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Corporate Governance Impact on Firm Performance: Evidence from Cement Industry of Pakistan

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Abstract

This study reveals relation between three corporate governance instruments (Board Size, Board Composition and CEO-Status) and one firm performance is measured using accounting-based measures (return on asset (ROA) of Karachi Stock Exchange listed cement firms is observed for the period 2007–2013. The ADF Test Multiple Regression and T-test exploration are applied to examine the significance & dependency of the overhead stated variables. Panel data methodology is utilized by estimate the arithmetic means, T-test and OLC by using the E-views. The finding revealed that there is a positive and significant relationship between ROA with board size and negative significant relationship between ROA with CEO-Status furthermore insignificant relationship between ROA with Board composition. The ramifications of this is that the board size ought to be restricted to a sizeable utmost also that the post of the CEO ought to be possessed by distinctive persons.

Keywords: Corporate Governance; Firm Performance; ROA, Board Size; CEO-Status.

Introduction

Corporate Governance (CG) is apprehensive with representing the corporate substances. Corporate substance does not mean to simply an organization however it incorporates all the business. CG concentrates on the abundance of business not on the Returns of the business. CG ensures the diversions of every last one of stakeholders from confiscation. Organized corporate governance helps to economic stability by upgrading the performance of organizations and expanding their right to gain entrance to outside capital. Corporate governance obliges a public policy objective. It diminishes the powerlessness of the financial crises. Lessens cost of capital and exchange cost. CG also anxieties with the relationship among administration, board of directorate, controlling shareholders, observing shareholders, and different stakeholders. There is no single meaning of CG that can be connected to all circumstances .The different definitions that exist today to a great extent rely on upon the establishment or creator, and in addition nation and lawful custom.

The tweak "corporate administration" came into well-known use in the 1980's to extensively depict the general standards by which the business and administration of organizations were directed and controlled. In spite of the fact that its use is presently regular, and the goals to be attained subsequently for the most part caught on, there is no generally acknowledged meaning of "corporate governance". In spite of the fact that the utility of definitions is constantly misrepresented, definitions do have the playing point of giving a general schema to examination and debate. For this reason, and in perspective of the relative early stages of the subject in Pakistan, a limited discussion of corporate governance is given underneath.

Laib A Dar, (2011) a fundamental meaning of corporate governance, which has been generally perceived, was given in a report by the advisory group under the chairmanship of Sir Adrian Cadbury tiled (the Cadbury Report): This meaning of corporate administration has been incorporated in different talks on the subject, including the 1998 last report of the Committee on The Financial Phases of Corporate Governance. The Cadbury Committee report characterizes it as "the framework by which organizations are administered and controlled". A corporate administration framework is embodied an extensive variety of practices and foundations, from accounting standard and laws concerning financial disclosure, to official remuneration, to size what's more organization of corporate sheets. A corporate administration framework characterizes who claims the firm, and manages the tenets by which financial returns are conveyed among shareholders, workers, managers, what's more different stakeholders. In that capacity, a district's corporate governance has profound ramifications for firm association, occupation frameworks, exchanging connections, and capital markets. Along these lines, changes in Pakistani arrangement of corporate governance are liable to have imperative results for the structure and behavior of nation business

In Pakistan, the first Code of CG was settled and issued by SECP in March 2002. At that point it was therefore consolidated in all the listed companies at stock exchanges in Pakistan. It was the first exertion by the government of Pakistan. In 2004, SECP made the first move to build the Pakistan Institute of Corporate Governance in public private association. Firm performance is an imperative idea that identifies with the way and way in which financial resources accessible to an association are prudently used to accomplish the in general corporate objective of a firm, it keeps the association in business and makes a more prominent prospect for future open doors. This study is a commitment to the continuous civil argument on the examination of the relationship that exists between corporate governance components and firm performance (BILAL LATIF, 2013).

Cement industries in Pakistan

The cement manufacturing in Pakistan has arisen a long way since independence when the country had less than half a million tons per annum production capacity. By now it has exceeded 10 million tons per annum as a result of formation of new manufacturing facilities and growth by the existing units. Denationalization and effective price deregulate in 1991-92 heralded a new era in which the industry has reached a level where surplus production after meeting local demand is predictable in 1997.

