Corporate Governance on Firm's Financial Performance: Evidence from Pakistan

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Abstract:
This experimental research for listed firms in Pakistan is conducted to examine the link between corporate governance and firm performance. In this research corporate governance is evaluated the set of variables, including CEO duality, board size, board meeting, and audit committee and board independence. The performance of the firm is measured by the three different method which are (i) return on asset (ROA), (ii) return on equity (ROE), (iii) Tobin's Q. Using the regression least squares method on 56 listed firms in Karachi stock exchange for the period of 2013 to 2017 for the period of five years, the findings of this research point out the several effects of corporate governance on firm performance. . Results of this study CEO, board size, board meetings and audit committee have positive impact on the firm's financial performance in Pakistan which is measured by the return on asset (ROA). Board Independence has a negative impact on the firm's financial performance.

Key words: *Corporate Governance, Financial Performance, Listed Firms, Pakistan*

Introduction:

Corporate governance focuses on the structure and process for the commerce direction and management of Firms. It involves the associations among company's controlling system, roles of its board directors, Shareholders and stakeholders. In addition corporate governance has relation with Transaction cost and, in turn, enhances firm performance. In accumulation, weak corporate governance reduces Investor self-confidence and discourages outside investment. According to study the relationship between corporate governance and firm performance are concluded that good corporate governance affects firm performance positively.

Security and Exchange Commission of Pakistan issued Code of Corporate Governance in March 2002 in order to make stronger the regulatory mechanism and its enforcement. The code of corporate governance is the major step in corporate governance reforms in Pakistan. The code includes many recommendations in line with international good practice. The major areas of enforcement include reform of board of directors in order to make it accountable to all shareholders and better disclosure including improved internal and external audits for listed companies. However, the code's limited provisions on director's independence remain voluntary and provide no guidance on internal controls, risk management and board compensation policies.The specific objective of this research is to examine the relationship between corporate governance and firm performance in term of three components: return on asset, return on equity, Tobin Q using Least Square method. From the sample, bank and financial institutions are excluded.

This paper investigates the impact of corporate governance on firm financial performance in Pakistan listed firms. This paper is planned in the following direction; it initiates with Section (1) that clarifies introduction, section (2) literature review and section (3) explain theoretical framework. The data collected as well as methodology of study are particular in Section (4) and also develop hypotheses. Furthermore, Section (5) discourses the result of analysis for time period 2013-2017.Lastly Section (6) conclusion and findings of this research and references.

Research Question:

What corporate governance practices have impact on firm performance?

Literature Review:

Corporate governance is a process which ensures that the investors appropriate profit. The procedure provides a structure for stakeholder and protects to stakeholder interest. Organization has batter rules and regulation improve performance and divined ratio high. The code of corporate governance presented through Security Exchange Commission of Pakistan (SECP) is initial 2002 revolutionary in corporate governance improvements in Pakistan. All the registered firms in Pakistan stock exchange must follow the providing of code.

(Farhan, Obaid et al. 2017) suggested that board independence has been found to negatively impact on corporation's performance. AC conferences and economic professionals' ratio did not affect firm's efficiency, whilst AC incentives and AC independence negatively affected organizations performance.(Duc and Thuy 2013)Used the bendy generalized least squares system on 77 listed corporations buying and selling over the period from 2006 to 2011. The findings of this be trained indicate that factors of corporate governance such because the presence of female board contributors, the duality of the CEO, the working experience of board participants, and the compensation of board members have optimistic effects on the efficiency of corporations, as measured with the aid of the return on asset (ROA). Nonetheless, board size has a terrible influence on the performance of organizations. This be trained additionally offers that ownership of board members has a non-linear relationship with a corporation efficiency.

(Vo and Nguyen 2014)Utilised the variable Generalized Least Squares (FGLS) on the dataset of 177 listed corporations in Vietnam in the course of 5 years, from 2008 to 2012, the findings of this gain knowledge of point out multiple effects of corporate governance on organization performance. First, duality function of the CEO is positively correlated with firm efficiency. 2d, there's a structural exchange in relation between managerial ownership and firm performance. 1/3, board independence has reverse effects on company efficiency. Fourth, this study however fails to provide an empirical proof aid the statistically massive relationship between board dimension and corporation performance. (Bhatt and Bhatt 2017)conclude the data of 113 listed firms in Malaysia and examined that the relationship between corporate governance have strongly effect of firm profitability ROA and ROE measured by code of corporate governance index in 2007 ,2012.(Katragadda 2013)investigated the relationship between corporate governance and firm performance, and firm value increase in developed and developing countries. Because the different elements effect in the economy. They suggested that the result is positively correlate with corporate governance and company's performance.

