Impact of Corporate Governance on Firm Financial Performance: An Empirical Evidence from Textile Sector of Pakistan

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Abstract- Researcher tries it best to discover the role of corporate governance on the evolvement/performance of firm as well as on other financial decisions. In this study corporate governance is measured by using five variables board size, board meetings, CEO duality, percentage of non-executive directors and percentage of independent directors.

ROA is not affected by the scale/size of board and impact insignificantly. Board size in context of Pakistan cannot become cause to increase or curtail firm ROA. Non-executive managers role doesn’t bear out the increment in evolvement of firm as well as in ROA of firm. Firm evolvement and ROA is associated negatively with the proportion of managers who are not director. Firm’s magnitude in size is large or small cannot increase the efficiency of firm in utilizing the assets for emolument, it always depend on the capabilities of mangers rather than size.

I. INTRODUCTION

Creditors and regulating bodies of companies often trap into conflict due difference in interest and construct inevitability need of corporate governance. Berle and Means (1932), (Morck, Shleifer et al. 1988)detailed that control in hand of specific people become major reason for conflict, which is normally between distinct stock holders and regulating bodies (directors).Level of available information is different among controller and stockholder whether they are distinctive or ordinary, controllers can ride over their interest by using the gap of unequal information. Directors control every project, they are the person actually familiar with every detail as well as pros and cons of project, no one can object on amount allotted to these project so they can easily use extra money than required due to their authorities. Another major area where they can get benefit is, selling companies asset or purchasing asset unfavorable in interest of company and its shareholders for example selling asset at a price which is even less than market price at the particular time period.

The role of all Executives is not same, differ according to personality, some really work for their organization and made them unbeatable by using all the opportunities available in environment in best interest of their depositors. The extents of these practices is bear in form of agency costs, which normally occurred in stabilizing relations between stakeholders (principal) and administrators (manager).

From last decade, researcher desired to explore the reasons and situations in which directors get edge to exploit the interest of shareholder by deceiving the facts around the globe for good understanding of real facts present in companies (Shleifer and Vishny 1997, Porta, Lopez-de-Silanes et al. 1999, Claessens, Djankov et al. 2000, Denis and McConnell 2003).

In some countries the trend is, big investor of companies are the part of management, in these case difference of interest doesn’t exist among key managers and giant depositors. Other group is consisting on that shareholder who doesn’t have invested a large amount of money, the conflict get up with them. Monitoring financiers’ wants that their invested capital remain save and also get some extra benefit in form of income gain, they are normally risk averse and remain relaxed in presence of gigantic investor because ratio of loss or cost curtail. (Shleifer and Vishny 1997).

A number of empirical studies makes clear that conflicts whether it is between gigantic investor and key mangers or between small investors and big depostor, will always effect the performance of company like Jensen (1986)for external funds controlling and Gompers, Ishii et al. (2003) for great fluctuation in stock prices and in management of book keeping and Ozkan and Ozkan (2004), for investment decisions and holding of amount in form of cash and Hu and Kumar (2004), for dividend payment decisions and Datta, ISKANDAR-DATTA et al. (2005), for mixture of internal and external finance. When management failed to bore away the goal due to pressure of conflict in interest of major stockholder of company (executives and shareholder), showed ineptitude of corporate governance. The decisions are made which are not beneficial such as curtail of leverage, huge amount in form of cash rather than investing in projects, less satisfaction of shareholder in form of less reimbursement of dividend declared amount and exhibited under performance than industry.

1.1 Objective of the study

Corporate governance is a burning question in the world of research, as geographical boundaries changed role of executives changed because the nature of people also very as parts of world. Author is collecting empirical evidences on the role of this important stockholder in the life of a company in Pakistan and in reference to textile industry which is the importance of great mount for Pakistan. The chief objective is about governance
practices in company by executive and influence role of these practices on corporate.

1.2 Research questions
1. Do corporate governance practices exist in textile sector of Pakistan?
2. Do corporate governance practices have impact on firm performance?

II. LITERATURE REVIEW

2.1 Corporate governance
Kybernan is Greek word which bring forth the term “Governance” which gave the meanings of direct, regulator, or administer. Largely governance is well-defined by exhibiting relationship between executive committee and the individuals of the company normally called shareholder having a strong stake in firm. A team of well-equipped people with experience, broad vision and interpersonal skills who are consider expert in directing organization, are authorized for making decisions in the best interest of shareholders. Governance contrivances are inevitable in developing and achieving long span goals as well as short term goals of company.

