Corporate Governance and Firm Financial Performance: Empirical Evidence from Pakistan Stock Exchange
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ABSTRACT
The aim of this article is to investigate the effect of companies act 2017 on governance parameter in Pakistan, especially in non-financial companies measures the qualities of a firm's financial performance (FFP). This article analysis the secondary data from the company’s annual reports of a sample of 120 non-financial companies from 11 different sectors. The non-financial companies are listed in Pakistan Stock Exchange (PSX), and time frame are selected from 2013 to 2018. The findings showed that Board Independence (BI), Audit Committee Independence (ACI), and the Women Directors (WD) on the board has a substantial and beneficial influence on FFP. However, interestingly, the Separate Leadership Structure (SLS) exerted a significant and negative effect on FFP. The study enriches the literature, policy, and practice especially after the introduction of the recent CG code 2017 in Pakistan. The findings suggest that the nomination of independent directors to the board and audit committee along with increasing the number of women directors on the board augment the independence of the board that has positive impacts on FFP.

Keywords: Separate Leadership Structure, Board Independence, Audit Committee Independence, Women Directors, Tobin’s Q.

JEL Classification: F65, G28, G34, M14

1. INTRODUCTION
After the financial scandals and crashes of major firms in the United States and Europe, which shattered investors' faith in corporations, CG grabbed a lot of attention after these crashes. Likewise, the Asian financial crises in 1997 also diverted the attention of countries in the region toward CG (Ho and Wong, 2001) as the crises had exposed the inefficiency of the board (OECD, 1999). Consequently, many countries introduced CG codes in the aftermath of the crisis. Among others, Pakistan also introduced its first CG code in March 2002 (Yasser, Entebang, & Mansor, 2011). In 2012, the SECP revised the code to improve and make the corporate practices compatible with international standards. In 2014, the SECP made some amendments to the code for enhancing its efficiency and practicability. In 2017, the SECP amended the code by emphasizing board structure and composition independence. However, this has also been recently revised in 2019 (Rahman, et al., 2021; Zahid et al., 2019).

CG is important for any economy's corporate sectors. It is the plan that leads and governs the businesses (Cadbury, 1992). The OECD, (1999) has defined CG as to direct and regulate corporations by updating and facilitating the board, managers, shareholders, and all other key stakeholders. CG assists firms by strengthening the monitoring and counseling functions of the board in Pakistan (Iqbal and Javed, 2017; Rahman et al., 2017). The board is a key mechanism of internal control (Fama, 2018) and it is good in monitoring if independent (Rahman et al., 2018). Characteristics of the board, such as SLS, BI, ACI, and the WD, are considered key elements for strengthening the governance in organization. The theory of agency also posits that the expropriation of shareholders by the manager could be minimized by improvement in structure (SLS) and composition (BI and WD) and its committee like the Audit committee (Fama and Jensen, 1983). Substantial empirical literature also provides support to these theoretical and regulatory postulations by reporting that firms' good practices improve their financial performance. Many studies found that SLS (Duru, Iyengar, & Zampelli, 2016) BI (Black, Kim, & Jang, 2006), and ACI have significant positive impacts on FFP. While, in contrast, some study find no (Almoneef, 2019) or negative relationship between CG and FFP (Singh, Tabassum, and Darwish, 2017).

Keeping in view the incongruence of the empirical literature and the introduction of CG code 2017, this study supposed to find out the impact of SLS, BI, ACI, and WD on FFP measured by TBQ from 2013 to 2018 of the non-financial firms listed on PSX. The study not only updates the literature but also informs the regulators and all other key stakeholders about the compliance as well as the importance of few good practices regarding the independence of the board and their association with firm financial prospects in the context of a developing country like Pakistan.
2. LITERATURE REVIEWS AND HYPOTHESES DEVELOPMENT

