Impact of Financial Factors on Karachi Stock Exchange Listed Firms’ Performance

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Abstract:
This study empirically scrutinizes the correlation among firm-wise financial factors and firm performance in the Pakistani industry from 2007 to 2012 using panel data regression. A flat belongings replica was resolute to be the right comes up to for the examination. The models recognize liability influence and movement as momentous financial factors upsetting Pakistani firm’s performance. Alternatively, the capture of the representation was established to play a uniformly significant role in a Pakistani firm’s marketplace concert, involving that firm-wise nonfinancial features should be scrutinized in prospect study.

Keywords: Financial factors, firm performance, Pakistani industry, preset belongings mock-up

Introduction:

Financial management appoints stratagems related to operating, investing, financing, and dividend allocation, all of which have significant impacts on firm performance. The impact of these firm-wise financial factors conveys diverse transforms in the recital of the firm. The outcome of these fiscal aspects may add to or reduce the firm performance. In the study, the financial factors are liquidity, financial leverage, activity, growth, profitability, size, dividend payout, business diversification, and geographical diversification.

Liquidity:

The liquidity of an organization is the ability to make payments as they fall due. (Moir, 1999). Another explanation is suggested by the positive impact of liquidity on performance. Firms facing a shortage of long term finance are likely to divert working capital to meet their term finance requirements which leads to poor performance (Schiantarelli, 1998).

The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets. Liquidity ratios measure the firm’s ability to pay its short-term debts as they come due. These ratios are of special interest to the firm’s creditors. (Lawrence J. Gitman, 2008).

Leverage:

Meaning of financial leverage stated as, the structure of issued capital is referred to as a company's gearing (Hussain, 1996). An inverse relationship exists between financial leverage and firm value (Rayan, 200). Firm values are significantly and positively related to firm size, leverage, and financial cost. Finally, the regression results show that financial structures for banking firms are positively related to the states of the business cycle (Shirley J. Ho a *, S.-C., 2010).

We analyze the effect of leverage on corporate operating performance using a panel database of 10,375 firms in 39 countries. Our results show that firms with higher leverage ratios prior to the onset of industry economic distress experience a decline in operating profits consistent with the idea that there are significant indirect costs of financial distress that are greater than the control benefits of debt. However, this conclusion is far from being the same in all countries (González, 2013).
Global diversification:

Geographical diversification is usually defined by the number of different locations from which a firm operates. By either of these definitions, small and medium-sized enterprises (SMEs) are much less diversified than large firms (L.Johans, 1987)

Dividend policy:

Dividends are commonly defined as the distribution of earnings (past or present) in real assets among the shareholders of the firm in proportion to their ownership. (George Frankfurter, 2003). It is only the results with Tobin’s q that produce a contra results. Surprisingly, the study reveals that the market value of firms has a negative relationship with dividend policy and the firm’s size but positively related to dividend payout ratio, leverage, and growth. Interestingly, the coefficients of all the variables regressed against Tobin’s q are statistically insignificant (Amidu, 2007).

Size:

The findings of this study aid in understanding the factors that affect the use of EC and the relationship with firm size and firm performance. From a managerial perspective, the empirical results of this study suggest sales growth is positively affected by the use of EC and firm size. This would accelerate the EC adoption process as transport operators tend to achieve higher sales growth if they use EC at a higher level of sophistication in the spectrum from simple usage, e-collaboration, e-booking, through to e-payment. We also found that EC adoption does not have significant impacts on the levels of profitability and customer satisfaction. However, our results suggest profitability can be affected by sales growth. Sales growth can also be affected by customer satisfaction. Our finding of the link between sales growth and firm size may affect transport operators’ growth strategy and operational scale (Mohammed A. Quaddus, 2011).

Business Diversification:

Diversification may involve internal or external, related or unrelated, horizontal or vertical, and active or passive dimensions either singly or collectively. Essentially, diversification involves a substantial change in the business definition (Kozami, 2006).

Activity:

Activity measures management’s efficiency in using firm assets to create sales over a certain period of time. (Zhenxing Mao & Zheng Gu, 2008).

Activity reveals how rapidly noncash assets flow through a firm and how quickly these assets generate revenue (Moyer et al., 2001). An increase in asset efficiency will lead to higher firm value and vice versa.

