Do Insiders Protect Debtholders’ Interest? 
Evidence from Pakistan

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ABSTRACT
This paper investigates the relationship between the agency cost of debt and insiders’ ownership while controlling the firm decisions regarding capital structure and dividends. Agency Study selected top 100 highly capitalized manufacturing firms listed in Karachi Stock Exchange as sample from the period of 2006-2010. By applying fixed effect and random effects technique of generalized least square regression, we found that insiders in Pakistan are more concerned with the cost of debt financing because they look their long term benefits and take care of their reputation which may destroy if firm become bankrupt in case of nonpayment of their debt obligation. So they try to avoid high agency cost of debt. Moreover study has analysis of impact of managerial ownership in Pakistan on the agency cost of debt.

Key words: Insiders ownership, managerial ownership, agency cost of debt, debtholders, Pakistan. 

INTRODUCTION
Jensen and Meckling (1976) identified agency conflict between debtholders and shareholders and narrated that large debt level may create risk shifting or asset substitution problem which constitute agency cost of debt. Agency cost of debt is implicit and explicit cost of monitoring by debtholders. If debtholders are able to strongly monitor manager’s actions, then it should have lower implied agency cost of debt. In this regard, fixed assets of the firm are always easy to monitor, while liquid assets and those assets which are not engaged in fix plant and equipment are difficult to monitor by debtholders, and Managers may use such assets to expropriate wealth form debtholders on behalf of shareholders. Debtholders want that there should be such ownership in a firm that disciplines the managers to take care the interest of debtholders. Insider’s ownership is frequently researched ownership pattern in previous years. This paper investigates what is the impact of insiders’ ownership on the agency cost of debt. It is because two different opinions are presented about insiders’ ownership. One argues that when insiders become owners of the firm, then owners-managers interests are converged. So decisions are done to give benefits to shareholders even at the expense of debtholders’ interest. So agency cost of debt should rise. Other opinion is that when managers become owners of the firm, they have long term motives and interests. They don’t show short term performance rather want to achieve long term return. Long term interests require that there should be no conflict of interest between shareholders and debtholders so that higher cost of debt can be avoided. Because if agency cost of debt is higher, then debtholders will charges higher interest rate that can result in financial distress of firm if firm is unable to pay it. Agency cost of debt may be lower according to this concept.

Although numerous studies can be found who have discussed agency cost and impact of insider ownership. But quite few studies have considered the question do insiders protect debtholders interest. Majority of the researchers have tested impact of managerial ownership on firm performance in the interest of shareholders, these researchers have ignored the presence of other stakeholder in the firm, which is debtholders. Present study is testing whether insiders in the Pakistani firms protect the debtholders interest or not.

The rest of the paper is structured as follows: Second section contains review of selected literature regarding variables of study. Third is the methodology adopted to do this research. Section four presents results and discussion on results and section five is comprise of conclusion of the study.

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LITERATURE REVIEW

Jensen (1986) presented the convergence of interest hypothesis. With their ownership managers less likely involve in wasteful activities for discretionary purpose. Managerial ownership acts as Effective internal control mechanism and positive monitoring substitutes to reduce agency conflict. Schulze et. al. (2001) conducted survey and found reverse results. They narrated that altruism, on the other extreme; intensify agency problems experienced by these privately held, owner-managed firms. Study of Ugurulu (2000) and Ang et. al. (2000) found that insider owners are significantly lower in the firms which face agency problem. Study of Doukas et. al. (2000) conveys that managers who are owners are not inclined to divert resources away from value maximization. Lasfer (2002) found that for low growth firms, as managerial ownership increases, the free cash flow problems are mitigated and firm value increases. Jung and Kwon (2002) and Singh and Navidson III (2003) found that when owner is also the manager of the company, then owner manager interests are converged. Dittmar et. al. (2003) proposed that agency costs of managerial discretion play an important role in explaining cash holdings.