2.1 Separate Leadership Structure and FFP
The separation of the Chairperson of the board (COB) from the Chief Executive Officer (CEO) is called SLS. The theory of agency posits this separation augments the monitoring abilities of the board (Fama and Jensen, 1983). Based on agency theory, the SECP, (2017) also required the separation of the two roles in CGC 2017. Many studies supposed the impact of SLS on FFP but reported mixed findings, such as positive (Duru, Iyengar, and Zampelli, 2016; Samad, Fauziah, Yusoff, and Lasyoud, 2018), negative (Haniffa and Hudaib, 2006; Bansal and Sharma, 2016; Latif et al., 2013; Khan et al., 2014) and no relationship between them (Shafique & Ali, 2019; Petra, 2005; CP, Mariappan, and Thyagarajan, 2018; Carty and Weiss, 2012). However, the topic has been less extensively investigated in Pakistan, especially after the introduction of CG code 2017 (Sheikh et al., 2018). However, it is hypothesized for further investigation:

H1: SLS has a positive and significant impact on FFP.

2.2 Board Independence and FFP
As per agency theory, BI is supposed to protect and strengthen the interests of shareholders and improving FFP (Brickley et al., 1997; Fama and Jensen 1983). Many others studies also supported that BI has a significant & positive correlation with FFP around the world Chou and Buchdadi, 2017; Tulung and Ramdani, 2018; Al-Najjar, 2018; Shahid, Abbas, Latif, Attique, and Khalid, 2020). However, Ahmad, Guohui, Hassan, and Naseem, (2016) documented a negative connection between BI and FFP in Pakistan. These study are also find out in others countries as well (Al-matar, Al-swidi, Hanim, and Fadzil, 2017; Singh, Tabassum, and Darwish, 2017). On the other side, some scholars supposed that BI has no link with FFP for Islamic banks of Pakistan (Hassan, Rizwan, and Sohail, 2017).

H2: BI has a positive and significant impact on FFP.

2.3 Women directors and FFP
Increasing the woman directors on the board play a major role in the world of CG in recent years (Pasaribu, 2017). Agency theory posits that women directors in the workforce, give more serious monitoring and advising services. The empirical findings demonstrate that having a female director on a board has a substantial beneficial impact on FFP (Pasaribu, 2017; Virtanen, 2012; Hassan et al, 2013; Rehman & Hameed, 2011). Many results show a negative connection between WD and FFP (Renee and Adams, 2009; Ahern and Dittmar, 2012; Galbreath, 2011; Jurkus, Chul, and Woodard, 2011; Bilal et al., 2018). Some research, on the other hand, revealed no significant link between woman directors on the board and firm financial performance. (Mohamad, Abdullah, and Kamil, 2010; Haslam, Ryan, Atkins, and Kulich, 2016).

H3: WD has a positive and significant impact on FFP.

2.4 Audit Committee Independence and FFP
AC enhances monitoring and auditing of the manager's actions in an organization. ACI reduces the fraud conduct by the manager in an organization and improves FFP (Chan and Li, 2008; Arslan et al., 2014). Some researchers noted a negative link between ACI and FFP. While some other studies could not provide any connection between ACI and
FFP (Klein, 2002; Arif and Syed, 2015; Al-najjar, 2018; Mahmood et al., 2015). In view of these, there is a need for further empirical investigation, especially in Pakistan.

**H4: ACI has a positive and significant impact on FFP.**

### 2.5 Control Variables

This study also included the control variable such as, CG code 2017 (CGC 2017), firm leverage (FLEV), firm size (FSIZE), and firm age (FAGE).

### 3. METHODOLOGY

#### 3.1 Theoretical framework

Following a theoretical framework has been proposed to evaluate the relationships between CG and FFP. The theoretical framework is presented below.

