner managed firms have a positively significant impact on equity ratio so that a family- owner managed firms tend to have higher equity to finance. This result is consistent with James (1999).

Furthermore, the coefficient of control exceeds cash flow right (CEC) has a significant positive relationship on bank leverage in term of liability ratio. This implies that bank leverage is higher if control exceeds cash flow rights. This result is consistent with Driffield et.al (2007). In addition, this also indicates that when control rights of the controlling owner exceeds cash flow rights there will be fear of sharing of control and being interfered by others and this often delays the decision of company to go for public offer. Consequently most companies will prefer to raise debt capital Pandey (1999). Furthermore, the coefficient of control exceed cash flow right (CEC) has a significant negative relationship on bank leverage in term of equity ratio as an alternative indicator of bank leverage. This

finding further buttress the result when using liability ratio in term of bank leverage which reveals that bank leverage is higher when a control right of the controlling owner exceeds cash flow rights. This result also suggest that firms where control rights of the controlling owners exceeds cash flow rights, the equity is lower they will prefer debt financing because of fear of losing control. Situations like this are associated with an over- reliance on debt due to large shareholder being unwilling to dilute their ownership, generally this known as non-dilution of entrenchment. Our finding is consistent with Claessens et.al (2002).

1.2 Objectives of the study.

In summary, this study involved two main objectives;

To examine how family owner managed firm affect bank leverage in a situation when family controlled firms the controlling owner and the manager belong to the same family, which helps to align the interests of the manager with the controlling owner.

To assess how control rights of the controlling owner exceeds cash flow rights which give rise to agency problem, and to what extent this impacts on bank leverage.

CHAPTER TWO

LITERATURE REVIEW ON CORPORATE GOVERNANCE

2.1 Introduction

Jensen and Meckling (1976) argue that the principal-agency theory otherwise known as the shareholder model is generally considered as the starting point for any debate on corporate governance. The agency theory sets out as a basis that better corporate governance should lead to higher stock prices and or better long-term performance, because managers are supervise well, and agency problems are minimized, leading to a decrease in agency cost and information asymmetry. However, Gompers et al. (2003) and La portal eta al. (2002) argue that firm performance may have little to do with agency explanation. The studies that examine the relationship between corporate governance and firm performance have emphasized such governance practices as board composition, board size, CEO turnovers and ownership of shares, disclosure and transparency and shareholders rights. As a result of these different views on the issue of corporate governance, the following will provide definitions of this term.

2.2 Definition of corporate governance

There is no universally held or single definition of corporate governance and certainly no definition that all countries agree on Mayes et al. (2001). As a result, corporate governance can be defined and practiced in different way globally depending upon the relative power of owners, managers and provider of capital Craig (2005). Generally, corporate governance can be defined as a procedure, customs, laws, policies, and institutions that affect the way a corporation is directed, administered or controlled. It can also be the relationships between stakeholders and the goals that are already laid down for the corporation to follow, in which the principal stakeholders are the following: shareholders, management, and the board of directors. In addition, employees, customers, creditors (banks and bond- holders) are stakeholders. The important objective of corporate governance is to ensure the accountability and transparency of those involved in the policy of organisation through mechanisms that will remove or reduce principal- agent problem.

In term of corporate governance mechanism and structure, Keasey and Wright (1993) defined corporate governance as a framework for effective monitoring, regulation and control of companies which allows alternative internal and external mechanisms for achieving the laid

down objectives. These mechanisms include those internal to the firm and its organisation, and those external to the firm such as statutory requirement and the operation of the markets. The internal mechanisms are the board composition, managerial ownership, and non-managerial shareholding which involve institutional shareholding. The external mechanisms are the following: statutory audit, the market for corporate control effectiveness in hostile takeovers, and stock market evaluation of corporate performance. However, the advantages of the entire corporate governance framework will be determined by the interaction among these governance mechanisms. Using the agency theory approach, Shleifer and Vishny (1997) defined corporate governance as a process in which a supplier of finance to firms assure themselves of getting a return on their investment. The authors posited that corporate governance is mainly concerned with principal agency problem between ownership and control. The authors emphasized that corporate governance should be seen as a set of mechanisms through which outside investors protect themselves against expropriation by insiders. In addition, Cadbury (2002) defined corporate governance as the system by which companies are directed and controlled by shareholders. In addition, in terms of attainment of company goals, objectives and performance, OECD (1999) view corporate governance as a set of relationship between the company's management, its board, its shareholders and stakeholders. It also provides the structure through which objectives of the company are set and the means of attaining those objectives, and monitoring performances.

2.3 The Significance of corporate governance:

Different authors have their own view for the reason for the introduction of governance in corporations; the following are the view of various academic scholars and international organisations for the significance of corporate governance system in firms.

Denis (2001) posited that the fundamental perception and understanding of the field of corporate governance originated from the fact that there are potential problems associated with separation of ownership and control which was inherent in the modern corporate form of organisation. As a result, the author viewed corporate governance as a structure with a set of institutional and market mechanisms that induce self-interested managers (controllers) to maximize the value of the residual cash-flow of the firm on behalf of its shareholders (the owners). Every author writing a paper on corporate governance always focused on this fundamental perception and understanding which field originated from; dated back to 1776 during that year Adam Smith had written about professional managers in his Wealth of

Nation. He found that as the manager of other people's money, it cannot be expected they should watch over the wealth anxiously. In addition, (1932) Berle and Means revealed that this problem made the corporation not performed well. Jensen and Meckling (1976) expanded ideal of the previous authors, and then proposed the theory of firm in which they apply agency theory to Modern Corporation. The author explained that a manager who owns anything less than 100 percent of the residual cash-flow rights of the firm will tend to have conflict of interest with outside shareholders. Based on these studies, several authors in the field of finance and economics have carried out studies to define measure and minimise these conflicts and their impact on firm value.

Moreover, the US government, investors, and academics focused on corporate governance after Enron filed for bankruptcy in December 2001. The Enron scandal later followed by another scandal at Tycon, Global Crossing, ImClone system, and WorldCom. The US congress acted against the scandal by enacting the Sabarnes-Oxyle Act (SOX) which was signed into law in 2002. Benton (2007) revealed that some people said that SOX was overreaction to the scandals. While it has some good points, the costs of implementation are excessive. Benton (2007) also found that corporate governance became important because of globalization, such as the move toward International Accounting Standard Board (IASB). This body based in London, is committed to developing single set of high quality, well understood and enforceable global accounting standard. In addition, the Basel Committee on Banking Supervision which is part of the Bank of International Settlement (BIS), published a guidance that was entitled ‘’ Enhancing Corporate Governance for Banking Organisation’’ This was based on papers published by the committee in 1999 and also the principles for corporate governance issue by the Organisation for Economic Co-operation and Development (OECD) in 2004. The reason for this guidance was to help ensure the adoption and implementation of sound corporate governance practices by banking organisations globally. According to the author he argues that this is not intended to establish a new regulatory framework over the already existing national legislation, and regulation or code.

In addition, Mallin, et al. (2005) explained several reason for development of corporate governance in the UK, firstly the collapse of corporate business, both in the financial and non-financial sectors such as Polly Peck, BCCI, and Baring. These suggest the ideal of emphasis on control to safe guard asset. Secondly the method of changing share ownership particularly in the US and UK, which led to greater concentration of share

ownership for institutional investors like pension funds, and insurance companies. For example in the UK institutional investors own about 80 percent of the UK stock market, but in US the percentage is less. Thirdly, the institutional investors are increasingly to diversifying their portfolios and investing in overseas. As a result they are looking for way in which their investment will be protected. Fourthly, with recent technological advances in communications and markets, ideas can be spread widely and quickly, institutional investors are globally linked to each other more and are forming common views on the main aspect of investment like corporate governance. Fifthly, as a result of diversity of businesses, such as family-owned firms and state-owned enterprises increasingly and they are seeking for external funding, whether through domestic or international sources. Corporate governance play the important role of providing confidence in those companies and this will help to obtain external funding at a reduced cost. Finally, good corporate governance brings confidence into the stock market and in the economic environment as a whole, by creating a more attractive environment for investment.

Furthermore, OECD (2004) revealed that corporate governance served as one of the main element in improving economic efficiency, growth and enhanced investor confidence. It provides a proper incentive for the board and management to pursue objectives that are in the interest of the company and its shareholder and to enhance effective monitoring. The availability of an effective corporate governance system, with Individual Corporation and across an economy assisted in providing a degree of confidence that is necessary for proper functioning of the market economy. For these reason the cost of capital is reduce and firm are encourage to used resources more efficiently, thereby underpinning growth.

Finally, Pati (2005) argue that for effective corporate governance, the boards and managers are accountable for pursuing it. The role of effective corporate governance is of great significance for society as whole. It enhanced the efficient use of scarce resources both within the organisation and larger economy, there is flow of resources to those sectors where there is efficient production of goods and services and the return is adequate to satisfy the demand of the stakeholders. It assists the managers to remain focused on enhancing performance and ensure they are replaced if they fail to perform. It forced the organisation to comply with laws and regulations in the corporate environment, and it helped the supervisors to regulate the economy objectively without favouritism and nepotism. In addition, effective corporate governance enhanced the confidence of investors, which encouraged them to

remain with the economic system. It decreased the risk of capital flight from an economy and increased the flow and variety of capital in the economy, from this result, the cost of capital becomes lower for companies.

2.4 Different forms of corporate governance.

Corporate governance takes various forms which happen as a result of differences in the structure of corporate organisation in difference countries, in area of regulation by the state, suggestions from various professional bodies, ownership structure and control, board composition and structure. Below are the outcomes of various academic scholars, and international organisations findings toward the filling the gap in different aspect of the literature in corporate governance of corporations.

2.4.1 Regulation by state and Professional bodies

The Corporate governance structure relies on the legal, regulatory, and institutional environment. Moreover, factors like business ethics and corporate awareness of the environment and societal interest of the communities in which the company is operating can also affect its reputation and the long- term success. In addition, corporate governance is also affected by the relationships among those that are involved in the governance system, controlling shareholders, which can be individuals, family holding block alliance, cross shareholding, and other companies acting through a holding company. Creditors play the role of external monitors on corporate performance, while employee and other stakeholders contributing to the long-term success and performance of the company and the role of the government create the overall institutional and legal structure for corporate performance. The duties of each of these actors and their interactions differ among OECD countries and among non-OECD countries. The law, regulation, voluntary adaptation all play a part and the most important is the market forces. OECD (2004) revealed that supervisory, regulatory and enforcement authorities should have the authority, integrity, and resources to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained. Winter (2002) explained that in US, the Enron failure brought a number of legislative initiatives like the Sarbanes-Oxley Act of July 2002. Further, in the EU a report by the high level group of company law experts on corporate governance reform was issued in November 2002. The main motivation of the report was to coordinate and strengthen efforts undertaken by and within members' state to improve corporate governance. The main objective was to improve shareholder protection and restore

confidence in the system, this high level group's recommendations was clearly inspired by the development of corporate governance development in the UK. Denis (2001) argues that the regulatory system in US is very much intertwined with the political system. Balasubramanian et al (2008) conducted a survey on Indian corporate governance practices and based primarily on responses to a 2006 survey of 370 Indian public companies and the authors revealed that Indian corporate governance rules appropriate for large companies, but need to improve in area of related party transactions. This is not strong for small companies and executive compensation is low using the US as a standard.

In UK Demmirag et al. (2000) explained that the Cadbury report in 1992 introduced the first of many new corporate governance guidelines. These were followed by the recommendation of the Greenbury and Hampel committees which was in turn incorporated into the combined code. These were followed by further reports which provide guidance as to implementation. The authors believed that the Cadbury report took a narrow view about corporate governance, by only looking into financial aspect of accountability. As a result, there is other policy development which recognised that corporate governance is not only about control. It includes developing and implementing effective accounting and business polices, and long- term strategic objectives. In addition, the authors explained further that, there was promulgation of various code of corporate governance there was debate about appropriate form and scope of corporate governance regulation and there should be three models for the regulation of UK listed companies. These are an auditing council, a commission for audit, and a UK SEC. At the end of the discussion, only a few people supported that corporate governance regulation should be assumed by audit regulatory body. The study supported that regulation should be by an independent body with statutory powers, like UK SEC. There was also debate on developing a corporate governance code by promoting disclosure on internal control and risk management which was an area that the Cadbury report neglected. This is also consistent with Mill, (1977) who posited that adequate internal control system can help company not to be expose to major business risk.

Moreover, Andrianova and Shortland et.al (2008) used a suitably modified locational model of banking to analyse the influence of institutions, such as deposit contract enforcement, in describing the share of government owned banks in the banking system given cross-country evidence. Using empirical analysis the authors found that institutional factors have more influence in determining the share of the state banks than political or historical

ones. They recommended that instead of privatizing or subsidizing state banks, government of countries should developed institutions that will bring up the development of private banking. The recommendation is consistent with. Yakasai (2001) on his conceptual explanation on corporate governance in a third world country, and author believes that the government has influence in the corporate structure of the banking industry.

The professional bodies also contribute their own suggestions toward the development of sound corporate governance system in corporations. The following are their suggestions; Company Secretary (2001) revealed that, in UK, the Association of British Insurers (ABI) publicly revealed that they have written to several companies which combined the roles of chairman and chief executive, asking for an explanation. In addition, under the London Stock Exchange combined code, listed companies need to explain departures from the code. Moreover, these explanations always state that the board considers it to be best interest of the company. The National Association of Pension Funds (NAFP) has criticised more than twenty leading UK companies for failing to comply with the combined code. The National Association of Pension Fund has revealed that 54 percent of companies surveyed failed to ensure the independence of the remuneration committee. The Association also revealed the chairman and chief executive duties and failure to reduce director' contract to one year as was recommended. The association said that a significant number of companies are failing to comply with the code and there is need for improvement. According to NAPF News (2000) the association manage to gain a delay in the introduction of the Financial Reporting Standard (FRS) 17, under the FRS 17 companies would have to value their pension scheme assets at market value, and their liabilities using the prevailing yield on high quality corporate bonds. The association has warned that the new standard will pressurise pension funds to reduced volatility by increasing their holding of UK bonds at the expense of other assets, such as equity. The Chairman of the association posited that this standard does little to increased transparency and may seriously damage pension provision in UK. Other association like Local Authority Pension Funds Forum (LAPFF) has also argues that shareholders want CEO remuneration to be related to industry benchmarks and open to shareholders review.

Moreover, company secretary (2001) explained that the shareholder voting working group has come out with a report examining the process of lodging proxies and shareholder voting at company meeting. The report focused on how the processes can be streamlined to improve the level and quality of voting in the UK for both domestic and overseas

shareholders. Finally, a recommendation was made that there should be development of an agreed ‘’ code of practice for implementation by all parties in the voting process’’ In addition, ISS report (2001) the Teacher Insurance Annuity Association-College Retirement Equities Fund (TIAA-CREF) has appeal to NASDAQ and the New York Stock Exchange to require shareholder approval of stock option plans with limited and clearly defined exceptions. The TIAA-CREF also submits proposal on issue of poison pill to fourteen companies and one proposal on board independence to four companies. The Association query two companies on the issues of dead-hand poison pills. At the end, fourteen of the companies have complied with TIAA-CREF’s request.

Furthermore, Andres and Vallelado, (2008) revealed that the Basel Committee on Banking Supervision (BCBS) have send noticed to the public the need to study, understand, and improved the corporate governance of banking sector. They advocate that a governance structure should compose of a board of directors and senior management. The key message of BCBS show that good corporate governance increases monitoring efficiency. In addition, the committee posited that corporate governance is necessary because is a foundation for a sound financial system, and to enhance the economic development of a country.

2.4.2 Ownership structure and control in corporate governance.

Ownership and control is very important in the framework of an effective corporate governance system as a result, the following are the outcomes of different academic scholars on ownership structure and control in corporate governance. Fama (1980) examined the separation of security ownership and control in a typical large corporation. He firstly set aside the presumption that corporations have owner in any meaningful sense. He revealed that the two function attributed to the entrepreneur are management and risk bearing which are treated as separate factors in a contract called Firm. The firm is disciplined by the competition from other firms. This brings new ideas for the whole workforce and individual members for efficient monitoring the performance of the entire work force and individual members. The author further explained that there are discipline and opportunities by the market for their services both within and outside the firm for managers and individual that participate in the firm. In addition, Fama and Jesen (1983) revealed that the contract structures of organisations are separate by ratification and monitoring of decision from initiation and implementation stage. The authors viewed organisation as a contract, and set up a mechanism for controlling agency problem in decision process. They argues that separation

of decision and risk bearing function take place in an organisation as a result of benefits of specialisation of management and risk bearing and also because of effective common approach to control the agency problem. Moreover, Jensen and Meckling (1976) used the empirical model from theory of agency and finance to develop a theory of ownership structure of the firm. They defined an agency relationship as a contract in which one or more persons (the principal) involved another person (agent) to perform some services and functions on behalf and delegating of duties and authority to the agent. The agency cost level is based on statutory and common law, human ingenuity in devising contracts and there is high incentive for any person to reduce agency cost.

Morck, et al (1988) investigates the relationship between management ownership and market valuation of the firm using an empirical analysis approach. The results shows that there a significant non-monotonic relationship, with valuation (Tobin's Q). The Tobin's Q firstly increases, and finally increases slightly as ownership by board of directors rises. For older firms the result shows that valuation (Tobin's Q) is lower for firms that is control by a member of the founding family than when it been control by officer that does not related to the founder. Barnhart and Rosenstein (1998) examined the combined effects of ownership structure and board composition on corporate performance. The authors found that insider ownership, board composition, and firm performance are related. This finding was inconsistent with Demsetz and Len's (1985) that found a curvilinear relationship between managerial ownership and performance. In addition, there was weak evidence of a curvilinear relation between the proportion of outside directors and performance which is the same finding by Weisbach (1988) who found that the institutional ownership and board composition can be replaced for managerial ownership has higher effect on board composition than vice-versa and it show that insider may remained as controller of the board of director as a result of high performance.

Crawford, et al. (1995) tested for the deregulation hypothesis that posited that bank CEO compensation which includes salary and bonus, stock option and stock ownership have influence on performance as banks management became less regulated. Using empirical evidence, the authors found that there was a significant increase in pay-performance sensitivities from their 1976-1981 regulation sub-samples to their 1982-1988 deregulation sub-samples. These increases are shown for salary and bonus, stock options, and common stock holding. In addition, they observed that increase in pay- performance relation was

linked with increased capitalization ratio of banks, and consistent with provision for incentive for wealth creation.

Moreover, Thompson and Wright (1995) evaluated the corporate restructuring transaction as a new development of corporate governance, especially to determine how far it changes the Agency problem link with management control. The forms of restructuring make a great contribution with firms in which the governance problems deal with diffused ownership and control. The authors revealed that change in ownership and financial structure may bring higher gain in shareholder value and operating performance. They recommended that there was a need for flexible approach to governance under which of the forms used should take the account of such specific factors as the firm's product life-cycle circumstances.