Florackis (2008) suggested a mix of four devices that can resolve the agency issue, which includes: managerial ownership, ownership concentration, short term debt and managerial compensation. Lafond and Roychowdhury (2008) found that, as managerial ownership declines, the severity of agency problem increases, declining the demand for conservatism. McKnight and Weir (2009) found that insiders ownership reduce the cost of agency problem, higher board shareholdings are associated with lower agency costs. Mustapha and Ahmad (2011) and Fatma and Chichti (2011) found that managerial ownership is a noteworthy factor in affecting the companies’ monitoring costs. Byrd (2010) finds no evidence, that managerial stock ownership or board independence mitigating agency conflicts. Ehsan (2012) It indicated that in case of Pakistan, firm’s insiders not only possess strong control over the funds but also attempts to use them for their personal benefits.

Almost all the researchers have conclude that when there is ownership of insiders in a firm, then decisions are done in the best favor of shareholders. Interests of owners and managers are converged. Gap in the literature is present which raises the question about the impact of ownership of insiders on the interest of debtholders. Although ownership of insiders protects the interests of shareholders but do debtholders feels security in such scenario? This question is still debatable.

METHODOLOGY

Data Description

Sample of this study is 100 manufacturing companies from Karachi stock exchange and study window is 2006-2010. There are total 604 listed companies in Karachi Stock Exchange as on 5 April 2012. We ignored financial firms because these firms need different and specialized accounting and financial treatment for their analysis. Moreover same statistical techniques cannot be applied for both types of firms in research based study because financial and non financial firms operate at different accounting and financial procedures. Among non financial firms, we selected 100 top capitalized KSE listed firms. Moreover we selected those firms which remained in business for the whole study period and enlisted during entire study period and should not have been merged due to any reason. For payout policy we included only those firms who pay dividend at least once in five years. Similarly we included only those firms of which financial and ownership data was available.

Variables:

**Measuring Agency Cost of Debt (ACD)**

Manso (2008) took the ACD as the difference between the total value of all-equity and levered firms. Doukas and Pantzalis (2003) defined ACD as conflict between shareholders and bondholders. They used three definitions of ACD. First is Market-to-book ratio defined as market value of equity divided by the book value of equity. This ratio measures the firm’s future growth opportunities. Second is the ratio of Total Assets/Gross Fixed Assets as a measure of firms assets tied up in fixed plant and equipment. Third is proportional measure of free cash flow measured as Operating Income before Depreciation minus Taxes minus Interest Expense minus Dividends whole divided by Total Assets.

Kayakachian (2000) used three measures of agency cost of debt. One is proportion of firm assets not invested in fixed plant and equipment. Equity holders find it easier to engage into wealth-transferring actions at the expense of bondholder’s wealth when the noncollateralized assets of the firm are of large proportions. Liquidity shows the ease with which firm assets can be manipulated at the bondholder’s expense. Third is R&D intensity measured by the ratio of R&D expenditures to total sales. According to him, it is very difficult for outsiders and debtholders to monitor the risk implicit in R&D expenditures. More expenditures in R&D show discretionary behavior from debtholders. So greater R&D intensity, greater debt agency cost.

Derived from the studies of Doukas and Pantzalis (2003), Kayakachian (2000) and Prowse (1990) our study is using following two proxies
Proxy 1: Proportion of firm assets not tied in fixed plant and equipment.
If a firm has higher proportion of fixed assets, then it is more difficult for the agents to engage in activities that harm debtholders. It is because if firm has higher proportion of fixed assets, it shows that firm has invested all its free cash flows in fixed assets to maintain that proportion. On the contrary, if a firm has higher proportion of firm assets not invested in fixed plant and equipment, it indicates the agency cost of debt.
Proportion of firm assets not tied in fixed plant & equipment = 1 – fixed assets/total assets