![Theoretical framework](image)

#### 3.2 Research Design

The study design and used the following econometric model to investigate the relationship between CG and FFP.

\[
TBQ_{it} = \beta_0 + \beta_1 SLS_{it} + \beta_2 BI_{it} + \beta_3 WD_{it} + \beta_4 ACI_{it} + \beta_5 CGC_{it} + \beta_6 FLEV_{it} + \beta_7 FSIZE_{it} + \beta_8 FAGE_{it} + \delta_i + \eta_t + \epsilon_{it} \hspace{1cm} \text{Model}
\]

Where:

- \(i\) = show number of firms i.e., top 120
- \(t\) = time i.e., 6 years from 2013 to 2018
- \(TBQ\) = TOBIN’S Q
- \(\beta\) = Beta
- \(SLS\) = Separate leadership structure
- \(BI\) = Board Independence
- \(WD\) = Women directors on the board
- \(ACI\) = Audit Committee Independence
- \(CGC\) = CG code 2017
- \(FLEV\) = show total debts of the firm
- \(FSIZE\) = firm size mean total values of firm assets
- \(FAGE\) = show year of incorporation of the firm
\[ \varepsilon = \text{chance of error or error term} \]

\[ \delta_t \text{ and } \eta_i = \text{stand for year dummy and industry dummy.} \]

### 3.3 Population and Sample
All non-financial firms that are listed on a PSX are included in the population. By employing stratified random sampling, the research looked at top one hundred and twenty non-financial companies from eleven different sectors that were listed on the Pakistan Stock Exchange. (Table 1).

#### Table 1. Show sample of the Research

<table>
<thead>
<tr>
<th>S.NO</th>
<th>Sectors</th>
<th>NO. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>i.</td>
<td>Textile</td>
<td>10</td>
</tr>
<tr>
<td>ii.</td>
<td>Cement</td>
<td>15</td>
</tr>
<tr>
<td>iii.</td>
<td>Power generation &amp; Distribution</td>
<td>10</td>
</tr>
<tr>
<td>iv.</td>
<td>Oil &amp; Gas marketing Companies</td>
<td>10</td>
</tr>
<tr>
<td>v.</td>
<td>Oil &amp; Gas exploration</td>
<td>8</td>
</tr>
<tr>
<td>vi.</td>
<td>Engineering</td>
<td>10</td>
</tr>
<tr>
<td>vii.</td>
<td>Automobile assembler</td>
<td>10</td>
</tr>
<tr>
<td>viii.</td>
<td>Technology &amp; Communication</td>
<td>10</td>
</tr>
<tr>
<td>ix.</td>
<td>Fertilizer</td>
<td>10</td>
</tr>
<tr>
<td>x.</td>
<td>Pharmaceuticals</td>
<td>11</td>
</tr>
<tr>
<td>xi.</td>
<td>Food &amp; Personal care products</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td><strong>Total</strong></td>
<td><strong>120</strong></td>
</tr>
</tbody>
</table>

### 3.4 Description of variables
The description of the variables presented below in table 2.

#### Table 2: Description of variables

<table>
<thead>
<tr>
<th>Variables</th>
<th>Description</th>
<th>References</th>
</tr>
</thead>
<tbody>
<tr>
<td>SLS</td>
<td>A value of 1 indicates a separate leadership structure, whereas a value of 0 indicates otherwise.</td>
<td>(Sunday, 2008)</td>
</tr>
<tr>
<td>BI</td>
<td>BI stand for independent directors on the board.</td>
<td>(Bansal &amp; Sharma, 2016)</td>
</tr>
<tr>
<td>WD</td>
<td>Show numbers of women directors on the board.</td>
<td>(Juhmani, 2017)</td>
</tr>
<tr>
<td>ACI</td>
<td>Stand for independency of audit committee.</td>
<td>(Bansal &amp; Sharma, 2016)</td>
</tr>
<tr>
<td>CGC 2017</td>
<td>CG code 2017 has a value of 1; otherwise, it has a value of 0.</td>
<td>CG code, (2017)</td>
</tr>
<tr>
<td>FLEV</td>
<td>Stand for company’s total liabilities to its equity.</td>
<td>(Al-matar et al., 2017)</td>
</tr>
<tr>
<td>FSIZE</td>
<td>FSIZE represent total value or assets of the firm.</td>
<td>(Kazi, Asad, &amp; Sahetiya, 2015)</td>
</tr>
<tr>
<td>FAGE</td>
<td>It is the year in which a company was first listed on the stock exchange.</td>
<td>(Bansal &amp; Sharma, 2016)</td>
</tr>
<tr>
<td>TOBIN’S Q</td>
<td>Calculated by the market value of the firms (MVF) divided by total assets.</td>
<td>(Bansal &amp; Sharma, 2016)</td>
</tr>
<tr>
<td></td>
<td>MVF = Market value of equity + the market value of debt.</td>
<td></td>
</tr>
</tbody>
</table>