Narrowly governance concept moves around the relations and interaction of different parties which includes company managers, executives, and stakeholders. Broadly governance is the game of guidelines, procedures and laws, if in favor of company interest then favorable governance otherwise it is called incompetence of management. It is not restricted within the company boundaries but also include services of private segment exist in market which facilitate company in attaining capital, improving efficiency, increased in sale to enhance profit, and abide by all the legal need and society well-fare is also part of it (Yasser 2011).

2.2 Board size
All the shareholder of company by using their voting right elect the persons which all they consider are the persons who can drive company through their practices toward achievement of vision and shareholder interest. A Board of a company also involved into the gratuities, selections, salary and replacement in activities of managers.

With the passage of time directors duties also changed and these duties also changed from company to company. (Caselli and Gatti 2007), to give a clear understanding of a person known as team of director said two point must be kept in mind, include that directors are actors which means their role will changed as situation changed and other one is context which exhibit the situation or environment. In this definition the word actors is not only used for directors in wide extent every person who have stake in organization is the actor according to author. The presence of all stakeholder stimulate directors to build value for them, they feel proud by sharing information of achievement with them. Context is the environment in which directors perform their decisions.

Board size means member which act as director. Normally formation of board is done as par the rules stated in ordinance, the normal practices are to include seven members in board (Andreou, Louca et al. 2014).

Different publications includes (Yermack 1996) and (Eisenberg, Sundgren et al. 1998), empirically showed that the companies that curtail the number of directors are more successful than those companies who has an army of director but (Dalton, Daily et al. 1999), reported contrary results than previous studies came on the scene (Wintoki, Linck et al. 2012). So, the diverse literature doesn’t clear that what mixture should be adopted, so it means the number of directors in your board depends on situation and interpersonal capabilities and efficiency of directors.

However more people are agree on the point that curtail in number of directors is more beneficial in decisions making and few directors really feel responsibility for decisions rather than transferring them on other shoulders. (Yermack 1996). However, various studies of the maritime corporations for instance, (RandØy, Down et al. 2003, Koufopoulos, Lagoudis et al. 2010, Syropoulos and Tsatsaromis 2011, Tsionas, Merikas et al. 2012)reported different facts about number of member as firm changed.

2.3 Board composition
The member of board are the person who have to in the best interest of shareholder. The purpose to make the team of efficient persons as being directors to control all the strategic level decisions in the company. They insure the interest of common shareholder from those manager who can manipulate the facts and can mislead the financial publications in the favor of their own veiled motives. (Jensen and Meckling 1976).

2.4 Non-executive boards
It is measured as the percentage of non-executive directors in the board.

(Harris and Raviv 2008), managers who are not on the positions of directors but directors made decisions on the information provided by them, play a key role in reducing conflicts between top management and shareholder. Those non-executive managers are abundant with elementary and vital information, incentives, and all the expertise need to control the situations, discipline, that’s why there importance can’t be curtailed. While, some studies also reported different facts about the importance of non-executive managers that they can’t see the full picture as top director can see due to availability of full information from all the managers’ expert in different areas. While it is the fact that if they made the part of board as assistance than they can take decisions without showing dependency on CEO. (Jensen 1993, Agrawal and Knober 1996). Under the umbrellas of facts Some researcher declared that non-executive managers are the best persons for critical decision due to practical involvement in business (Fama and Jensen 1983), and self-governing and not any pressure by CEO (Weisbach 1988). By (Tricker 1984), presence of mangers who are not executives in board can make the decisions more better. Theory presented on the dependency of resources also claim that role of mangers who are not executives, can be highly constructive for organization due to their services, prestige and acquaintances as well in reference to external setting.

2.5 Independent directors
Security and exchange commission Pakistan has laid down the rules for the number of independent directors that there must be one independent director in the board or one third of total members in the board.

Experiential research conducted by (Rosenstein and Wyatt 1990), conveyed that positive relationship among independent directors in board with the performance of organization and this relationship is not mere positive but also significant. This is not mere proved from this publication but Chinese researcher (Yuetang, Ziye et al. 2006) also bear out it. Researchers (Baysinger and Butler 1985, Brickley, Coles et al. 1994, Yermack 2004), operations becomes more suffocated and better as number of independent directors increased in top executive panel.

2.6 Board meetings

Board meetings means how many time all the members of your organization’s board sit together to take strategic level decisions. Corporate Governance code of Pakistan (2002) specified that meetings should be organized after specified and equal time period by issuing a formal notice to all the members in which purpose of meeting should be disclosed so all the member prepared for meeting. However, it was also made compulsory that with each quarter, one meeting should be held. The meeting plan for though out the year should be revealed at the start of the year so all members become familiar with future conduct, along with the timing of all the meetings and importance of attendance for each director (Yasser 2011).