The cement industry in Pakistan expressions two serious threats: shutting of units based on wet process, and deprived cash flow execution the units incapable of debt overhauling due to swelling cost of electricity, furnace oil and imported craft paper used for cement packing. The cost of furnace oil alone has increased by nearly 100% in the last 15 months alone. With the increase in furnace oil the increase in electricity tariff has also become inevitable

At present there are 24 cement industries are operation in Pakistan, 4 of these factories are in public sector and rest are included in private sector. The installed capacity of cement is 16300 thousand tons out of which 9935 thousand tons of cement was produced in 2012-13. The major industry of Pakistan has been allowed duty free import of plant and machinery.

Pakistan has remained a net importer of cement yet because of the privatization of units working under state control and ensuing development programs by the new holders upheld by monetary has pushed the business to a point where the nation is certain to achieve an oversupply circumstance. Be that as it may, the late increment in vitality expense gives chance to the productive units focused around dry methodology to support the circumstances for a moderately more period. It would likewise be conceivable in light of the fact that the extension by the current units and foundation of new units are generally deferred.

Pakistan's concrete business is separated into two different areas, North and South. The northern area includes the Punjab, NWFP, Azad Kashmir and upper parts of Balochistan, though the southern locale involves the whole region of Sindh and lower parts of Balochistan. Generally, the southern district has dependably been surplus in bond generation however with the foundation of more plants in the northern parts of the nation the locale has gotten to be very nearly independent in supply of concrete.

Statement of problem

A ton of work is carried out to look at the relationship of the corporate Governance and Firm performance in the entire world. At the same time work identified with this field is not accessible for Pakistani cement industry in abundance. In this study our focus is the cement factories of Pakistan to look at the relationship between Corporate Governance and Firm performance that, does the corporate governance influences the firm performance or not? Investors in Pakistan have a little data about the performance of cement industry and how the corporate qualities influence the performance of firm.

Study objectives

1. To make a sustenance to Corporate Governance investigation in Pakistani industry.
2. To examine the effect of the Corporate Governance on Firm performance in the cement industry of Pakistan.
3. To observe the impact of corporate governance on firm's cost-effectiveness (Profitability) in cement sector of Pakistan.

For the purpose of this study, as Independent variables, we are using Board size, CEO Duality and Board Composition and the firm performance (Return on Assets) as the dependent variable.

Due to lack of CG some failure in Pakistan

Taj Company

Laib A Dar, (2011) the Taj Company was included in poor corporate administration practices. The organization was running a plan through which it had the capacity get tremendous measures of stores unlawfully. What was significantly more disillusioning was the religious connection the organization had joined with its name. Indeed 15 years after their false practices have been ceased; the organization still owes substantial liabilities to in excess of 25000 individuals.

Crescent Bank Fraud

Laib A Dar, (2011) the whole top managerial staff and CEO Anjum Salaam of Crescent Standard speculation bank were legitimately ceased from running their business locales on confirmations of suspected extortion and sporadic bookkeeping. Outside Examiners had anticipated a missing measure of over Rs.6 Billion, separated from unlawful upkeep of parallel accounts, covering of bank resources, un-approved gigantic subsidizing of gathering organizations, unlawful interests in land and stock exchange, and so on the SECP made legitimate move against the organizations officers, albeit a significant part of the moves made were reprimanded as inadequate.

PTCL

Laib A Dar, (2011) the privatization of PTCL was likewise a huge corporate scandal. An ex-Senior Vice President has guaranteed the privatization as Pakistan's Biggest Financial extortion. PTCL previous authority further remarked that the arrangement was shut on 2.6 billion dollars including U-fone & Paktel, however just U-fone had endeavor estimation of more than 6 billion dollars which does exclude resources of U-fone. Also, evaluating choices were made through old records as opposed to deciding current business sector esteem, which implies, it was similar to Buy One Get 2 Free offer. It has been accounted for further that in September 2006, when Etisalat had declined to respect the bargain, they were offered a mystery value markdown of 394 million dollars alongside responsibility to lay off 20,000 representatives and to shoulder the half cost of design. Preeminent Court of Pakistan has effectively given ruling against the privatization of PSO and Pakistan Steel and if PTCL's privatization gets tested on genuine actualities, it will bring frightening results.