Proxy 2: Liquidity of firm assets.
Liquidity indicates the ease with which wealth can be manipulated at the bondholders’ expense. For example managers may put out cash dividends to shareholders, potentially expropriating wealth from debtholders. If the assets are more liquid, then managers can expropriate wealth from debtholders for the equityholders more easily. Higher the liquidity of firm assets, the greater the opportunity for managers to engage in activities that harm debtholders. So higher the liquidity of firm assets, higher the probability of agency cost of debt.
Liquidity of firm assets = cash & marketable securities / total assets

Measuring Insider Ownership (IO):
Almost all researchers measured the insiders’ ownership by same method. For example Singh and Navidson III (2003) measured it as Log of percentage of total equity held by the executives and the board members of a firm. Fatma and chichit (2011) measured it as number of shares that are owned by directors and members of boards divided by total of shares. Harford, Mansi and Maxwell (2008) took it as the ratio of top-five insider holdings of common stocks to the total shares outstanding. Kusnadi (2003) measured it as percentage of equity ownership by the insiders, i.e. executive directors. Byrd (2010) and Doukas and Pantzalis (2003) measured it as fraction of outstanding shares owned by all managers and members of the board of directors expressed as a percent. Lasfer (2002), Gillian et. al. (2002) and Florackis (2008) measured it as proportion of shares held by directors. Woidtke (2001) and Ang and Cox (1997) measured it as number of shares in a firm held by insiders divided by total number of shares outstanding. Lingling Wu (2004) measured it as percentage of shares owned by the chairman and president of the firm. Agrawal and Knoeber (1996) measured it as Percentage of equity owned by officers and directors.

Almost all the researchers have used similar definition of the insider ownership. So our study has also used the same:
“The number of common shares own by insiders divided by total number of common shares outstanding. Insiders consist of officers, affiliated directors, beneficial owners and principal shareholders”. (Kayakachoiian, 2000).

Present study also contains the analysis of relationship of managerial ownership with agency cost of debt. Study measured managerial ownership by the number of common shares own by executives and directors (other than family members) divided by total number of shares outstanding.

Measuring Control Variables:
We include various control variables in the analysis that potentially affect the agency cost of debt. Set of contro; variables in the study are Leverage (LEV), Dividend payout ratio (DP), Profitability (PROF), Size of firm (SIZE) and Growth of firm (GROWTH).

First control variable of the study is debt ratio (LEV) of the firm measured by book value of contractual long term debt / Book value of total assets. Following Fatma and chichit (2011), Crutchley (1999), Atmaja et. al. (2007)

\[
LEV = \frac{Total\ Contractual\ Debt}{Book\ Value\ of\ total\ assets}
\]

Mao (2003) found that that agency cost of debt does not increase with increase in leverage. We expect negative relationship between debt ratio and agency cost. It is because debt constrains the managers and it reduces the free cash flow, so reduces the manager’s discretions. Debt contains fix obligations. Managers are afraid of losing jobs if firm fails to fulfill financial obligations and goes to bankrupt. In case of family ownership, leverage plays more roles in reducing agency cost of debt because they have issues regarding reputation. If firm fails to pay back debt obligation, name of family destroys along with the bankruptcy of firm. Moreover, owners of family managed firms are more conscious about the increased cost of debt financing. In addition to LEV, present study also used firm’s dividend payout as a control variable. Dividend payout is measured by following formula: Following Kayakachian (2000)

\[
DP = \frac{Dividends\ per\ share}{Earnings\ per\ share}
\]

Where dividends per share are obtained by dividing dividends paid by total no of shares outstanding. We expect that there is positive relationship between dividends and agency cost of debt. Dividends show the expropriation of wealth from debtholders. The cash which can be used to pay debtholders obligations in future is paid to shareholders in the form of debtholders. This is increasing the wealth of shareholders on debtholders expense.
Present study is also using profitability as control variable. Profitability is measured as Ratio of net income to sales. Following Doukas and Pantzalis (2003)

$$PROF = \frac{Earnings\ after\ interest\ and\ taxes}{Total\ Sales}$$

We expect positive relationship between agency cost of debt and profitability. Because increased profitability means more cash flows. So owners have incentive to invest that cash in risky projects. So problem of risk shifting or asset substitution may occur.

