The Association between Corporate Governance, Risk Assessment and Debt Contracting

A Dissertation Submitted to the School of Business in Candidacy for the

Degree of Doctor of Philosophy

By

Husam Aldamen

Bond University

Gold Coast, Queensland

Australia

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STATEMENT OF SOURCES

To the best of my knowledge and belief, the work presented in this thesis is original, except as acknowledged in the text. All sources used in the study have been cited, and no attempt has been made to project the contribution of other researchers as my own. Further, the material has not been submitted, either in whole or part, for a degree at this or any other University.

_____ _____

Husam Aldamen Date

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ABSTRACT

This thesis examines the relationship between corporate governance, risk assessment and debt contracting within the Australian context where companies are heavily reliant on intermediated debt financing. The Debt Contracting Model (DCM) posits that higher levels of corporate governance decrease the variability in cash flows and reduce the probability of default (reduce default risk) and correspondingly also increase the quality of value-relevant information disclosed (reduce information risk). As a result of influencing risk assessment, higher levels of corporate governance are expected to increase access to the quantity and type of debt and to lower cost of debt.

The empirical evidence largely supports the relationships proposed in the DCM. In particular, higher levels of corporate governance are associated with an increase in access to bank debt through the reduction of risk. Furthermore, there is evidence that higher levels of corporate governance lower the cost of debt for all debt types via the impact on risk assessment. However, these results are driven by the larger companies. The evidence shows that smaller companies do not access more quantities or types of debt nor do they pay lower cost of debt in the presence of higher levels of corporate governance.

These results add to the body of accounting research by establishing the importance of corporate governance for debt contracting in markets that depend heavily on intermediated debt. More importantly, the evidence suggests that there is a lower cost-benefit trade-off for smaller companies than larger companies at least in terms of increasing access to debt and reducing cost of debt. Consequently, this study could assist regulators in raising questions about the merits of the universal adoption of costly corporate governance.

TABLE OF CONTENTS

STATEMENT OF SOURCES II

ACKNOWLEDGMENTS III

ABSTRACT IV

TABLE OF CONTENTS V

LIST OF FIGURES VIII

LIST OF TABLES IX

CHAPTER ONE: INTRODUCTION 1

1.1 OVERVIEW 1

1.2 MOTIVATION FOR THE THESIS 2

1.3 RESEARCH PROBLEM 7

1.4 CONCEPTUAL FRAMEWORK 7

1.5 METHODOLOGY 9

1.6 RESEARCH OBJECTIVES 11

1.7 CONTRIBUTION TO KNOWLEDGE 11

1.8 ORGANIZATION OF THE THESIS 13

CHAPTER TWO: THEORY DEVELOPMENT 14

2.1 INTRODUCTION 14

2.2 DEBT CONTRACTING MODEL (DCM) 14

2.3 DEBT CONTRACTING DIMENSIONS 16

2.4 THE ROLE OF RISK ASSESSMENT 20

2.4.1 DEFAULT RISK 21
2.4.2 INFORMATION RISK 24

2.5 ROLE OF CORPORATE GOVERNANCE 32

2.5.1 CORPORATE GOVERNANCE DIMENSIONS 32
2.5.2 CORPORATE GOVERNANCE DIMENSIONS AND RISK ASSESSMENT 35
2.5.3 CORPORATE GOVERNANCE AND DEBT CONTRACTING 41

