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Corporate Governance Practices and Firm Performance:Evidence from Karachi Stock Exchange

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Abstract: Good governance is the building block of any organization for long-lasting relationship with its stakeholders. Corporations with better governance practices, attracted more investment flows in global dynamic markets and stays ahead of their competitors. Now a day's best business practices and corporate social responsibilities are considered as a double edge sword for corporations. The more you adopt these practices the more you can enhance your economic performance. This paper sheds light on the structural relationship between corporate governance and firm performance of twenty-five firms listed at Karachi Stock Exchange for the year 2011-2014. The study is based on the impact of corporate governance mechanisms (Board Size, Log of Sales) on firm performance (Return on Assets and Total Assets Turn over (TAO.) The outcomes provide proof of a positive relationship between Log of Sales and total assets turn over, while shows a negative relationship between Log of sales and return on assets. There is a significant however negative relation between board size and total assets turn over. This study implies that board size should be perfectly matched in term of executives and non-executives' directors' to improve firm value in the long run.

Keywords: Corporate governance; Firm performance; Karachi Stock Exchange.

1. Introduction

The firm performance is a relevant construct in planned management research and has significant impact in corporation growth and business expansion. It is observed that firm performance is mainly dependent on good corporate governance practices. The more an organization follows good governance model the more positive will be the firm growth[1].

In corporate governance, the major vital are those methods and directs that are planned to decrease or mitigate the most important problems. Enron's bankruptcy was the result of bad governance practices. Corporate governance practices are different in different regions according to their specific dynamics of each society. In global business, it's most important to consider those corporate governance practices which undertake all stakeholders' interest in the business[2].

In Pakistan corporate governance is relatively a new phenomena that come into practice.

The country economic system is mostly undocumented and does not emphasis on reward and punishment solely based on individual performance. Good governance practices such as accountability, disclosure of all financial information and environment friendly practices are merely considered as important rather than focus on profit maximization with all possible means. Firmly held possession, unprofessionalism, audit instability and general structural flaws are the main obstacles in promoting good governance practices inside in organization [3].

1.1. Problem statement

Food To find out the relation between corporate governance and firm performance of selected corporation listed in Karachi Stock Exchange.

1.2. Objectives of the Study

Objectives ofthe study are as follows:

i. To find out the relationship between corporate governance and firm performance.
ii. 2. To find out that how much corporate governance practices affect the firm performance.
iii. 3. To find out that in which firm the corporate governance practices are better than others.
iv. To give suggestions and recommendations for improvement in food policy prescription/measures.

1.3. Scope of the Study

This study provides sufficient information that enables investors to knowhow corporate governance directly or indirectly affects firm performance and how much it influences firm performance. The research also discloses that how corporations use governance practices within their firms and improved their performance.

1.4. Significance of the study

Impact of good governance on firm performance is very pivotal in Pakistan because the investors are much more rely on secondary information. This study provides information about top listed companies of Karachi Stock Exchange as well as gives significant insight to all the stakeholders regarding governance and performance.

2. Literature Review

Corporate governance is essential for any kind of organization. The most important goal is to point out the board, the stakeholders, and the shareholders exactly what their responsibilities and duties are inside the company. Along with better governance practices, it’s pretty easy to know what the important members of the business are expected to do. Everyone ought to be accountable for his or her action[4].Another essential feature of corporate governance is actually mitigating or even reducing the quantity of risk that's involved. Via corporate governance practices, a company can completely avoid scandals, scams, and felony liability from their organization. Corporate governance practices are pivotal due to its nature before outdoors forces can do anything to any corporation; it's possible for the organization to manage matters by itself through self-policing[5].

Corporate governance practices are widely accepted by the public. This is mainly because of the idea associated with disclosure as well as transparency in the system. Due to fair financial disclosure, corporate governance practices can achieve more support from employees and general public. Moreover, there is the proven fact that as a result of such practices there's a less chance of fraud as well as company-wide felony activities, which assist gain the actual trust from the public too[6].