Nevertheless, La portal, et.al (1999) used the data on ownership structures of large companies in the 27 richest economies to investigate the fundamental controlling shareholders of these firms. The empirical analysis of the sample revealed that, except in economies with very good shareholder protection, few of these firms are widely held. The findings do not match Berle and Mean's view on Modern Corporation. Instead, these firms are controlled by families or the state. The equity control through financial institution is very rare and the controlling shareholders have power over firms in excess of their cash flow rights. This happens through the use of hierarchy and taken part in the management activities.

Hart (1995) used conceptual analysis in examining the corporate governance debate, and provided some recommendations which will be useful as a guide to policy makers. The first section of his paper reviewed the situation under which the corporate governance issue is necessary and used public quoted company as a case study. The author revealed that corporate governance occurs wherever contracts are incomplete and agency problem occur. He explained that board of directors, proxy fights, large shareholder, hostile takeovers and financial structure (choice of debt) are used as mechanism for controlling management (governance mechanism). In addition, the author argues that market economy can be obtained efficient corporate governance by on its own. He made the following suggestion from his finding for policy implication**:** the statutory rule is weak; therefore Cadbury's approach of trying to enlighten and persuade companies to make amendments in their corporate governance was definitely the best. Cadbury's recommendations should be observed as an overview of corporate governance, although Cadbury was promoted, and it is

necessary to make sure that the already laid down mechanisms can operate freely to provide actual checks and balances on managerial behaviours.

Furthermore, Agrawal and Knober (1996) assessed empirically the seven mechanisms in controlling the agency problems between managers and shareholders. The mechanisms are: shareholding of insiders, debt policy, the managerial labour market, and market for corporate control. The authors provided an empirical evidence of how each mechanism depends on each other in large firms. They found that a cross-sectional OLS regression of firm performance can be misled, and they revealed the relationship between four of the mechanisms were each is included in a separate OLS regressions. The four mechanisms are the insider shareholders, outside-directors, debt and corporate control activity. Certainly, the effect of insider shareholding vanishes when the whole mechanisms are included in a single OLS regression, and the effect of debt and corporate control activity vanish too when estimations are made in a simultaneous method approach.

Caprio et al (2007) examined the impact of the ownership structure of banks and shareholder protection law on bank valuations on controlling for differences in banking regulation. Using Ordinary Least square (OLS) regression in samples from different countries, the authors found that except in a few countries with very strong shareholder protection law, banks are not widely held, rather banks tend to be controlled by a family or state. The result on valuation shows that larger cash-flow rights by the controlling owner boost valuations, weak shareholders protection laws decrease bank valuations and increase cash-flow rights reduces the negative effects of weak shareholders protection laws on the valuations. These results show that expropriation of minority shareholders in banks is global, and the laws can play a role in restraining this expropriation. Therefore, the issue of cash-flow rights is an important mechanism for governing banks.

Glassman and Rhodes (1980) conducted an empirical analysis study on the relative performance of owner controlled and bank managers. The study focuses upon cost, growth, and profit. The authors test for non-linearity to determine empirically at what percentage of ownership performance differences become obvious. The result shows that owner controlled banks give higher profit rate than manager controlled banks, and the effect of manager control on growth and cost is not as clear. The test for non-linearity shows that the effects of ownership control are not evident until relative high level of ownership control exists.

Moreover, Spong and Sullivan (2007) provided a survey of research which was carried out on how different structures of corporate governance influence bank performance. Using multi-variance regression in analysing the data, the authors found that ownership stake for hired manger can help to improved bank performance similar with reduction in principal-agent problem claimed in theory of finance. The board of director have a positive effect on bank performance when directors have a significant financial interest in the bank. While the financial position of managers and the directors have significantly influence their way toward risk taking and banks risk trade-offs. The authors recommended that ownership and wealth relationship can surely significantly affect banks overall performance. Banks with weakness in ownership and management must be willing to improve their operation and the bank regulators to indentify the corporate governance problem, and find the corrective measured in solving the problems.

Benito and Conyon (1999) used empirical modelling to examine the determination of directors' compensation in UK quoted companies. The new idea in this study was focused on the governance mechanisms that determined pay outcome. The authors result shows that the directors' compensation was associated to corporate performance but its effect was overshadowed by company size variable. The pay-for-performance estimate become quantitatively higher over the sample period and this finding was consistent effect has been found using USA data. The study did not reveal the adoption of either a remuneration or nomination committee or of separation of the positions of CEO and chairman in influencing the pay awards. The authors were able to differentiate finding of a cross sectional relationship between pay and the corporate structure. The method used make the cross-sectional correlation insignificant and the impact of internal boardroom control system surely relate to the feature of individual companies. The authors recommended that the policy recommended by Cadbury committee and other organisation should be examined carefully in using it to solve problems in corporate governance operation of UK companies.

In addition, Weir and Mcknight (2000) empirically revealed the same finding with Benito and Conyon (1999) that there was no evidence to support the efficiency of internal governance structure as recommended by Cadbury and there was impact between the quality of director and performance. The authors recommended that external control mechanism was more effective than internal ones and there should be policy debate about effectiveness in different governance mechanism. Denis (2001) used the paper titled twenty-five years of

corporate governance research and counting to make his own contribution to issue of corporate governance. He notices that there was lack of understand on the method in which the various corporate mechanism interact with one another and other features of the firms and economies. He recommended that researchers need to assess firms and their governance method in the way of amendment and adaptation, because of nature of corporation that have change with time and it will continue. The more developed economies should improve the efficiency of their economies by showing the important role that corporate governance play.

Finally**,** under the ownership structure, La bruslerie and Latrous (2007) examined the ownership structure and debt leverage of French firm by using empirical test. The authors revealed the following; at low level of ownership, controlling shareholders used more debt in order to increase their voting power and disallow unfriendly takeovers attempts. At a level when ownership reached certain point, controlling shareholders' objectives converge further to those of outside shareholders. In addition, the authors found that the fear of financial distress will make the controlling shareholders to decrease the firm's leverage ratio.

2.4.3 Ownership Structure and Earning Management.

The link between ownership and earning management in firms is very important because the manipulation of firm's financial earnings is either direct or by indirect accounting methods. This may happen when a firm cannot meet investor expectations in the period of volatile earning. Consequently, earning management is considered to be misleading and thus fraudulent. This change may follow the entire accounting standard and laws and this activity cannot take place without the influence of ownership structure of the firms. As a result the impact of ownership on earning management is an important area in corporate governance of firms. Against this background, some authors have expressed their view on the effect of ownership structure and earning management of firms.

Existing literature argues that financial reporting is of higher quality when firms have stronger corporate governance mechanism and when there is greater demand for quality financial reporting. To this end, Wang (2006) highlighted the link between founding family ownership and earnings quality distinguishing between the entrenchment effect and the alignments effect. This indicates that at higher level of family ownership there will be entrenchment effect on the supply of earning quality, or alignment effect on the demand for earning quality. The author revealed that founding family ownership is link with higher

earning quality that is lower abnormal accruals, higher earnings in formativeness and less persistence of transitory component in earning. Moreover, the author also posited that there is nonlinear relation between family ownership and earning quality. This occur as a result of an inverted U-shape relationship between family ownership and earning quality with evidence from the study this shows that family firms report earnings of higher quality than non-family firms up to certain level of ownership (67.44% in the abnormal accruals analysis, 57.88% in the earning in formativeness analysis, and 58.72% in the analysis of persistence of transitory losses). This indicates that on average family firms report earning of higher quality than–non-family firms. However, when family ownership exceeds certain level (about 58%-67%) family firms start to report earnings of lower quality than non-family firms.

Bhaumik and Gregoriou (2010) examined the literature on issues such as why family firms are found in various business organisations. The authors focused on the mechanisms by which family retain control over firms and the incentives for the families in control to expropriate other stakeholders by way of tunnelling. In addition, the authors found evidence on issue of earning management in family firms. The authors suggest that for the fact that the literature on family control is rich, the contexts in which empirical evidence are undertaken is relatively few. As a result, the authors recommended that there is need to expand it to other contexts especially in form of cross-country comparison of relative effect of agency conflicts and institutions on these issues.

Furthermore, Xu and Nguyen (2010) empirically revealed that firms with dual class ownership structure may have lesser earnings management activities than firms with single class structure. The authors claimed that firms with dual class, earnings management activities have a positive effect with managerial cash flow rights and negative effect with managerial voting rights. Furthermore, divergence between voting and cash flow rights has a negative effect on earning management. However, switching the sample of firms from dual class structure to single class structure earnings management activities is higher through the switching.

2.4.4 The legal enforcement in corporate governance:

The level of legal protection of investors in any country is an important factor in determining the development of the financial market of company in that country. The systematic differences in structure of law and enforcement among various countries in area of historical trend of their laws, level of corruption, and the quality of their enforcement will surely determine the difference in financial development. As a result, these are the findings of authors toward the study of legal protection and enforcement in corporate governance of different countries.

La portal, et al. (1998) examined the legal rules covering protection of corporate shareholders and creditors, the origin of the rules and quality of enforcement in 49 countries. Using empirical analysis the result revealed that common law countries have the strongest, French countries have the weakest, and the German-and Scandinavian-civil- law countries are at the middle. In addition, the authors found that concentration of ownership of shares in largest public companies was negatively related to investor protections, and the same with hypothesis that small, and diversified shareholders are not likely to be recognized in countries that cannot protect their right. Klapper and Love (2004) used current data on corporate governance (CG) ranking in firms across 14 developing markets. Using empirical evidence the authors found that there was variation in firm- level of governance in the sample and the firm-level of governance was lower in those countries that have weak legal systems and firm level of corporate governance should take seriously for countries with weaker legal system. In addition, better corporate governance was correlated with higher operating performance. Johnson, et al. (1999) empirically used the Asian financial crises to revealed how legal institution affected corporate governance on the depreciation and stock market. The authors found that managerial agency problem can make countries with weak legal system loss the confidence of investor and in a cross-country regression, corporate governance variables enumerate more of the variation in exchange rate and stock market performance during the Asian crises than macroeconomic variables. The author found that the protection of minority shareholder right was one of the main reasons for depreciation and stock market declines during the crises.

La portal, et al. (2000) examined the level of protection by law on investors, both shareholders and creditors from expropriation by the managers and controlling shareholders

of firms. The authors explained the differences in law and how effective in implementation across countries, given the origin of these differences, enumerate their consequences, and examined the strategies of the corporate governance reform. The authors posited that legal approach was more meaningful way to understand corporate governance and its reform than the conventional differentiations between bank-centered and market-centered financial system. Furthermore, La portal, et al. (2002) formulated a model of the effects of legal protection of minority shareholders and of cash-flow ownership by controlling shareholder on the valuation of firms. The model was tested empirically using sample of 539 large firms from 27 developed economic countries. The results revealed that, higher valuation of firms in countries with well protection of minority shareholders, and firms with higher cash-flow ownership by controlling shareholders. The finding of this study was consistent with DeAngelo and DeAngelo (1985). The study also contributed to the theoretical framework on the effects of corporate ownership structure on valuation (Demsetz and Lehn (1985) and Morck, et.al (1988). In addition, Shleifer and Vishny, (1997) examined the corporate governance with special focused to the importance of legal protection of investor, and ownership concentration in corporation around the world. According to the authors, corporate governance deals with agency problem, the separation of management and finance, the question of corporate governance was how to assure the supplier of capital that they get return on their investment. The authors proceed forward, by posited that agency problem give an opportunities for the managers to run away with supplier's of capital fund or used them on irrelevant project with well documented. In the absent of governance it will be failure, as a result of the above, legal protection of investors rights, was one of important element of corporate governance. The concentration ownership through large share holders, takeover, and bank financing are general method of control that can help investors to get back their money. Even though large investors can be assist effectively in providing solution to agency problem, but they may be inefficient in redistribution of the wealth from other investor to themselves.

2.4.5 Cross Country Analysis of corporate governance:

There are several authors' problems and findings to the issues of corporate governance structure using both developed and developing economies as a case study. McGee, (2008) conducted a study in eight Asian countries, but China and Japan are not included based on, certain corporate governance guidelines as indentified by OECD, World

Bank, and IMF and examined how these guidelines are being used in some Asian countries. The author found that none of the countries scored an average of fifty percent in the analysis based on the corporate governance guidelines, particularly in the area of equal treatment of shareholders, disclosure of interest, disclosure standard, and independent audit. The high score of India and Korea was not surprised, India was known for bureaucracy and corruption, and the companies are making effort on the issue of corporate governance. Korea has an opportunity for capital for the companies and because of the Korean economy. Vietnam which have low score as a result of been a new entrance to the market, and private sector was still at rudimentary stage, with high growth rate. The author recommended that the score will get better with times, but there are both internal and external pressures to improve the Asian countries corporate governance.

Moreover, Morck and Nakamura (1999) explained that the history of Japanese corporate ownership is necessary due to the fact that on its critical examination, it tend to undermine the argument that Japanese have a complex 'alternative' corporate governance system. A group of companies associated with stable inter-corporate shareholdings called a keiretsu. Any keiretsu in which a bank act as a central role is called a bank group or financial keiretsu. The authors empirically analysed the banks and corporate control in Japan. They explained that poor liquidity cash flow, poor stock market performance and job creation all these predict banker appointment to be member of boards of bank group firms. In addition, banks also act in the interest of shareholders, this happen when dealing with firms in bank group. The authors further explained that corporate governance mechanisms apart from oversight by banks will be necessary in these firms. Using empirical analysis of a large sample of Japanese firm, the authors found that Japanese bank are primarily in the short term interest of creditors when having business with firm outside bank groups, and corporate control mechanisms other than bank oversight appear to be essential in these firms. In addition, their findings are the same with banks 'Propping' up trouble bank group firms. The authors recommended that bank oversight need does not lead to maximizing corporate governance value.

In Korea, Baek, et al. (2002) assessed the importance of corporate governance in determining firm value during the 1997 Korean financial crises. Using an empirical approach, the authors revealed that Chaebol (business Group) firms with a higher ownership concentration by unaffiliated investors observed a smaller reduction in their share value. In

addition, the firms with higher disclosure quality and alternative sources of financing also suffer less contrast. The Chaebol firm with concentrated ownership by family shareholders experience a larger drop in their equity. The firm in which controlling shareholders' voting right is over their cash flow rights borrow more fund from the banks and are highly diversified and also have lower returns. The reorganisation of Cheabol firms brings a positive and significant higher return, but those noticed with diversification have a significant negative result. These results suggest that the owner-managers of Chaebols at times pursue their own private interest during the period of expansion of the investment at the expense of other shareholders' interests. In contrast non-Chaebol firm with diversifying expansionary action experience an insignificant positive return. The authors revealed that change in firm value during such crisis was a function of a firm-level in corporate governance measure and owner-managers incentives. In addition, Choi and Hassan (2005) examined the effect of ownership and governance on bank performance by looking at the post financial crisis period of the Korean commercial bank industry and found out whether the foreign investor as part of ownership structure had any significant effect on the bank's performance. Through empirical investigation, the authors found that the extent of the foreign ownership level, not mere existence of foreign ownership has significant positive effect on the bank return, and significant negative effect with bank risk. The number of outsider board directors does not have any significant effect on performance.

Moreover, Claessens (1997) empirically revealed how the Czech and Slovak Republics mass privatization schemes used a voucher programme with competitive bidding process to change the corporate governance of a large number of firms. The author found that more ownership had an impact on higher equity prices. A large number of ownership by local investors was associated with higher equity prices and a large number of foreign owners did not have higher equity prices. These implied that control by these investors involved cost for minority shareholders by reducing firm efficiency. Finally, the author found that equity prices were lower initially for those firms in which the bank sponsored the investment funds with large a stake. This implies that an investment that the bank sponsored will be facing a conflict of interest.

Reinhard (2003) overviewed the German corporate governance through economic perspective by noticing that German corporate governance was different from Anglo-Saxon countries because the system was regarded as a standard example of an insider-controlled and

stakeholder-oriented system. The author revealed the following as a result of different developments and recent changes in the corporate governance system. The systems function based on cross-ownership and shareholder concentration and multiple relationships between the shareholders and the companies in question. The reason for this feature as being highly ambivalent is that German corporate governance system for some time can be regarded mainly for the interest of the active stakeholders and at the expense of others, especially the outsider investors. Also the reform assists in improving the traditional system by examining it in a systemic context. The fundamental structure that was the set of incentives, disallowing of stakeholders to secure their interest and opportunities and a transition to a more modern capital market outsider based model is not yet seen. The author recommends that the only option is to transit to the Anglo-saxon model of market-based corporate governance, not because it is better than the old system but the old system cannot be restored.

Gorergen and Renneboog (2008) provided an overview to the recent development of German corporate governance system. They found that the German corporate governance system are characterise by market for partial control, large shareholders, and bank/creditor monitoring a two-tier system (management and supervisory). The board is determined by shareholder and employees on supervision on the board. The system is with the disciplinary product market and the corporate governance rules based on EU control together with German code and legal doctrine. The level of corporate governance efficiency is based on stakeholder value maximization, and the relationship between ownership and profitability has changed. The German CEOs seem to have the highest total cash pay in Europe and pay- for performance relationship is determined by large shareholder control. Furthermore, Ekehart and Heisenberg (1999) noticed that German transparency legislation (WpHG) is not adequate to achieve the objective of transparency as stated by the Europeans Commission and the German parliament. Then in comparing to developed economies, the German stock market is dominated by large shareholders due to a proxy vote and board membership. Against this backgrounds, the authors empirically studied the German corporate governance system and revealed that low transparency of control was likely to increase the cost of capital to affect German corporation relative to their international competitors listed in the market that are more transparent. The performance of the corporation will be determined by bank control. The authors recommended that transparency is necessary to let investors know where to invest and who to control over voting rights. In addition, Drobetz, et al. (2003) empirically

conducted a study on corporate governance and expected stock return, in which they used Germany as a case study. The authors found a positive relation between the corporate governance rate (CGR) and firm value, and expected returns are negatively correlated with the CGR and any investment method that bring high-CGR firms, and allow low-CGR to bring abnormal returns of about twelve percent on annually during the samples period.

Furthermore, Chirinko, et al. (1999) examined the impact of share- ownership, creditor-ship and networking by institutions on Dutch non-financial firms, and empirically tested for the effectiveness of various mechanism of corporate control. The authors revealed that the Dutch systems of corporate governance are not similar to Anglo-saxon and the German counterpart, in the following way. There are ways to limit the voting power of shareholders and the structure on ground by put a lot of weight on the role of the supervisory board. The authors found evidence to support the ideal that share-ownership by financial institutions was important in Dutch corporate governance. Then also the role of share-ownership by financial institutions, especially bank conglomerate indirectly for large creditors and for insider control by networking. In addition, the authors found a non-linear relationship between firm performance and ownership by banks. This indicates that the role of shareholder was limited in Netherlands. There was a significant positive relationship between ownership by insurance companies and pension funds and the probability of networking.