2.6 COMPANY SIZE EFFECT 51

2.7 SUMMARY 54

CHAPTER THREE: RESEARCH DESIGN 57

3.1 INTRODUCTION 57

3.2 OVERVIEW OF RESEARCH DESIGN 57

3.3 SAMPLE AND DATA COLLECTION PROCEDURES 59

3.4 OPERATIONALISATION OF CONSTRUCTS 60

3.4.1 ACCESS TO DEBT 60
3.4.2 COST OF DEBT 63
3.4.3 CORPORATE GOVERNANCE 64

3.4.4 RISK ASSESSMENT....66
3.4.4.1 DEFAULT RISK....66
3.4.4.2 INFORMATION RISK....67
3.4.5 CONTROL VARIABLES....69

3.5 ANALYSIS PROCEDURES....72

3.5.1 DESCRIPTIVE STATISTICS....73
3.5.2 MULTIVARIATE ANALYSIS....73
3.5.3 SENSITIVITY ANALYSIS....81

3.6 SUMMARY....83

CHAPTER FOUR: ANALYSIS OF EMPIRICAL RESULTS....84

4.1 INTRODUCTION....84

4.2 DESCRIPTIVE ANALYSIS....84

4.2.1 SAMPLE FRAME....85
4.2.2 DEBT CONTRACTING VARIABLE DESCRIPTIONS....87
4.2.2.1 ACCESS TO THE QUANTITY OF DEBT....87
4.2.2.2 ACCESS TO TYPES OF DEBT....89
4.2.2.3 COST OF DEBT....93
4.2.3 INDEPENDENT VARIABLE DESCRIPTION....95
4.2.4 CONTROL VARIABLE DESCRIPTION....97
4.2.5 SUB-SAMPLE VARIABLE DESCRIPTION....99
4.2.6 CORRELATION ANALYSIS....104

4.3 HYPOTHESIS TESTING....106

4.3.1 DEFAULT RISK AND DEBT CONTRACTING....106
4.3.2 INFORMATION RISK AND DEBT CONTRACTING....110
4.3.3 CORPORATE GOVERNANCE AND RISK ASSESSMENT....112
4.3.4 CORPORATE GOVERNANCE AND DEBT CONTRACTING....114
4.3.5 CORPORATE GOVERNANCE, DEBT CONTRACTING AND COMPANY SIZE....119

4.4 SENSITIVITY ANALYSIS....122

4.4.1 ALTERNATE DEBT ACCESS MEASURES....123
4.4.2 ALTERNATE DEFAULT RISK VARIABLE....124
4.4.3 ALTERNATE INFORMATION RISK VARIABLE....126
4.4.4 ALTERNATE CORPORATE GOVERNANCE VARIABLE....132
4.4.5 ALTERNATE COMPANY SIZE VARIABLE....139
4.4.6 SUMMARY OF SENSITIVITY ANALYSIS....145