Recently a lot of companies focus on corporate social responsibilities to maintain a good public image. The reason is to take high moral ground in such a competitive environment. With corporate governance practices, the organizations take much more responsibility because of its actions, and the facts that the general public now has much more knowledge, understanding and demands for ethical and environmentally friendly behaviors from businesses[7].

2.1. Empirical Evidence of Developing Countries

(Bin Tariq, 2008)[8]studied the impact of good governance practices on overall performance of a corporation. Financial data of 150 listed corporations in Pakistan were used for analysis during the period 2003 to 2005. The result shows that ROA,ROE and P/B ratio are positively connected with the corporate governance index.

(Rajendran, 2012)[9]studiedthe impact ofgood governance practices on overall financial performance. Sri Lankan listed banks financial data were usedduring the period 2006 to 2010. The outcome reveals that board of directors & board committees directly impact on firm financial performance.

(Xia Chen, 2015)[10]evaluated the effect of independent board size on firm performance in China by using an exogenous shock persuades by the Sarbanes – Act (SOX) and its subsequent exchange rules. The findings show that self-governance in board audit committee; nominating committee and the compensating committee boost the firm value positively.

(David I Meinie, 2011)[11]studied the South African market to examine the determinant of CEO compensation. The outcome shows that remuneration to chairperson, chairperson nationality, and executive compensation to chairperson are the key factors which positively contribute to firm performance. Moreover, board size, board age, firm size and CEO compensation are also play an important positive role.

(Saibal Ghosh, 2004)[12]used panel data from Indian manufacturing companies regarding CEO compensation determinants. The result shows that board size is directly affect the overall firm performance.

(Rashid Zaman, 2014) [13]Studied the impact of good governance practices on overall performance of a corporation. Target area was banking sector of Pakistan. Financial data were used from years 2007 to 2011. The outcome shows that transparency and disclosure (T&D) are constructive relations with firm performance but ownership structure is inversely related with ROA and ROE.

Empirical Evidence of Developed Countries:

(Alon Brave, 2008)[14]investigated the impact of good governance practices regarding hedge fund activism on firm value in the USA from 2001 to 2006. The outcome shows that up to date observing of shareholders can significantly improve bond rating and yield in long run investment process. Moreover, the findings show that these good governance practices influence the bond yields and bond rating due to its nonpayment risk reduce disagreement of interest and increases productivity. Moreover, the result shows that concentrated ownership negatively affects bond yields and rating.

(Rob Bauer, 2004) [15]studied the connection between corporate governance and firm performance in the European market. The outcome shows that these good practices highly improve firm performance. In addition, the outcome also shows that good governance practices in a small corporation increase its firm performance to the optimum level.

(Wolfgang Drobetz, 2003)[16]evaluated theGerman capital market to study the effect of good governance practices on firm value. The outcome shows that good governance machenisms and directly boost firm valuatoin.

(Ozkan, 2007)[17]investigated theimpact of CEO remuneration and their impact on firm value. Data were taken from UK companies during the years 1999 to 2005. The end result shows that CEO remuneration has a direct significant impact on firm value while thesindings were not same for total compensation.

(Peter Klein, 2005)[18]Examined the impact ofgood governance practices on firm value.A sample of 263 Canadain firms were analyzed. The result shows that shareholder rights, compensation policies, shareholder interests and transparent discloure mechanisms are the key components which improve due to these good practices.

(Yoshiro Miwa, 2002) [19]Studied the realtionship of famous directors in a corporation and their effect on corporation value in Japan. Cotton-spinning firms data were usedfor study. The result shows that corporations with well-known directors achieved greater income because their directors knew how to monitor the firm and when to control management to keep the corporationin the right track.

(Ann Lau, 2004)[20]Evaluated the effect of executive compensation and firm size on firm performance. Data were taken from 104 firms of New Zealand during the years 1998 to 2002. The result shows that firm size and executive compensation has a positive effect on firm performance in New Zealand capital market. Moreover, the outcome also shows that New Zealand pays less to CEO than the US.