### 4. DESCRIPTIVE STATISTICS
Table 3 explains the mean value (MV), the standard deviation (SD) along with the values of minimum (Min) and maximum (Max). TBQ has a mean value is 0.236, show that the average value of Tobin’s Q to be 23% in non-financial
firms in Pakistan along with standard deviation which is 0.207. The MV of the SLS is 0.890, mean that 89% persons are occupied the SLS in Pakistan non-financial firms. The minimum and maximum value of SLS respectively 0 & 1, while the SD is 0.313. BI has 0.1 and 0.9 minimum and maximum values with mean 0.321 respectively. Mean value of BI is 0.321, shows that average 32% members are independent on the board in Pakistani non-financial firms. The WD has a minimum value of 0.01 and a maximum 0.99 with mean 0.326 while standard deviation is 0.123. The mean value of WD shows that 32% woman are occupied on the board in Pakistani non-financial firms. ACI has value as a minimum 0 and maximum 2.06 along with 0.178 is the standard deviation. It MV is 0.278, show that 27% members are independent in audit committee in Pakistani non-financial firms.

Table 3: Descriptive Statistics

<table>
<thead>
<tr>
<th>Variables</th>
<th>Min</th>
<th>Max</th>
<th>MV</th>
<th>SD</th>
</tr>
</thead>
<tbody>
<tr>
<td>TBQ</td>
<td>0.100</td>
<td>1.980</td>
<td>0.236</td>
<td>0.207</td>
</tr>
<tr>
<td>SLS</td>
<td>0</td>
<td>1</td>
<td>0.890</td>
<td>0.313</td>
</tr>
<tr>
<td>BI</td>
<td>0.1</td>
<td>0.900</td>
<td>0.321</td>
<td>0.144</td>
</tr>
<tr>
<td>WD</td>
<td>0.01</td>
<td>0.990</td>
<td>0.326</td>
<td>0.123</td>
</tr>
<tr>
<td>ACI</td>
<td>0</td>
<td>2.060</td>
<td>0.278</td>
<td>0.178</td>
</tr>
<tr>
<td>CGC</td>
<td>1</td>
<td>1</td>
<td>0.332</td>
<td>0.472</td>
</tr>
<tr>
<td>FLEV</td>
<td>0.02</td>
<td>1</td>
<td>0.509</td>
<td>0.222</td>
</tr>
<tr>
<td>FSIZE</td>
<td>19</td>
<td>33.110</td>
<td>23.684</td>
<td>1.523</td>
</tr>
<tr>
<td>FAGE</td>
<td>2</td>
<td>157</td>
<td>34.417</td>
<td>20.987</td>
</tr>
</tbody>
</table>

5. PEARSON’S CORRELATION MATRIX (PCM)

PCM values are reported in Table 4, show that all the CG variables have a statistically significant correlation. The CG variables like BI, WD, and ACI are positively correlated with FFP. However, SLS having a negative correlation with FFP. The results also noted that all correlations are less than point eighty (0.80), which stand for no multicollinearity in the modal (Gujarati and Porter, 2009).

Table 4 revealed that TBQ, BI, WD, ACI, and CGC 2017 move in the same direction. Respectively, the TBQ also moves in the opposite direction with SLS, FLEV, FSIZE, and FAGE. Table. 4 also reported that the SLS has a positive correlation with all the variables, except FLEV, FSIZE and FAGE. There are moderate positive correlation between BI and WD, weak positive correlation between BI and ACI, FLEV and FAGE are found. A weak negative correlation found among BI and CGC 2017 & FSIZE. The WD has a weak positive relationship with ACI and FLEV. The correlation between the WD on the board and CGC 2017, FSIZE and FAGE are found to be negative. ACI has a weak positively significant relation with CGC 2017, FLEV, and FSIZE and has a weak negative relationship with FLEV. CGC 2017 has a negative significant relationship with FLEV and FAGE, and a positive relationship with FSIZE. FLEV has a weak positive significant relationship with FSIZE and negative significant with FAGE. FAGE has also negatively correlated with FSIZE.