ENGRO Group of Companies

Laib A Dar, (2011) SECP was forced to bear colossal feedback once it had permitted Fertilizer monster ENGRO to secure its auxiliary ENGRO Foods. Faultfinders accepted that the organization was connected with the urea business and were massively worried about the degree to which cleanliness prerequisites for the business would be met by ENGRO sustenance's. However SECP counter contention was focused around the way that ENGRO has had a rich history of sound corporate administration which fulfilled SECP that ENGRO will be capable in respects to cleanliness issues connected with ENGRO nourishments. Time demonstrated that Engro's corporate administration was in great practice and has prompted the accomplishment of ENGRO foods with products such as Olpers Milk.

Mehran Bank

Laib A Dar, (2011) the Natio nal Accountability Bureau (NAB) has recuperated Rs1.6 billion in the well-known Mehran Bank outrage case by offering Benami property of old banks boss Younus Habib in Islamabad. The sum is expressed to be the nation's greatest ever single money recuperation in an adamant advance default case. Likewise, the Younus Habib Group will likewise pay Rs420 million. As per the NAB, Younus Habib, previous boss working officer of the outdated bank, had offered to settle his risk through the offer of his Benami property also appropriately went into a settlement understanding of Rs1.6 billion with the National Bank of Pakistan. The Mehran Bank had been doing gravely since its exceptionally starting in January 1992, and saving money masters credited this poor execution to Younus Habib's inclination for extra-curricular banking exercises.

Literature review

The ton of studies has been inspected the relationship between corporate governance and performance of the firm that indicate how great administration practices have expand the financial quality to firms, higher profit and lower risk Systematic hazard (Shleifer, 1997; John, K. & L. W. Senbet, 1998 and Harmilalin, B., & Weisbach, 2003). The experimental investigation of Mitton (2001) which taken example of 398 firms incorporate Korean, Malaysian, Indonesian, Philippines, Thailand have observed that the firm-level contrasts in variables are identified with corporate governance has solid effect on firm performance amid East Asian Crisis in 1997 also 1998. The results recommend that better value execution is connected with firms that have markers of higher disclosure quality, higher outside ownership focus also they are concentrated instead of enhanced.

Fich & Shivdasani, (2004) find that organizations with executive investment opportunity arrangements have higher market to book ratio, higher Profitability and they report a positive securities exchange response when firms report investment opportunity plans for their executives. The study by Ashraf & Ghani, (2005) looks at the beginnings, development, and the advancement of accounting standards and exposures in Pakistan and the variables that affected them. They report that absence of investment assurance, legal inefficiencies, and weak enforcement systems are more basic variables than are social elements in clarifying the condition of accounting in Pakistan. They presume that it is the requirement systems that are vital in enhancing the Quality of accounting standard in emerging economies. La Porta, Lopez-de-Silanes, Shleifer, & Vishny, (1999) contends that an investor's security has a tendency to be more noteworthy when the legitimate environment is stronger, and consequently his readiness to contribute has a tendency to increment. They discover solid positive affiliation between corporate governance and performance of the firm. Drobetz, Schillhofer, & Zimmermann (2004) discovered a positive relationship between corporate governance and firm performance for German public firms. Aggarwal et al (2008) decides the number of administration characteristics with information accessible for each one firm-year perception, and afterward characterize the administration list as the rate of characteristics a specific organization has set up. Adjaoud et al (2007) utilized the 2002 rankings to look at the relationship between firm performance and the governance scores. They found that the relationship for the most part was definitely not significant between the scores and accounting based measures of the performance, (for example, ROI, ROE, EPS, and business to-book) while the relationship between the scores what's more measures of worth made, (for example, business quality included furthermore financial quality included) was generally significant.

Board structure has depended intensely on agency concept, concentrating on the control capacity of the board. Agency theory treats the organization as a nexus of agreement through which different members execute with one another (Jensen & Meckling, 1976). Since resources are the property of the shareholders, a principal–agent issue may emerge on the grounds that administrators need to settle on choices concerning the gainful utilization of these advantages. Introducing a governing body can be a powerful instrument for checking top supervisors and adapting to this issue and to decrease agency costs (Fama, 1983). Consequently, agency theory is utilized to analyze the part that the directorate may play in helping the performance of the associations they administer (Jackling, 2009). On the other hand, the agency problem appears to be less essential in the setting of family firms with high possession focus, given that the controlling shareholders have sufficient impetuses, force and data to control top supervisors (Jensen & Meckling, 1976).