Profitability:

The traditional accounting definition of profitability is net income (i.e., revenues minus all expenses) (Gershon, 2009). This research was made to examine the various factors that determine the effects of share pricing on the performance of the firm. Considering all the variables that were used for the study to test its effect on the performance of the firm, only the earnings per share of the firm proved to be significant among the other variables return on assets and equity, return on investment and overheads at 95% confidence interval (Gyimah, 2011).

Growth:

The growth is a subject to various dynamic restraints of which financial, demand and managerial restraints will be crucial (Barthwal, 2004).
The investment industry demands that managers maximize sales and earnings growth over time. This prescription is based on the presumption that growth is synonymous with shareholder value creation. Our empirical results indicate that maximizing growth does not maximize corporate profitability or shareholder value. On the contrary, companies with moderate growth in sales or earnings show the highest rates of return and value creation for their owners (Ramezani, 2002).

The context of the Study:

The liquidity of a business is the capability to construct expenditures as they reduce payable. Meaning of financial leverage stated as the organization of issued principal is referred to as a corporation’s gearing. The customary secretarial meaning of profitability is net proceeds (i.e., revenues less all expenses). The growth is a subject to an assortment of energetic manacles of which monetary, demand and executive fetters will be central.

Dividends are frequently defined as the allocation of incomes (past or present) in genuine possessions in the middle of the shareholders of the firm in quantity to their possession. Diversification may engage interior or outside, connected or not linked, flat or perpendicular, and vigorous or unreceptive scope moreover individually or together. Diversification engross a sizeable vary in the business definition.

Activity events management’s potential in using the firm property to create sales over a certain phase of time. Geographical diversification is frequently defined by the figure of a different position from which a firm activates. Small and medium-sized enterprises (SMEs) are much less diversified than large firms.

This study empirically examines the association between firm-wise financial features and firm performance. The ambition of a firm is to make the most of the value for its shareholders, and the job of financial management is to assist understand the objective. In a complete way, this revised effort to examine the collision of an extensive range of firm-wise financial factors, including operating, investing, financing, and dividend policies, on Karachi Stock Exchange listed firms performance in Pakistan using panel data from KSE listed firms.

Purpose of the study:

A detailed thoughtful of this affiliation be supposed to assist classify customs to recover their firm performance. By investigative key economic results from operating, investing, financing, and dividend strategies, this study attempts to explore a wide series of firm-wise financial factors’ impact on KSE firms’ performance in Pakistan. Though empirically our study could present proof concerning how firm value is exaggerated by firm-wise financial factors, the realistic function might help the business, discover ways to get better firm value in the capital marketplace.

In our Pakistan there is awfully modest effort on firm-wise financial factors, some researchers have resolute only a few factors of the financial side which influence the firm’s performance in Pakistan. As there are many other factors which affect the firm performance in Pakistan, and yet it is not completely know how about all these firm-wise financial factors due to this lack of in order a lot of problems there in the measurement of firm value in Pakistan.

Main problems:

In this study, there is an attempt to find the answer to the question “How firm value is affected by firm-wise financial factors.” These firm-wise financial factors are liquidity, financial leverage, activity, growth, profitability, size, dividend policy, business diversification, and geographical diversification. There is not a proper system from the government of Pakistan for giving awareness about the problems of these firm-wise financial factors. Very little research has done about all these firm-wise financial factors in Pakistan.

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Objectives of the Study:

This study effort to examine the collision of an extensive variety of firm-wise economic aspects on firm performance in Pakistan by means of panel data from Karachi Stock Exchange firms. The objectives of the of the study are

Examine the financial factors distressing the firms’ performance listed in the Karachi Stock Exchange of Pakistan.

To find the liaison flanked by the financial leverage, liquidity, business diversification, and geographical diversification and their blow on firm performance.

To study the augment in firm size, growth and profitability amplify firms’ performance.

To study the moderate in firm size, growth and profitability decline firms’ performance.

Significant of the study:

A thorough understanding of this relationship should help Karachi Stock Exchange identify ways to improve their firm performance. Our study endeavors to identify.

Financial factors that have positively and/or negatively affected KSE firms’ performance. The findings may help industry practitioners find ways to improve performance and ultimately the firm value by strengthening factors with positive effects and minimizing factors with negative impacts.