Table 4: Pearson’s Correlation Matrix (PCM)

<table>
<thead>
<tr>
<th>Var</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. TBQ</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. SLS</td>
<td>-0.09**</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. BI</td>
<td>0.42***</td>
<td>0.08**</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. WD</td>
<td>0.57***</td>
<td>0.09**</td>
<td>0.61***</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The asterisks three stars (*** ) indicates significance at 1%, two stars (**) indicates at 5%, and one star (*) indicates at 10% level.

6. MULTIVARIATE ANALYSIS

The acceptance of the null hypothesis, p-value 0.9977 explains that Random Effect Modal (REM) is a better choice for estimation than Fixed Effect Modal (FEM). Hence the study employed REM for analysis presented in table 5. Moreover, the rejection of the null hypothesis of the Breusch-Pagan Weisberg test provides evidence for heteroscedasticity, and hence REM is used with the robust option for consistent estimation (Johnston, 1971; Zahid et al., 2020).

Table 5: Random Effect Model (REM)

<table>
<thead>
<tr>
<th>TBQ</th>
<th>Coefficient</th>
<th>P-value</th>
<th>Std.errs</th>
<th>Z-statistics</th>
</tr>
</thead>
<tbody>
<tr>
<td>SLS</td>
<td>0.1087***</td>
<td>0.000</td>
<td>0.0196</td>
<td>-5.57</td>
</tr>
<tr>
<td>BI</td>
<td>0.1678**</td>
<td>0.002</td>
<td>0.0548</td>
<td>3.06</td>
</tr>
<tr>
<td>WD</td>
<td>0.7883***</td>
<td>0.000</td>
<td>0.0631</td>
<td>12.52</td>
</tr>
<tr>
<td>ACI</td>
<td>0.1294**</td>
<td>0.001</td>
<td>0.0377</td>
<td>3.43</td>
</tr>
<tr>
<td>CGC</td>
<td>0.0176*</td>
<td>0.174</td>
<td>0.0129</td>
<td>1.36</td>
</tr>
<tr>
<td>FLEV</td>
<td>-0.0334*</td>
<td>0.224</td>
<td>0.0275</td>
<td>-1.22</td>
</tr>
<tr>
<td>FSIZE</td>
<td>-0.0264***</td>
<td>0.000</td>
<td>0.0041</td>
<td>-6.53</td>
</tr>
<tr>
<td>FAGE</td>
<td>-0.0005*</td>
<td>0.156</td>
<td>0.0004</td>
<td>-1.42</td>
</tr>
</tbody>
</table>

The REM shows that R-square is 0.45, means that there is 45% variation in the performance. The REM also indicated the values of (F-stat= 494.69) and prob (F-stat) = 0.0000, reported that the REM is better for explaining the relationship (CG variables & FFP variables). R² (goodness of the model) shows that 0.45 of TBQ was contributed by the independent variables.