4.5 SUMMARY....146

CHAPTER FIVE: DISCUSSION AND CONCLUSION....149

5.1 INTRODUCTION....149

5.2 DISCUSSION OF RESULTS....149

5.3 IMPLICATIONS OF THE STUDY....158

5.3.1 THEORETICAL IMPLICATIONS....158
5.3.2 PRACTICAL IMPLICATIONS....160
5.3.3 REGULATORY IMPLICATIONS....161

5.4 LIMITATIONS OF THE STUDY....162

5.4.1 THREATS TO INTERNAL VALIDITY....162
5.4.2 THREATS TO EXTERNAL VALIDITY....166

5.5 FUTURE RESEARCH....167

5.6 CONCLUSION....170

5.6.1 RESEARCH SUMMARY 170
5.6.2 CONCLUDING REMARKS 175

REFERENCES 176

APPENDIX A: REVIEW OF LITERATURE 197

A.1 QUANTITY OF DEBT 197

A.2 TYPE OF DEBT 201

A.3 COST OF DEBT 205

APPENDIX B: AGENCY CONFLICT AND DEBT CONTRACTING 213

APPENDIX C: CORPORATE GOVERNANCE OVERVIEW 216

C.1 CORPORATE GOVERNANCE DEFINITION 216

C.2 DEVELOPMENTS IN CORPORATE GOVERNANCE DEFINITION 218

C.3 ASX CORPORATE GOVERNANCE PRINCIPLES 222

APPENDIX D: CORPORATE GOVERNANCE DIMENSIONS AND ELEMENTS 226

D.1 MANAGEMENT OVERSIGHT 226

D.2 FINANCIAL QUALITY 229

D.3 EQUITY CONTROL 231

APPENDIX E: CORPORATE GOVERNANCE VARIABLES 233

E.1 MANAGEMENT OVERSIGHT VARIABLES 233

E.2 FINANCIAL QUALITY VARIABLES 235

E.3 EQUITY OWNERSHIP VARIABLES 237

APPENDIX F: EXTENDED DISCUSSION ON DEBT CONTRACTING 238

F.1 DISCUSSION ON ACCESS TO QUANTITY OF DEBT 238

F.2 DISCUSSION ON ACCESS TO TYPE OF DEBT 242

F.3 DISCUSSION ON COST OF DEBT 244

APPENDIX G: SUMMARY STATISTICS FOR ALL QUINTILES FOR MAIN SAMPLE 249

APPENDIX H: SUMMARY STATISTICS FOR ALL QUINTILES FOR SUB-SAMPLE 261

APPENDIX I: MULTICOLLINEARITY TEST 269

APPENDIX J: HYPOTHESES TESTS 270

APPENDIX K: SENSITIVITY ANALYSIS 278

K.1 ALTERNATIVE MEASURES OF ACCESS TO DEBT 278

K.2 ALTERNATIVE MEASURES OF DEFAULT RISK 286

K.3 ALTERNATIVE MEASURES OF INFORMATION RISK 291

K.4 ALTERNATIVE MEASURE FOR CORPORATE GOVERNANCE 303

K.5 ALTERNATIVE MEASURES FOR COMPANY SIZE 308

LIST OF FIGURES

FIGURE 2.1: DEBT CONTRACTING MODEL 15
FIGURE 2.2: CORPORATE GOVERNANCE CONSTRUCTS 33
FIGURE 2.3: CORPORATE GOVERNANCE DIMENSIONS AND ELEMENTS 36
FIGURE 2.4: DIMENSIONS IN THE DEBT CONTRACTING MODEL 44
FIGURE 3.1: MEASURES OF DEBT CONTRACTING MODEL..... 58

LIST OF TABLES

TABLE 2.1: SUMMARY OF HYPOTHESES 54
TABLE 2.1: SUMMARY OF HYPOTHESES (CONTINUED) 55
TABLE 3.1: SUMMARY OF SAMPLE DETAILS 60
TABLE 3.2: SUMMARY OF THE FOURTEEN INDIVIDUAL CORPORATE GOVERNANCE VARIABLES 65
TABLE 3.3: SUMMARY OF MEASURES 72
TABLE 3.4: EXPECTED SIGNS FOR THE PARAMETERS IN THE DCM 78
TABLE 4.1: SAMPLE FRAME 85
TABLE 4.2: SUMMARY STATISTICS FOR QUANT 88
TABLE 4.3: ANOVA RESULTS FOR QUANTITY OF DEBT ACCESSED FOR DIFFERENT SIZED COMPANIES 89
TABLE 4.4: INTEREST BEARING DEBT ACROSS THE FOUR DEBT TYPES 90
TABLE 4.5: SUMMARY STATISTICS FOR ACCESS TO THE FOUR DEBT TYPES 91
TABLE 4.6: ANOVA RESULTS FOR ACCESS TO THE FOUR DEBT TYPES 92
TABLE 4.7: ANOVA RESULTS FOR ACCESS TO DEBT TYPES FOR DIFFERENT SIZED COMPANIES 93
TABLE 4.8: SUMMARY STATISTICS FOR COST OF DEBT (%) 93
TABLE 4.9: ANOVA RESULTS FOR COST OF DEBT FOR DIFFERENT SIZED COMPANIES 94
TABLE 4.10: SUMMARY STATISTICS FOR THE INDEPENDENT VARIABLES 96
TABLE 4.11: ANOVA RESULTS FOR THE INDEPENDENT VARIABLES FOR DIFFERENT SIZED COMPANIES 97
TABLE 4.12: SUMMARY STATISTICS FOR THE CONTROL VARIABLES 98
TABLE 4.13: ANOVA FOR CONTROL VARIABLES FOR DIFFERENT SIZED COMPANIES 99
TABLE 4.14: SUB-SAMPLE SUMMARY STATISTICS FOR DEBT CONTRACTING VARIABLES 101
TABLE 4.15: SUB-SAMPLE SUMMARY STATISTICS FOR INDEPENDENT AND CONTROL VARIABLES 102
TABLE 4.16: CORRELATION ANALYSIS FOR THE MAIN SAMPLE 105
TABLE 4.17: CORRELATION ANALYSIS FOR THE SUB-SAMPLE 105
TABLE 4.18: RELATIONSHIP BETWEEN DEFAULT RISK AND THE DEBT CONTRACTING VARIABLES 107
TABLE 4.19: RESULTS FOR HYPOTHESIS ONE 109
TABLE 4.20: RELATIONSHIP BETWEEN INFORMATION RISK AND DEBT CONTRACTING VARIABLES 111
TABLE 4.21: RESULTS FOR HYPOTHESIS TWO 112
TABLE 4.22: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND BOTH DEFAULT RISK AND INFORMATION RISK 113
TABLE 4.23: RESULTS FOR HYPOTHESIS THREE 114