Extant financial literature has explored firm market performance as related to firm-wise financial characteristics from various perspectives. These financial characteristics or factors differ across firms and result from policies regarding operating, investing, financing, and dividend distribution. It is necessary to have an overall review of various financial characteristics discussed in previous studies prior to a comprehensive investigation of firm-wise factors’ impacts on KSE Listed firms’ performance.

Research Questions:

In this study we want to find the answer to the following research questions:

Whether firm size and growth matter for firm performance is a significant one.

Do the firm values are considerably and absolutely connected to firm liquidity and leverage.

Does firm dividend policy positively affect firm performance?

Do business diversification, and geographical diversification in a different way concern firm performance at the attendance or lack of growth prospect.

Literature Review:

The liquidity of an organization is the ability to make payments as they fall due. (Moir, 1999). Another explanation is suggested by the positive impact of liquidity on performance. Firms facing a shortage of long term finance are likely to divert working capital to meet their term finance requirements which leads to poor performance (Schiantarelli, 1998). The degree to which an asset or security can be bought or sold in the market without affecting the asset’s price. Liquidity is characterized by a high level of trading activity. Assets that can be easily bought or sold are known as liquid assets. Liquidity ratios measure the firm’s ability to pay its short-
term debts as they come due. These ratios are of special interest to the firm’s creditors. (Lawrence J. Gitman, 2008).


This study shows that liquidity positively affects firm performance and operating profitability in general, but for firms with a low level of information transparency, high liquidity will hurt the firm value. One alternative explanation for the results is that high Q firms are sought after by institutions for prudent-man reasons, or reverse causality. Through robust check using the two-stage least square equation, we get the similar results as OLS. We conclude that liquidity has a causal effect on firm performance (Chiming Wu and I-Hsuan Liu).

This study explores whether stock liquidity has a positive affect with firm value in Indonesia Stock Exchange and also explores whether liquidity premium or sentiment investors causes stock liquidity has a positive affect with firm value in Indonesia Stock Exchange. Higher stock liquidity (lower relative effective spread) has higher firm value. Price-to-operating income ratio does not significantly affect stock liquidity (Hansen, 2013).

Meaning of financial leverage stated as, the structure of issued capital is referred to as a company's gearing (Hussain, 1996). An inverse relationship exists between financial leverage and firm value (Rayan, 200). Firm values are significantly and positively related to firm size, leverage, and financial cost. Finally, the regression results show that financial structures for banking firms are positively related to the states of the business cycle (Shirley J. Ho a *. S.-C., 2010).

We analyze the effect of leverage on corporate operating performance using a panel database of 10,375 firms in 39 countries. Our results show that firms with higher leverage ratios prior to the onset of industry economic distress experience a decline in operating profits consistent with the idea that there are significant indirect costs of financial distress that are greater than the control benefits of debt. However, this conclusion is far from being the same in all countries (González, 2013). In countries with a high level of protection of shareholder rights and a strong system of legal enforcement, there is a negative effect of leverage on corporate operating performance when industries experience poor performance. This effect reveals the predominance of financial distress costs over the benefits of debt. (Víctor M.González, 2013).

Leverage has the probability of enhancing the performance of firms if well-structured and managed. The effect of leverage on the performance of firms in the same industry is mixed as it has negative effects on Union Bank, Zenith Bank, United Bank for African and Platinum Habib bank while having positive effects on Diamond Bank and Access Bank (Ezeji, 2012). Geographical diversification is usually defined by the number of different locations from which a firm operates. By either of these definitions, small and medium-sized enterprises (SMEs) are much less diversified than large firms (L.Johans, 1987).

We found considerable support for the importance of international diversification. Additionally, the findings of a curvilinear and inverted U-shaped relationship between international diversification and performance and the interaction effects of product and international diversification have important theoretical and managerial implications. These results show the critical importance of the ability to manage such diversification. Although there are multiple potential benefits, effective implementation and management of diversification (international and product) are necessary to realize those benefits (Michael A.Hitt, 1997).