Melis (2000) evaluated the Italian corporate governance system in area of ownership and control, functioning of the board, executive remuneration and the role of the banks market for corporate control, and block-holders. The author found that the Italian corporate governance is consisting of poor market orientation, and apparently absent of market for corporate control. The banks have a role of corporate external financing, the ownership and control was fully of the present of block-holders. The active investor are able to monitor the senior management effectively, as a result of this, the minority shareholder are to be the victims of block-holder and the minority shareholders' right are pull down by the Draghi reform. The authors recommended that further research should be carried out on how to develop the board structure, taking into consideration the innovation of board statutory auditors and involvement of executive committee as forms of two-tier board structure.

Moreover, Tam (2000) examined the models of corporate governance for Chinese companies and the study revealed that the following major corporate governance issue have to be resolved: Chinese's large state owned partially privatised, state enterprise sector have been decrease in area of contributing to industrial output, dominance in urban and employment in the main industries and the access to bank finances. The author found that the current condition of Chinese state enterprises corporate governance does not matter in term of development and performance, it clearly shown that the method used from Anglo-American model of corporate governance have not been working as expected. It is expected that China will continue to follow its successful marketisation process and open door policy in order to ensure that the competitive market as initial condition could be attained in the future. Bai, et al. (2002) empirically revealed the following question concerned the corporate governance and firm valuation in China. Does a firm's corporate governance affect its market value? Are shareholders in china are ready to pay a premium for good governance standard? And how is the premium compared with that of other emerging market? The authors found that better governance companies according to the index used are link with higher market stock market value, good corporate governance is very important in China's emerging stock market and Chinese investors are ready to pay a significant premium for better governance standard. The authors made the following recommendations: The Chinese regulatory authorities should make use of the results of this study to formulate the best practice code guided toward the Chinese institutional background, and current capital development level. In addition, the firm should put more effort to improve their market performance and maximizing shareholders' wealth, followed the method used by market leaders, and make improvement in areas that will have greatest impact on their relative corporate governance system.

In addition Cooke and Sawa (1998) examined the debate of corporate governance that was going on around the world with more emphasises on Japan which was credit-based financial system which involved the intercompany shareholdings, intercompany director-ship and bank. The question is, with globalization of trade whether the corporate governance system of credit-based financial system will be converging with Anglo-Saxon over a period of time. The authors made following the suggestion that, there is need for strengthening the position of statutory auditors, by making them and the board of statutory auditors to be more independent of management. In addition, there is need for separation of board members under the unitary board system in Japan; this is between the non-executive directors and executive

directors with main role of non-executive being the planning and monitoring of management strategies. There is need for activation of board of directors by reducing the number of directors and dispensing management committee. Frijns, (2006) explained that in the past few years there was an increasing in numbers of Japanese firm voluntarily breaks away for example the case of Sony. The author has the same question with the Cooke and Sawa (1998) but empirically claimed that well governed firm are significantly out-performed poorly governed up to fifteen percent per annual. Then using overall index indices in the study to determine how well the companies are governed. The authors found that not all categories are important, but financial disclosure, shareholder rights, internal control and remuneration are very important for stock price performance. The authors discovered that other provision toward board accountability, market for control, and corporate behaviour are not so important.

In Thailand, Alba, et al. (1998) discovered that the following are the problems facing the corporate financial structure of Thailand this include: Weakness in corporate governance structure, and this contributed to the Thailand financial crises. Also the long-term funds from local sources for firms are scarce due to lack of institutional investors and the firms mainly relied on bank financing. Against this background, the financing and corporate governance structure of large corporation in Thailand have lead to inefficient investment with excessive diversification and decrease in profit over the past few years. The authors used empirical evidence to shows that there are signs of deterioration in corporate performance before the crises, productivity growth is slow down, and leverage is high in compared with international standard. The authors recommended that large corporation need to reduce their financial vulnerability to economic problem and corporate governance needs to improve in order to enhance the efficiency of the investment.

Nevertheless, Bauer, et al. (2003) empirically examined whether good corporate governance leads to higher common stock returns and enhanced firm's value in Europe. The result shows a positive relationship between performance variables and corporate governance variable, this relationship weaken substantially after adjusting for differences country. Contrary to Gompers et.al (2003) that found a negative relationship between governance standards and earning based performance ratios.

However, in UK and US Tylecote and Ramirez (2006) empirically used corporate governance and innovation in comparing UK with US. The author asked the question that,

how well does UK corporate governance and financial system (CG & FS) support and motivated toward innovation? Each CG &FS focused with four challenges which vary by sectors such as novelty, reconfiguration visibility and spill-over. The High novelty in technologies and market required high industry-wide professional, and the need for radical change in configuration need strong pressure for shareholder value. The authors revealed that Low visibility of innovation process need shareholder engagement, and high spill-over to and from stakeholders required whole stakeholders' inclusion. The author made a conclusion that the UK CG &FS was rated higher than US. This result is from the recent field survey and the rating which is an indication of well account for the relative R&D intensity and specialization of UK owned firms.

In addition, Dremirag, et al. (2000) used conceptual approach to overview the corporate governance with reference to (Berle and means, 1932, Tricker, 1984) that the problems of corporate governance in listed companies are well-know and long established. Further, they posited that many scandal that happen in the 1980s resurrected the debate on how best to ensure that managers accountable to shareholders that continue at present day. The publication of Cadbury report in 1992 introduced the first of many new corporate guidelines. This was followed by the recommendation of Greenburg and Hampel committees, which was later incorporated into the combined code. The Turnbull reports give guidance for companies using the requirement of the combined code with attention to internal control. This development of corporate governance was defined as financial accountability under Cadbury approach that has the interest of shareholders in mind and was also make sure by allowing the managers to exercise enterprise in term of risk-taking and innovation. The authors recommended that the regulation of corporate governance in UK will change for better at this point of development. The authors made the following contribution to the issue: By examined the effect of policy given to the companies, and evaluate the important of the policy for future developments regarding the regulation of corporate governance. There is also need for policy to be know by regarding the important of the objective of corporate governance, through awareness of the type of governance mechanism available and the interaction that exist between these objectives and mechanism.

Moreover, Dasaraju (2008) overviewed the code of corporate governance in emerging economies with reference to India, and compared the system with other developed countries. The author revealed that India was having good corporate governance mechanism, and

disclosure practices are on the same level with world counterpart .Then the author argue that India was not having corporate governance failure as it occurred in other developed countries like UK and US. India has made several voluntary innovations to increase the performance and efficiency of corporate governance. The author recommended that that there was need to improved corporate investor confidence of the companies in India. Balasubramaian, and Khanma (2008), empirically identify areas where corporate governance of India was relatively strong and weak, where regulation are either relaxed or strengthened and whether cross-sectional relationship between corporate governance index and performance measurement. The authors found that, the level of obeying the legal norms is very high in most areas, but not fully completed. India corporate governance rules seem to be suitable for larger companies, but used some strengthen in area of related party transaction and relaxation for some companies. The executive compensation was low compared to US standard. Also the authors revealed that there is a positive relationship for the entire overall governance index. For index for shareholder right is significant positive with profit of the firms, and with firms that have potential for growth. The Sub-index for board structure (board independence and committee's structure) disclosure board procedure and related party transaction are not significant. The non-result of board structure contradicted to other current studies. The authors recommended that India's legal requirements are too strict to the extent that obeying the rule excessively does not produce valuation.

Furthermore, Pati (2005) used empirical approach to investigate post implementation scenario of corporate governance policies in India banking, which happen after the recommendation of Advisory Group (2001) and others, which brought difference results. The study used correlation and ordinary least square estimator and the author found that corporate governance issues has been developed with ownership structure with withdrawal of safety net decrease of pre-emptive norms, and more exposure to market discipline. In addition, there is serious implementation of difference measure that required for making sure for better governance in banks in India. The same reforms happen in financial sector of corporate governance structure in UK. Mallin, et al, (2005) used conceptual approach in reviewed the post Cadbury committee report development in UK corporate governance provision, the position play by institutional and strategic investors. Also the practice of corporate governance in Europe as continent, and the UK and US are compared, along with roles of banks and capital markets. The authors revealed that the used of international

accepted accounting and auditing standard have assist and in making sure that UK have a high level of transparency and disclosure in the financial sector happen to reflect in the corporate governance structure. While the institutional investors have been active in laying their programme for strong share ownership in companies which they invest, and there are lay down stipulated behaviour consistent with incentives of management of strong quality firm which does not try to exploit the advantage of information. The corporate governance of EU and US reform proposal are compared with prospect for convergence in procedures examined. The author suggested that the proposal of capital regulation for banks in Basel II will likely to decrease competition in financial sector.

Moreover, in Latin America Reyes (2007) used functional analysis approach to revealed that the reason for the region not to practice the corporate governance system of US. The author found that lack of separation between ownership and control in Latin American companies was the main reason for them deviating from principle of corporate governance design for market system. In the region there was evidence of lack protection of minority shareholders and other stakeholders, and the legal system was weak with lack of enforcement. The author recommended that, there should be more focus on the effectiveness of protection of minority shareholders and other stakeholders against misused of corporate asset by block-holders and not only on directors duties. In addition, he affirmed that the allocation of important supervisory and judicial powers to administrative agencies such as Colombia superintendence of corporation, the Argentine inspection of Justice or the Chilean superintendence of securities and insurance will solved the problem.

In Uganda, CMA (2006), found that there are difference effort that have been made by various organisation like bank of Uganda, the institute of corporate governance of Uganda, and the Capital Market Authority (CMA) to improved the corporate governance system. The CMA designed the guideline in a minimum standard for sound corporate governance practice by public companies and issuers of corporate debt in Uganda. This development in the regulatory frame work of the CMA is very important at this period as a result of awareness the importance of governance in both emerging and developing economies for improvement of domestic and regional capital market growth. It was based on this, that CMA conducted a survey of compliance level of seven listed companies by using the data from annual report of those companies. The organisation found that there are needs

for better clarity when providing for corporate information, and there is need for improvement in degree of reporting and most companies provide generic information.

Furthermore, in the Middle East and North African region Sourial (2007) overviewed the governance model of the corporate sector and securities market of eleven countries in the region out of eighteen countries. The author revealed that recently the region has undergone some reforms and restructuring on legislative, but the main issue is the gap between legislative framework and enforcement. In addition he found that Middle East and North Africa (MEND) market corporate sector is fully with block holder (insider) and they depend on banks for sources of financing. In the region banking sector are having burdened with non-perform loan (NPLs), resulting from over lending couple with conflict of interest, and international fraud and over value of collaterals. Market disciplines with various guideline and tools are yet to developed to extent of improving corporate governance practices and markets are either inefficient or mainly weakly efficient. Moreover, the family business in the region has a foundation, and is the backbone of the regional countries' economies, and it was like that for long period of time. The author recommended that the tradition and cultures should be allowed to choose their acquaintance measure with number of reforms measures that will bring better corporate governance practices. The new innovation might bring resistance to reforms and it may collapse. Finally, the author suggested that the banks should play their role properly, as the main stakeholders as they are far developed in compared with securities market in the region.

In Nigeria, Ahunwan (2002) provided the account of the system of corporate governance in Nigeria and examined the prospect for recent reform and how it will contribute to more governance. The author found that the judiciary system is weak, and the economy is made of underdeveloped market institution, a high level of information asymmetries, deeply rooted with corruption and disregard for rule of law. As a result, the majority of the shareholders expropriated the benefit of control without taking the interest of the minority shareholders into consideration. However, the author revealed that although the reforms have brought some progress, the reform has to address the deeper causes of the problem for example an ineffective legal system, ownership structure and capital market. In addition, the author claimed that ultimately, the successes of corporate governance reforms are associated with broader government reforms of Nigeria state and this will make the country to compete in the global economy.

Furthermore, Rossouw, et al (2002) explained that since the publication of the Cadbury report that defined corporate governance as the system by which companies are directed and controlled. The King's report in South Africa used this definition as a base in formulation of corporate governance system in South Africa. The authors reviewed the corporate governance that currently exists in South Africa by looking at both financial and ethical dimensions of corporate governance. The authors posited that there are indications that corporate governance in South Africa is developing with confusion and the cause of this confusion makes the revision of corporate governance an ongoing concern. For South African to participate in the global economy they have to meet the international corporate governance standards; however, they have to do this without separating themselves from the rest of the African continent. The authors found that confusion with South African corporate governance was noticed by the globalization of South Africa companies and their reliance on foreign capital flows. The situation in the country is also complicated as a result of insufficient statutory and legal backing on the broad corporate governance level for the directives that have developed on the narrow corporate governance level.

The authors suggested that the companies have to solve local challenges such as economic empowerment of the black majority in South Africa, how to eliminate the crime such as fraud and money laundering, the reality of Acquired Immune Deficiency Syndrome (AIDS) and how to deal with poverty in the country.

Broshko and Li (2006) examined from both theoretical and legal perspectives the United State rules-based and Canadian principle-based approach in area of regulation and enforcement of corporate governance. The authors found that following the factors allow Canada to have a principle-based system: The Canada market consists a far greater proportion of companies that managed by the firm's founders with small firms that lack financial resources to obey the US rules. The principle based approach was more effective in establishing a culture of compliance corporate governance principles, imposed the way of implementing governance standard on the capital market and involvement instead on legislators as under the rules-based approach. The empirical study show that Canadian firms in comparison to US firms have smaller board with fewer independent director holds meeting regularly. In addition, there is less likely to have CEOs also serving as the chairman of the board, and fraction of the independent directors sitting on the difference committee was significantly lower. The authors maintained that they hesitate to mention the advantages of Canadian principle-based system because of the fact that there are changes and innovation in

the system, then any system they want to adopted to will depend upon whether Canada will experiences its own series of failure in the governance of the companies which will lead to the downfall of the economy.

At global level Khanna, et al. (2006) used empirical analysis to examine the globalization and similarities in corporate governance, with cross-country analysis. The authors found that, some scholars argue that globalization should force the firms to maintain the most efficient system of corporate governance. The authors posited that economically interdependence countries have the nearly the same corporate governance laws protecting the stakeholders. However, the authors claimed that virtually no relationship between corporate governance practice and globalization in across the countries in term of firm level. The authors recommended that globalization may have introduced some common corporate standards, and unfortunately these standards have not been implemented. Pinto (2005) used conceptual approach to discuss how globalization has improved the development of corporate governance. The author found that the issue of corporate governance of stakeholders and ownership model deal with how a particular system develop and the level to which the system can influence one another. The process of globalization has bring up the issue of whether a certain system was optimal and given the competition there may be some form of convergence, the trade globalization has bring up a significant economic and policy issue. While the comparative corporate governance studies have influence good economic decision and enhance investors' confidence which will have some effect.

2.4.6 The power of shareholders

Oluyemi (2005) posited that shareholder is presenting a major role in the provision of corporate governance. Moreover, the author asserted that small or diffused shareholders exert corporate governance by directly voting on critical issues such as mergers, liquidation and some fundamental changes in the business strategy. They also indirectly elect the boards of directors to represent their interests and oversee the myriad of managerial decisions. The author further revealed that incentive contracts are common mechanism for aligning the interest of managers with those of shareholders. Then the board of directors may negotiate managerial compensation with believe that it will yield a particular results. In addition, the author argue that large ownership is another mechanism will disallowed the managers from deviating too much from the interest of the owners. Large shareholders have incentives to obtain information and monitoring managers, and they can also elect their representative to the board of director and

check managerial control of the board. They can also be more effective in exercising their voting rights than an ownership structure which is dominated by small and uniformed investors. Consequently, large shareholders can be more effective in the negotiation of managerial incentive contract that align owner and manager interests than poorly informed small shareholders whose representative the board of director can be manipulated by the management. However, DeAngelo and DeAnglo (1995) revealed that large ownership brings some corporate governance problems, this occur when the large investors exploit business relation with other firm they own which will profit them at the expense of the bank. Moreover, with larger shareholders private benefits of control can be maximised at the expense of smaller shareholders.

OECD (2004) specified the following as the basic shareholder rights this including the right to secure method of ownership registration, convey or transfer share, obtained relevant and material information on the corporation on a timely and regular basis. Then participate and vote in general shareholder meeting, elect and removed members of the board, and share in the profit of the corporation. In addition, shareholders should have the right to participate in, and to be sufficiently informed on decision concerning fundamental corporation changes, for example amendments to status or articles of incorporation, the authorisation of additional share and extraordinary transactions, including the transfer of all or substantially all assets that in effect result in the sale of the company. Moreover, capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed, and the exercise of ownership rights by shareholders, including institutional investors, should be facilitated.

Furthermore, Shleifer and Vishiny (1997) revealed that in more extreme situation large shareholders have outright control of the firm and their management with fifty-one or more per cent ownership. As a result, they address the agency problem in the sense that they have general interest in profit maximization and have enough over the assets of the firm so that their interest are respected. In addition the authors argue that because large shareholders control by exercise their voting rights, their power based on the degree of legal protection of their votes. Majority ownership only works if the voting mechanism works, and majority ownership dictate the decision of the company and in which they need the enforcement by courts. According to the authors, in US large shareholding and especially majority ownership are not relatively uncommon, this because of legal restriction on high ownership and exercise

of control by banks, mutual funds, insurance companies and institutions. Holderness and Sheehan (1988) found that many shareholders have over fifty-one percent in the public firm. Black and Coffee (1994) claimed that there is dispersed ownership by diversified shareholders in UK. However, Gompers et al. (2003) posited that shareholders rights vary across firms by using the indices of twenty-four governance rules and constructing a Governance Index to proxy for the level of shareholder right of about 1500 large companies. The authors empirically show that firm with stronger shareholders rights have increase in firm value, more profits, higher sales growth, lower capital expenditure, and involvement in less corporate acquisition.

Moreover, Hart (1995) found that small shareholders have little incentive to oversee the management or attached through a proxy fight, the author further explained that some authors believed that one method to improved corporate governance was to ensure that a company has one or more large shareholders. In the UK it is suggested that the institution has an important part to play in this area. The author argue that where a large shareholder having less than 100 percent shares of the company, agency problems may be reduced, but it cannot be removed. The large shareholder will underperform in monitoring and intervention activities because he did not receive 100 percent of the gains, the large shareholder may use his voting power to improve his position at the expense of other shareholders. Then the large shareholder may easily become part of management, such as running the company by himself. Another problem with the large shareholder is that if the large shareholder is an institution, the shareholders of the institution will hire a manager to act on their behalf. This will definitely introduce a new principal-agent problem. This clearly shows that managers of the institution will do a good job to monitor, as against to pursing his own goal which involves the extraction of some private benefit from managers of the company who are meant to monitored. In addition, Lipton and Lorsch (1992) explained that shareholders should focus their attention on the financial and strategic performance of the company and they should not use the corporate governance system to pursue social and political ends. The authors revealed that such activity only increased the tension between shareholders, managers and directors, diverting the latter two groups from focusing the way they will improve the performance of the company.

Payne, et al. (1996) posited that legally, institutions that are acting as fiduciaries should take the interest of beneficiaries as important. Also fiduciary agents are banks trustees

which are not to consider self interest or interest of the third parties on decision making that affect asset value (shareholder voting). Moreover, management may work to established themselves firmly at the expense of outsider shareholders and may force the institutional investors to vote in support of their proposals. The study provide an empirical analysis whether banks voting system is consistent with beneficiary interest. The results shows that where directors interlock and income-related relationships occurs, bank tend to vote in favour of management anti-takeover proposal. If there are no businesses relationships banks tend to vote against the proposal.