Size of the firm is also among the control variables. Firm size is measured as the natural log of the total assets of the firm. We anticipate positive relationship between firm size and agency cost of debt because large sized firms are difficult to monitor by the debtholders. Last control variable is growth of the firm which present study measured by market to book ratio: Following Woidtke (2001), Florackis (2008) Lasfer (2002), McKnight and Weir (2009) and Ferreira (2004)

$$Growth = \frac{market\ value\ of\ equity + Book\ Value\ of\ debt}{Book\ Value\ of\ Total\ Assets}$$

More cash flows are expected with growth opportunities. Asset substitution or risk shifting problem may arise. So we expect positive relationship between growth opportunities and agency cost of debt.

We estimate the following regression models. In the first model, insider ownership is regressed against debt agency cost whereas in second model, insider ownership is replaces by managerial ownership to check the individual impact on the agency cost of debt.

$$ACD_t = \beta_0 + \beta_1 (IO)_{it} + \beta_2 (LEV)_{it} + \beta_5 (DP)_{it} + \beta_6 (PROF)_{it} + \beta_7 (SIZE)_{it} + \beta_8 (GROWTH)_{it} + \beta_9 (YRDUM)_{it} + \epsilon_{it} \quad (Eq. 1)$$

$$ACD_t = \beta_0 + \beta_1 (MO)_{it} + \beta_2 (LEV)_{it} + \beta_5 (DP)_{it} + \beta_6 (PROF)_{it} + \beta_7 (SIZE)_{it} + \beta_8 (GROWTH)_{it} + \beta_9 (YRDUM)_{it} + \epsilon_{it} \quad (Eq. 2)$$

Whereas

ACD = Agency cost of debt (Proxy I) measured by proportion of firm assets not tied in fixed plant and equipment and
ACD = Agency cost of debt (Proxy II) measured by liquidity of firm assets.
IO = Insiders ownership, LEV = Leverage, DP = Dividends, PROF = Profitability, MO= Managerial Ownership

**Technique Used**

This study used Fixed Effects and Random-effects Generalized Least Square (GLS) regression on panel data is used to examine the given relationship between CSR and FP. Rather than OLS (Ordinary Least Square), GLS (Generalized Least Square) is capable of generating those estimators which are Best Linear Unbiased Estimators (BLUE) because it takes into account the variability in the dependant and independent variables explicitly (Gujrati, 2003, pp.395).

**RESULTS & DISCUSSION**

Table 1 gives the detail of descriptive analysis of 100 firms listed at Karachi Stock Exchange (KSE) of Pakistan from the period 2006 to 2010. Agency cost of debt is used as a dependant variable which is measured by two proxies: one is proportion of firm assets not invested in fixed plant (ACD1) and equipment and other is liquidity of firm assets (ACD2). Out of these remaining variables, five are control variables (Debt ratio, Dividend Payout Ratio, Profitability of firm, Size of Firm and growth opportunities of firm), and independent variable is ownership structures: Insiders ownership and managerial ownership (IO & MO). A panel data analysis is followed in which each firm-year is treated as individually which helps to establish a total sample of 500 firm year observations. So each variables has 500 number of observations for 5 years period. Mean ACD1 value is 55.0%. It shows that firms have minimum of 5% and maximum of 97% Mean value of ACD2 comes out to be 11.03%. ACD as measured by liquidity of firm assets is zero in its minimum case and 77.90% in its extreme case. It tells that firms also have zero ACD in Pakistan.