3. Research Methodology

The population of the research consists of the 25 corporations listed in Karachi Stock Exchange from 2011 to 2014. A company is contained in the sample, if the information is available for the period i.e. 2011 to 2014. The information is collected from SECP, SBP, companies' annual reports and web sites. The following table provides details of the sample for the study;

Table 1

Companies
Attock Refinery Limited
Cherat Cement Co. Ltd
Dawood Hercules Co. Ltd
Engro Foods Ltd
Engro Corporation Limited
Fauji Cement Co. Ltd
Fauji Fertilizer Bin Qasim Ltd
Fatima Fertilizor Co. Ltd
Glaxo SmithklinePakLimited (GSK)
Honda Atlas Cars (Pakistan) Ltd
Hub Power Co. Ltd
K-Electric Ltd
Kohat Cement Ltd
Kot Addu Power Ltd
Lucky Cement Company
Maple Leaf Cement Factory Limited
Mari Petroleum Ltd
Pak Oilfields Ltd (POL)
Pak Petroleum Ltd (PPL)
Pak State Oil Co. Ltd (PSO)
Pak Suzuki Motor Co. Ltd
Pak Telecommunication Co. Ltd (PTCL)
Pioneer Cement Limited
Shell PakLimited
The Searle Company Limited

3.1. Model

To finds the association between corporate governance and firm performance, the following model is used for the study:

$$ROA/TAO = \beta 0 + \beta 1BS + \beta 2LgSales \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

Where TATOis Total assets turn over; BS is Board size; ROA is Return on assets and LgSales is Sales revenue. TAO is measured as net sales over total assets; ROA is calculated as net income over total assets and LgSales is the log of sales (log is log to the base 10).

3.2. Variables

1. Independent variables:

Board size & Log of sales

2. Dependent variables:

Return on assets & Total assets turn over

3.3. Model specification

The Regression model is used for this study. Through this model mean, median, stander deviation, maximum, minimum, kurtosis, skewness are calculated for this study. For data analyses, statistical software Minitab 17 is used.

4. Findings & Analysis

This portion is consist of descriptive statistics, correlation and regression analysis. Which show that whether there is any relation between TAO, board size, and sales? Also show that whether there is significant relation or insignificant relation among TAO, board size and sale. The table shows the relation among ROA, board size and sales.

4.1. Descriptive Statistics

TABLE 1: Reports the descriptive statistics of all the variables used in the study.
This table shows the mean and standard deviation, median, maximum, skewness, kurtosis values. The values of the variables reflect that the data is normal. The mean, standard deviation and median of TAO are 1.298, 1.162 and 0.935 respectively. Moreover, the mean, standard deviation and median of BOD size is 9.440, 2.222 and10.000 respectively. The total assets have the highest standard deviation i-e 2720171.

Table1: Descriptive Statistics: TAO, Board size, NI, TA, ROA, LgSales

Variable	**Mean**	**StDev**	**Median**	**Maximum**	**Skewness**	**Kurtosis**
TAO	1.298	1.162	0.935	6.480	2.31	6.51
Board size	9.440	2.222	10.000	15.000	0.56ss	-0.28
TA	340125	2720171	33489	27257618	9.99	99.81
ROA	0.1124	0.2814	0.0670	2.6775	8.01	71.63
LgSales	4.5695	0.5954	4.5545	6.0747	0.39	-0.03

4.2. Correlation Statistics

This table shows "Pearson correlation coefficients" for dependent and independent variables. Each row shows correlation coefficient for the variables.