OECD (2004) revealed that corporate governance should ensure that equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtained effective redress for violation of their rights. The confidence of minority shareholders is enhanced when the legal system provides mechanism for minority shareholders to bring lawsuits when they have a reasonable point to believe that their rights have been violated. The provision of such enforcement mechanisms is a main responsibility of legislators and regulators. Furthermore, Shleifer and Vishiny (1997) posited that a substantial minority shareholder has the incentive to obtain information and monitor the management, thereby avoiding the traditional free rider problem. They have enough voting control to put pressure on the management in some situations, or have power to force the management out through a proxy fight or takeover. The authors explained that large minority shareholders are more complicated since they have to make alliance with other investors in order to exercise control. The power of the managers to interfere in this alliance is highly enhanced, and the courts have the power to protect their rights. As a result the large minority shareholding may be relevant only in countries with relatively powerful legal systems, while in countries with weak legal system are more likely to have outrights majority ownership. In addition, Oluyemi (2005) found that minority shareholders may exert corporate governance directly through their voting rights and indirectly by the board of directors electing them, but there are some factors that can prevent minority shareholder from effectively exerting corporate control. This occurs as a consequence of large information asymmetries between managers and minority shareholders, as managers have enormous direction over the flow of information. The minority shareholders frequently lack the expertise to monitor managers accompanied by each of the shareholder’s small stake which can induce a free rider problem.

This indicates that each shareholders relies on others to undertake the costly process of monitoring managers, this imply that there is too little to monitoring.

Nevertheless, the agency theory argue that better corporate governance give higher stock price and improves long-term performance, this as a result of managers are better supervised and agency cost is reduced Gompers, et al. (2003) shows that firms with sound corporate governance practice have higher valuations, higher profit, higher sales growth, lower capital expenditure. Brown and Caylor (2004) revealed that better governance are relatively more profitable, more valuable and pay-out more cash to their shareholder, and Gov-Score are more highly link to with performance. Based on the above evidence, an examination of corporate governance variables responsible for improvement in firm performance on the basis of the principal agent theory has produced difference results. The studies of corporate governance practices in this regard, include board composition, board size, and power separation between board chairperson, and CEO.

2.4.7 The Board Composition and Size

The composition of the board of directors is very important for the board to perform their functions without any control from anybody. The board should include individual with good personal character and ability to perform the board's duties, integrity, having sense of accountability, record of success, and leadership qualities. In addition, he or she must be expert in the field of finance with experience, and must always think strategically. The directors must show his committed to the organisation by prepared and present for meeting.

Most of the empirical studies on effect of board composition on firm performance are given difference result, contrary to expectation. Vafeas and Theodorous (1998) examined the relationship between board structures with performance in UK by using the data from 250 publicly traded firms. With the following assumption that; the non-executive board members are purported to improve the board's monitoring quality since they are more likely to be independence in mind. In addition, with director stock ownership thought to grant directors shareholder-like interest which motivating director to increase their monitoring performance. Then choosing an independent board chairman was purported to improve a board's monitoring quality. Finally, the monitoring value of non-executive should be best exemplified in the work of those standing committees which concentrated on decision control duties (the audit remuneration, and nomination committees). Expectedly, these board monitoring feature are to lead to higher corporate performance. On the contrary, the results

revealed an insignificant relationship between the percentage of non-executive directors, leadership structure, board ownership and committee composition to the firm performance. Based on the above findings from the study, the authors recommended that uniform board structures have been advocated by most of the scholars will not basically improve performance and markets will determine the monitoring.

Wagner, et al. (1998) used two studies to empirically examined the commonly belief that corporate board are likely to have positive effects on organisation performance when include outside directors. The first study shows that, on average the greater presence of outsider is relate with higher performance, but also the greater presence of insiders. Instead of the result given the evidence of positive outsider effect, these result suggested the existence of a curvilinear homogeneity effect by which performance is relative greater by presence of either insider or outsider directors. The second study used hierarchical polynomials regression analysis of data from 259 US companies, the result indicate the presence of a curvilinear relationship between insider/ outsider composition and Performance measured as return on assets.

Furthermore, Heracleous (2001) argues that the accepted ‘‘Best Practices’’ on corporate governance has generally failed to find convincing link between these practices and organisation performance. Using empirical analysis, the result shows that the relationship between two best Practices CEO/chair duality and insider and outsider composition and organisation performance to be insignificant. He proposes four possibilities and implication for each of the possibilities for this relationship that is mutually exclusive. Firstly, the possibility that best practices in corporate governance’s index is not a determinant to organisation performance and the implication is that corporate governance best practice needs to be seriously reorganised without any doubt. Secondly, that operational performance of theoretical concept has low face validity and there is need for higher face validity of operation by behavioural observation and interview of the directors**.** Thirdly, the studies are not wide to aiming to show board characteristics to organisational performance and not to take note of systemic factor and there is need for research models and paradigms that can explain the systemic and multi-directional influences. Lastly, that difference type of organisation performance need difference practice in corporate governance and this indicate that a contingency idea needs to be incorporated in the study of governance. Bhagat and Black (2002) noticed that on the board of directors of American Public companies,

independent directors are more numerous, and many financial analysts and institutional investors are confident that a monitoring board composed of independence directors is an important structure of good corporate governance. The authors used empirical evidence to disprove the believed by using the first large sample, to determined the degree of board independence (Proxied by fraction of the board of independence directors minus the fraction of inside directors on a company's board) correlate with different measures of long-term performance of large American firms. The authors found that low-profitability firms increased the independence of their board of directors, but there was no evidence that this method succeeded, firms with a more independent board did not perform better than other firms. The author results support the method of the firm to test the board structure that rejecting the conventional monitoring of board. Moreover, Prasanna (2006) investigate whether the board independence has any influence in maximizing value. The author revealed that the empirical analysis did not produce evidence to show that there was relationship between independence board and value maximization. The author suggested that other related controlling variables such as shareholding pattern, market presence, and industry growth should be include in the study. However, the corporate governance reforms changing from non-executive director to independent which shows that over the past five years corporate board have change drastically. Currently most of the boards of companies have the highest number of non-executive directors. The institutional body in-charge of regulating is monitoring seriously to make sure that there are present of non-executive directors on the board of company. In addition, Raheja (2005) models the interaction of firm insiders and outsiders on a corporate board and discussed the question of board's ideal size and composition. In the model the results shows, that the board duties was for monitoring and making CEO succession decision. The insider directors are better informed on the quality of the firm investment projects, although outsiders can use CEO succession to encourage insiders to show their superior knowledge and assist the board in implementation of higher value projects. The optimal board structure was determined by trade off between maximizing the ability of outsiders not to accept inferior projects and the optimal board size and composition are function of director's and the firm's features. Finally, the author developed testable implication for cross-sectional variation in the optimal board structure across firms.

Guest (2008) used a comparative analysis of the UK and US legal institution in proposing the hypothesis that UK board will play a weaker monitoring role and the board

structure will not determined by monitoring related factors. With empirical evidence, the result revealed that board structure determinants are difference in predicting way across various institutional setting, in contract to current US mandatory reforms, and UK reforms have been voluntary. The author view support this position, that UK reforms do not have significant impact on board structure, although many firms refuse to comply and those that that comply do so for economic reason. The reforms demonstrate how to reduce CEOs ability of good performance to influence board structures.

In a different method in measuring efficiency relating to performance, Tanna, et al. (2007) examined sample of eighteen banks in United Kingdom and Provided with empirical results on the link between the efficiency of UK banks and two important aspect of Board structures, which are Board size and Board Composition. In this study the authors used Data Enveloped Analysis (DEA) to estimate the technical, allocative, and cost Efficiency of banks. The authors found that board size was associated to efficiency. Moreover this impact was not robust across different samples and specifications. The compositions of the board have a positive and significantly impact on all measure of efficiency. The finding provides evidence in support to the theoretical argument of Fama and Jensen (1983) also the recommendation of the Basel Committee on Banking Supervision (2006) revealed that non-executive director can bring valuable knowledge into the bank in other to enhance independence and objectivity.

In case of the board size, there is clear indication of negative relationship appears to occur between board size and firm performance. Yermack (1996) conducted an empirical study to show the relationship between board size and firm value in a sample of 452 large US firms. The author found an inverse relationship between board size and firm value, that largest fraction of lost value occurs as board increases from small to medium size. The financial ratio, which are profitability, and operating efficiency decreases as the board size increases and provide stronger CEO performance incentives from compensation and risk of dismissal. The results robust to different control variables for company size, industry membership, and insider stock ownership growth opportunities, and alternate corporate governance structure. Tanna, et al. (2008) empirical revealed that board size has a link with efficiency. The authors show evidence on the effect of board size and composition on the efficiency of UK banks, although the impact was no rousted across various samples and specifications.

Furthermore, Jensen (1993), Lipton and Lorsch (1992) found that firms with larger boards are less performed than firms with fewer boards and are easier for CEO to control. Then firms with larger boards' size cost of remuneration, sitting allowance, and other expenses are higher than firms with fewer board size. Lipton and Lorsch (1992) claimed that a smaller board size will make directors to know each other, in other to deliberate on issues more effectively with directors making contribution and reaching a true agreement from the deliberation. Moreover, Andres, and Vallelado, (2008) in their presentation of a paper on role of the board of directors in corporate governance in banking with a large sample of international commercial banks to test the hypothesis of dual role of directors. The empirical study revealed an inverse relationship between bank performance, and board size, and also between the proportion of non-executive directors and performance. This indicated that bank board composition and size are related to director's ability to monitor and advice management, therefore, larger independent boards might prove more efficient in monitoring and rendering more valuable advice.

2.4.8 Power separation between board chairperson and CEO

Several of the studies that examined the separation of board chairperson and CEO argue on the basis that agency problem is higher when the same officer holds both positions. Bhagat and Bolton (2008) examined empirically the relationships among corporate governance, performance, corporate capital structure and ownership structure. The result shows that CEO-Chairman separation was significantly correlated with operating performance. Baliga and Moyer (1996) investigate the relationship between the CEO duality and firm performance, it consider the pronouncement effect in duality structure, accounting measure of corporate performance. The empirical analysis of data shows that market was indifferent to changes in duality status of firms, there was little evidence of operating performance changes around duality status, and there is weak evidence that duality status affect long-term performance when other factors that can impact the performance have been control. Brickley, and Jarrel, et.al (1997) using empirical evidence posit that separating the chairman of board and CEO will reduce agency cost in firm and improved performance. Pi (1993) examined the variation in performance and the relationship between performance with top management team ownership structure, and the composition of the board of directors for a sample of US bank holding companies. The performance was measured on Return on Asset, and Return on Equity. An efficiency was measured by using an Econometric Frontier

Approach (EFA) as cost efficiency as performance. The result shows that on the average, banks where the CEO is also the Chairman of the board under-perform those banks where the CEO is not Chairman of the board. The author found that the relative different in performance was higher for Return on Asset (ROA) than for Cost Efficiency. This indicate that Chairman-CEO banks are more output for cost inefficient (ability to control cost) relative to non-Chairman-CEO banks. Secondly, for non-Chairman-CEO banks there was significantly positive relationship between performance and CEO ownership. Thirdly for Chairman- CEO Banks the relationship between performance and CEO ownership was significantly negative. Finally, the author suggested that the level of performance for either Chairman-CEO or non-Chairman-CEO banks was generally not related to ownership by institutions or large block-holders, and the proportion of insiders board members.

2.4.9 Contemporary state of corporate governance

In examination of how global financial crises affect the development of corporate governance, Baker (2009) argues that there are factors which are not related to corporate governance such as macroeconomic policy and weakness in the global financial infrastructure act as major significant role in the financial crises. Although, there other factors that are incomplete list of contributing factor but some of this might be the excessive losses, monetary policy after 2000, the inadequate regulation of the sub-prime mortgage market in the US. In addition, the unsatisfactory functioning of credit rating agencies and the lack of centralised cleaning house for credit derivatives. However, there was little that national corporate governance system did seriously to solve the crisis especially with respect to financial institutions. For examples, many banks could not avoid the temptation of leveraging their balance sheet to unsustainable level in a variety of complex and opaque ways. Then also the temptation to chase competitors in an upward spiral of risk was not avoidable and bank boards were not able to effectively manage the risk they were exposed. In addition, the author explained that there was failure of internal control, which is a fundamental corporate governance responsibility of the board and shareholders. The board and shareholders were not effective in restraining the behaviour of the bank in excessive building up of leverage, moreover, the author recommended that the recent corporate governance reform around the world should not be reversed with view that corporate governance system as a whole has failed entirely. As a result corporate governance should be view as work in

progress, and the global financial regulation needs more attention of the regulators and policy makers.

OECD (2009) analysed the impact of failure and weakness in corporate governance on the financial crisis. The paper focused on risk management system, executive salaries, accounting standards, and regulatory requirements all are proved to be insufficient in some areas. The remuneration systems are certainly not closely related to the strategy and risk profile of the companies. The paper recommended that importance of well qualified board function and better risk management was not limited to financial institutions. The remunerations of the boards and senior management are also a serious controversial issue in most OECD countries. The present situation requires the need for OECD to re-assesed the adequacy of its corporate governance principles and practice.

Mallin (2005) reviewed the corporate governance in UK and concluded that the adoption of international accepted accounting standard has assisted the UK in having a high level of transparency and disclosure in the corporate and financial sectors. This was built on the sound foundation of the Cadbury (1992) recommendation, along with the corporate governance that evolved through different reports such as Greenbury, Hampel, Turnbull, Myners, Higgis and Smith. In July 2003 there was revised Combined Code which was issued and has improved the framework for corporate governance. The institutional investors have been active in sharing ownership in the company in which they invested into. According to the author, in the UK and US institutional investor have become very relevant over the last thirty years as their share ownership has increased tremendously and they have become active in their ownership role. Furthermore, the author revealed that the UK principles for corporate governance are market conform because they stipulate behaviour consistent with incentives of management of high quality firms and they do not take the advantages to exploit information. In addition, the author argues that competition in both product and financial markets services is important for appropriate market incentives in corporate governance. Therefore lack of incentive codes of conduct and legislation will likely bring about ineffectiveness in governance. The author suggested that the proposed capital regulation for banks in Basel 11 is likely to reduce competition in financial sector.

Hart (2005) argues that market economy can achieved efficient corporate governance by itself, from this statement. The author found that part of policy implication case for

statutory rules is weak, and Cadbury approach of enlighten and persuading companies to bring innovation into corporate governance is the best. The Cadbury recommendation should be seen in the context of corporate governance structure generally. Although, Cadbury recommendation is promoted, but it is also important to make sure the existing mechanisms operate freely to bring adequate check and balances on managerial behaviour. If there is any attempt to weaken this mechanism, this may allow corporate governance to be more rigid, and the company performance will be worse in the long term.

Moreover, O'Hara and Macey (2003) recommended that a hybrid approach to cooperate governance in which most firms are governed with US model, and banks are governed according to the Franco-German is idea. The authors believed that Franco-German model is likely to be well operated in the US than it has been in European continent because US has a developed private enforcement system in which beneficiaries of fiduciary duties can sue in the law court in order to vindicate their rights. In addition, the authors used the dominant model of corporate governance in economics and law which posited that corporation is a complex set of ''explicit and implicit contracts''. This implies a set of contractual arrangement among various claimants to the products and profits generated by the companies. The claimants are not only shareholders, but include creditors, employee-managers, and the local communities in which the business is operating, suppliers, and customers. In banking industry the claimants also include the regulators in their duties as insurers of deposits and lenders of last resort and been an agents of other claimants.

Gischer et al. (2007) shows a comparative analysis between corporate governance of Anglo-Saxon and Continental European system with the following features: There are no separation of the management board and supervisory board in Anglo-Saxon corporate governance system because it is shareholder and capital market oriented. The interests of other stakeholders are not directly pursued in the system. While in case of Continental Europe and Japan corporate governance system, the management board and supervisory board are separated. The supervisory board include the employee representatives, representatives of loan granting banks and major shareholders, the management board job is to act on behalf of the company and not on behalf of shareholders and there is balance of interest. In addition, in Anglo-Saxon corporate governance system, financing of company does not depend on long-term and partial collateral loans, there are flexibility of labour market exist for employee with transferable know how and consequently, there are

consistency in corporate governance and capital and labour markets. While the corporate governance system in Continental European has a feature of protection the corporate interest which is to pursue stakeholder value. The sunken costs related to specific investment are covered by codetermination and control rights, with long-term human and real capital investments. The Continental European has feature of collective bargaining and the principle of relation banking.

The authors, argues further that a shift from the continental European corporate governance system, which was not failed for a long term and can be noticed with the following features: The European system has certain rigidity due to the necessary linkages, and there is a capital market which has become flexible recently. Internationally, operating of major banks prefer the Anglo-Saxon system of corporate governance, but cooperative and saving banks believed in regional focus that agree with long term relationship banking for both the small and medium scale enterprise and private customers. As a result, these financial institutions are bound to continental European corporate governance system. A change to Anglo-Saxon system does not only need all the feature of the system have to be adjusted to achieve a consistent system of corporate governance and labour markets. Then a change in the system requires the evidence that the desired corporate governance system will be beneficial to overall.

OECD (2004) revealed that the corporate governance frame work will based on the legal, regulatory and institutional environment, and there are other factor such as business ethics, corporate awareness of the environment. In addition, societal interest of the area in which the firm operates may also have effect on its goodwill and its long-term success. As a result, there is no single model of good corporate governance, but the organisation indentified some common element as benchmark for good corporate governance. The principle is based on this common element and this is formulated to the different model that exist for instance the issue of board structure and the term they will use as member is not universally agreed. The organisation does not lay emphasised on one particular board structure. For example in a two tier system we have supervisory board while the key executive is referring to the management board. The organisation stated that the difference in area of legislation, regulation, self regulation, and voluntary standard will vary from one country to another, and the bank regulators are aware of this statement. The Basel Committee on Banking Supervision (2005) noted that there are differences in legislation and regulatory frame work

across countries in area of function of the board and senior management. In some countries like Germany, China, and Spain there is separation between management and a supervisory board. While in US, UK, Australia and other 37 countries there is a sole-board system. In France, Finland, Switzerland and Bulgaria operate a mixed board structure, in which the firms can decide to operate either sole or supervisory boards.