**Table 1: Descriptive Statistics**

<table>
<thead>
<tr>
<th></th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACD1</td>
<td>500</td>
<td>0.005</td>
<td>0.970</td>
<td>0.549</td>
</tr>
<tr>
<td>ACD2</td>
<td>500</td>
<td>0.000</td>
<td>0.779</td>
<td>0.110</td>
</tr>
<tr>
<td>IO</td>
<td>500</td>
<td>0.000</td>
<td>0.920</td>
<td>0.178</td>
</tr>
<tr>
<td>MO</td>
<td>500</td>
<td>0.000</td>
<td>0.730</td>
<td>0.024</td>
</tr>
<tr>
<td>LEV</td>
<td>500</td>
<td>0.000</td>
<td>0.934</td>
<td>0.190</td>
</tr>
<tr>
<td>DP</td>
<td>500</td>
<td>-14.470</td>
<td>22.726</td>
<td>0.467</td>
</tr>
<tr>
<td>SIZE</td>
<td>500</td>
<td>19.055</td>
<td>26.156</td>
<td>2.269</td>
</tr>
<tr>
<td>GROWTH</td>
<td>500</td>
<td>0.038</td>
<td>15.650</td>
<td>1.346</td>
</tr>
</tbody>
</table>

Mean IO in Pakistani firms is 17.82% Insiders’ ownership in Pakistani firms ranges from 0 to 92%. MO is ownership of directors (other than family member) and executives of the company. Pakistani firms have
average of 2.42% managerial ownership in them. Managerial ownership in Pakistani firms is 0% in its lower case and 73.54% at its extreme case. These statistics depict that Pakistani firms have less trend of managerial ownership. Although ownership of Board of directors is quite prominent in pattern of shareholding in Pakistani firms, but the directors who own majority of shares are more often family members, so their ownership falls in the category of family ownership in our study.

Table 2: Correlation Matrix

<table>
<thead>
<tr>
<th>Variables</th>
<th>ACD1</th>
<th>ACD2</th>
<th>IO</th>
<th>MO</th>
<th>DR</th>
<th>DP</th>
<th>SIZE</th>
<th>GROWTH</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACD1</td>
<td>1</td>
<td>.354**</td>
<td>-.258**</td>
<td>-.112*</td>
<td>-.538**</td>
<td>.003</td>
<td>.151**</td>
<td>.200**</td>
</tr>
<tr>
<td>ACD2</td>
<td>1</td>
<td></td>
<td>-.271**</td>
<td>-.133**</td>
<td>-.323**</td>
<td>.062</td>
<td>.116**</td>
<td>.060</td>
</tr>
<tr>
<td>IO</td>
<td>1</td>
<td>.350**</td>
<td>.060</td>
<td>-.081</td>
<td>-.246**</td>
<td>-.190**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>MO</td>
<td>1</td>
<td>.068</td>
<td></td>
<td>-.039</td>
<td>-.078</td>
<td>-.099**</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEV</td>
<td>1</td>
<td>.027</td>
<td>.030</td>
<td></td>
<td>-.073</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DP</td>
<td>1</td>
<td></td>
<td>-.095**</td>
<td>.085</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>1</td>
<td></td>
<td>.019</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GROWTH</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).
*Correlation is significant at the 0.05 level (2-tailed).

Table 2 show the correlation between variables employed in our study. Table shows that problem of multicollinearity does not exist in variables involved in study.