Table 2: Correlation among TAO, Board size, TA, NI, ROA and LgSales

	TAO	**Board size**	**NI**	**TA**	**ROA**
Board size	-0.032 *0.750*				
NI	-0.130	0.047			

	0.1977	*0.646*			
TA	-0.059 *0.563*	0.126 *0.123*	0.013 *0.896*		
ROA	-0.0125 *0.214*	0.202 *0.044*	0.189 *0.059*	-0.044 *0.667*	
LgSale	0.499 *0.000*	0.0212 *0.034*	0.368 *0.00*	0.131 *0.194*	-0.061 *0.544*

The result shows a negative correlation of board size with total assets turnover, and a positive correlation with Log of sales, net income, total assets, and return on assets. There is also a positive correlation between net income, board size, total assets, log of sales and return on assets. In addition, total assets are negatively correlated with ROA and positively correlated with log of sales. The results also show a negative correlation between total assets and log of sales.

4.3. Regression Results

Panel reports results for Model. F-statistic and Adj-R2 represent the the regression model. Coefficient of the variables is represented in 1st row P-Value of the coefficient is represented in the next.

Table 3: Regression among TAO versus Board size, and Lgsales

Variables	**Coefficient**	**P-Value**
Constant	-2.711	0.001
BS	-0.0758	0.106
Lgsales	1.034	0.000
F-value **R-Seq(Adj)**	17.83 25.38%	

The above model shows the significant relation between variables. The outcome shows a significant but negative association between board size and total assets turn over. The findings also reveal that Board size negatively effects on firm's performance, means that large number of directors in a board decreases the efficiency of the firm. The outcome is matching with the result of[21], which shows that boards of directors often neglect to effectively keep track of the firm's administration. The board may not effectively keep track of executive overall performance because board culture prevents constructive critique and due to informational asymmetry issues that exist between management and the board. Therefore fragile management is actually negatively related to overall firm performance.

Further result shows a significantly positive relationship of LgSales with total assets turn over. Lgsales used as a proxy for size since the market consist of large and small companies which may decrease the performance of overall market, therefore the size of the company took control variable as proxy by sales revenue. The R-sq (Adj) shows that the dependent variable explains by the independent variable with 25.38%.

Table 4: Regression amongROA, Board size and LgSales

Variable	**Coefficient**	**P-Value**
Constant	0.391	0.091
BS	-0.0250	0.055

LgSales	-0.0092	0.894
F-Value **R-Seq(Adj)**	2.08 2.13%	

This model shows significant inverse relation between board size and return on assets. The number of directors in a corporation represents the board size. It significantly impacts on firm performance. The large number of directors in a board creates many problems, such as asymmetric information, conflicts, lack of proper communication and leadership destabilize the efficiency of large boards. Findings of this research is matching with the result of (Velnampy, 2013),[22] which shows that corporate governance practices do not affect corporations ROE and ROA performance. This study further shows an inverse association between Lgsales and returns on assets. LgSales is used as a proxy for large size since the market consist of large and small companies which affect the performance of the overall market, therefore the size of the company is considered control variable proxy by sales revenue. The R-sq (Adj) shows that the dependent variable explains by an independent variable with 2.13%.

5. Summary, Conclusion& Recommendations

In this study the impact of good governance practices on overall firm performance was examined. Data from twenty five (25) companies listed at Karachi stock exchange was analyzed during the period 2011 to 2014.Two proxies used from firm performance perspectives were used that are Return on Assets (ROA) and Total Assets Turnover (TAO) and two proxies from good governance perspectives were used that areBoard Size (BS) and Log of Sales (Lgsal).

The following results reveal by the study:

1: There is a significant but negative relation between board size and total assets turn over.

2: There is an insignificant negative relation between sales and return on assets.

3: There is a significant positive relationship between LgSales and total assets turn over.

The outcome shows a negative relationship between Return on Assets (ROA), Lgsal and Board Size (BS), while finds a negative relationship between Earning per Share (EPS) and Dividends per Share (DS). Moreover, the result shows a positive relation between EPS and Lgsal. Further study calls for a comparative study of corporate governance and firm performance by selecting more than 25 companies. Researchers can also make better research by increasing the time period. They can use data for more than four years. They can also use more variables for a comprehensive and reliable result.

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