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Corporate Governance and Firm Performance: A Case Study of Textile Spinning Firms Listed at Karachi Stock Exchange (KSE)

Tayyab Zeeshan Shahid[1], Sarfraz Hassan[1], Farah Naz[2]
[1]Institute of Agricultural and Resource Economics, University of Agriculture, Faisalabad;
[2]School of Management Studies, The University of Faisalabad
Email: farah.naz@tuf.edu.pk

Abstract

This paper enlightens the antecedences triggered by the governance based mechanisms upon the performance of the listed firms at Karachi Stock Exchange (KSE). For this purpose, one of the heavily contributing industries of Pakistan, the textile spinning industry has been targeted. The firms indulged within the process of empirical estimation were listed at KSE for the period of 2009 to 2017. Sources of the data were annually audited financial statements published by firms, Balance Sheet Analysis (BSA) and Financial Statement Analysis (FSA) published by the State Bank of Pakistan (SBP). The framework of study undergone descriptive analytical reasoning followed by the panel data methodological approach, utilizing fixed effect methodological adaptations at major. The results deduced that the governance based mechanisms carved by the Securities and Exchange Commission of Pakistan (SECP), upon an aggregate level, affected positively and significantly the performance of listed firms.

Keywords: Corporate governance, Karachi Stock Exchange, Performance, Textile Spinning Firms

Introduction

Overall performances evinced by the firms eventually points towards the extent of which the set of mechanisms are being adopted. Invariable performance wangled by the institution will explicitly be fraternized by the corporate governance mechanisms espoused by the firm itself. These mechanisms are so to be known as the governance tools. Steady or unsteady outcomes exhibited by firms eventually points towards the adoptability to the body of mechanisms associated with the corporate governance (Iskander and Chamlou, 2000).

The Organization of Economic Corporation and Development (OECD) explained the corporate governance that it indulges the framework dealing efficiency and transparency among the market structure, where consistently prevailing law and order situations and articulation of responsibilities associated by the authorities are submerged without any discrimination (OECD, 2013).

Primarily, the study figures multi-dimensionally, the functionalities of the set of governance based mechanisms yielding their impacts upon the performances of the firms. Corporate governance is a tool that gradually mechanizes the corporate formation to be managed, merged, organized, and to be operated in a way that all the stakeholders under an institution collectively collaborate and contribute towards the uplifting of their nascent institutions (Jensen and Ruback, 1983).

This study unfolds a broader concept of economic prosperity where the governance based mechanisms capitulates the performances of firms, thus jointly collaborates and contributes to assemble the healthier economic conditions for the country. The performance of an industry is solely beholden by the deliberate performances of its constituent firms. Individual performance of the firms eventually escalates the aggregate performances of an industry (Hawawini et al., 2000).

Corporate Governance in Pakistan

Before 1999, Corporate Law Authority (CLA) was the sole authority to regulate domestic business activities after that Securities and Exchange Commission (SEC) replaced CLA by holding all the authorities and responsibilities. The SEC became sole authority recognized for the capacity enhancement, making the firm strategies and the implementation to the policies carved by considering corporate laws (SECP, 2014).

Aims of Study

1. The study aims to explore different dimensions of corporate governance structure and the performance of firms.

2. This study aims to unfold the relationship between adoptability of corporate governance structure and exhibited performances of the firms.

Literature Review

There is a broader shelf of literature defining the corporate governance but the concept slightly differs individually. Higher payoffs eventually unbolt the way toward innumerable opportunities including capacity building, enhancement of capabilities, strengthening of mechanisms that guarantee the ultimate achievements to the firms (Gillan, 2006).

The corporate governance mechanisms are the actual practices made by the governance authorities by keenly utilizing the mechanisms of governance frameworks (Nam et al., 2004). These are the practices that eventually help gaining the confidence of both the investors and the market itself (Denis and McConnell, 2003).

The application of governance based mechanisms uplifts the performances of firms. These elevated performances upon ultimately contributes in the uprising of an industry, thereby inducing the performance of an economy (Duca, 2015).

The parameters reflecting the performances of firms points toward the backend utilization of set of mechanisms. (Wn et al., 2014). The board meetings including the size of the board, larger the board of directors size more will be the efficiency a firm will achieve (Johl et al., 2015).

Methodology

Sample Selection

The selection of the firms for the purpose of empirical estimation, was based upon the consistency and the availability of the concerning firms that is generally known as the non-probability sampling technique specifically evolved for the purpose of data collection. The best fit firms to the criteria were selected.

Data Collection

The study assessed the relationship between corporate governance mechanisms and firm's performance of listed companies at (KSE). Data were collected from annual reports published by the listed companies and the Balance Sheet Analysis (BSA) published by the State Bank of Pakistan (SBP) respectively. The study examined the data consisted of the 40 shortlisted firms for the years 2009 and 2017.