2.5 Special feature of banks

The innovation and development of technologies, the consolidation of banking industry, globalisation and the deregulation have made the banking industry face a lot of challenges. Consequently, banks are confronted with more competition and a volatile global environment than other firms. Against this background, there are significant findings from different authors toward the issue of corporate governance in the banking sector. Pati (2005) revealed that banks provide financing for commercial enterprises, basic financial services to broad segment of the population and access to payments systems, and making liquidity and credit available in a difficult market condition. Furthermore, the author ascertained that the banking industry is highly sensitive to public scrutiny and is more vulnerable to the risk of attracting adverse publicity through failings in governance and stakeholder relation. The banking sector has a special form of corporate governance with its management being guided by law or regulatory codes. The author also found that the governance of banks is different from other financial sectors base on the complexity of its activities, opacity of books of accounts, control of government and the excessive power of regulation of financial institutions. This raises question on the issues of transparency, disclosure and agency relationship. Moreover, the author claimed that banks have a peculiar problem that is different from other corporations which include the following: The activities of banks are not open and this makes it difficult for shareholders and creditor to monitor. When the largest amount of capital is with the governments the bank activities are opaque, because banks were heavily regulated by government. In addition, ownership may be dispersed by mandate, and takeover may be hindered through prohibition on bank ownership. The control of bank deposits by government can undercut incentives for depositors to monitor management, and this will push the responsibility for government banks to other parties or institutions. Finally, banks differ from other corporations in terms of their complexity and level of their business risks, and the effect if these risks are poorly managed.

The banking sector constitutes the largest intermediaries worldwide, as a result of this having a sound corporate governance system will surely enhanced their efficiency in their activities, and this will increase the economic growth of the country. Therefore, Levine (2002) examined three interrelated features of financial intermediaries in which the banking sector was involved worldwide and how these characteristics affect corporate governance. Firstly, banks have greater opaqueness than other firms, and this increases the agency problem due to the greater information asymmetries between insiders and outsiders investors in the banking system. Secondly, banks regulators are very strict in their duty of regulation banks and this frequently reduces the corporate governance mechanism. The author finally argues that, government ownership of banks usually alters the corporate governance structure of banks since banks are owned by the state in most countries. This makes the corporate governance of the banking sector to be different from other industries.

Furthermore, Andres and Vallelado (2008) explained that as a result of the importance of banks in the economic system and nature of banking business, which make it possible to show greater concern about the problem involved in the corporate governance in the banking system, also there are mechanism available to deal with such problems. The authors further revealed that the complexity of the banking system increases the level of asymmetry of information and reduces the stakeholder capacity to monitor bank manager decisions. The banks are the main element in the payment system and play a highly important role in the functioning of economic systems, and they have a high level of leverage. Consequently, banks face more regulation than other corporations, in which they are responsible for safeguarding depositors' rights, guarantee the stability of the payment system and reduce systemic risk. Furthermore, the author explained that regulations of banking bring several challenges in the area of corporate governance, which means it can be considered as another mechanism of corporate governance. In most cases it reduces the effectiveness of other mechanisms in coping with other problems. However, the main aim for the regulator of banks, which is to reduce systemic risk, may conflict with the main goal of shareholders which is to increase share value. The conflict between the regulator and the shareholders goals introduces a new agency problem. Moreover, Levine (2004) argues that banks are more important for industrial expansion, corporate governance of firms and capital allocation. The efficient mobilisation and allocation of funds by the banks will lower the cost of capital of firms increase capital formation and stimulate productivity growth. As a result, the function of

banks has ramifications for the operations of firms and economic prosperity of the nations. Having said this, the governance of banks themselves has central roles. Therefore, with the issue of banking crises seriously publicised the effect of poor governance of banks.

In addition, Macey and O' Hara (2003) found that the distinction between banks and other corporations is that banks are highly geared considering the low proportion of equity in their capital structure, and the liabilities are large in the form of deposits, which are available to their creditors and depositors on demand. Their liquidity production function which is through the holding of liquid assets and issuing liquidity liabilities as a result, banks create liquidity for the economy. Against this background, all the reasons mentioned above make banks 'special' and financial intermediaries. The above authors also explained further that commercial banks pose a serious corporate governance problem for managers and regulators, as well as for claimants on firms' cash flow such as investors. According to the authors the debate on corporate governance focused on two very different issues: whether corporate governance should focus exclusively on protecting the interest of equity claimants in corporation, or whether corporate governance should instead expand its focus to deal with problem of other group called stakeholders or non-shareholders constituencies. In this study the authors used conceptual evidence, to show that the Anglo-American model of corporate governance exclusively focuses to maximize shareholder value, and take the market of corporate governance into consideration. On the other hand, the of Franco-German model view corporate governance to be an industrial partnership, in which the interest of long-term shareholders-mainly banks employee groups, should have the same respect as those of shareholders. The authors support the hybrid approach to corporate governance. They recommended that bank directors should expand their fiduciary duties beyond shareholders to include creditors and to take solvency risk explicitly and systematically into consideration when making decisions. In addition, the authors mention that empirical evidence shows that countries in which the activities of banks are restricted, probability of having a banking crisis is greater even if the regulatory system is a smooth functioning one.

Furthermore, Ciananelli and Gonzalez (2000) and Nedelchev (2004) argue that corporate governance in banking has three features which are information asymmetry, agency theory and the regulation of the state. The authors used this as a premise to examine the governance in banks. Nedelchev (2004) used empirical evidence in examining Bulgaria's banking system. The author found that corporate governance in banking in Bulgaria depends

on transition period with a low level of shareholder protection. There is a high level of information asymmetry, and positive image created by international recognised auditors with the strength from current legislation from listed banks. Ciananelli and Gonzalez (2000) conceptual analysis, of their finding was consistent with Nedelchev (2004) by revealed that commercial banks are distinguished by more complex structures of information asymmetry.

Caprio jr. and Levine (2002) Levine (2004) and Arun and Tuner (2004) found that banks constitute the greatest financial intermediaries globally with the following facing corporate governance structure. There is bad corporate control, with diffused and concentrated equity, and debt holder forces. There is also lack of well-trained supervisors, and cost of raising capital is a problem. In addition, there is presence of distributional cartels, with bank insiders exploiting the bank for their own purposes. These can bring bank failure and thereby reduce the corporate finance and economic development. Using Conceptual approach in analysing the problems, the authors found out that these problems are common in emerging markets than in developing countries. There is greater opaqueness in banking than other industries with greater government regulation, these method weaken many traditional governance mechanisms. The authors recommended that where government ownership is wide, privatization is essential. Also where government deposit insurance coverage is extremely generous, the reforms should induce creditors with the ability and incentives to monitor banks, and there should be foreign entry into the banking system.

Nevertheless, Ariff and Hoque (2007) used Australian banks as a case study and posited that a superior governance structure accepted that is adhered to fastidiously at each bank which will provide the best financial services to their customer within a well-governed banking system. In other to achieve this, there is need for an environment that will encourage banks to compete for customers in a competitive banking atmosphere. According to the authors, from Shleifer and Vinshy (1997) defined corporate governance as a way in which the supplier of finance to corporations assure themselves of getting a return on their investment. The authors explained that in the banking sector the supplier of funds are the providers of the tier -1 and tier -2 capitals. When the banks provide the loans, their ability to get the loan back from their debtors is very important. This indicate the long –term survival of banks depends on earning an adequate return on investment to the providers of fund, and the investors will expect to know whether good corporate governance exist in a bank that is performing well. Ariff and Hoque (2007) explained further that the banking sector is

tremendously significant in the nation economy and if they have bad management, there will be a serious bad effect on the economy as a whole. This is because of their primary role they play in terms of intermediation of saving of investment, also in servicing the economic agents with efficient payment system mechanism. In addition, the authors posited that failure of the banks due to poor corporate governance structures will impact on the economy and will be very damaging and destabilising. The authors suggested that the systemic risk from bank failure should be avoided because corporate governance of banks is a serious issue which has to be taken as a first priority in an economy of nation. In addition, the activities of banks is licensed, the set of regulations protecting the banking sector is particularly needed to be adhered to very strictly by banks as it has been supervised by prudential authorities of each country in the world.

Trayler (2007) argue that banking worldwide is a high profile level industry, which plays a crucial important role, not only in a country's economy, but as well the world's economy. This shows that the banking sector has a crucial function of ensuring that the stability and integrity of the global financial system. The failure of the world's largest banks and the fear of the consequence are of great concern for the regulators and governments worldwide, and the author believes that banks are different from non-financial companies, as a result of their public purpose and the position of trust that they hold in the nation. For this reason, the author examined the corporate governance in 100 top banks in the world by using the 13 governance characteristics to determine if there are similarities or differences in their corporate characteristics as measured by performance and risk. The author revealed that the main key finding is as follows: banks that have lower percentage of internal directors may perform better than banks that have higher percentage of internal directors, and the suggestion by board to established audit committees is no longer a differentiator in performance.

Moreover, Nam (2007) used conceptual analysis to overview the corporate governance structure in Korean banks. The author found that the banking sector featured as one of the main factors lead to the financial crisis in Korea in 1997, which show that government intervention for various reasons was responsible for a weak banking system. The wrong structure of corporate governance and the decision making system of Korean banks contributed to the fragility of the banking sector. The author recommended that for sound corporate governance of the banking industry, the decision making authority should be

allocated equitably so that checks and balances are properly operate within the organisation. Nevertheless, Andrea (2007) reveals that banks are among the most important sources not only for finance, but also for external governance of firms. Then corporate governance of banks is an important factor for growth and development. In his argument, the author support Ross Levine (2004) point of view and his co-authors from World Bank, which seriously query the question of present of a banking regulatory framework? The debate on the corporate governance of banks has put forward latest discussions on the future of banking regulatory system. The question now is whether the regulatory intervention should be the most important corporate control mechanism in banking or should regulators focus on introducing incentives for appropriate market behaviour?

In addition, Bertus and Yost (2007) used the worldwide studies of banking performance and banking stability to show that market attributes are directly related to the ability of individual markets to monitor and discipline banks. The authors empirically investigate the link of national wealth with bank regulatory policies, as measured by the three Pillars of New Basel Capital Accord, which include capital regulatory oversight, supervisory oversight and market discipline for different countries. The authors found that countries with greater monitoring, as measured by accounting and auditing practices, financial transparency, and credit rating efficacy are linked with greater wealth and less risk. In addition the authors found no evidence that capital regulatory oversight or supervisory oversight influence a nation's wealth. Moreover, the degree of market information was positively related to the level of average GDP, but negatively related to growth rate in GDP.

Manthos et.al (2009) examined the relationship between bank-level of productivity and the country –level of capital requirement, official supervisory power, market discipline and restriction on bank activities in twenty-two countries. In this study, the authors used Mamquist index as empirical tools to estimate the total factor productivity growth of banks and using robust bootstrap procedure to regress the first stage TFP growth scores on regulatory variables. The authors found the following from their study; from the three pillars of Basel lI, only market discipline has impact on productivity growth. This suggested that the policy makers should make sure there is adequate disclosure of information, and promote a framework that gives an incentive for private monitoring. Moreover, restrictions on bank activities had an impact on productivity growth, and the percentage of asset own by foreign

banks and credit to the private sector as a percentage of GDP influenced positively the total factor productivity of banks.

Finally, Furfine (2001) argues that banks have been both regulated and supervised so that it will not fail and in order to maintain the safety and viability of the financial system. Presently, an increase in developments in technology and increase in financial sophistication have challenged the ability of traditional regulation and supervision to encourage a safe and sound banking system. The author questions was whether banks can effectively be employed as monitors of their pairs by providing the first empirical examination of the pricing of interbank lending agreements. The finding provides enough evidence that banks are effective monitors of their peers by showing that interest rate paid on federal funds transactions reflect differences in credit risk among the borrowers, especially borrowing banks with higher profitability, higher capital ratios and fewer problem loans pay a lower interest rate on federal funds loans. The results implied that banks indentify risk in peers and effectively monitor other banks.

2.6 Corporate governance and bank capital structure

In relation to ownership structure, most of the research studies on the role and function of modern firms were based on the principle of widely dispersed ownership. This principle originated from Berle and Means (1932) and has been further developed by Baumol (1959), Jesen and Meckling (1976), and Grossman and Hart (1980). A recent study has shown that there some concentration of ownership occurred among the largest American corporations Demsetz (1983) ,Sheifer and Vishny (1986), Morck et, al. (1988). Higher level of ownership occurred in corporations of developed economies (La porta et, al. (1998, 1999), as well as revealing that ownership and control can be separated to favour the large shareholders by finding out who has the highest control rights. Research studies of other developed countries found that more significant concentration of ownership in these countries for instances in Germany Edward and Fischer (1994), Frank and Mayer (1994), in Japan Prowse (1992), in Italy Barca (1995) and OECD countries European corporation government network (1997). In case of developing economies ownership is also concentrated (La porta et, al. (1998), Kang and Shivdasani (1995) the study revealed that in several countries large corporations have large shareholders and in addition, these shareholders are involved in corporate governance mechanism. These studies were against, the Berle and Mean studies

that managers are uncountable. Based on the above studies the Berle and Means argument on Modern Corporation has become outdated.

Caprio et al. (2007) assessed the impact of the ownership structure of banks and shareholder protection laws on bank valuation by controlling for various form of regulations in bank. The authors revealed that banks are not widely held, instead family or state control banks. In addition, higher cash-flow rights by the controlling owner boost valuation, greater cash-flow rights reduced the unfavourable effect of weak shareholders protection laws on valuations. These result shows that ownership structure is an essential mechanism for the governing of banks. Nevertheless, Cleassens et al. (2000) examined the separation of ownership and control for 2980 corporations in nine East Asian countries. The authors revealed that in all the countries, control rights exceed cash-flow rights using pyramid structure and cross-holding. They proceed further in their study by arguing that separation of ownership and control was common among family- controlled firms and small firms. Claessens et al. (2002) carried out empirical study on the difference between the family ownership of cash-flow rights and ownership of voting rights in East Asian economies. The authors found that the excess of large shareholders' voting rights over cash-flow rights decreases the total value of the firm. Cronqvist and Nilson (2003) reveal that in Sweden, the cash-flow ownership does not exceed voting rights that negatively affected the value of the firm. In addition, Claessens et al. (2002) examined whether ownership by families, the state, widely held firm or widely held financial institutions affected market- to-book ratio. They found that concentrated ownership with any types of owners has impact with increased in Market-to-book Ratio.

La porta et al. (1999) revealed that except in economies with good shareholder protection, relatively few of these firms are widely held this is in contradiction to Berle and Mean view of ownership of the modern corporation. Instead, these firms are controlled by families and the controlling shareholders have power over the firms in excess of their cash-flow rights by the use of pyramid and involved in management activities. Villalonga and Amit (2006) argues that to know whether and when family firms trade at premium or discount relative to non-family firms, there should be special attention to the three elements in the meaning to family firms; these are ownership, control and management. Does family ownership deceased or increased value? Berle and Means (1932) asserted that ownership concentration should have positive effect on value because removed the conflict of interest

between owners and managers. Demsetz (1983) belief that ownership concentration was endogenous output of profit maximization decision by the shareholders and should not affect firm value. Demsetz and Len (1985), Himmelberg et al. (1999) and Demstz and Villalonga (2001) revealed the same finding with Demsetz (1983). In addition, Anderson and Reeb (2003) assessed the impact of family ownership and management, although they did not separate ownership from control. Above all, none of these studies control for endogeneity of ownership and control which was shown as main determinant of their effect on firm value. The authors further investigate the relationship between founding-family ownership and firms' performance and found that family firms performed better when family members served as CEO than non-family members served as CEO of the firm. This suggested that family ownership is an important mechanism in corporate governance structure.

Moreover, classical corporate finance theories argue that increase in leverage reduces managerial agency cost and strengthen corporate governance, because debt is being used by investors to generate information to assessed major operating decision. Jesen and Meckling (1976), Harris and Ravis (1991) Harvey et.al (2004) revealed that leverage is positively correlated with firm value when investment opportunities are scarce and debt reduces the problem of overinvestment. In addition, Kaplan (1989) revealed that a higher financial leverage associated with leverage buyout have a positive impact on corporate performance. Weill (2003) provide empirical evidence on the relationship between leverage and corporate performance using Frontier Efficiency Techniques to measure performance of medium-sized firms from seven Europeans countries by finding that a positive impact between leverage and corporate performance. Myers (1977) posited that agency cost was as a result of conflicts of interest shareholders-debt-holders and suggested that a higher leverage was correlated with a lower corporate performance. Nevertheless, Berger and Di Patti (2003) tested the corporate governance theory that predicted that leverage affects agency cost and thereby influence firm performance, and they revealed that the data on US banking was consistent with the theory. Moreover, La bruslerie and Latrous (2007) revealed that the relation between ownership structure and leverage varies according to the level of controlling shareholders' equity ownership. When controlling ownership is at low level, debt contrary to equity allows controlling shareholders to restrict the dilution of their voting power. According to the authors, this was found that debt in term of leverage was used by controlling shareholders to protect themselves from unnecessary takeovers.

Furthermore, Driffield, et al. (2007) empirically investigates the effect of ownership structure on capital structure with references to the context of over-investment and over-borrowing within the East Asian corporations during the financial crisis. The authors revealed that the impact of separation of control rights from cash-flow rights on leverage and firm value within family managed firms will be different from those that are managed by non-family firms. In case of family firms being managed by the owners, higher concentration and incentives effect will likely have positive impact on both capital structure and firm value. Then entrenchment effects (against minority shareholders) will likely increase leverage but decrease the value of the firm. In addition, their study found the inherent simultaneity between capital structure and firm value will lead to higher leverage and this will likely reduce agency costs of outside equity and increase firm value, and this will motivate managers to act more toward the interest of shareholders.

The question however remains whether the same corporate governance mechanisms that work for non-financial firms also work for banks. Caprio et al. (2007) explained that the moment a bank usefully mobilises and distributes funds, this will surely reduce the cost of capital to the firms and this will increase capital accumulation and productivity growth. In addition, in some countries banks act as major equity holders and creditors and this makes them useful in governing corporations. The authors further argue that once bank managers encounter sound governance mechanisms banks will raise capital at a lesser cost, allocate people's saving usefully and operate sound governance on the firms they fund. The important of bank capital structure cannot be overemphasized against this background. Diamond and Rajan (2000) posited that capital structure in a bank is affected by bank safety, the ability of banks to refinance at a lower cost and ability to obtain repayment from borrowers or to liquidate them. However, Berger et.al (1995) revealed that banks differ from other firms in two important areas that affect their capital structures. These are the availability of regulatory safety net that protects the safety and soundness of banks and this certainly reduce the bank capital. It also includes the regulatory requirement that increased the amount of capital of some banks.

In relation to ownership structure in banks, Caprio et al. (2007) found that banks are not widely held, instead a family or a state controls banks. Also, higher cash-flow rights by the controlling owner boost valuation, greater cash-flow rights reduced the unfavourable effect of weak shareholders protection laws on valuations. These results show that ownership

structure is an essential mechanism for governing banks. In banking industry, Mehran and Thakor (2009) argue that the total value of banks and its equity capital are significantly correlated, and the bank's assets and liabilities, also the net present value (NPV) to shareholders, for investment is related to bank capital. From this point of view, those with higher control rights will have higher return on their investment. These indicate that those banks with sound governance may have a capital structure that will bring good returns.