TABLE 4.24: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES USING 2SLS 116

TABLE 4.25: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES USING OLS 117

TABLE 4.26: RESULTS FOR HYPOTHESIS FOUR 119

TABLE 4.27: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES FOR THE DIFFERENT SIZED COMPANIES 120

TABLE 4.28: RESULTS FOR HYPOTHESIS FIVE 122

TABLE 4.29: RELATIONSHIP BETWEEN DEFAULT RISK (ZSCORE2) AND THE DEBT CONTRACTING VARIABLES 126

TABLE 4.30: RELATIONSHIP BETWEEN THE INNATE COMPONENT OF INFORMATION RISK AND THE DEBT CONTRACTING VARIABLES 131

TABLE 4.31: RELATIONSHIP BETWEEN THE DISCRETIONARY COMPONENT OF INFORMATION RISK AND THE DEBT CONTRACTING VARIABLES 132

TABLE 4.32: RELATIONSHIP BETWEEN DEFAULT RISK AND CORPORATE GOVERNANCE 134

TABLE 4.33: RELATIONSHIP BETWEEN THE INNATE AND DISCRETIONARY COMPONENTS OF INFORMATION RISK AND CORPORATE GOVERNANCE 135

TABLE 4.35: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE (GOV2) AND THE DEBT CONTRACTING VARIABLES 137

TABLE 4.36: CORRELATION ANALYSIS FOR THE TWO CORPORATE GOVERNANCE VARIABLES AND COMPANY SIZE 138

TABLE 4.37: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE (GOV2) AND THE DEBT CONTRACTING VARIABLES (WITHOUT SIZE) 139

TABLE 4.38: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES FOR SMALL AND LARGE COMPANIES 140

TABLE 4.39: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES FOR THE TOP300 COMPANIES 143

TABLE 4.40: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES FOR SMALL COMPANIES 145

TABLE A.1: EVIDENCE ON CORPORATE GOVERNANCE AND QUANTITY OF DEBT ACCESSED 200

TABLE A.2: EVIDENCE ON DETERMINANTS OF ACCESS TO TYPE OF DEBT 204

TABLE A.3: RESEARCH ON THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND COST OF DEBT 211