Results of Generalized Least Square Regression

Table 3 shows the regression results drawn by Generalized Least Square Regression. Model 1.1 is showing the relationship between ACDI with independent variables and Model 1.2 is showing relationship between ACDII and independent variables. Results are illustrating that random effect model is most appropriate in explaining both models because Hausman statistics is not significant at p less than 1%. Results of model 1.1 is showing that Insider ownership is significant and negatively (-0.259, p<0.05) related with agency cost of debt measured by proportion of firm assets not invested in fixed plant and equipment. Increase in the ownership in insiders in the Pakistani firms reduces the proportion of firm assets not invested in fixed plant and equipment by 25.9%. This means that increase in insider ownership reduces the agency cost of debt. This is confirmed by the results of model 1.2. Results are advocating that insider ownership is significantly negative related (-0.416, p<0.05) with agency cost of debt measured by liquidity of firm assets. Thus statistics of both models is indicating robustness of results by confirming each other findings. These results are also according to our expectations. It shows that insiders in Pakistani firms have not preference of having assets that are not part of fixed assets and equipment. Having such assets which are generally more liquid, makes it less likely that the firm would have to go to capital markets where it would be monitored by investors. It shows that the firms which are more owned by insiders have lower agency cost of debt. Debtholders feel secure to issue debt to the firms which are owned by insiders and they should charge less cost of financing from such firms. Higher insiders’ ownership in the firms means that insiders bear a higher proportion of costs of their purquisites consumption. Convergence of interest with shareholders take place. Our results are convincing that in Pakistani firms, insiders are not involved in asset substitution or risk shifting problems. They don’t increase the wealth of shareholders on the expense of debtholders. And they don’t produce incentives to expropriate debtholders wealth as they maintain lower proportion of such assets which is not tied in fixed plant and equipment or liquid assets.

Table 3: Results of GLS Regression (Model 1)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Model 1.1</th>
<th>Model 1.2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FE Model</td>
<td>RE Model</td>
</tr>
<tr>
<td>Constant</td>
<td>1.476**</td>
<td>1.020*</td>
</tr>
<tr>
<td>Insider Ownership</td>
<td>-0.008</td>
<td>-0.259**</td>
</tr>
<tr>
<td>Leverage</td>
<td>-0.360*</td>
<td>-0.434*</td>
</tr>
<tr>
<td>Dividend</td>
<td>-0.001</td>
<td>0.002</td>
</tr>
<tr>
<td>Firm Size</td>
<td>-0.003</td>
<td>-0.014</td>
</tr>
<tr>
<td>Firm’s Growth</td>
<td>0.004</td>
<td>0.005</td>
</tr>
<tr>
<td>Year Dummy</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>R2</td>
<td>0.289</td>
<td>0.379</td>
</tr>
<tr>
<td>Hausman Test</td>
<td>9.16 (insignificant at p&lt;0.01)</td>
<td>9.33 (insignificant at p&lt;0.01)</td>
</tr>
</tbody>
</table>

* & ** are respectively significance levels at 1%, 5% and 10% respectively.
that it is relatively easy to monitor the selling of firm assets or their shift from one use to another. So higher the proportion of fix assets for a firm, the more difficult it is for managers to engage in projects that harm debt holders. Higher the proportion of firm assets not invested in fix plant and equipment; the easier it is for the managers to engage in activities that harm debtholders. This justifies the negative relationship of debt ratio with proportion of firm assets not invested in fix plant and equipment. Payment of installments and interest reduces the amount of those liquid assets. So only fix assets are remaining that can be easily monitored by debtholders. So increase in debt ratio reduces the agency cost of debt. Same relation is found when agency cost of debt is proxied by liquidity of firm assets as shown in Table 4. Dividends are found to be positive but insignificant related with both proxies of agency cost of debt although we were anticipating strong negative relationship of them. Size and growth opportunities are also insignificant related with ACD1 and ACD2.