Tombs, (2002) clarifies that there are distinctive classifications of representatives he positioned them in three sorts of school of musings towards the Governance style. Firstly representatives see that the part of white color laborers who are administering is of heading and assuming responsibility and they accept that their part is helpful. Workers of second school of thought accept that over administering tenets and regulations make alarm among workers. Representatives of third school of thought accept that representing laborers are for the most part inept towards their employment and they embrace totalitarian style generally.

3.1 Mechanism of Corporate Governance:

For quantifying corporate administration and Firm performance diverse variables are utilized by the analysts, for example, Board Size, Board Composition, Audit committee (AC), Annual General Meeting (AGM) and the Status of CEO. We are using three variables from these

- Board Size
- Board Composition
- CEO Status

Board Size

Normally it is said that limited board size is to enhance performance of the firm on the grounds that the profits by bigger governing body expanded observing are exceeded by the poorer correspondence and decision making of bigger groups [Lipton & Lorsch, (1992); Jensen, (1983)]. Brown & Claylor, (2004) add to this writing by demonstrating that organizations with board sizes between 6 and 15 have higher profits for value and higher net overall revenues than do firms with other board sizes. At the point when board size builds, office issues in the meeting room increment all the while, in this way prompting more executive agency problems and interior conflicts among executives. Additionally, a huge board is more liable to be controlled by the CEO instead of the board controlling administration. Eisenberg et al, (1998) keep up that when board size builds, coordination furthermore correspondence issues increment. This reasons more noteworthy organization issues and expenses.

H0 = There is no relationship between board size and return on assets (ROA)

H1= There is relationship between board size and return on assets (ROA)

Board Composition

In this examination board organization is an independent variable. Independent directors are needed on the board to control the exercises of official executives because of their sharp conduct, and make a check and adjust on the board (Jensen & Meckling, 1976). Independent directors are considered as "decision specialists" (Fama, 1983). Non-executives directors can lessen managerial utilization. Non-administrators chiefs act as agent in the middle of organization and outer stake holders. As indicated by the Tricker, (1984) the of non-executives directors on Boards gives "extra windows on the world" According to Pakistani Code of corporate governance (2002) sheets of executives must have the extent of official chiefs should not surpass 75%.

H0 = There is no relationship between board composition and return on assets (ROA)

H1= There is relationship between board composition and return on assets (ROA)

CEO Status

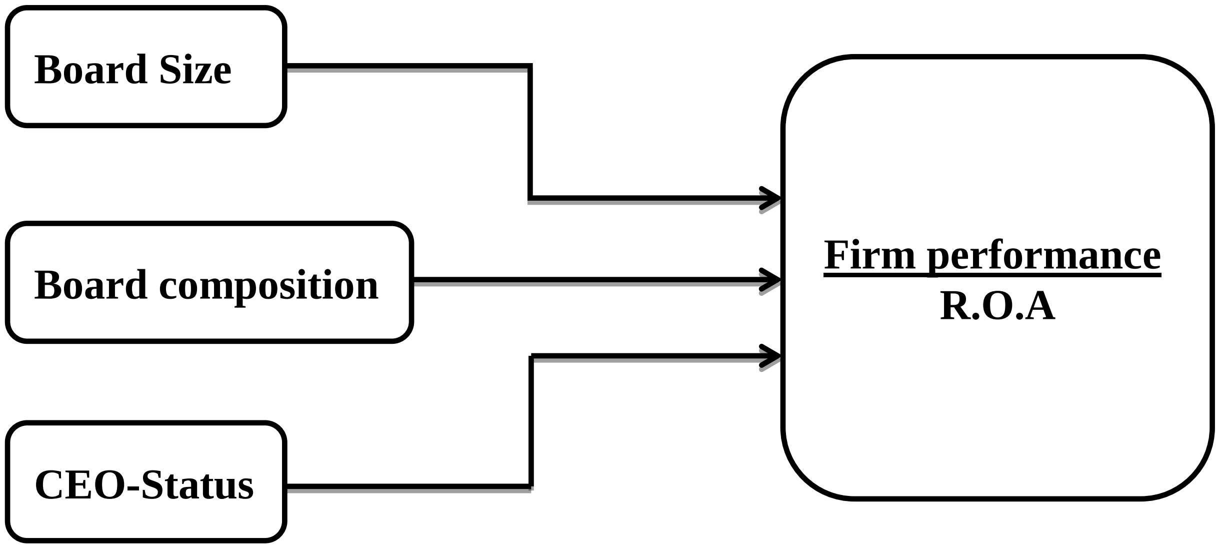
A broadly bantered about corporate governance issue is whether the two most essential positions in an organization the Chairman of the Board and the CEO– should be held by two separate individuals (a dual authority structure) or one individual may be allotted both portfolios (an unitary authority structure).