TABLE A.3: RESEARCH ON THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND COST OF DEBT (CONTINUED) 212

TABLE C.1: PRINCIPLES OF GOOD CORPORATE GOVERNANCE 222

TABLE C.2: REVISED CORPORATE GOVERNANCE PRINCIPLES 225

TABLE F.1: NUMBER OF COMPANIES WITH INTEREST BEARING DEBT BY ECONOMIC SECTORS 238

TABLE F.2: QUANTITY OF INTEREST BEARING DEBT BY ECONOMIC SECTORS 239

TABLE F.3: QUANTITIES OF INTEREST BEARING DEBT BY INDUSTRY GROUPS 241

TABLE F.4: INTEREST BEARING DEBT BY LINE ITEMS 243

TABLE F.5: COST OF DEBT BY ECONOMIC SECTORS (%) 244

TABLE F.6: ANOVA RESULTS FOR THE CONSUMER STAPLES AND INFORMATION TECHNOLOGY SECTORS 245

TABLE F.7: COST OF DEBT BY INDUSTRY GROUPS (%) 246

TABLE F.8: COST OF DEBT BY DEBT TYPES (%) 247

TABLE F.9: ANOVA RESULTS FOR COST OF DEBT BY DEBT TYPES 247

TABLE F.10: RESULTS OF TUKEY'S HSD POST HOC TEST FOR COST OF DEBT BY DEBT TYPES 248

TABLE G.1: SUMMARY STATISTICS FOR QUANTITY OF DEBT ACCESSED FOR ALL QUINTILES 249

TABLE G.2: RESULTS OF TUKEY'S HSD POST HOC TEST FOR QUANTITY OF DEBT ACCESSED 250

TABLE G.3: SUMMARY STATISTICS FOR ACCESS TO THE FOUR DEBT TYPES FOR ALL QUINTILES 251

TABLE G.4: RESULTS OF TUKEY'S HSD POST HOC TEST FOR ASSET FINANCED DEBT AND BANK DEBT 252

TABLE G.5: SUMMARY STATISTICS FOR COST OF DEBT FOR ALL QUINTILES (%) 253

TABLE G.6: RESULTS OF TUKEY'S HSD POST HOC TEST FOR COST OF DEBT 254

TABLE G.7: SUMMARY STATISTICS FOR THE INDEPENDENT VARIABLES FOR ALL QUINTILES 255

TABLE G.8: DISCRIMINANT ANALYSIS RESULTS FOR DEFAULT RISK (ZSCORE) 256

TABLE G.9: DECOMPOSITION OF ZSCORE 257

TABLE G.10: RESULTS OF TUKEY'S HSD POST HOC TEST FOR THE INDEPENDENT VARIABLES 258

TABLE G.11: SUMMARY STATISTICS FOR THE CONTROL VARIABLES FOR ALL QUINTILES 259

TABLE G.12: RESULTS OF TUKEY'S HSD POST HOC TEST FOR THE CONTROL VARIABLES 260

TABLE H.1: SUB-SAMPLE SUMMARY STATISTICS FOR QUANTITY OF DEBT ACCESSED FOR ALL QUINTILES 261

TABLE H.2: SUB-SAMPLE SUMMARY STATISTICS FOR ACCESS TO THE FOUR DEBT TYPES FOR ALL QUINTILES 262

TABLE H.3: SUB-SAMPLE SUMMARY STATISTICS FOR COST OF DEBT FOR ALL QUINTILES ... 263

TABLE H.4: SUB-SAMPLE SUMMARY STATISTICS FOR THE INDEPENDENT VARIABLE FOR ALL QUINTILES 264

TABLE H.5: SUB-SAMPLE SUMMARY STATISTICS FOR THE CONTROL VARIABLES FOR ALL QUINTILES 265

TABLE H.6: ANOVA RESULTS FOR THE VARIABLES IN THE SUB-SAMPLE 266

TABLE H.7: TUKEY'S HSD POST HOC TEST RESULTS FOR THE VARIABLES IN THE SUB-SAMPLE 267

TABLE H.8: CALCULATION RESULTS FOR THE ACCRUALS QUALITY VARIABLE (ACCRL) 268

TABLE I.1: VARIANCE INFLATION FACTOR FOR INDEPENDENT AND CONTROL VARIABLES .. 269

TABLE J.1: RELATIONSHIP BETWEEN DEFAULT RISK AND THE DEBT CONTRACTING VARIABLES INCLUDING INDUSTRY DUMMIES 270

TABLE J.2: RELATIONSHIP BETWEEN INFORMATION RISK AND THE DEBT CONTRACTING VARIABLES INCLUDING INDUSTRY DUMMIES 272

TABLE J.3: RELATIONSHIP BETWEEN DEFAULT AND INFORMATION RISKS AND CORPORATE GOVERNANCE INCLUDING INDUSTRY DUMMIES 273

TABLE J.4: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES USING 2SLS INCLUDING INDUSTRY DUMMIES 274

TABLE J.5: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES USING OLS INCLUDING INDUSTRY DUMMIES 275

TABLE J.6: IMPACT OF CORPORATE GOVERNANCE ON DEBT CONTRACTING VARIABLES FOR DIFFERENT SIZED COMPANIES INCLUDING INDUSTRY DUMMIES..... 276

TABLE K.1: RELATIONSHIP BETWEEN DEFAULT RISK AND DEBT CONTRACTING VARIABLES (DEBT CONTRACTING VARIABLES SCALED BY TOTAL ASSETS) 280