Outlook to Variables

The study at hand utilized two sets of variables.

Performance of the Firms

For the sake of identification to the performance of the listed firms, the variables constructed were the Return on Assets (ROA).

Table 1: Firm's Performance

Variables	Symbols	Description
Return on Assets	ROA	Profitability of a firm relative to the total assets

Source: Authors Own Calculations

Table 1 indicates the variable representing the performance exhibited by the firms, Return on Assets (ROA). The variable ROA is the actual profitability of the firms with respect to the assets declaration by that consequent firm.

Corporate Governance Mechanisms

Table 2 represents the variables indicating governance of the firm were the Board Size (BODS), Board Remunerations (BRUM), Audit Committee Members (ACM), Auditor's Remunerations (ARUM), Annual General Meetings (AGM), Meeting Fee (MF), and the CEO's Duality Status (DS).

Table 2: Corporate Governance Mechanisms

Variables	Symbols	Description
Board Size	BODS	Count to the numbers of Directors on Board
Board Remunerations	BRUM	Paid up amounts to Board Members for their services
Audit Committee Members	ACM	Count to the numbers of Audit Committee
Auditor's Remunerations	ARUM	Paid up amounts to Audit Committee Members for their services
Annual General Meetings	AGM	Count to the numbers of meetings held
Meeting Fee	MF	Fee paid to the members against the meeting charges
Duality Status	DS	If a person occupies more than one post then 0 otherwise 1

Source: Author's Own Calculations

Dummy Variables

The study incorporated the utilization of the dummy variables, d2, d3, d4, d5, d6, d7, d8, and d9 representing the time fixed effect within the framework.

Econometrical Framework and Modeling

The study incorporated the utilization time fixed and location fixed effects, the multiple regression approach deducing the results.

Model Specification

The study utilized time fixed and location fixed effects utilizing the multiple regression analytical approach for the estimation of the firm's data.

Empirical Results

Description to Variables

The study upon the corporate governance and the firm's performance introduce the set of fundamental variables named as, BODS, BRUM, ACM, ARUM, AGM, MF, and DS.

Table 3: Descriptive Statistics of Corporate Governance Mechanisms

Variables	Mean	Minimum	Maximum
BODS	7.19	6	10
BRUM	9447507.1	0	99608400

Variables	Mean	Minimum	Maximum
ACM	3.33	3	4
ARUM	1286394.1	1335	3250000
AGM	5.43	4	18
MF	254103.05	0	4500060
DS	0.46	0	1

Source: Author's Own Calculations

Table 3 depicts the proximity to the count number of Directors on Board (BODS) upon an average was founded to be around 7 members. The mean value of the remunerations associated with the BOD representing the BRUM is the approximate mean remunerations that the firms bear upon an average of 94 lacks for each firm. It is the average amount by which the BOD's are being paid by their nascent firms.

While considering the approximate number of ACM's to be around 3, the remunerations associated with the ACM's founded to be approximately around the rupees 12 lac that upon an average paid by the each firm.

Further the results deduced that, upon an average, the approximately 5 meetings were organized by each listed firm. Approximately 2 lack rupees paid against the MF to the members by the firms. The descriptive analytical statistics for the DS revealed that more than 45% of firms, more than one post occupied by the same person.

Table 4 indicated that the firms, upon an average, receiving the profitable returns in term of the assets. The value of the variable ROA, 5.27 indicating the gain by the firms in term of the returns upon an average is more than 5 times as compared to the initial assets invested within the firms.

Table 4: Descriptive Statistics to Performance Variables

Variables	Mean	Minimum	Maximum
ROA	5.27	0.06	17.68

Source: Author's Own Calculations

Fixed Effect Regression

The empirical evaluation of the raw facts was followed by the descriptive analytical statistics, by specifically utilizing the statistical and econometrical techniques to compare changes in compliance for 2009 to 2017 followed by the norms of the fixed effect model for both the individual and the time fixed effects. F-test reporting the significance of change.

The r-square and the adjusted r-squares are then defining the model fittings along with the detailed significances and the estimate results of the coefficients of the fixed effects, for both the time and individual fixed effects.

ROA as Dependent

When ROA was considered, the regression framework adopted the appropriate methodological approaches for handling the fixed effect regression models, the time fixed effect, individual fixed effects and the interactions among them.

Time Fixed Effect

The time fixed effect for the impact estimation of the governance variables upon the performance variables indulged the variables (dummy), d2, d3, d4, d5, d6, d7, d8, and d9 respectively. The results of time fixed effect regression among the variables is presented within table 5.