Numerous studies tended to the CEO duality performance relationship; with conflicting results (K.Boyd, 1994). There is just feeble confirmation that duality status influences long term performance, in the wake of controlling alternate components that may affect the performance. Berg & Smith, (1978) Presumed that there is a possibility of organization fetched when CEO performs double part. In this manner, the division of the two positions improves shareholder esteem. Fama, (1983) additionally contended that focus of decision administration and decision control in one individual diminishes a board's adequacy in observing top management. Case in point, when a CEO doubles as board chairman, these results in clash of diversions and grows agency costs.

H0 = There is no relationship between CEO-Duality and firm performance

H1 = There is relationship between CEO-Duality and firm performance

Research frame work



Methodology

Research design/ Sample

The data utilized for this study is originated from Reviewed Financial Statements of the recorded firms and Balance Sheet Analysis of joint stock companies listed on Karachi Stock

Exchange (2007-2013).the organizations utilized are chosen by non-probability sampling method. An aggregate of 12 listed firms are utilized for analysis. Panel data system is tackling since it joins time series and cross sectional data. Multiple regressions and estimation is Ordinary Least Squares (OLS) used for analysis of this systematic study.

Specification of model

A panel data methodology is utilized for this examination in light of the fact that, as indicated it encourages evacuation of the undetectable heterogeneity that may exist in the diverse firms. Yasser, (2011) inferred that, the first focal point of panel data regression is this that by joining the time series and cross sectional data gives better enlightening data, less co-linearity among the variable and more effectiveness. What's more besides, panel data minimizes the biasness that may be created if separate firm level data are isolated into wide totals. Furthermore at long last, panel data can quantify the impacts that are impractical to see in immaculate cross area or unadulterated time series data.

We used the following economic model for our study.

$$Y = \alpha + \beta_{\times} + \mu$$

Where,

Y = Dependent variable
α = Constant
β = Coefficient of explanatory variable (Mechanism of Corporate Governance)
× = Explanatory variable
μ = Error term (assumed to have independent across time period and zero mean)

By implementing the economic model by way of in equation:

$$ROA = \alpha + \beta(BS) + \beta(BC) + \beta(CEO) + \mu$$

Description of variables

Table A and B reveal the description of dependent and independent variables respectively used in this study.

Table A: Dependent variable description

Variable	Measurement/ Description
ROA= Return on Assets	$\frac{\text{Net Income}}{\text{Total Assets}}$

Table B: Independent variable description

Variable	Measurement/ Description
Board Size	Number of total director in the firm.
Board Composition	It reveals the number of executive and non-executive director in the firm.

CEO-Status	Used as dummy variable: zero (0) value for if the CEO occupies the two and more post as Chairman, MD and GM otherwise (1).

EMPIRICAL RESULTS AND DISCUSSION:

Table C: Descriptive Statistics

	ROA	Board Size	Board Composition	CEO-Status
Mean	7.23	9.03	3.23	0.09
Median	11.03	10.00	5.23	0.00
Mode	12.00	11.60	6.00	0.00
Std. Deviation	13.43	2.63	9.21	0.29
Skewness	5.35	0.33	3.16	2.90
Kurtosis	4.95	0.06	2.75	6.60
Range	7.00	8.00	5.00	1.00
Maximum Value	44.00	10.00	3.00	1.00
Minimum Value	-28	7.00	2.00	0.00

We can conclude from the above table that mean of the ROA of the firm is 11.03. The results clearly reveal that almost every N34 turnover the return on assets is 7.23%. Above table clearly shows that board size of approximately 9 is enough for the good performance of firm. The CEO status shows that 91% of CEO has the dual assignment as chairman, MD and GM. Board composition has the insignificant impact on the ROA.