TABLE K.2: RELATIONSHIP BETWEEN INFORMATION RISK AND DEBT CONTRACTING VARIABLES (DEBT CONTRACTING VARIABLES SCALED BY TOTAL ASSETS) 281

TABLE K.3: IMPACT OF CORPORATE GOVERNANCE ON DEBT CONTRACTING VARIABLES USING 2SLS (DEBT CONTRACTING VARIABLES SCALED BY TOTAL ASSETS) 282

TABLE K.4: IMPACT OF CORPORATE GOVERNANCE ON DEBT CONTRACTING VARIABLES USING OLS (DEBT CONTRACTING VARIABLES SCALED BY TOTAL ASSETS)..... 283

TABLE K.5: IMPACT OF CORPORATE GOVERNANCE ON DEBT CONTRACTING VARIABLES FOR DIFFERENT SIZED COMPANIES (DEBT CONTRACTING VARIABLES SCALED BY TOTAL ASSETS)..... 284

TABLE K.6: DISCRIMINANT ANALYSIS RESULTS FOR DEFAULT RISK (ZSCORE2)..... 286

TABLE K.7: DECOMPOSITION OF ZSCORE2 287

TABLE K.8: RELATIONSHIP BETWEEN DEFAULT RISK (ZSCORE2) AND DEBT CONTRACTING VARIABLES 288

TABLE K.9: RELATIONSHIP BETWEEN DEFAULT RISK (TIMES) AND DEBT CONTRACTING VARIABLES 290

TABLE K.10: RELATIONSHIP BETWEEN INFORMATION RISK (ACCRL) AND THE FIVE INNATE FACTORS 291

TABLE K.11: SUMMARY STATISTICS FOR THE INNATE AND DISCRETIONARY COMPONENTS OF INFORMATION RISK FOR ALL QUINTILES..... 292

TABLE K.12: ANOVA RESULTS FOR THE INNATE AND DISCRETIONARY COMPONENTS OF INFORMATION RISK 293

TABLE K.13: TUKEY'S HSD POST HOC TEST RESULTS FOR THE INNATE AND COMPONENT OF INFORMATION RISK 293

TABLE K.14: RELATIONSHIP BETWEEN THE INNATE COMPONENT OF INFORMATION RISK AND THE DEBT CONTRACTING VARIABLES..... 294

TABLE K.15: RELATIONSHIP BETWEEN THE DISCRETIONARY COMPONENT OF INFORMATION RISK AND THE DEBT CONTRACTING VARIABLES 295

TABLE K.16: RELATIONSHIP BETWEEN INFORMATION RISK (ACCRL2) AND DEBT CONTRACTING VARIABLES 298

TABLE K.17: INDUSTRY-SPECIFIC COEFFICIENTS ESTIMATED TO CALCULATE ABNORMAL ACCRUALS (INFORMATION RISK) 301

TABLE K.18: RELATIONSHIP BETWEEN INFORMATION RISK (ACCRL3) AND THE DEBT CONTRACTING VARIABLES 302

TABLE K.19: RELATIONSHIP BETWEEN DEFAULT RISK (ZSCORE AND ZSCORE2) AND CORPORATE GOVERNANCE (GOV AND GOV2) 304

TABLE K.20: RELATIONSHIP BETWEEN THE INNATE AND DISCRETIONARY COMPONENTS OF INFORMATION RISK AND CORPORATE GOVERNANCE (GOV AND GOV2) 305

TABLE K.21: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE (GOV2) AND THE DEBT CONTRACTING VARIABLES 306

TABLE K.22: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE (GOV2) AND THE DEBT CONTRACTING VARIABLES (WITHOUT SIZE) 307

TABLE K.23: IMPACT OF CORPORATE GOVERNANCE ON DEBT CONTRACTING VARIABLES FOR SMALL AND LARGE COMPANIES INCLUDING INDUSTRY DUMMIES 309

TABLE K.24: RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND THE DEBT CONTRACTING VARIABLES FOR THE TOP300 COMPANIES 310

TABLE K.25: IMPACT OF CORPORATE GOVERNANCE ON THE DEBT CONTRACTING VARIABLES FOR SMALL COMPANIES INCLUDING INDUSTRY DUMMIES 311