Table 5: Time Fixed Model Estimation with Dependent ROA

Source	SS	df	MS
Model	4180.85765	15	278.723843
Residual	1981.61301	344	5.76050292
Total	6162.47065	359	17.1656564

Number of obs	=	360
F(15, 344)	=	48.39
Prob > F	=	0.0000
R-squared	=	0.6784
Adj R-squared	=	0.6644
Root MSE	=	2.4001

ROA	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
BODS	1.252833	.1405376	8.91	0.000	.9764114	1.529254
BRUM	6.37e-08	6.46e-09	9.86	0.000	5.10e-08	7.64e-08
ACM	1.887922	.3057346	6.18	0.000	1.286577	2.489266
ARUM	9.96e-07	1.47e-07	6.80	0.000	7.08e-07	1.28e-06
AGM	.1687584	.0470924	3.58	0.000	.0761332	.2613837
MF	2.08e-07	1.67e-07	1.24	0.215	-1.21e-07	5.37e-07
DS	-.1621181	.257384	-0.63	0.529	-.6683626	.3441263
d2	-.1273218	.5394032	-0.24	0.814	-1.188265	.9336217
d3	-.1813372	.5408933	-0.34	0.738	-1.245212	.8825372
d4	.1040674	.5440731	0.19	0.848	-.9660613	1.174196
d5	-.355669	.5454751	-0.65	0.515	-1.428555	.7172173
d6	-.2655267	.5434633	-0.49	0.625	-1.334456	.8034026
d7	-.4872211	.5388009	-0.90	0.366	-1.54698	.5725379
d8	-.3927889	.5492695	-0.72	0.475	-1.473138	.6875605
d9	-.470318	.5409518	-0.87	0.385	-1.534308	.5936716
_cons	-12.54227	1.307916	-9.59	0.000	-15.11479	-9.969753

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Source: Author’s Own Calculations

The regression results indicated that the dummy variables utilized within the methodological framework i.e. d2, d3, d4, d5, d6, d7, d8, and d9 with ROA and the governance variables (BODS, BRUM, ACM, ARUM, AGM, MF and DS) having the insignificant results that actually presented within table 6.

Individual Firm’s Fixed Effect

The incorporation of the dummies with respect to the individual firms provided a number of variables i.e. d10, d11, d12, d13, d14, d15, d16, till d48, respectively. The results of individual firm’s fixed effect regression, among the variables are presented within table 6.

Table 6: Individual Fixed Model Estimation with Dependent ROA

Source	SS	df	MS
Model	4406.96809	12	367.247341
Residual	1755.50257	347	5.0590852
Total	6162.47065	359	17.1656564

Number of obs	=	360
F(12, 347)	=	72.59
Prob > F	=	0.0000
R-squared	=	0.7151
Adj R-squared	=	0.7053
Root MSE	=	2.2492

ROA	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
BODS	1.186515	.1311189	9.05	0.000	.9286274	1.444403
BRUM	6.39e-08	6.02e-09	10.61	0.000	5.20e-08	7.57e-08
ACM	1.939279	.2861391	6.78	0.000	1.376494	2.502065
ARUM	1.06e-06	1.39e-07	7.63	0.000	7.87e-07	1.33e-06
AGM	.1670119	.0440037	3.80	0.000	.0804644	.2535594
MF	2.18e-07	1.55e-07	1.41	0.161	-8.72e-08	5.24e-07
CEO	-.1167373	.2404757	-0.49	0.628	-.5897108	.3562362
d10	0	(omitted)				
d11	0	(omitted)				
d12	0	(omitted)				
d13	0	(omitted)				
d14	0	(omitted)				
d15	0	(omitted)				
d16	0	(omitted)				
d17	0	(omitted)				
d18	-2.291612	.7683516	-2.98	0.003	-3.802824	-.7803997
d19	0	(omitted)				
d20	0	(omitted)				
d21	0	(omitted)				
d22	0	(omitted)				
d23	0	(omitted)				
d24	0	(omitted)				
d25	3.079082	.7668122	4.02	0.000	1.570897	4.587266
d26	0	(omitted)				
d27	-1.974753	.7659336	-2.58	0.010	-3.48121	-.4682966
d28	0	(omitted)				
d29	2.337928	.7626388	3.07	0.002	.8379515	3.837904
d30	0	(omitted)				
d31	0	(omitted)				
d32	0	(omitted)				
d33	0	(omitted)				
d34	0	(omitted)				
d35	0	(omitted)				
d36	0	(omitted)				
d37	0	(omitted)				
d38	0	(omitted)				
d39	0	(omitted)				
d40	-1.703946	.7776799	-2.19	0.029	-3.233505	-.1743861
d41	0	(omitted)				
d42	0	(omitted)				
d43	0	(omitted)				
d44	0	(omitted)				
d45	0	(omitted)				
d46	0	(omitted)				
d47	0	(omitted)				
d48	0	(omitted)				
_cons	-12.5622	1.190242	-10.55	0.000	-14.9032	-10.22121

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Source: Author's Own Calculations

The regression results indicated that the dummy variables utilized within the methodological framework i.e. d10, d11, d12, d13, d14, d15, d16, till d48 with ROA and the governance variables (BODS, BRUM, ACM, ARUM, AGM, MF and DS).