2.7 CEO Duality

CEO is highest rank in the hierarchy of management level. CEO duality means this highest rank can be further divided as in some organization this post is for one person who will be CEO while some organizations add chairman post also in their hierarchy. (LATIF, SHAHID et al. 2013). Level of conflicts will be increased when these two most powerful position will be in the possession of one person. (Javid and Iqbal 2010).

(Yermack 1996), different persons on these two position surge the performance of business procedure. (Core, Holthausen et al. 1999), company costs will not be curtailed while significantly increase when top post will be hand over to different persons. (Brown and Caylor 2004), also declared that companies remain comfortable due to less conflict and politics when division in top post doesn’t exist.

2.8 Return on assets

When organization total income earned in a fiscal year is divided with the total assets owned by the firm in that particular period, result are called ROA(LATIF, SHAHID et al. 2013). It is the result of equation which is made by dividing net income with total assets hold for that time period. (Khan, Nemati et al. 2011). Mangers are independent in using the assets of the firm in the best interest of organization, so this ratio is use not only to see the position of a particular company, that how much they are getting benefits from their assets in generation of income but the skills of a manger can be estimated by using it. (Epps and Cereola 2008). With the passage of time ROA has become widely used technique for appraisal of performance and pronounced the efficiency of asset (Aras 2015).

(da Silva and Leal 2005), in Brazil the standard for scrutiny of the performance of management is ROA, tiniest level is four percent who reported performance with the help of this ratio. Companies with efficient leaders and directors give higher return on assets. Impact of corporate governance on the value of asset and share is positive and association is significant, Brazilian firms bear out this fact.

III. RESEARCH METHODOLOGY

3.1 Population and sample selection

Companies operating in textile sector is the Population of this study, and includes only those companies listed stock exchange of Pakistan. Textile companies dealing in different operation like spinning or in whole processes needed in textile as some gigantic companies are independent in all operations, are 156 whose share are traded in stock exchange of Pakistan. 60 companies out of 156 was selected to infer the result about population, for selection of 60 companies technique used was random sampling. In selection of companies the things which was also considered was accessibility of data vital for analysis, substitutes for additional information. Data collected for five years period ranging from 2010 to 2014. 2002 was the year in which code for corporate governance was supplied and in 2012 SECP revised it for further improvements. In past Textile sector played a crucial role in strengthen of our economy, now again government reform are boosting this sector. The most important objective to pick out only this sector is to see how with help of changes in management this sector can dominate the economy of Pakistan in near future.

3.2 Sources of data collection

Examiner has collected required amount of data from authentic source like annual published material in form of report of selected firm and booklets offered by state bank of Islamic republic Pakistan. Statistics related to corporate governance includes board size, CEO duality, board meetings, executive ownership, percentage of executive directors, percentage of non-executive directors and percentage of independent directors collected for the time period of five years from 2010-2014. BSA is database system in which SBP (state bank of Pakistan) in which indicator of information performance are stored and information about major financial decisions such as dividend declaration and payment. Therefore, for the sake of analysis in this study author used random sampling technique and sample includes 300 firm years.

3.3 Hypothesis development

H1: There is negative relationshipamong board size and firm performance.

H2: There is negative association between CEO duality and firm performance.

H3: Board meetings have positive impact on firm performance

H4: There is positive association between board composition and firm performance.

H5: There is negative association between board size and dividend policy.
H6: There is a negative association between board composition and dividend policy

Table: 1 Definition of variables and proxies

<table>
<thead>
<tr>
<th>Variables</th>
<th>Proxies</th>
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<tbody>
<tr>
<td>ROA</td>
<td>Return on assets ratio</td>
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<tr>
<td>B SIZE</td>
<td>total no. of directors in the board</td>
</tr>
<tr>
<td>Non-executive director’s</td>
<td>percentage of non-executive directors in the board</td>
</tr>
<tr>
<td>Independent director’s</td>
<td>percentage of independent directors in the board</td>
</tr>
<tr>
<td>B MEETINGS</td>
<td>total no. of meetings held by the board during year</td>
</tr>
<tr>
<td>CEO DUALITY</td>
<td>if the chairman/CEO is the same person=1, otherwise 0</td>
</tr>
<tr>
<td>SIZE</td>
<td>natural log of total assets</td>
</tr>
<tr>
<td>AGE</td>
<td>age of company</td>
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</tbody>
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IV. RESULTS AND FINDINGS

Table: 2 Regression analysis (Dependent Variable: ROA)

| Variables     | Coefficients | P>|t| |
|----------------|--------------|-----|
| B SIZE         | -.0233398    | 0.278|
| CEO DUALITY    | -.057338***  | 0.000|
| B MEETINGS     | .0011099     | 0.488|
| NON EX DR      | .0002909     | 0.278|
| IND DR         | -.000631*    | 0.097|
| SIZE           | -.0037747    | 0.939|
| AGE            | -.0000713    | 0.841|

Prob> F = 0.0000
R-squared = 0.7065
Note: level of significance 1%***
Level of significance 5%**
Level of significance 10%*

Return on assets (ROA) is regressed on rest of the explanatory variables. Regression results show that F value of the model .0000 is less than .05 which means that fit is good for the data. Value of R-square is .7056 this means 70.56% variation in dependent variable return on assets is explained by the explanatory variables of the model.