Having said this, the objective of this study is to examine how agency problem which exist between the manager and shareholders which could be mitigated in family owner managed banks affect the bank leverage. The study further investigates how control right of the controlling owner that often exceeds cash flow rights affect leverage in a bank with high ownership concentration and also give rise to serious agency problem. The empirical enquiry into ownership structure in banks by La porta et al. (1999) did not research in detail on the ownership structure of banks in each country and they did not focus on many commercial banks, and also Barth et al. (2001 and 2004) empirically revealed the degree of state ownership of banking sector in a cross country analysis but they did not give full detail on the ownership structure of banks. Mehran and Thakor (2009) examine the link between bank capital and bank valuation. We are however not aware of any research exploring the possible role of corporate governance of banks on bank's capital management. Using cross-country bank-level data, this present study aims to bridge this gap in the literature. The analysis of bank leverage is very important because there is a need to understand the relationship between leverage decisions and the ownership structures of banks which have been emphasised in the wake of the current financial crisis that shows the risk of lending booms which result in the downturns of the global economy. Consequently, this study focus on the following hypotheses: Firstly, bank leverage is likely to be lower in family- owner managed firms. Secondly, bank leverage is likely to be higher if control exceeds cash flow rights.

CHAPTER THREE

METHODOLOGY

3.1 Introduction

Caprio et al. (2007) provides two questions on ownership. Firstly, are banks widely held or do they have controlling ownership with significant control and cash flow rights. Against this background, this study model Caprio et al. (2007) and advance the course of study of governance and bank capital structure by considering leverage as dependent variable and include family or individual owner and Control exceed cash flow rights has independent variables. A database from Caprio et al (2007) is used covering 244 banks across 44 countries to assess the impact of the family owner managed firms and control exceeds cash-flow rights on leverage In addition, Caprio et al. (2007) explained that owner's voting rights will exceed the owner's cash-flow rights when the owner controls votes through difference affiliated parties without having the rights to all cash-flow received by those affiliated parties.

3.2 A model of Bank leverage

On the basis of the existing literature, we focus on the following hypotheses:

(i) Bank leverage is likely to be lower in owner managed family firms.

(ii) Bank leverage is likely to be higher if control exceeds cash flow rights

Thus for the i-th bank, bank leverage can be determined as follows:

$L_{it} = \beta_0 + \beta_1$ family-ownership+ β_2 CEC+ $\beta_3 X_i$ + ui

Where leverage is measured by the liability ratio (total liability as a share of total assets). Other control variables X includes bank size (proxied by bank assets), profitability and also geographical regional dummies indicating if the bank is located in Asia, Africa, Latin America (the reference category being OECD countries).

Finally, ui is the random error term, which is independently and identically distributed.

3.3 Data and Variables.

3.3.1 Data Sources.

The data for study come from Caprio et al (2007) a new data based covering 244 banks across 44 countries. The study indentified that (1) non-financial institutions own banks shares, (2) BANKSCOPE and the BANKERS ALMANAC have only information on financial institutions, (3) Bank ownership was traced through corporations back to individuals. The WORLDSCOPE have ownership data of firms, as a result, the study used WORLDSCOPE in addition with 20-F filings, company reports, and filings from National Stock Exchanges and Securities Regulations to know the ultimate owners of corporations that own share in banks. The ownership data are from year 2001, but there are some instance of using 2000 data this result that ownership pattern are very stable this will not bring any problems and bias to the result of the study.

3.3.2 Sample.

The study uses Caprio et al. (2007) database that is made up of sample consisting 244 banks across 44 countries and focuses on the largest banks which depicts the level of comparisons across the countries. In addition, the largest banks tend to have the most liquid shares, make it to be less concern that liquidity differences drive the results.

3.4 Control rights.

From the earlier study of Caprio et al. (2007), the data on control rights of banks which was build up from La port et al (1999, 2002) method for assessing the ownership structure of firms. The major shareholders are from financial or non-financial corporation. When a shareholder has x per cent indirect control over bank A , if she control directly firm B that is if she hold at least 10 per cent of voting rights of firm B, invariably she have direct control x per cent of the vote of bank A. In another situation, a shareholder have x per cent indirect control over bank A, if she controls directly firm C that invariably controls directly firm B, which directly controls x per cent of the votes of bank A. The author further explained that the control chain from bank A to firm C can be with a long sequence of firms, in which each have control greater than 10 per cent voting rights above the next one. In case there are many chains of ownership between a shareholder and the bank, then there will be sum up of control rights across all of these chains. The authors later indentify the multiple shareholders that have above 10 per cent of the votes. Then later pick the largest controlling owner, and this analysis was carried out while including an indicator in case if a bank have

multiple controlling owners. However, this did not change the result of the study. From this process banks are divided into these categories which are; widely held banks which do not have a controlling owner that is no shareholder owns 10 per cent or more of the voting rights. Then finally created controlling owner with minimum of 10 per cent of voting rights of the banks to form: a) a family or individual owner, b) a widely held financial institutions, and c) a widely held non financial institutions.

The following variables are associated with control and explained as follows, which is also described in Table that shows the summary of the descriptive statistics.

WIDELY: This is a dummy variable which is equal to one, if there is no legal entity owns 10 per cent or more of the voting rights, and otherwise zero.

CONTROL: This is equal to the fraction of the bank's voting rights, if any owned by its controlling shareholder.

FAMILY: This is a dummy variable equal to one, if an individual or family is the controlling shareholder, and zero otherwise.

3.5 Cash flow rights.

Cash flow rights are the amount invested in the equity share capital of the firm. Caprio et al. (2007) data shows that the direct and indirect cash flow right of the controlling (CF) are calculated as follows; The direct and indirect cash flow right can obtained by shareholder, for example if the controlling shareholder of bank A holds the fraction y of cash flow in firm B then firm B invariably holds the fraction x of the cash flow rights in bank A. Therefore, the indirect cash flow rights in bank A of the controlling shareholder are equal to the product of x and y. Assuming, there is a long chain of controlling ownership, therefore the products of the cash flow rights along the long chain will be used. In addition, CF is equal to the fraction of the bank's cash flow rights owned directly and indirectly by its shareholder.

3.6 Measurement of research variables

For the purpose of this study, the paper considers corporate governance as an independent variable which is proxie in the study by family –owner managed firm, and control exceeds cash-flow rights, and dependent variable as leverage. This used to find out how family or individual owner, control exceed cash flow rights is significantly associated with leverage. For a balance econometric definition of the model, the study equally considers

inclusion of both control and dummy variables which include profitability ratio, bank size, and Asia, Africa and Latin American countries.

3.6.1 Control Exceeds Cash-flow rights (CEC)

Claessens et al. (2002) have shown that the separation of control and cash flow rights of the controlling owner has important implications for corporate governance. The particular interesting case is when control rights exceed cash flow rights because it may give rise to some agency costs. Higher voting rights are often associated with pyramid ownership structures and crossholding. Such situations are associated with an over-reliance on debt due to large shareholders being unwilling to dilute their ownership by raising equity finance, generally known as *non-dilution of entrenchment.*

Caprio et al. (2007) data provides information on controlling owner's cash flow and control rights. The paper classifies a bank as having controlling owner if the shareholder has direct and indirect voting rights that sum up to 10 per cent or more (measured by the variable control10). Assuming no shareholder holds 10 per cent of voting rights, the study classify the bank as widely held. Conventionally 10 per cent voting rights are adequate to exert control; this cut-off is used in the literature (e.g., see La porta et,al. 1999, 2002). Similarly, cash flow rights refer to direct and indirect cash flow rights of the controlling shareholder (CF), which equals the fraction of the bank's cash flow rights, at 10 per cent (measured by the variable CF10). Using these two variables, we generate a variable control exceeds cash flow (CEC) as follows: CEC=Control10-CF10.

3.6.2 Family.

Family is defined as a group of people in relationship through by blood or marriage according to this study. The computation of family was based on Caprio et al. (2007) with following assumption that family is equal to 1 if an individual or family is the controlling shareholder and zero otherwise. This computation was done for each of the banks across the countries in the regions.

3.6.3 Size.

This is the logarithm of the bank's total asset, this bank total asset is in million of US dollars, the sources of the data is from Bankscope. In this study the size is used as one of the control variable in measurement of leverage, and this indicates the business structure of each of the bank in each country in the region.

3.6.4 Performance ratio

Profitability ratio and Return on asset (ROA)

Pandey (2005) Profitability ratio is calculated so as to know the operating efficiency of the banks. Apart from management of bank, creditors and owners are interested in the profitability of the company. The creditors need their interest and the repayment of principal regularly, and the shareholders need a required rate of return on their investment. All these are possible only when the company earn enough profits. In this study, the profitability ratio was measured by profit over total assets. This was used as a controlling variable in order to determine the association between the governance and bank capital structure in term of leverage. The return on asset (ROA) is calculated as pre-tax profit over total assets which is used as performance ratio

3.6.5 Capital structure.

Pandey (2005) defined Capital structure of a corporation as the proportionate relationship between debt and equity. The equity includes paid up capital, share premium and reserves and surplus (retained earnings). In addition the author explained that the company assets can be financed either by increasing the owner's claims or the creditors' claim. The owners' claims is high immediately the firm raises fund by means of issuing ordinary shares, or through retaining the earnings, and also the creditors' claims shut up by borrowing . Therefore these various ways of financing representing financial structure of firm, traditionally, short-time borrowing are not part of methods of financing the firm capital expenditure, hence the long-term claims form the capital structure of the firm. From the above point of view capital structure decision is an important aspect of managerial decision. In this study the dependent variables is the capital structure in term of leverage which was calculated as follows; Liability Ratio which is the total liability over the total assets and equity ratio is equity over total assets. The figure used in this calculation is obtained from BANKSCOPE Caprio et al (2007).

3.6.6 Dummy variable.

The study classifies banks in each country into regions e.g. Asian, Africa, Latin America, and OECD, and this was arranged alphabetically. Each of the columns corresponding to every bank in the classification is done according to the region, with Asia, Africa, Latin America and OECD equal to 1 or otherwise zero. In addition, Asia, Africa, and Latin America banks are used as the dummy variable relative to the banks in OECD

countries, which serves as a base. The reason is to control for possible differences in leverage across the banks in the countries in each of the three regions.

3.7 Descriptive statistics of bank ownership around the world.

Table 1 summarises the quartile distribution of these three variables, namely, control10, CF10 and CEC. It follows from our sample distribution that CEC takes a value 0 for about 78.7% banks in our cross-country sample. Given this skewed distribution of the variable, first three quartiles for CEC10 turn out to be zero while the maximum value of CEC10 is as high as 94. We include this variable CEC10 to capture the implication of underlying agency problem of this type of ownership structure for bank leverage and performance.

Table 2 provides summary statistics for all the countries in the samples. While Table 3 provides statistical summary base on each region, what extent to which banks are widely held, and also show the controlling owner if the banks are not widely held. The result indicates that about 48.1 per cent of the samples are widely held in the OECD region, which is the highest, follow by 13.6 per cent for the Latin America region, 9 per cent in Asia region, while 7.7 per cent in Africa. This indicates that Africa has the least widely held banks. Table 2 also provides the summary statistics of the family or individual owners. The result indicates 64 per cent in the Latin America, which is the highest percentage, followed by 47 per cent in Asia, 38 per cent in Africa and OECD with 21 per cent.

Table 3 also indicates the summary of the statistics on divergent between control rights and cash flow rights (control exceeds cash flow rights (CEC10a)). There is a variation in the average percentage of control exceeds cash flow rights across the region of the sample of 244 banks. Latin America has the highest with 63.6 per cent, with 38.5 per cent in Africa, 16.7 per cent in Asia, while OECD has the least with 15.3 per cent.

Table 1 Showing the distribution of Control Exceeds Cash Flow (CEC)

QUARTILE	Control 10 (Percentiles)	CF10 (Percentiles)	CEC10 (Percentiles)
Minimum			
Q1	0	0	0
Q2	26	18	0
Q3	56.750	43.750	0
Maximum	100	100	94

Table 2. Summary of descriptive statistics for the overall sample

Variables	Mean	S.D.	Minimum	Maximum	N
Liabilityratio	0.924	0.040	0.720	0.980	244
Equityratio	0.076	0.040	0.020	0.280	244
Pftta	0.009	0.016	-0.150	0.060	244
Widely held	0.303	0.461	0.000	1.000	244
Family1	0.340	0.476	000	1.000	244
Cec 10a	0.213	0.410	0.000	1.000	244
Size	16.404	1.991	11.160	20.770	244

Note: This table shows the report of the summary statistics for the variables. Liability ratio which is the Leverage is calculated as total liabilities over total assets of the bank and equity ratio is calculated as l equity over total assets of the bank. Pftta is indicated as Profitability ratio which is calculated as profit over total assets of the bank, Widely held is a dummy variable which is equals one if there is no controlling shareholder, and zero otherwise, Family 1 is a dummy variable which is equal to one if an individual or family is the controlling shareholder, and zero otherwise, Cec10a indicated as when control exceeds cash flow at 10 per cent in the bank, Size is the logarithm of bank's total assets.

Table 3. Summary of Descriptive Statistics Based on Region.

Region	Variable	Mean	S.D.	Minimum	Maximum	N
Latin America	Pftta	0.018	0.015	0.000	0.060	22
	Cec10a	0.636	0.492	0.000	1.000	22
	Family1	0.640	0.492	0000	1.000	22
	Widely held	0.136	0.351	000	1.000	22
	Size	15.498	1.389	12.25	18.080	22
	Liabilityratio	0.900	0.037	0.800	0.950	22
	Equity ratio	0.100	0.371	0.050	0.200	22
Asia	Pftta	0.009	0.009	-0.020	0.030	78
	Cec10a	0.167	0.375	0.000	1.000	78
	Family1	0.470	0.503	000	1.000	78
	Widely held	0.090	0.288	0.000	1.000	78
	Size	15.532	1.447	12.550	18.08	78
	Liabilityratio	0.913	0.045	0.760	0.970	78
	Equityratio	0.086	0.046	0.030	0.240	78
Africa	Pftta	0.017	0.012	0.000	0.040	13
	Cec10a	0.385	0.506	0.000	1.000	13
	Family1	0.380	0.506	000	1.000	13
	Widely held	0.077	0.277	0.000	1.000	13
	Size	14.411	2.033	11.160	17.300	13
	Liabilityratio	0.883	0.071	0.720	0.940	13
	Equityratio	0.119	0.071	0.060	0.280	13
OECD	Pftta	0.007	0.019	-0.150	0.060	131
	Cec10a	0.153	0.361	0.000	1.000	131
	Family1	0.210	0.412	000	1.000	131
	Widely held	0.481	0.502	0.000	1.000	131
	Size	17.274	1.930	13.650	20.770	131
	Liabilityratio	0.939	0.023	0.840	0.980	131
	Equityratio	0.061	0.023	0.020	0.160	131
						244

Note: This table reports the summary statistics for the variable for the study. Pftta is the Profitability ratio, which is calculated as profit over total assets of the bank, Cec10a is the control exceeds cash flow rights at 10 per cent in the bank, Family 1 is a dummy variable that is equal to 1 if a family or individual is the controlling shareholder, and zero otherwise. Widely held is a dummy variable that equal to one if there is no controlling shareholder, and zero otherwise, Size is the logarithm of the bank's total assets, Liability ratio which is the Leverage is calculated as the total liabilities over total assets of the bank, Equity ratio also know as leverage is calculated as the equity over total assets of the bank.

Figure 1:

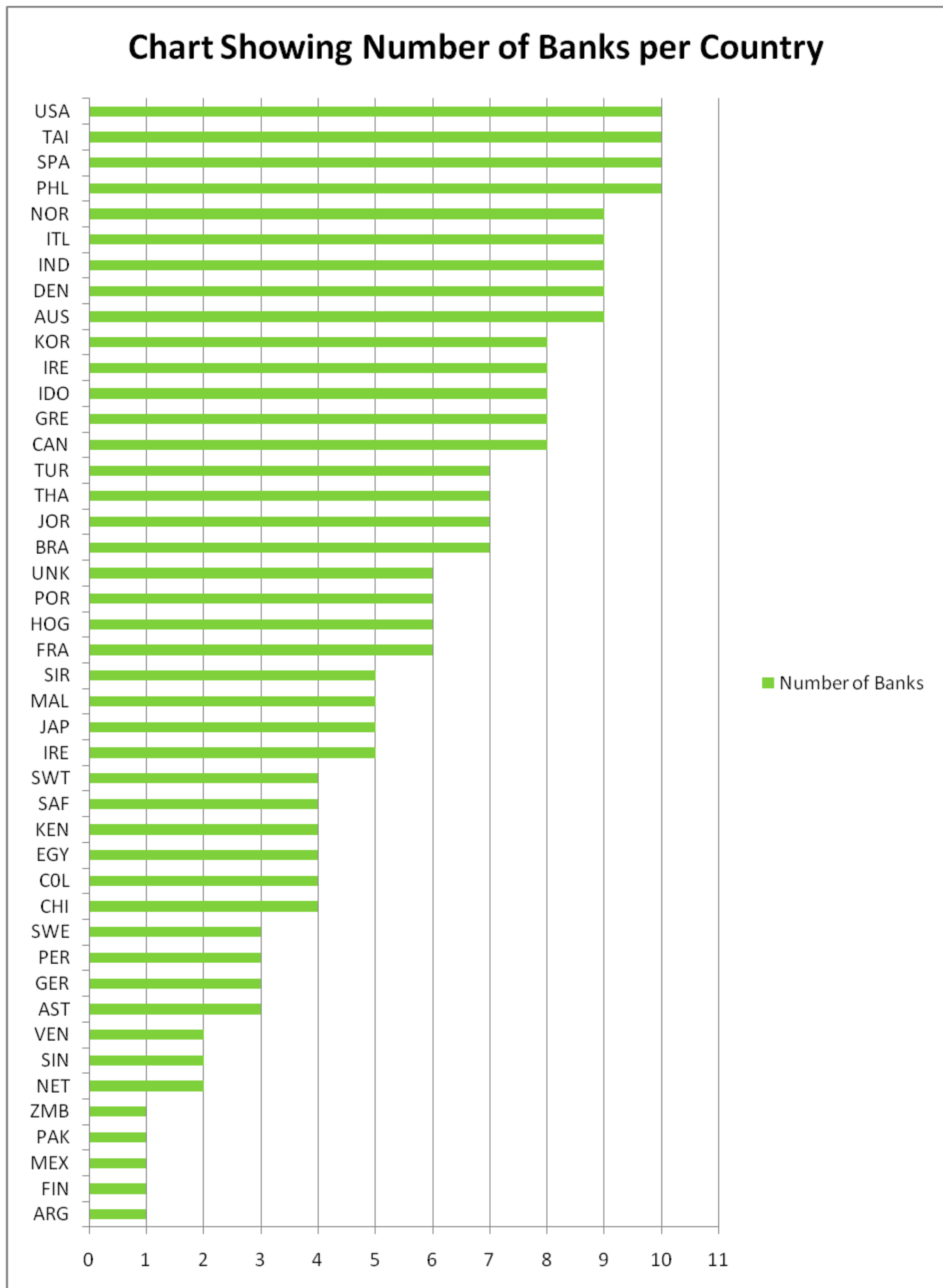


Figure 2: Chart Showing the nuber of banks in Non-OECD countries

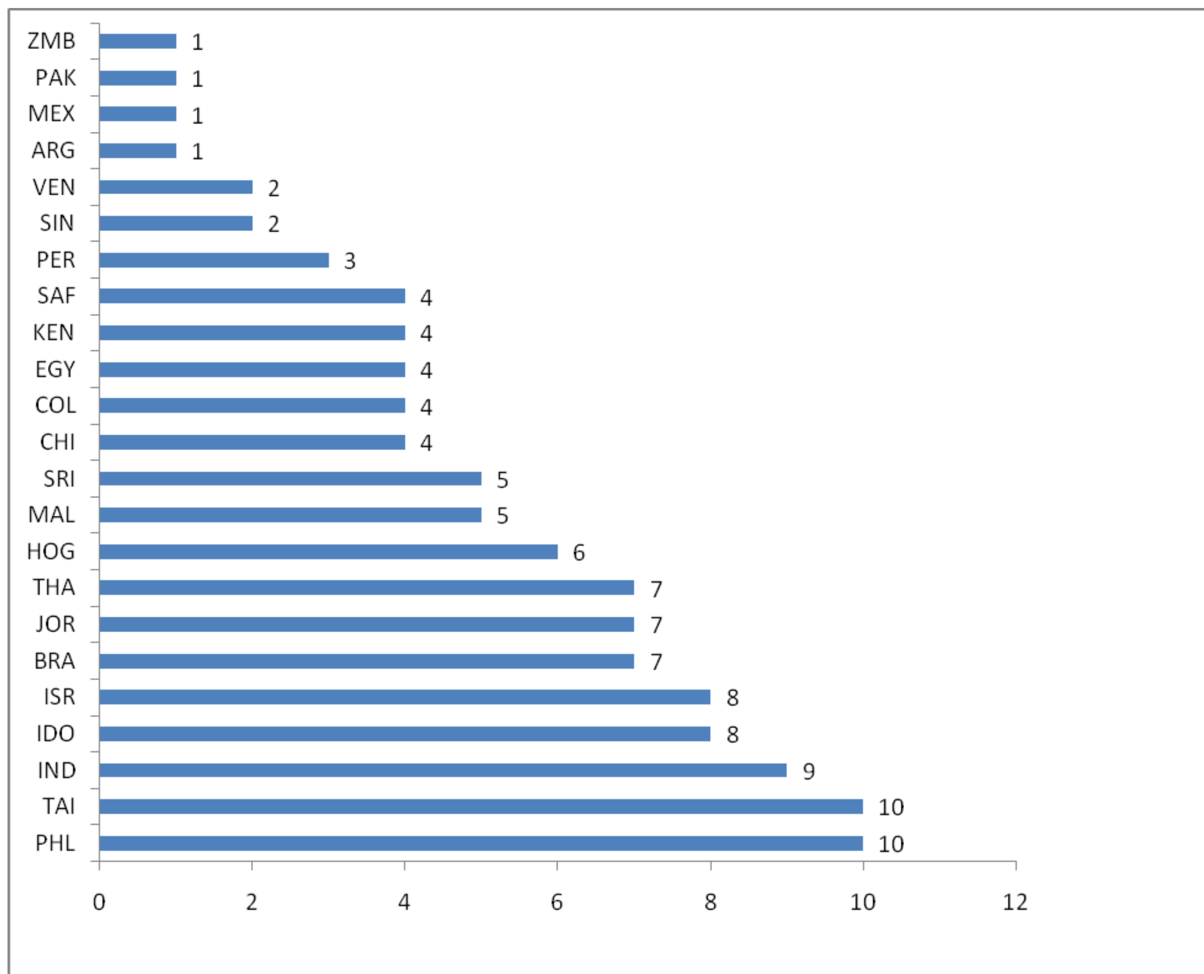


Figure 3: Chart showing the number of banks in OECD countries

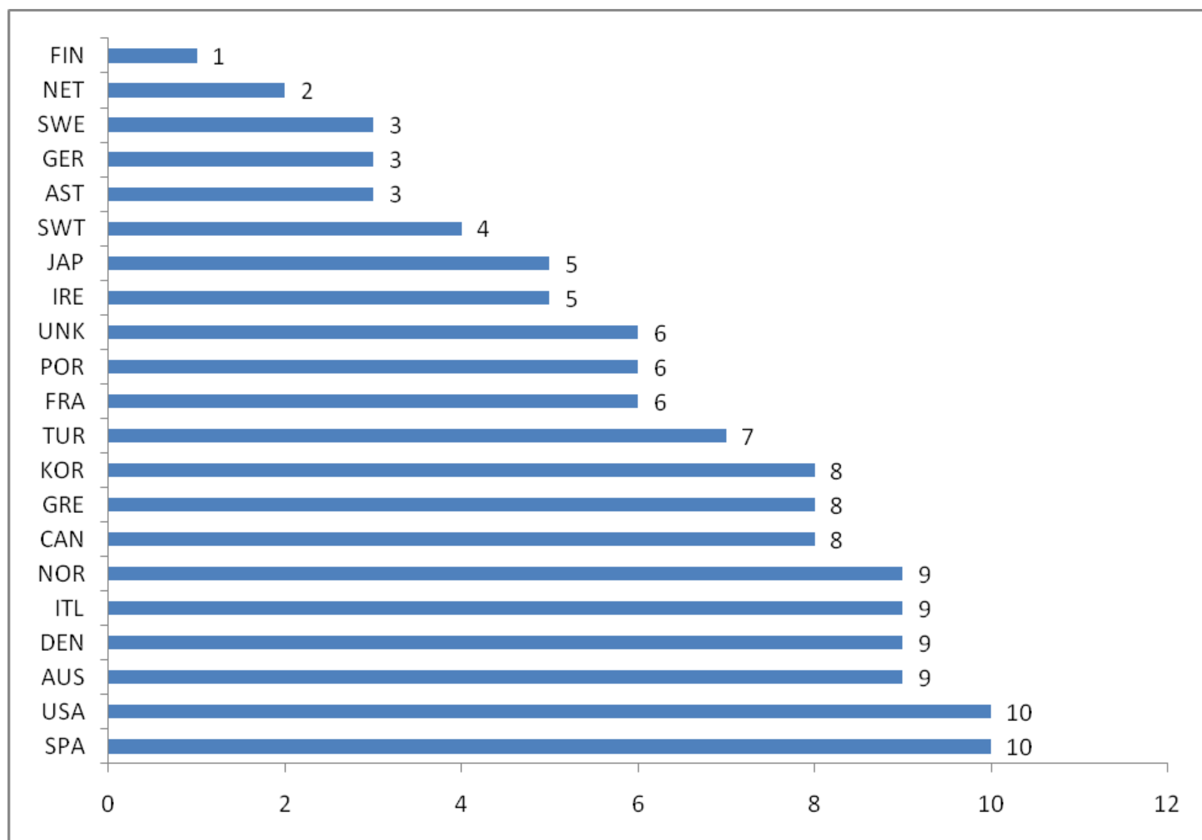
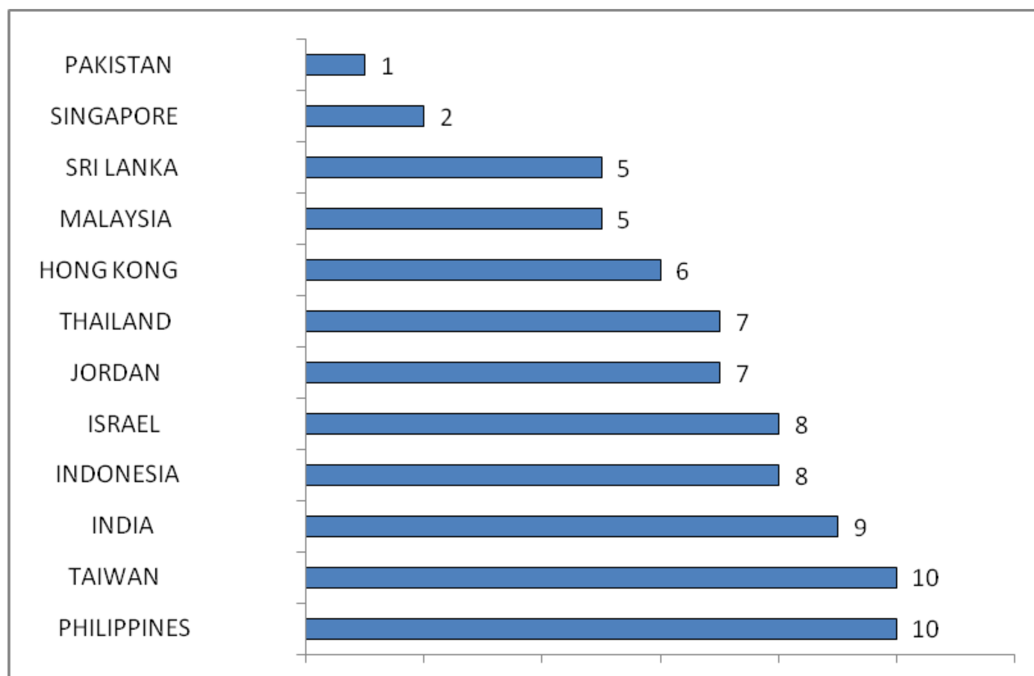


Figure 4: Chart showing the nuber of bank in Asia countries



CHAPTER FOUR

Results of the Data Analysis

4.1 Regression results

In this section this paper present OLS estimates of the empirical model using two alternative indices of bank capital structure, namely, liability ratio and equity ratio. Following our central hypotheses the study includes family ownership and control exceeds cash (CEC) flow as the two key explanatory variables. Other control variables include bank size, profitability ratio and geographical dummies indicating if the bank is located in Asia, Africa Latin America (the reference category being OECD countries); these regional dummies control for variation in bank capital structure across the regions. For each dependent variable, the study uses two specifications. Specification (1) does not include family ownership and control exceeds cash flow rights which are included in specification (2). Thus specification (2) is a more complete model of our interest and we couch our discussion in terms of specification (2). These estimates are summarized in Table 3 below.

TABLE 3. OLS Estimates of bank capital structure.

	Liability ratio		Equity ratio		Liability ratio (outlier-free)		Equity ratio (outliers free)	
	Specification 1	Specification 2	Specification 1	Specification 2				
Variables	Model 1 Column 1	Model 1 Column 2	Model 2 Column 3	Model 2 Column 4	Model 1 Column 5	Model 1 Column 6	Model 2 Column 7	Model 2 Column 8
Intercept	0.816** 0.026 (31.713)	0.830** 0.024 (34.012)	0.183** 0.025 (7.317)	0.169** 0.024 (7.135)	0.823** 0.026 (31.804)	0.835** 0.025 (33.500)	0.176** 0.026 (6.629)	0.165** 0.026 (6.441)
Size	0.007** 0.001 (5.016)	0.007** 0.001 (4.773)	-0.007** 0.001 (-5.173)	-0.007** 0.001 (-4.927)	0.007** 0.001 (4.674)	0.006** 0.001 (4.490)	-0.007** 0.002 (-4.504)	-0.006** 0.001 (-4.322)
Profitability	-0.587* 0.299 (-1.96)	-0.613* 0.270 (-2.268)	0.595* 0.295 (2.017)	0.621* 0.265 (2.344)	-0.528* 0.281 (-1.876)	-0.547* 0.251 (-2.180)	0.518* 0.285 (1.817)	0.536* 0.255 (2.104)
Family is the controlling owner	-	-0.019** 0.005 (-3.473)	-	0.019** 0.005 (3.591)	-	-0.018** 0.005 (-3.305)	-	0.018** 0.005 (3.203)
Control exceeds cash flow at 10%	-	0.011* 0.006 (1.730)	-	-0.011* 0.006 (-1.771)	-	0.008 0.001 (4.490)	-	-0.007 0.006 (-1.188)

Asia	-0.013* 0.006 (-2.291)	-0.010* 0.005 (-1.891)	0.014* 0.005 (2.553)	0.011* 0.005 (2.160)	-0.017** 0.006 (-2.970)	-0.013* 0.005 (-2.520)	0.015** 0.006 (2.684)	0.012* 0.005 (2.222)
Africa	-0.023* 0.010 (-2.280)	-0.023* 0.011 (-2.075)	0.022* 0.010 (2.321)	0.022* 0.011 (2.103)	-0.025* 0.010 (-2.449)	-0.023* 0.011 (-2.062)	0.025* 0.010 (2.413)	0.023* 0.011 (2.036)
Latin America	-0.026** 0.009 (-3.047)	-0.025** 0.009 (-2.889)	0.026** 0.009 (3.046)	0.025** 0.009 (2.912)	-0.020** 0.008 (-2.601)	-0.018* 0.007 (-2.428)	0.020** 0.008 (2.617)	0.018* 0.007 (2.429)
R^2	0.34	0.38	0.35	0.40	0.33	0.37	0.32	0.35
F-statistic	24.60	20.68	26.15	22.10	22.12	18.44	20.54	17.08
No of observation	244	244	244	244	228	228	228	228
Number of countries	44	44	44	44	44	44	44	44

Dependent variable is leverage which are liability and equity ratios. Size of the bank is Log(total assets) and Profitability ratio is profit over total assets are control variables. Family is the controlling owner is a dummy variable equal one if a family is the controlling shareholder and zero otherwise. Control exceeds cash flow (CEC) at 10% is equal to 1 if CEC at 10% is greater or equal to 2 and zero otherwise. Geographical regional dummies indicating if the bank is located in Asia, Africa and Latin America (reference category being OECD countries). Column (5)-(8) indicate the test for outliers in order to examine the robustness of the samples.

The numbers with significant level are coefficient value, while the middle numbers are the standard error and Numbers in the parentheses refer to t-statistics.

***significant at 1 per cent level.*

**significant at 5 per cent level.*

*Heteroskedasticity is corrected using White-adjusted standard errors.

Table 3 shows the OLS estimates of the two key governance variables, namely, family-ownership and control exceeds cash flow rights. It follows from column 2 of Table 3 that the estimated coefficient of family ownership is -0.019, suggesting that bank leverage is significantly lower in banks which are family owned. This in turn highlights that family owned firms tend to be more risk averse than others, even at the highest level of concentration, which in turn may generate a negative relationship between family ownership and bank leverage. This result is consistent with Daly and Dollinger (1992) who found that family owner managed firms are more risk-averse at highest level of concentration. Also the results is consistent with Anderson et al. (2002) who suggested that the consequence of family managed firms for a long term is that the firm will enjoy a lower cost of debt financing compared to other non-family managed-owner firms. More interestingly, the estimated coefficient of Control exceeds cash flow rights (CEC) is 0.011, which is statistically significant too. This implies that control exceeds cash flow has a positive effect on liability ratio. Consequently, higher control rights (in relation to cash flow rights) may give rise to serious agency problem and therefore an over- reliance on debt due to controlling

shareholders being unwilling to dilute their ownership. Our finding is consistent with prior study by Driffield et.al (2007). In addition, this also suggests that the control rights of the controlling owner exceeds cash flow rights there will be fear of sharing of control and being interfered by others and this often delays the decision of company to go for public offer. Consequently most companies will prefer to raise debt capital (Pandey 1999).

Column 2 of Table 3 shows the estimates of equity ratio as an alternative indicator of bank leverage. These results are generally in line with the results obtained from using liability ratio as a measure of leverage. In particular, we find a positive significant effect of family ownership on equity (estimated coefficient of 0.019), thus revealing preference for equity financing. This further strengthens the position of our result in model 1.where the inverse relationship between leverage and family owner managed firm is interpreted as dependence on equity rather on liability. This result is consistent with James (1999) who revealed that in a family- managed firms which made up of higher equity, there is possibility of holding long on investment and this will result in higher investment efficiency. In addition, the coefficient of control exceeds cash flow rights has a significant negative relationship on leverage but not so strong. This suggests that firms where control rights of the controlling owners exceed cash flow rights, the equity is lower, they prefer liability financing because of fear of losing control, , generally known as non-dilution of entrenchment Claessens et.al (2002)

Among other results, there is evidence that the size of bank has a positive and significant effect on debt with coefficient of 0.007. This indicates that larger banks tend to have significantly higher leverage. The latter can be facilitated by greater transparency of larger bank activities. This finding is consistent with the Rajan and Zingales, (1995) and Friend and Lang (1988) that revealed that size of firms are positively related to leverage. Similarly bank size has a negative and significant effect on equity ratio. Moreover, profitability ratio has a negative significant effect on bank leverage and this estimated coefficient of -0.613. This result is consistent with Friend and Lang. (1988) who revealed there is negative relationship between profitability and leverage in term of debt. Thus more profitable banks have lower loan, but higher equity as there the more profitable banks find it easier to raise finance from markets. There is also significant regional variation in this respect. All three regional dummies for Asia, Africa, and Latin America have negative and significant coefficients, suggesting that banks in each of these regions has a significantly lower debt relative to their counterparts in the more developed world. However, in Table 3

column 4 using equity ratio as an alternative indicator of bank leverage, these dummies variables have a positive significant effect. This suggests that banks in each of this region rely more on equity (rather than debt) finance.

Moreover, outlier test is used to examine robustness results and it shows that control exceeds cash flow have insignificant effect on leverage. Thus before testing for the outlier of the sample, there is a weak significant effect which indicates that when controlling owner rights exceeds cash flow rights it might not have strong effect on equity and liability. In addition, all others variables have the same effect as when the outliers which are observation which are numerically distant from the rest of the data have not being removed.

Table 3a: Showing diagnostic test for table 3

Test	Liability ratio	Equity ratio	Liability ratio Free outlier	Equity ratio Free outlier
JB test (normality)	108.15	109.24	3.28	115.86
JB test p value	0.00	0.00	0.19	0.00
Ramsey's RESET test	51.70(0.00)	51.23(0.00)	22.27(0.00)	48.41(0.00)

Numbers in the parentheses refer to P-Value.

The result of Jarque-Bera test (JB) from the above table show that for both liability ratio and equity ratio the p-value is significant, this indicates that the series are not following a normal distribution. This suggests that the data is non-normality. However, when the sample is free outlier the p-value of liability ratio indicates insignificant, this confirmed with normality of the data.

The Ramsey RESET test indicates shows that there are no misspecifications this because coefficients of the variable are not equal to zero. This suggest that the model is correctly specified, no omitted variables and there is correlation between explanatory variable (Independent variable) and error.