The study finds that product diversification has an inverted U-shaped effect on firm performance, geographic diversification has a U-shaped one, and the interaction of them has a negative impact on firm performance (Hao Shen and Dong Wang, 2011).
We find that geographically diversified firms have higher R&D expenditures, advertising expenses, operating income, ROE and ROA than those of industrially diversified firms. In addition, higher R&D expenditures create value for multi-segment global firms [MG], but not for single-segment global firms. This result implies that there exists an interaction effect between industrial and geographic diversification. The relatedness of segments (Herfindahl index) and foreign involvement (Foreign sales to total sales) also play a role in firm value. Unrelated segment diversification and higher foreign involvement reduce firm value (Young Sang Kim a, 2008).

Despite the increase in global diversification over time, we find that global diversification is associated with valuation discounts that are economically and statistically significant relative to single-segment, purely domestic firms (David J. Denis D. K., 2002).

The findings of this study suggest that geographical diversification of US casino firms can achieve semi-success. Apparently, as casino firms expand into diverse geographical markets, they can reduce risk; however, at the same time, they are subject to firm performance discounts. Managers of casino firms should be cautious about this trade-off between risk and firm performance when implementing geographical diversification strategies. Although geographical diversification may be a valuable option to stabilize returns by reducing sensitivity to a specific geographical area, such action can also impair firm performance and shareholders’ wealth (Kyung Ho Kang S. L., 2012).

Our evidence points out those firms achieve higher gains from international diversification when they engage in core-related Greenfield investment transactions. We document significant positive abnormal returns and post-investment profit margin gains in the performance of firms that expand their core business across national markets. Foreign investments outside the core business of the firm are found to be associated with significant negative announcement effects and profit margin losses in years following the investment (Lang Reviewed, 2003).

Dividends are commonly defined as the distribution of earnings (past or present) in real assets among the shareholders of the firm in proportion to their ownership. (George Frankfurter, 2003).

It is only the results with Tobin’s q that produce a contra results. Surprisingly, the study reveals that the market value of firms has a negative relationship with dividend policy and the firm’s size but positively related to dividend payout ratio, leverage, and growth. Interestingly, the coefficients of all the variables regressed against Tobin’s q are statistically insignificant (Amidu, 2007).

Dividend changes negatively relate with future earnings for large firms. However, there is a problem associated with residual cross correlations in this initial model, so we conclude that there is no significant relationship between dividend changes and further earnings for large and small Norwegian non-listed firms. (Norwegian, 2011).

The main thrust of this study was to find out the relationship between dividend policy and the performance of banks in Ghana. From the results of the study, the average dividend paid by banks over the study period was. Also, it is apparent that firms that pay dividend increase their performance. Consequently, in Ghana, banks should pay dividends in order to reduce agency cost and enhance their performance. The results also reinforce earlier findings that leverage, size of a bank and bank growth enhance the performance of banks. Consequently, our results suggest strong evidence in favor of dividend policy increasing the performance of banks (Marfo-Yiadom, 2011).

Dividend payout affects firm performance and that this relationship is strong and positive. It, therefore, shows that dividend policy is relevant and therefore affects the performance of a firm hence its value contrary to theories that view dividend policy as irrelevant (Mahalang, 2012).

That firm performance has a significant impact on the dividend payout of listed firms in Nigeria. That is, an increase in the financial wellbeing of a firm tends to positively affect the dividend payout level of firms (Uwuigbe, 2012).

The findings of this study aid in understanding the factors that affect the use of EC and the relationship with firm size and firm performance. From a managerial perspective, the empirical results of this study suggest sales growth is positively affected by the use of EC and firm size. This would accelerate the EC adoption process as transport
operators tend to achieve higher sales growth if they use EC at a higher level of sophistication in the spectrum from simple usage, e-collaboration, e-booking, through to e-payment. We also found that EC adoption does not have significant impacts on the levels of profitability and customer satisfaction. However, our results suggest profitability can be affected by sales growth. Sales growth can also be affected by customer satisfaction. Our finding of the link between sales growth and firm size may affect transport operators’ growth strategy and operational scale (Mohammed A. Quaddus, 2011).

The findings of our research show that there is no relationship between firm size and firm performance. The results indicate that firms could increase their performance by supporting the prospector strategy and developing their technological architecture accordingly (Adnan Kalkana, 2011).