Unit root test results

Non stationary of time arrangement information has regularly been considered as an issue in trial investigation. Working with non-stationary variables prompts spurious backslide results, from which further instigation is useful in vain. In this manner, it is foremost to test the stationary of all course of action entering in the model. The ADF test was used to test the stationary of the course of action. The invalid speculation was that the variable under investigation has an unit root, against the alternative that it doesn't. The results of the test for the variables are presented in Figure. Despite the ADF test, the study moreover attempted to assess the example of the variables graphically. The graphical representation of the variables shows the relative ordinary for the variables as the ADF test.

Table D: Results of ADF Test for Non Stationary

Variables	ADF test at level		ADF test at 1st difference	
	Calculated	lag	Calculated	lag
ROA	2.12	1	4.15**	1
LBS	2.23	1	4.75*	1

BC	2.53	1	4.95*	1
CEO	2.61	1	6.32**	1

Note: - The asterisks (*) and (**) indicates statistical significance at the 5 percent and 1 percent significance level.

The results reported in Table D are finished with example and catch. Results demonstrated that all course of action show non stationary in levels. In that capacity, the invalid hypothesis that each of the time courses of action has a unit root can't be rejected. Then again, there is no verification of a unit root when the plan is at first contrasts. The no stationary theory was discharged in all cases. It suggests that all the variables under investigation are stationary from the earliest starting point qualification at 1 percent level of centrality except for LK which was stationary at 5 percent level of diacritical's, as can be translated from table D.

REGRESSION RESULTS:

Table E: Regression result

Dependent Variable: ROA				
Method: Least Squares				
Date: 21/12/14 Time: 10:47				
Sample: 2007 2013				
Included observations: 84				
Variables	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	2.89512	5.92171	0.488899	0.6987
LBS	4.004604	2.005957	1.99653	0.0053
BC	0.282871	0.068027	4.158240	0.1254
CEO	-8.96291	4.295484	-2.086627	0.0075
R Square = 0.62		**Mean dependent var** = 7.23521		
Adjusted R^2 = 0.3844		**S.D. dependent var** = 13.43215		
F-statistic = 14.421168		**Sum squared resid** = 82.18976		
Prob (F-statistic) = 0.000544		**Durbin-Watson** = 0.81531		

The proposed model careful results are outlined by the above table. The slope coefficients of the LBS in the OLC researches have positive effect on ROA though the incline coefficients of the BC have likewise positive effect on ROA and CEO has negative impact on ROA.

The Adjusted R square is .38 which clarifies 38% assortment in the dependent variable (ROA) spoke to by the illustrative variables LBS, BC and CEO. The estimation of Durbin Watson is .81 which suggests that there is certain autocorrelation of remaining.

The change of one percent (%) in LBS achieves 4.0046% change in ROA while BC will realize. 0.282871% changed by 1 percent change in ROA by considers other variable consistent. Evaluation of LBS and CEO are highly significant. Board composition reveals the insignificant relation with the ROA.

Conclusion

There is doubtlessly various studies have been directed so far is still on going on the examination of the relationship between firm performance measures and corporate governance systems, however the consequences of these studies are blended. This study analyzes the relationship that exists between firm Performances, by utilizing pointer (ROA) furthermore three corporate governance systems (board size, board composition and CEO status). For information investigation we have utilized 12 Cement industries listed on the Karachi Stock Exchange for the time of 2007-2013. Panel data approach is utilized; the technique for examination is various relapse furthermore the t-test. The study reveals the accompanying results:

- There is a positive relationship between Firm Performance [Accounting Measures (ROA)] and Two Corporate Governance Mechanisms (Board size & Composition) however board size has significant and board composition has insignificant impact on ROA.
- There is a negative relationship between ROA and CEO status and has significant impact on ROA.

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