

Corporate Governance and its effect on the Share Value of the listed Companies – An Empirical Study on Textile Sector of Pakistan



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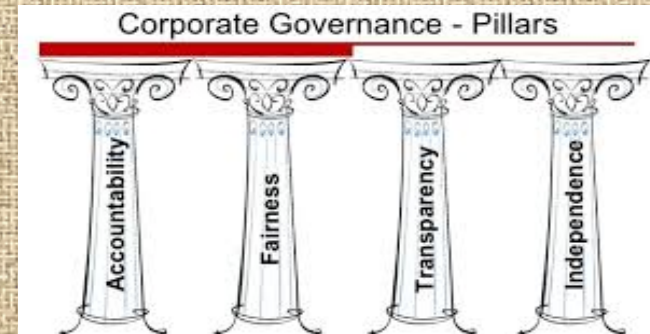
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Corporate Governance – Brief History

- CG has existed for as long as companies have existed but as a field of study it is less than 70 years old.
- Last 40 Years:
 - Lots of activities in this field
 - Codes, reports & Laws have come out.
 - Number of research papers & theories have evolved.
- Some Scandals in USA (World Com (Over statement of Profits by \$3.8 billion), Enron (Misuse of director's powers), Waste Management Inc. (Overstatement of earnings by \$ 17 billions over 6 years).
- Some Scandals in UK (BCCI, Barings Bank, Mirror Group, Polly Peck).



International scandals Resulted In:

The World reaction to these corporate wrongs led to development of laws & codes for better corporate governance .

- Some Scandals in Pakistan (Crescent Bank, Islamic Investment Bank, Pakistan Steel Mills & Indus Bank).

National scandals Resulted In:

Pakistan's regulatory authority (SECP) issued a code of CG in 2002 , which was revised in 2005. All PSX companies have to follow them, six main areas are addressed in codes i.e. BoD, CFO, CS, corporate & financial reporting framework , Corporate ownership structure , Audit committee & compliance with COCG.



Introduction

- Governance is “the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization toward the achievement of its objectives” (Glossary of CIA Part 1 - IIA).
- There are two components of governance (CIA Part 1 - IIA), which are as under:
 - Strategic Direction
 - Oversight
- The corporate governance variables are BS, BM, AC and DR.
- (Berle, A., & Means, G., 1932) there is weak relationship between corporate governance & EPS.
- (Gompers, P.A, Ishii, J.L., & Metrick, A., 2003) – strong Corporate governance have strong relationship with the shareholders value.
- (Hermalin, B.E., & Weisbach, M.S., 1998) Effective board size leads to positive relationship with EPS.
- (Afshan, Farooq, Ghulam, Mula Nazar, Fahad, 2016) evolution of financial decisions considering (ROA) rather than share value of the firm.

Textile Industry – Overview

- Textile sector is one of the important business areas of Pakistan.
- It contributes almost 1/4th which is around 40% of the economy
- Having 8% of GDP of the nation.
- It has kept up an average contribution of around 55% in national exports (Dr. Noor Ahmed, 2016).
- Textile segment is considered as the spine for Pakistan,
- Textile sector faced hard period from 2008 to 2009 because of
 - Globalization and
 - Variances in cost of utilities (i.e. Power, Gas, and Petrol).

Problem Statement

- Most of the Textile Companies in Pakistan are Family Owned.
- Family Owned Textile Companies normally do not comply with CG, so create an impact on its share value, which needs to be explored.
- So, problem statement becomes:

“To explore the impact of Corporate Governance on the Share Value of the listed Textile Companies of Pakistan”.

Research Questions

- What is the effect of Board Size on EPS?
- What is the effect of Board Independence on EPS?
- What is the effect of Board Activism on EPS?
- What is the effect of Audit Committee on EPS?
- What is the effect of Director’s Remuneration on EPS?
- What is the effect of CG on Share Value?

Research Objectives

- To find out the impact of Board Size on EPS
- To find out the impact of Board Independence on EPS
- To find out the impact of Board Activism on EPS
- To find out the impact of Audit Committee on EPS
- To find out the impact of Director's Remuneration on EPS
- To find out the impact of CG on share value

Scope of Research

- Twenty (20) Textile companies of different segments.
- All the companies are public listed companies and active on PSX.
- Time span for the analysis is from FY 2010-16.

Significance of Study

- The majority of the textile organizations are family controlled.
- Most of the researchers have evaluated firms performance through ROA and ROE.
- We have considered EPS for evaluating firm's share value.
- The latest research on Textile sector was for the period up to 2014 and we have extended the period to 2016.
- This study would be quite helpful for the textile industry, recommendations could have been used to manage different problems having impact on share value.

Research Limitations

- Limited to the Textile Companies listed on PSX.
- Research is based on the secondary data.
- The selected period for this research is from financial year 2010 - 2016.
- Firm's share value is measured through EPS, any other variable like the share price itself either the book value or market value could have been used.