Table 4: Results of GLS Regression (Model 2)

<table>
<thead>
<tr>
<th>Variables</th>
<th>Model 2.1</th>
<th></th>
<th>Model 2.2</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FE Model</td>
<td>RE Model</td>
<td>FE Model</td>
<td>RE Model</td>
</tr>
<tr>
<td>Constant</td>
<td>1.440*</td>
<td>0.764</td>
<td>1.162</td>
<td>0.005</td>
</tr>
<tr>
<td>Managerial Ownership</td>
<td>-0.128***</td>
<td>-0.091</td>
<td>-0.005</td>
<td>0.052</td>
</tr>
<tr>
<td>Leverage</td>
<td>-0.361*</td>
<td>-0.455*</td>
<td>-0.083</td>
<td>-0.259*</td>
</tr>
<tr>
<td>Dividend</td>
<td>0.003</td>
<td>0.002</td>
<td>0.001</td>
<td>0.003</td>
</tr>
<tr>
<td>Firm Size</td>
<td>-0.033</td>
<td>-0.004</td>
<td>-0.041</td>
<td>0.009</td>
</tr>
<tr>
<td>Firm’s Growth</td>
<td>0.005</td>
<td>0.006</td>
<td>-0.002</td>
<td>-0.002</td>
</tr>
<tr>
<td>Year Dummy</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>R2</td>
<td>0.217</td>
<td>0.365</td>
<td>0.002</td>
<td>0.293</td>
</tr>
<tr>
<td>Hausman Test</td>
<td>16.77*</td>
<td></td>
<td>11.29 (insignificant at p&lt;0.01)</td>
<td></td>
</tr>
</tbody>
</table>

* , ** and *** are respectively significance levels at 1%, 5% and 10% respectively.

Table 4 shows the GLS results while replacing IO by MO from the model. First MO is regressed against ACD1 in the presence of LEV, DP, SIZE and GROWTH. Results are illustrating that fix effect model is more appropriate in explaining this model as Hausman test is significant at 1% level of confidence interval. Here MO is significant and negative significant (-0.1280, p<0.01) with ACD1, explaining that one percent increase in the ownership of managers, decrease the ratio of such assets which are not part of fix assets by 12%. In managerial owned firms, there is less proportion of assets that are not part of fixed plant and equipment. As lower proportion of such assets represent lower agency cost of debt, so in Pakistani firms, where managerial ownership is higher, agency cost of debt is lower. Managers and owners of Pakistani managerial owned firms don’t expropriate debtholders’ wealth for their own perquisites. Same results cannot be reported when MO is regressed against ACD2. Here random effect model is more appropriate to explain the model because Hausman test statistics is not significant. Results of this model are also advocating that MO is positive related with ACD2 but this is not significant. This highlights the notion that managers in Pakistani firms, when become the owners of the firm, they have motives to increase the cash and cash equivalents in their hands. That might cause agency cost of debt. But this result is not too strong.

CONCLUSION

This paper investigates the question that do insiders’ protect the interest of debtholders in Pakistan. Study investigates that what is the impact of ownership by insiders on the agency cost for debtholders while controlling the firm’s decisions regarding capital structure and dividends. We conducted this study on the sample of KSE 100 companies’ i.e. top companies of Pakistan (capitalized wise) and study period is 2006-2010. Through our research, we have tried to find whether insiders in Pakistan only act in the favor of shareholders or they concentrate on long term performance of the firm by avoiding the creation of agency cost between shareholders and debtholders or debtholders and managers. Moreover study has determined the individual role of managerial ownership in reducing agency cost of debt. Our findings are illustrating that Pakistani firms owned by insiders have lower agency cost of debt. Insiders don’t create incentives to expropriate bondholders’ wealth or to maximize shareholders wealth on the expense of debtholders. So insiders in Pakistan don’t overlook the debtholders interest. They focus on more term performance of the firm rather than long short term interest of shareholders. Similarly, if only managerial ownership is considered rather than all insider ownership structures, then managerial owned firms also proved to have lower agency cost of debt. Moreover we found that companies that use more leverage reduce agency cost of debt because debt reduces the discretionary abilities of the managers. Our study recommends that debtholders can finance without fear in such firms which are more owned by insiders. Findings of this study have valuable contribution in the existing financial literature because no study has analyzed the impact of insiders in the agency cost of debt. Future researchers may expand this research by incorporating more types of equity ownership structures.
REFERENCES