7. EMPIRICAL FINDINGS AND DISCUSSION

A significant (p = 0.000 < 0.05) and negative correlation is found between SLS and FFP. This explain that the separate leadership structure is not effective in developing country i.e., Pakistan. The finding also contrary to agency theory, may have a possible explanation that the division of work or authority affects the efficiency of the firm and board. The finding which reject H1 are similar with Sheikh and Karim, (2015) and Bansal and Sharma, (2016). The negative finding also not support the CGC 2017, that requires the separation of the chairperson from the CEO. However, the findings are inconsistent with Samad et al., (2018) and Duru et al., (2016) who document a positive and significant influence of the SLS on FFP which might be due to differences in context. However, BI has a significant & positive (p = 0.002 < 0.05) association on FFP. This clarifies the effectiveness of BI in the context of Pakistan. The finding support the argument of the agency theory that BI is important for strengthening the monitoring of managers and minimizing agency costs (Fama and Jensen, 1983). The findings which accept H2 also provide support to CGC 2017 which recommended that BI augmenting its monitoring and counseling roles. The results are similar with others prior studies like Rizwan, Asrar, Siddiqui, and Usmani, (2016); Ritchie, (2007); and Gondrige, Clemente, and Espejo, (2012). However, the finding is inconsistent with Al-matar et al., (2017); and Singh et al., (2017) which might be due to change in context or methodology.
Likewise, the finding of WD also shows a significant and positive (p = 0.000 < 0.05) impact on FFP. This explain the importance of women directors on the board for improving FFP in the context of Pakistan. The finding endorse agency theory which support WD for their risk-aversion, transparency, and unique approach (Liu et al., 2014; Rahman & Zahid, 2021; Zahid et al., 2020). The positive finding which accept H3 also provide support to CGC 2017 that encouraged the nomination of women directors to the board. The finding show similarity with Peizhi and Ramzan, (2020) and Khan and Subhan, (2019) in Pakistan. However, the finding is inconsistent with Ahern and Dittmar, (2012); Galbreath, (2011); Fauzi and Locke, (2012); and Renee and Adams, (2009). Similarly, ACI has a statistically positive and significant (p = 0.001 < 0.05) impact on FFP. This explain that ACI is important and effective in the context of Pakistan. The finding endorse agency theory that support increasing independence of the board and committees including AC for augmenting merit, transparency, and quality of financial information reporting. The positive finding also provide support to CGC 2017 that recommended an increase in the independence of the AC. The finding which accept H4 is also consistent with Amir, (2018); Nuryanah and Islam, (2011); and Al-matari et al., (2017). However, the finding is dissimilar to Al-ahdal, Alsamhi, Tabash, and Farhan, (2020).

The CG code 2017 issued by SECP, statistically insignificant (p = 0.174 > 0.05) and impacted the FFP positively. There is no other literature about CGC 2017 to provide support to CGC 2017. FLEV is negatively and insignificantly (p = 0.224 > 0.05) influence the FFP, which is similar to Shahid, Siddiqui, Qureshi, and Ahmad, (2018). In contrast, Khatab, Masood, Zaman, Saleem, & Saeed, (2010) find a positive association between them (FLEV & FFP). The consequences of FSIZE is statistically and significantly (p = 0.003 < 0.05), and affected the FFP negatively, which is similar to Iqbal & Javed, (2017). On the other hand, Ilaboya and Ohiokha, (2016) find positive link between them (FSIZE & FFP). The consequences of FAGE are insignificant (p = 0.156 > 0.05) and negatively correlated with TBQ (Zhou, Owusu-Ansah, and Maggina, 2018). This study is inconsistent with Sarkar and Sarkar, (2000).

8. CONCLUSION, CONTRIBUTIONS AND RECOMMENDATIONS

The study contribute and updates all the key stakeholders including SECP, PSX, and listed companies about the importance of board independence. This study also contribute to the literature that how CG code 2017 issued by SECP, has important for the independence and composition of the board. The study also contribute to the practice and policy recommendations for policy maker in Pakistan. The importance of CGC 2017 contribute especially those related to board independence improves firms’ compliance to good practices that have positive implications for their FFP in Pakistan. Given that, it is recommended to increase the board independence along with audit committee. Furthermore, based on the positive role of women directors with FFP, it is also recommended to increase their representation on the board. They augment independence of the board by raising critical issues, safeguarding stakeholders’ interests, effective monitoring and less social ties with management (Rahman et al., 2021).

9. LIMITATION AND FUTURE DIRECTION

Besides, the limitations of the study are, as it has a purely quantitative approach that could be enriched in the future by considering the qualitative or mixed method of research. The study also employed a few characteristics of CG; hence future studies may also consider its other recommendations of CGC 2017 and hence experience, compensation, managerial and institutional ownership could also be considered in the future.

REFERENCES