Summary of Operationalization of variables

Sr. #	Variables	Type	Formula	Citations
1	Board Size (BS)	IV	Count	SECP Code Of Corporate Governance -2012.
2	Board Independence (BI)	IV	Count	SECP Code Of Corporate Governance -2012.
3	Board Activism (BA)	IV	Count	SECP Code Of Corporate Governance -2012.
4	Audit Committee (AC)	IV	Count	SECP Code Of Corporate Governance -2012.
5	Director's Remuneration (DR)	IV	Count	SECP Code Of Corporate Governance -2012.
6	Earnings per Share – (EPS)	DV	Net Profit / Total Outstanding Shares	(Mirza, Holt, and Orrell, 2010) (Catarina Alexandra. , 2012)

Hypothesis

- H_1 : There is significantly negative impact of Board Size on EPS
- H_2 : There is significantly positive impact of Board Independence on EPS.
- H_3 : There is significantly positive impact of Board Activism on EPS.
- H_4 : There is significantly positive impact of Audit Committee Meetings on EPS.
- H_5 : There is significantly positive impact of Director's Remuneration on EPS.

Mathematical Equation

$$\text{EPS} = \alpha_0 + \alpha_1 \text{BA} + \alpha_2 \text{BI} + \alpha_3 \text{BS} + \alpha_4 \text{AC} + \alpha_5 \text{DR} + E$$

Unit Root Test (Stationary Test)

- All the variables are stationary at level except board size which is stationary at 1st Difference

Descriptive Analysis

Variables	EPS	DR	BS	BI	BA	AC
Mean	20.84	13.39	7.67	11.60	33.64	4.45
Median	13.96	10.32	7.00	0.57	7.16	4.00
Maximum	107.76	42.35	11.00	100.00	100.00	12.00
Minimum	-131.96	1.54	7.00	0.00	0.48	2.00
Std. Dev.	31.28	10.13	0.94	19.72	36.11	1.35
Skewness	-0.57	0.93	1.10	2.03	0.37	2.67
Kurtosis	9.21	3.05	3.12	7.08	1.40	14.23
Jarque-Bera	233.25	20.24	28.46	193.48	18.03	903.50
Probability	0.000000	0.000040	0.000001	0.000000	0.000121	0.000000

Correlation Analysis

Correlation						
t-Statistic						
Probability						
Variables	EPS	AC	BA	BI	BS	DR
	1					
EPS	-----					

	0.02	1				
AC	0.18	-----				
	0.85	-----				
	-0.05	0.15	1			
BA	-0.55	1.75	-----			
	0.58	0.08	-----			
	-0.03	-0.18	0.28	1		
BI	-0.4	-2.09	3.42	-----		
	0.69	0.04	0.00	-----		
	-0.11	-0.1	0.28	0.20	1	
BS	-1.32	-1.21	3.46	2.41	-----	
	0.19	0.23	0.00	0.02	-----	
	0.09	-0.13	0.11	0.04	0.17	1
DR	1.08	-1.61	1.27	0.43	2.04	-----
	0.28	0.11	0.21	0.67	0.04	-----

Pooled Least Square

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AC	2.76	0.42	6.43	0.00
BA	-0.04	0.03	-1.28	0.19
DBS	2.96	1.80	1.63	0.10
BI	0.03	0.06	0.63	0.52
DR	0.56	0.10	5.35	0.00

Fixed Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AC	7.28	2.57	2.82	0.00
BA	0.00	0.34	0.00	0.99
BI	-0.16	0.34	-0.48	0.62
DR	-0.48	0.49	-0.98	0.32
DBS	3.30	3.99	0.82	0.41
C	-3.82	20.45	-0.18	0.85

R-squared	0.42
Adjusted R-squared	0.28
Prob(F-statistic)	0.000089

Random Effect Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AC	4.25	2.26	1.87	0.06
BA	-0.04	0.11	-0.34	0.72
BI	-0.03	0.18	-0.19	0.84
DR	0.12	0.35	0.35	0.72
DBS	2.98	3.90	0.76	0.44
C	0.84	13.38	0.06	0.94
Weighted Statistics				
R-squared	0.03			
Adjusted R-squared	-0.008133			
Prob(F-statistic)	0.54			

Hausman Test

Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.	
Cross-section random	10.78	5	0.05	
Cross-section random effects test comparisons:				
Variable	Fixed	Random	Var(Diff.)	Prob.
AC	7.28	4.25	1.51	0.01
BA	0.00	-0.04	0.10	0.90
BI	-0.16	-0.03	0.08	0.64
DR	-0.48	0.12	0.11	0.07
DBS	3.30	2.98	0.70	0.70
R-squared	0.42			
Adjusted R-squared	0.28			
Prob(F-statistic)	0.000089			

Co-Integration Test

		t-Statistic	Prob.	
ADF		2.84	0.0022	
Variable	Coefficient	Std. Error	t-Statistic	Prob.
RESID(-1)	-0.63	0.16	-3.9	0.00
D(RESID(-1))	-0.11	0.12	-0.89	0.37
R-squared	0.22			
Adjusted R-squared	0.21			

Conclusion

- The mean EPS during the year is Rs 20.84 considered as better EPS, which indicates the good CG structures and its compliance in some selected textile companies.
- In Pooled Least Square, The BI, BA and BS have insignificant relationship.
- Results of Fixed Effect (FE) supports our model.
- Hausman Test, Model is having fixed effect endorses the results of FE.
- Co-Integration exist (Alternate hypothesis accepted) among Corporate governance and Share Value of the textile firms.

Recommendations

- Textile firms should comply with Corporate Governance requirements.
- Firms should help the strategists in overseeing the relationship in growing new rules to induce global investors.
- The inventors must know the significance and relationship of corporate governance with share value of the firm before investing into that organization.

Thank You