The domino effect illustrate that ROA is not affected by the scale of the board and impact insignificantly. Board size in context of Pakistan cannot become cause to increase or curtail firm ROA. So author concluded that Board size is inappropriate to use for measurement of firm performance. (Harvey Pamburai, Chamisa et al. 2015) also bore out the result of this study that corporate governance in term of size or dependence on managers doesn’t leave impact on performance in form of profit as other factors add, so relation is insignificant.

Study discovered that further division in highest rank referred to CEO duality, negatively hit the ROA. Firm employed same person on the both highest post of CEO as well as chairman surge the performance at satisfactory level. Some negative points are also associated with CEO duality as cost increase when remunerations are paid to different persons, clashes among managers also increase and affect the firm performance in negative way. (LATIF et al., 2013) also bear out the result of this study. Ujunwa (2012), has testified that a relation which is negative exist between CEO duality and evolvement of firm. Abdul rehman&Haniffa (2005), also bear out this relationship by back upping it with their research work.

Evolvement of firm and ROA receives insignificant affect from the variable Board meetings. How many times Board conduct meetings have no connection or impact on firm profit or performance. In case of Pakistan meetings are not for sake of discussion or brainstorming while these are just to share basic information or fulfill requirement of SECP, that’s why in setting of Pakistan it doesn’t have association with ROA. (Harvey Pamburai, Chamisa et al. 2015) also bear out this fact.

ROA receive insignificant affect from the variable included in study that is role of non-executive mangers in board. Role or presence of non-executive mangers in board in context of Pakistani culture cannot become cause to increase or curtail your ROA. . In case of Pakistan role of non-executive mangers in board are not for sake of discussion or brainstorming while they are included only to fulfill the requirement of SECP and they are not independent person while employed by nepotism, the goals which SECP wants to achieve by creating an environment in which directors feel their decision can be challenged, not achieved.

In Pakistan, one of the major and important sector playing role in progress is textile, in which non-executive mangersrole...
doesn’t bear out the increment in evolvement of firm as well as in ROA of firm. (Mehran 1995), (Herermalin & Weisbach 1991), (Zahra and Stanton 1988) declared; ROA neither increase or curtail in the presence of managers who are not executives. Hypothesis H4 is rejected.

Firm evolvement and ROA is associated negatively with the proportion of managers who are not director. Independent directors are largely employed through nepotism which naturally decrease their stake in the company, and remained unable to perform the role for which they are inducted in board. Evolvement and performance curtail due to increase in supplementary cost as number of managers who are not director’s increase. The similar result’s evidence also found in publications of Bhagat&Black (1999), (2001), Herermalin&amp;weisbach (1991), Klein (1998) cantor, dana, & peck (1983); that firm evolvement is associated negatively with the proportion of managers who are not director. Whether firm’s magnitude in size is large or small cannot increase the efficiency of firm in utilizing the assets for emolument, it always depend on the capabilities of mangers rather than size.

V. CONCLUSION

Researcher tries it best to discover the role of corporate governance on the evolvement/performance of firm as well as on other financial decisions. Course of action for payment of dividend is one of the crucial decision in the life of corporate. This decision is taken by considering all opportunity cost which are normally future investment and satisfaction of existing and potential shareholder is also considered. Dividend payout ratio is the direct measure of dividend policy used in this study.

In this study corporate governance is measured by using five variables board size, board meetings, CEO duality, percentage of non-executive directors and percentage of independent directors.

ROA is not affected by the scale/size of board and impact insignificantly. Board size in context of Pakistan cannot become cause to increase or curtail firm ROA. Further division in highest rank referred to CEO duality, negatively hit the ROA. Firms employed same person on the both highest post of CEO as well as chairman serge the performance at satisfactory level. How many times Board conduct meetings have no connection or impact on firm profit or performance. Non-executive mangers role doesn’t bear out the increment in evolvement of firm as well as in ROA of firm. Firm evolvement and ROA is associated negatively with the proportion of managers who are not director. And at the last whether firm’s magnitude in size is large or small cannot increase the efficiency of firm in utilizing the assets for emolument, it always depend on the capabilities of mangers rather than size.

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