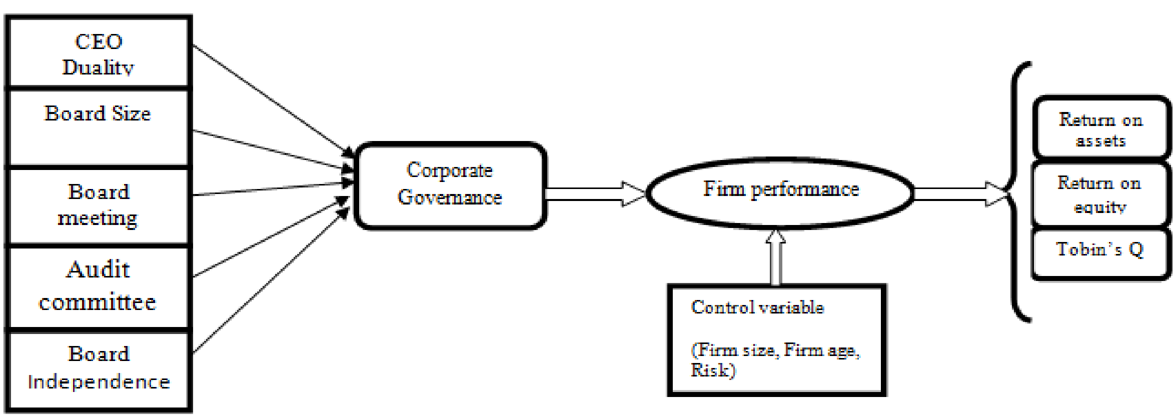
(Dzingai and Fakoya 2017) the relationship between board structure and firm financial performance utilising the random result model in a panel knowledge of listed mining firms over a period of 2010-2015 suggested that there is weak negative relationship between board size and firm size on financial performance and confident relationship between board independence and return on equity. Result point out the corporate governance improved in firm profitability. Furthermore(Shahwan 2015) conclude that the relationship between pleasant of

CG and Egyption listed corporations is somewhat low. Our result don't help the direct association between CG practices and monetary performance. Furthermore, there's an insignificant indirectly relationship between CG practice and the likelihood of fiscal distress.(Mehrabani and Dadgar 2013)observed from the study of the selected firms performance positive and the direct relation between corporate governance and firm performance approved from the data used over the period from 2001 to 2010.On the other hand evidence from(Haider, Khan et al. 2015)report that the of firm has based on the capabilities of managers instead of size. Return on asset (ROA) has not affected by the size of board and impact insignificantly. Board sizeindirect relation with firm performance in special.

To check out relationship between corporate governance and firm performance a study conducted by(Yasser, Entebang et al. 2015)to use the data 30 listed Pakistani firms over the period 2008 – 2009 and examined the direct and significant relationship between return on equity and profit margin (firm performance) and corporate governance mechanisms used the variable (board size, board composition and audit committee. Furthermore described the relation by(Todorovic 2013) conclude that corporate governance positively correlate with company performance .Level of company performance more increase to use the corporate governance rules and regulation .Furthermore suggested that organizations with high level of implementation of practice of corporate governance have most performance and have most profitable.

Furthermore to check the relationship between corporate governance and Pakistani communication sector to use the data during 2009 a study conducted by (Yasser 2011) investigates the direct relationship with corporate governance and company performance .In extra the author reports that good governed organization have most profitable most valuable and pay out most dividend to shareholders as compared to other organizations which have not implement of corporate governance principles.

Theoretical Framework:



Dependent variable measures the firm financial performance by using the return on assets (ROA), return on equity (ROE) and Tobin's Q ratio. Tobin's Q ratio calculates the market value of firm performance. Independent variable is the CEO duality, board size, board meeting, audit committee and board independent. Control variables use firm size, firm age and risk factor effect on firm financial performance.