Interactions among the Time and Individual Fixed Effect

The interactions among the variables utilized by the time fixed effect and the individual fixed effect with dependent ROA has been presented in table 7.

The actual independent variables (BODS, BRUM, ACM, ARUM, AGM, MF and DS) along with the dummy variables (d2, d3, d4, d5, d6, d7, d8, and d9) deduced from the time fixed effect for ROA and the dummies for individual effect (d10 to d48) shared the common intercept.

Table 7: Interactions among the Time and Individual Fixed Effect with ROA

ROA	Coefficients	St. Error	T	P>|t|
BODS	1.8955	0.133	8.94***	0
BRUM	6.3409	6.0709	10.45***	0
ACM	1.9167	0.2882	6.65***	0
ARUM	1.0809	1.4109	7.71***	0
AGM	0.1673	0.0445	3.76***	0
MF	2.3909	1.5809	1.51	0.132
DS	-0.1355	0.2426	-0.56	0.577
d18	-3.0645	0.865	-3.54***	0
d25	3.5143	0.859	4.09***	0
d27	-1.604	0.901	-1.78*	0.076
d29	2.7048	0.893	3.30***	0.003
d40	-1.8783	0.848	-2.21**	0.028
constant	-12.3	1.239	-9.93***	0

Source: Author's Own Calculations

*, **, *** *indicates significance at 10%, 5% and 1% respectively*

ANOVA Table

Table 8 expresses the ANOVA Statistics where the mean square values for both the regression and residual were, 222.08 and 5.07, respectively.

Table 8: ANOVA Table with Dependent ROA

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 **Regression**	4441.67	20	222.08	43.75	0
Residual	1720.79	339	5.07		
Total	6162.47	359			
Dependent Variable: ROA					
Predictors: (Constant), BODS, BRUM, ACM, ARUM, AGM, MF, DS, and d2, d3, d4, d5, d6,…….d48					

Source: Author's Own Calculations

Furthermore the results indicated that at 1% level, the significant relationship among the both mechanisms that the F-statistics 43.75 (p = 0.000, < 0.01) as indicated in table 8.

Model Summary

Table 9 depicts the model fitting as a result of the regression analysis. The results indicated that model is explaining 72% of the variations.

Within the estimation BODS, BRUM, ACM, ARUM, AGM, MF, DS, and d2, d3, d4, d5, d6, till d48 were the predictors with dependent ROA.

Table 9: Model Summary with Dependent ROA

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.827	0.7208	0.7043	2.253
Predictors: (Constant), BODS, BRUM, ACM, ARUM, AGM, MF, DS, and d2, d3, d4, d5, d6,…….d48				
b. Dependent Variable: ROA				

Source: Author's Own Calculations

Conclusions

The study primarily focused upon the textile spinning firms listed at KSE and firms are governed under the rules and regulations carved by SEC of Pakistan. The study concluded that the governance based mechanisms carved by the SECP strongly affects the performance of the firms. Upon an average, the numbers of Board of Directors (BODS) of the listed spinning firms at KSE were found to be approximately 7.

Similarly, the Audit Committee members (ACM) were found to be upon an average 3 in count belonging to the firms. Approximate numbers of meetings reported by the firms were 6 approximately and the Duality Status (DS) depicted that less than half of the sample population, 46% of the listed firms under study were found to be encouraging the duality status.

The operational costs were found to be the sound contributor toward the achievements of the firms. Within our analysis, these operational costs were so to be known as the Board's Remunerations (BRUM), Auditor's Remunerations (ARUM) and the Meeting Fee (MF) where upon an average the approximate spending of the firms were 90 lack rupees, 12 lack rupees and the 2.5 lack rupees, respectively.

High operational cost eventually contributed toward the higher payoffs to the firms by means of Return on Assets (ROA) where upon an average the firms attaining 5 times more than the initial investment in the case of ROA.

The study further illuminates the need of improvements within the core governance based mechanisms, especially to create collaboration among different sects or the sectors of the economy. Furthermore, the remunerations to the governing agents should be raised, this eventually escalate the spirit of the agents to perform better and to achieve the optimality for their nascent firm.

Importance must be drowning toward the apprehension by means of the interactions or the general meetings, among the shareholders and the managing authorities of the firms to maintain the harmony and also to create better understanding.

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