4.2 OLS Estimate of Bank Capital structure and Performance

Weill (2003) revealed that there is a relationship between leverage and performance of firms and Myers (1977) suggested that a higher leverage is correlated with a lower

corporate performance. As a result, in this section the paper started with two indicators of capital structure namely the liability ratio and equity ratio also the indicator of performance is Return on assets (ROA). The observation in this study can be summarised as following:

Table 4. OLS Estimate of Bank Capital Structure and Performance in Asia, Africa and Latin America Countries relative to OECD Countries

Variable	Liability (1)	ROA (2)	Equity (3)	ROA (4)
Intercept	0.853** 0.032 (26.331)	0.106** 0.017 (6.068)	0.138** 0.222 (6.249)	-0.001 0.006 (-0.205)
Size	0.006** 0.002 (3.480)	-0.000 0.000 (-0.370)	-0.005** 0.001 (-4.104)	0.000 0.000 (0.312)
ROA	-1.652** 0.299 (-5.522)	-	1.144** 0.228 (5.022)	-
Liability		-0.099** 0.017 (-5.828)	-	-
Equity		-	-	0.161** 0.028 (5.662)
Family is the controlling owner	-0.001 0.008 (-0.175)	0.004* 0.002 (2.103)	0.011* 0.005 (2.064)	0.002 0.002 (1.161)
Control exceeds cash flow rights at 10%	0.013* 0.008 (1.669)	0.005* 0.002 (1.943)	-0.009 0.006 (-1.575)	0.005* 0.002 (2.011)
Asia	-0.030** 0.009 (-3.375)	-0.010** 0.003 (1.943)	0.024** 0.006 (4.322)	-0.011** 0.003 (-4.411)
Africa	-0.041** 0.010 (-3.928)	-0.004 0.003 (-1.160)	0.028** 0.010 (2.704)	-0.004 0.003 (-1.315)
Latin America	-0.036** 0.012 (-3.091)	-0.007* 0.004 (1.741)	0.025** 0.008 (3.242)	-0.007* 0.004 (-1.854)
R^2	0.33	0.28	0.43	0.30
F-statistic	15.68	12.27	24.09	13.33
No of observation	228	228	228	228
No of countries	44	44	44	44

The study used OLS Estimation with leverage in term of liability and equity ratios as dependent variables and Performance indicator return on asset (ROA). Size of bank is the Log(total assets) which served as a control variables. Family is the controlling owner is a dummy variable equal one if a family is the controlling shareholder and zero otherwise. Control exceeds cash flow (CEC) at 10% is equal to 1 if CEC at 10% is greater or equal to 2 and zero otherwise. Geographical regional dummies indicating if the bank is located in Asia, Africa and Latin America (reference category being OECD countries).

The numbers with significant level are coefficient value, while the middle numbers are the standard error and Numbers in the parentheses refer to t-statistics.

***significant at 1 per cent level.*

**significant at 5 per cent level.*

*Heteroskedasticity is corrected using White-adjusted standard errors.

Table 4 columns 1 and 4 indicate liability ratio and equity ratio as bank leverage show that a family-owner managed firm has no significant relationship with debt but with equity ratio. This suggests that Family owner managed firm rely more on equity financing. While control exceeds cash flow rights have a positive effect on liability ratio and with insignificant relationship with equity. This implies that when controlling owner control rights exceeds cash flow rights they depend more on liability rather on equity because of fear of losing control. Moreover, return on asset (ROA) has a negative effect with liability ratio and a positive effect with equity ratio. This show that when firm rely on liability the return on asset (ROA) may be lower and when they rely more on equity the return on asset (ROA) may be higher

In Table 4 column 2 and 4 examined how family owner managed firm and control exceeds cash flow influence performance. There is indication that family owner managed and control exceed cash flow rights have a positive effect on return on asset (ROA). This suggests that ownership structure can influence the performance of bank.

In case of the Regional effect like Asia, Africa and Latin America on bank leverage the result is the same as indicated in Table 3. However, Asia, Africa and Latin America have a negative effect on return on asset (ROA). This may due to lower activities in financial intermediation of the region.

4.3 OLS Estimation of Bank Capital structure and Performance in OECD and Non-OECD Countries.

Ownership concentration is prevalent both in OECD countries and Non-OECD countries, but among the OECD countries except US and UK where ownership concentration is not prevalent the reason is that the changing pattern of share ownership lead to a greater concentration of ownership in the hand of institutional investors such as pension fund and insurance companies. This indicates that in UK and US most of the firms are relatively widely held. In Germany and Japan equity ownership are more concentrated where bank play a significant roles in governance. This suggests that within the OECD countries there is market centred economies which are US and UK and also bank centred economies which are Japan and Germany where financial institution have significant control over firms. In some part of Western Europe Denins and McConnel (2003) revealed that family-ownership is very common.

In Non-OECD countries there are high ownership concentration but being developing countries introduction of sound corporate governance principle into the banking sector have not being possible because of poor legal protection, weak information disclosure requirement and dominant owners Arun and Turner (2002). Compared with OECD countries where there are better sound corporate governance principles in the banking sector. In addition, in most developing countries that are Non-OECD countries the banking sectors are not intermediate efficiently because of management performance and market structure compared with OECD countries with well developed financial intermediation.

Against this background, in this section the study classified the banks in each country to OECD and Non-OECD with OLS estimates of the empirical model using two alternative indices of bank capital structure, namely, liability ratio and equity ratio in addition bank performance indicator as return on asset (ROA) in OECD and Non-OECD countries.

Table 4a: Showing diagnostic test for table 4

Test	Liability (1)	ROA (2)	Equity (3)	ROA (4)
JB (normality)	3.96	511.79	64.09	455.48
JB P-value	0.14	0.00	0.00	0.00
Ramsey's RESET test	0.86 (0.35)	1.11 (0.29)	20.12 (0.00)	0.38 (0.54)

Numbers in the parentheses refer to P-Value.

The result of Jarque-Bera test (JB normality test) from the above table show that for return on asset (ROA) with equity ratio the p-value is significant, this indicates that the series are not following a normal distribution. This suggests that the data is non-normality. However, for liability ratio the p-value indicates insignificant, this confirmed with normality of the data.

The Ramsey RESET test indicates diagnostic test shows that there are no misspecifications this because coefficients of the variable are not equal to zero. This suggest that the model is correctly specified, no omitted variables and there is correlation between explanatory variable (Independent variable) and error.

Table 5. OLS Estimation of Bank Capital structure and Performance in OECD Countries and Non-OECD Countries.

	OECD Countries				Non-OECD Countries			
Variable	Liability (1)	ROA (2)	Equity (3)	ROA (4)	Liability (5)	ROA (6)	Equity (7)	ROA (8)
Intercepts	0.894** 0.038 (23.837)	0.095** 0.021 (4.534)	0.070** 0.016 (4.379)	-0.011 0.007 (-1.557)	0.683** 0.047 (14.478)	0.105** 0.029 (3.661)	0.300** 0.042 (7.12)	0.004 0.013 (0.333)
Size	0.004* 0.002 (1.806)	6.96E 0.000 (0.018)	-0.001 0.001 (-1.373)	0.000 0.000 (0.404)	0.016** 0.003 (5.483)	-0.001 0.001 (-0.819)	-0.015** 0.003 (-5.602)	-0.001 0.001 (-0.826)
ROA	-1.706** 0.439 (-3.885)	-	1.124** 0.251 (4.487)	-	-1.269** 0.003 (-3.364)	-	0.899** 0.320 (2.810)	-
Liability	-	-0.090** 0.021 (-4.364)	-		-	-0.099** 0.033 (-3.029)	-	-
Equity		-	-	0.315** 0.063 (5.004)	-	-	-	0.003** 0.040 (2.826)
Family is the controlling owner	-0.000 0.014 (-0.017)	0.004 0.003 (1.277)	0.008 0.006 (1.391)	0.000 0.003 (0.150)	-0.012 0.010 (-1.167)	0.004 0.003 (1.651)	0.017* 0.008 (2.142)	0.004 0.003 (1.314)
Control exceeds cash flow rights at 10%	0.033* 0.014 (2.427)	0.005 0.004 (1.192)	-0.012* 0.005 (-2.388)	0.006 0.004 (1.440)	-0.014 0.009 (-1.598)	0.005* 0.002 (2.068)	0.003 0.008 (0.406)	0.006* 0.002 (2.599)

R^2	0.21	0.21	0.41	0.40	0.40	0.27	0.42	0.25
F-statistic	7.54	7.62	19.80	19.01	16.68	9.11	18.17	8.47
No of observation	121	121	121	121	107	107	107	107
No of countries	23	23	23	23	21	21	21	21

Dependent variable is leverage in term of liability and equity ratios and return on asset (ROA). Log(total assets) is size of bank. Family is the controlling owner is a dummy variable equal one if a family is the controlling shareholder and zero otherwise. Control exceeds cash flow (CEC) at 10% is equal to 1 if CEC at 10% is greater or equal to 2 and zero otherwise.

The numbers with significant level are coefficient value, while the middle numbers are the standard error and Numbers in the parentheses refer to t-statistics.

***significant at 1 per cent level.*

**significant at 5 per cent level.*

*Heteroskedasticity is corrected using White-adjusted standard errors.

Table 5 columns 1 and 3 illustrate how family owner managed and control exceeds cash flow affect bank leverage in OECD countries. The result indicates that family owner managed is insignificant on bank leverage. This suggests that in OECD countries the family owner managed effect is not so important because ownership is more dispersed. However, control exceeds cash flow rights have a positive significant effect on liability ratio and a negative significant effect on equity ratio. This implies that when controlling owner control rights exceeds cash flow they will depend more on debt financing rather on equity financing so that they will not lose control. This result is consistent with Table 3 result.

In Table 5 columns 2 and 4 show how family owner managed firm and control exceeds cash flow affect return on assets (ROA). There is indication that the two variables are insignificant in OECD and Non-OECD countries. Moreover, liability has a negative significant effect on return on assets (ROA) while equity has a positive significant impact on return on asset (ROA). This show that when firm rely on liability the return on asset (ROA) may be lower and when they rely more on equity the return on asset (ROA) may be higher. However in Non-OECD countries control exceeds cash flow has a positive significant effect on return on asset (ROA).This suggests that when controlling owner control right exceeds cash flow rights the return on asset increased which show an indication of more performance.

Generally, return on assets (ROA) indicates the same effect on both liability and equity ratios. This finding is the same as indicated in Table 4

Table 5 columns 5 and 7 illustrate the effect of family owner managed and control exceeds cash flow on bank leverage. The result show that family owner managed firm have a positive significant effect with equity ratio this indicate that in Non-OECD countries family owner managed firm rely more on equity financing. This result is consistent with Table 3 result. However in case of control exceeds cash flow there is evidence of insignificant relationship on bank leverage.

Table 5a: Showing diagnostic test for table 5

Test	OECD Countries				Non-OECD Countries			
	Liability (1)	**ROA (2)**	**Equity (3)**	**ROA (4)**	**Liability (5)**	**ROA (6)**	**Equity (7)**	**ROA (8)**
JB Test	9.96	1362.35	6.56	1210.43	0.23	51.18	0.98	58.32
JB P-Value	0.01	0.00	0.04	0.00	0.90	0.00	0.61	0.00
Ramsey's RESET test	3.55 (0.06)	5.65 (0.02)	3.60 (0.06)	11.07 (0.00)	4.21 (0.04)	0.95 (0.33)	10.53 (0.00)	0.02 (0.90)

Numbers in the parentheses refer to P-Value.

The result of Jarque-Bera test (JB normality test) from the above table show that for return on asset (ROA) the p-value is significant, this indicates that the series are not following a normal distribution. This suggests that the data is non-normality. However, for liability ratio and equity ratio the p-value indicates insignificant, this confirmed with normality of the data.

The Ramsey RESET test indicates diagnostic test shows that there are no misspecifications this because coefficients of the variable are not equal to zero. This suggest that the model is correctly specified, no omitted variables and there is correlation between explanatory variable (Independent variable) and error.

4.4 OLS Estimation of Bank Capital structure and Performance in Asia countries.

Classens et.al (2000) found that in most East Asia countries there is ownership concentrated and control is enhanced through pyramid structures and cross holding among firms with family as controlling owner. Consequently, in this section the paper investigate the effect of family-ownership and control exceeds cash flow rights on bank leverage OLS estimate to show how family owner managed and control exceeds cash flow affect bank leverage and performance.

Table 6. OLS Estimate of Bank Capital Structure and Performance in Asia Countries.

Variable	Liability (1)	ROA (2)	Equity (3)	ROA (4)
Intercepts	0.719** 0.068 (10.576)	0.076** 0.027 (2.766)	0.261** 0.054 (4.852)	0.012 0.015 (0.773)
Size	0.015** 0.004 (3.468)	-0.001 0.001 (-1.126)	-0.012** 0.003 -3.701)	-0.001 0.001 (-1.173)
ROA	-0.910* 0.407 (-2.233)	-	0.567* 0.265 (2.141)	-
Liability	-	-0.064* 0.032 (-2.027)	-	-
Equity	-	-	-	0.071* 0.037 (1.949)
Family is the controlling owner	-0.022* 0.013 (-1.776)	0.006* 0.003 (1.862)	0.022* 0.009 (2.439)	0.006* 0.003 (1.772)

Control exceeds cash flow rights	-0.030* 0.011 (-2.615)	0.005* 0.002 (2.122)	0.014 0.012 (1.187)	0.006* 0.002 (2.540)
R^2	0.32	0.21	0.33	0.19
F-statistic	8.42	4.62	8.70	4.19
No of observation	75	75	75	75
No of countries	12	12	12	12

Dependent variable is leverage in term of liability and equity ratios and return on asset (ROA). Size of bank is the Log(total assets) which served as a control variable. Family is the controlling owner is a dummy variable equal one if a family is the controlling shareholder and zero otherwise. Control exceeds cash flow (CEC) at 10% is equal to 1 if CEC at 10% is greater or equal to 2 and zero otherwise.

The numbers with significant level are coefficient value, while the middle numbers are the standard error and Numbers in the parentheses refer to t-statistics.

***significant at 1 per cent level.*

**significant at 5 per cent level.*

*Heteroskedasticity is corrected using White-adjusted standard errors

Table 6 columns 1 and 3 present effect of family owner managed firm and control exceeds cash flow on bank leverage. There is evidence of negative significant effect of family owner managed firm on liability ratio and a positive significant effect on equity ratio. This suggests that in Asia countries family owner managed firms prefer higher leverage by rely more on equity financing rather than debt financing. This result is consistent with Table 3. In addition, control exceeds cash flow rights have a negative significant relationship with liability ratio and insignificant effect with equity ratio. This implies that when controlling owner control right exceeds cash flow rights the firms prefer lower bank leverage by rely less on debt financing so that they will not lose control if they rely on equity.

Table 6 columns 2 and 4 contain information on how family owner managed firm and control exceeds cash flow rights influences performance. There are indications that these two variables have positive significant effect on return on assets (ROA). This indicates in Asia countries the family owner managed firms and when control exceeds cash flow rights the bank performed better.

Moreover, the effect of both liability and equity ratio on return on assets (ROA) show that liability have a negative effect on return on assets while equity have a positive significant impact on return on assets (ROA). This suggests as the banks in Asia countries have a higher return on assets their debt financing continue to be lower. However when equity financing increases the return on assets (ROA) also increases. In addition, return on asset (ROA) has the same significant effect on liability and equity. This result is consistent with results in Table 4 and 5 of this study.

Table 6a: Showing diagnostic test for table 6

Test	**Liability (1)**	**ROA (2)**	**Equity (3)**	**ROA (4)**
JB (Normality)	1.20	53.94	1.90	56.04
JB P-Value	0.55	0.00	0.39	0.00
Ramsey's RESET test	0.83 (0.37)	0.01 (0.10)	1.07 (0.30)	0.40 (0.53)

Numbers in the parentheses refer to P-Value.

The result of Jarque-Bera test (JB normality test) from the above table show that for return on asset (ROA) the p-value is significant, this indicates that the series are not following a normal distribution. This suggests that the data is non-normality. However, for liability ratio and equity ratio the p-value indicates insignificant, this confirmed that the series have normal distribution of the data.

The Ramsey RESET test that indicates the diagnostic test shows that there are no misspecifications this because coefficients of the variable are not equal to zero. This suggest that the model is correctly specified, no omitted variables and there is correlation between explanatory variable (Independent variable) and error.

4.5 Conclusion

This paper provides empirical results to show important characteristics of the prevalent ownership structure around the world by reveals the effect of family-owner managed firms and control exceeds cash flow rights on bank capital structure. Based on the evidence from the study, family owner managed firms prefer bank with more equity financing than debt financing as a result of a positive relationship between family-owner managed and equity. This suggests that family-owner managed firms prefer lower leverage in term of debt, by injecting more equity and minimised the level of liability. This analysis also implies that family owner-manage firms believed in firm survival by having strong equity to assets base so that they can pass firm on to their heirs. The above finding is applicable to banks in Asia, Africa and Latin America countries in relative to banks in OECD countries as show in Table 3 and 4. In addition for bank in Asia countries as a case study also give the same evidence with reference to Table 6. However in OECD countries there is insignificant effect of family owner managed firm on bank leverage but in Non-OECD countries the family owner managed have a significant effect by rely more on equity financing as indicated in Table 5

Moreover, the study also examine the relationship that occur when control rights of the controlling owner exceeds cash flow rights and bank leverage and it has a negative significant effect on bank leverage using equity ratio as indicator for bank leverage. However, using liability ratio as indicator for bank leverage there is a positive significant effect. This suggests when control right of the controlling owner exceeds cash flow rights, the equity is lower and they prefer debt financing because of fear of losing control. This result is consistent for banks in Asia, Africa and Latin America countries relative to OECD countries but with weak significant effect on bank leverage as indicated in Table 3. Furthermore, for bank in OECD countries there is a strong significant effect of control exceeds cash flow on bank leverage compared with bank in Non-OECD countries does not have significant effect on bank leverage with reference to Table 5.

However, in Asia countries as a case study control rights exceeds cash flow rights have a significant effect on bank leverage by rely more on equity financing rather than debt as shows in Table 6. Generally family owner managed and control exceeds cash flow rights have a positive effect on performance indicator (ROA) for banks Asia, Africa and Latin America with reference category (relative) to bank in OECD countries and also same evidence for banks in Asia countries as a case study.

4.6 Policy implication

Higher control rights may give rise to serious agency problem and this associated with over reliance on debt due to controlling shareholders being unwilling to dilute their ownership for fear of losing control. Rather controlling shareholders may prefer firms to use more debt since debt holders have no voting rights. However, in this study there is evidence that when controlling owner control rights exceeds cash flow rights they may rely more on debt (liability) financing with higher return on assets increase (ROA). Consequently, controlling shareholders and management of the banks should not allow excessive building up of bank leverage through debt (liability) level as excessive leverage may be one of the reasons for current financial crisis.

In addition, in a family-owner managed firms they should be involved more to a certain level of risk taking because from the above evidence when a family owner managed firm rely on debt the return on asset (ROA) is more higher, but if they rely on equity there is no significant effect especially bank in Non- OECD countries relative to banks in OECD countries. As a result, this may improved the financial intermediation of bank in Non-OECD.

Moreover, the regulators should consider the measure to control bank leverage by including leverage ratio in pillar 2 as part of indicator for monitoring bank supervision in order to avoid excessive bank leverage. Also the regulators should be mandatory the bank with optimal capital structure that indicates a balance between the proportion of debt (liability) and equity hold. This will also allow the bank not to build up excessive leverage. Furthermore, the improvement of governing of banks depends on debt because investors use debt to generate information and monitor the management. Therefore, there is need for tighten capital requirement which will reduce the risk of bank failure.

4.7 Limitation of the study.

One of the weaknesses of this study is that there are no enough bank data from Africa and Latin America and this may hindered the results of the study. In addition, the level of ownership structure and control affect capital structure may depend on quality of banking system, the legal and judiciary protection of different shareholders, EPS, value and role of regulatory authority these are issues for future study.

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