Equation Model:

$$ROA = \alpha + \beta_1 CEOD + \beta_2 BSIZE + \beta_3 BM + \beta_4 AC + \beta_5 BINDEP + \beta_6 FSIZE + \beta_7 FAGE + \beta_8 RISK + \epsilon \ldots\ldots\ldots (1)$$

$$ROE = \alpha + \beta_1 CEOD + \beta_2 BSIZE + \beta_3 BM + \beta_4 AC + \beta_5 BINDEP + \beta_6 FSIZE + \beta_7 FAGE + \beta_8 RISK + \epsilon \ldots \ldots \ldots (2)$$

$$Tobin'sQ = \alpha + \beta_1 CEOD + \beta_2 BSIZE + \beta_3 BM + \beta_4 AC + \beta_5 BINDEP + \beta_6 FSIZE + \beta_7 FAGE + \beta_8 RISK + \epsilon \ldots \ldots . . (3)$$

Where, α is the constant, β1,β2,β3,β4,β5,β6,β7 and β8 is the coefficient of the explanatory variable (corporate governance mechanisms); fit is the explanatory variable and is the error term(ε)(assumed to have zero mean and independent across time period).

Variable	Notations
CEO Duality	$CEOD$
Board Size	$BSIZE$
Board meeting	BM
Audit committee	AC
Board Independence	$BINDEP$
Firm Size	$FSIZE$
Firm Age	$FAGE$
Risk	$RISK$

Methodology:

The objective of this study checks the impact of corporate governance on firm financial performance in Pakistan. In this study using the quantative approach and data is collected by secondary source such as annual report, corporate governance report over the period of 2013 to 2017. Five years data use for determine the firm performance in Pakistan. The sample size of the study 56 public listed firms in Karachi stock exchange Pakistan. Listed firms include five different industries:

(1) Textile industry

(2) Technology & communication industry

(3) Fertilizer industry

(4) Cement industry

(5) Sugar industry

Variables and Measurements:

Dependent variables		
Return on assets	**ROA**	Net profit / total assets
Return on equity	**ROE**	Net profit / total equity
Tobin's Q	**Q**	Total market value/total assets value
Independent variables		
CEO duality	**CEOD**	CEO also chairmen 1 otherwise 0
Board size	**BSIZE**	Total number of director
Board Meeting	**BM**	Number of meeting during the year
Audit Committee	**AC**	Total member of the committee
Board Independent	**BINDEP**	Part of independent member to total board
Control variables		
Firm size	**FSIZE**	Log of total assets
Firm age	**FAGE**	Total age of company
Risk	**RISK**	Total debt/ total assets

Hypotheses:

H_1:There is a positive relationship between corporate Governance and financial performance of listed firms in Pakistan.

H_0: There is a negative relationship between corporate Governance and financial performance of listed firms in Pakistan.

Data Analysis:

Descriptive Analysis:

The descriptive statistics is obtainable to analyze the firm's financial performance. The table 2 shows that the mean, minimum, maximum and standard deviation value for variables. Mean denotes the average value, standard deviation appearances deviation from mean and 280 observations. The descriptive statistics shows the average of return on assets (ROA) 19.4% mean, minimum value -9.388, maximum value 24.155 and standard deviation is 1.834.

Table: 2Descriptive Analyses:

	Mean	**Minimum**	**Maximum**	**Std.Dev**
ROA	0.194	-9.388	24.155	1.834
ROE	0.137	-9.737	5.19	1.033
Q	100.7	0.004	650.793	145.77
CEOD	0.085	0	1	0.28

BSIZE	8.253	4	99	5.661
BM	4.996	0	14	1.609
AC	3.417	2	6	0.78
BINDEP	1.489	0	6	1.167
FSIZE	6.822	2.57	10.317	1.108
FAGE	34.2	7	68	14.402
RISK	-2.445	-540.043	19.076	35.725

Source: Authors' Calculations Using E-Views software

The return on equity (ROE) mean 13.7%, minimum value -9.737 and maximum value 5.19 for the time period of 2013-2017 and standard deviation is 1.033. Tobin's Q ratio mean 100.7 shows that the effective utilization of resources. CEO duality means 8.5% and 28% standard deviation. Board size is the total member of the board and Board meeting during the year shows average value 8.25, 4.99 and Std.Dev 5.661, 1.609 respectively. Independence of board members mean1.48 and standard deviation 1.167. Control variables, Firm size, Firm age and risk average 6.8, 34.2 and-2.44.

Correlation Analysis:

Table: 3Correlation Analysis:

	CEOD	BSIZE	BM	AC	BINDEP	FSIZE	FAGE	RISK
CEOD	1							
BSIZE	-0.072	1						
BM	-0.095	0.098	1					
AC	-0.082	0.155	0.101	1				
BINDEP	0.090	0.034	0.016	0.019	1			
FSIZE	0.011	0.026	0.202	0.275	0.104	1		
FAGE	0.147	-0.036	0.015	-0.286	0.101	0.271	1	
RISK	0.023	0.000	0.055	0.048	0.030	0.216	0.032	1

Source: Authors' Calculations Using E-Views software

Table 3 shows relationship between dependent and independent variables use to correlation method. Through the correlation check the positive and negative relation of the variables and determine the relationship among independent variables (What is the effect of one variable on the other variable). CEO duality has strong relation 1 with CEOD. Board size, Board meetings and audit committee show negative relationship and board independence, firm size, firm age and risk according to correlation results show the positive relation. So the data no multicolinearity exist its means no value more than 0.7.

Regression Analysis:

Table: 4 Dependent variable ROA

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.624201	0.499358	-1.250007	0.2124
CEOD	0.097820	0.208402	0.469383	0.6392
BSIZE	0.002508	0.010270	0.244152	0.8073
BM	0.015477	0.036635	0.422457	0.6730
AC	0.059568	0.079171	0.752390	0.4525
BINDEP	-0.023937	0.049811	-0.480556	0.6312
FSIZE	0.088029	0.057637	1.527307	0.1279
FAGE	-0.004825	0.004317	-1.117806	0.2646
RISK	-0.044620	0.001638	-27.24833	0.0000
R-Squared 0.737674 Prob(F-Statistics) 0.0000				

Regression results of the table 4 are the value of R-squared 0.737 in return on assets which shows that all the explanatory variables explains return on assets 73%. R square and Prob (F-statistic) value is 000 showing that the whole model is fit for the analysis. Dependent variable return on assets has strong relationship between independent variables CEOD, BSIZE, BM, AC and BINDEP.This section analysis of financial performance of listed firms in Karachi stock exchange Pakistan tables 4 present the regression results for ROA.CEO duality as positive and insignificant relation with performance (ROA) and (ROE). Board size and board meeting shows the positive and insignificant on return on assets reinforced by(Farhan, Obaid et al. 2017) result finding are also supported, and (Duc and Thuy 2013).Board independence relationship between negative and insignificant with return on assets strong relate this finding(Duc and Thuy 2013). Firm size positive and significant on return on assets and risk negative and significant level 0.05 percent relation with return on assets by same finding this researcher(Farhan, Obaid et al. 2017). This paper finding firm age shows that negative and insignificant with return on assetsand (Afshan at el 2016) also supported this finding.

Table: 5 Dependent Variable ROE

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.044224	0.535355	-1.950526	0.0521
CEOD	0.262359	0.223845	1.172059	0.2422
BSIZE	0.088754	0.043781	0.924179	0.0054
BM	-0.002933	0.039272	-0.074674	0.9405
AC	-0.035876	0.084293	-0.425612	0.6707
BINDEP	0.051488	0.053544	0.961610	0.3371
FSIZE	0.164960	0.061970	2.661929	0.0082
FAGE	0.002684	0.004644	0.578067	0.5637
RISK	-0.000868	0.001762	-0.492798	0.6226
R-Squared 0.039				

CEO duality shows that positive relationship between return on equity. Board size positive relationship with return on equity in significant level 0.05 percent (Yasser, Entebang et al. 2015). Board meeting and Audit committee is negative and insignificant relationship with return on equity. Board independence is Positive and insignificant relation on return on equityare supported by(Vo and Nguyen 2014).Firm size positive and significant relations with return on equity. Risk has negative and insignificant relationship between return on equity. Return on equity has positive and insignificant relationship. R-squared value 0.039263 means that 39 percent.

Conclusion:

The conclusion of this study checks the impact of corporate governance on firm financial performance in Pakistan. Least square method is used for the analysis of results for the time period 2013-2017. In this study Corporate governance mechanism consists of CEO duality, board size, board meetings and audit committee which have positive and insignificant impact on the firm's financial performance on return on asset (ROA). Board independence shows that negative relation with ROA but positive. Board size and firm size have positive and significant relation with return on equity ROE. Audit committee AC and Board independence BINDEP shows that positive and significant on Q ratio but firm size and firm age have negative and insignificant. According to Regression results the R-squared value is 0.737 which shows that all the independent variables are 73% explains the dependent variable return on assets is ROA.

Context for future research

Regarding future direction of study put the effort at growing the sample size of the study and the variable of corporate governance. Because in this study takes the sample of 5 years that's why this is a pilot study.

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