According to findings, market share, labor productivity, and firm size are important determinants for the economic performance of firms. Larger firm size helps in achieving better economic performance due to the large quantities involved. Size of the firm is important as a measure of relative status in the capital market and the market for its products (Acaravcı, 2006).

Along with market share, absolute firm size plays a dominant role in explaining variations in profitability. Estimation results support the conventional wisdom of a positive firm size-profit relationship. The estimated relationship is nonlinear in the sense that gains in profitability reduce for larger firms (Lee, 2009).

This study finds a significant negative association between firm size and firm performance (ROA) at a 1 percent significant level. However, a significant association between leverage and auditor type with firm performance enables to be empirically evidenced by this study. Somewhat surprisingly, model (2)'s explanatory power is insignificant indicating to the inability of the proposed variables (firm size, leverage, and auditor type) in explaining the expected effect on firm performance (ROE) (Alzharani, 2011). Mohammed Abdullah Alzharani found a significant negative association between firm size and firm performance is present at one percent significant level (Alzharani, 2011).

It is argued that it is unjustifiable to regard the small firm as simply a "scaled-down" version of a large firm. Instead, in several important areas of economics, the small firm behaves in a way which is the opposite of that proposed by conventional theory, calibrated upon the large firm sector (Storey Reviewed, 1989).

Diversification may involve internal or external, related or unrelated, horizontal or vertical, and active or passive dimensions either singly or collectively. Essentially, diversification involves a substantial change in the business definition (Kozami, 2006).

We find that overinvestment is associated with a lower value for diversified firms and that segments of diversified firms overinvest more than single-line businesses do. These results are consistent with one source of the value loss being the greater propensity of multi-segment firms to overinvest. We also find evidence that suggests the subsidization of poorly performing segments contributes to the value loss from diversification (Berger, 1995).

We find that both industrial and geographic diversifications are associated with firm value decrease (Kim, 2007). Business diversification reduces the firm value by documenting that the segments of diversified firms have lower operating profitability than single-line businesses (Philip G.Berger, 1995).

Business diversification is not a successful path to higher performance, but it is less definitive on the question of the extent to which diversification hurts performance. The firms that become more diversified appear to perform poorly before becoming more diversified, indicating that firms that diversify do not become poor performers only or mainly because they diversify. A plausible explanation for our results is that diversifying firms seek growth through diversification because they have exhausted growth opportunities in their existing activities (Lang, 1993).
Our results show that on both types of performance measures, the group of diversified firms on average tends to perform better. The data show that with an increasing degree of diversification, the average return on assets, the average return on equity and average market return, increase and the average risk per average unit return decreases (Pandya, 1998).

There is a negative relationship between diversification and performance: related diversified firms are associated with lower performance (Marinelli, 2011). Activity measures management’s efficiency in using firm assets to create sales over a certain period of time (Zhenxing Mao & Zheng Gu, 2008).

Activity reveals how rapidly noncash assets flow through a firm and how quickly these assets generate revenue (Moyer et al., 2001). An increase in asset efficiency will lead to higher firm value and vice versa.

Activity measures management’s efficiency in using firm assets to create sales over a certain period of time. Activity reveals how rapidly noncash assets flow through a firm and how quickly these assets generate revenue (Moyer et al., 2001).

An increase in asset efficiency will lead to higher firm value. That asset revaluations by UK firms are significantly positively associated with future changes in operating performance, over one, two, and three years subsequent to the revaluation (Aboody, 1999).

It can be concluded intangible assets have a positive effect on a firm’s competitive advantage. A firm with higher intangible asset will have a higher competitive advantage. The source of a firm’s competitive advantage over its competitor comes from its core competencies (Fanani, 2012).

The traditional accounting definition of profitability is net income (i.e., revenues minus all expenses) (Gershon, 2009). This research was made to examine the various factors that determine the effects of share pricing on the performance of the firm. Considering all the variables that were used for the study to test its effect on the performance of the firm, only the earnings per share of the firm proved to be significant among the other variables return on assets and equity, return on investment and overheads at 95% confidence interval (Gyimah, 2011).

Taken together, the main findings were that firm profitability is predominantly determined by firm-level variables, and that sector effects play a relatively minor role. A possible interpretation is that heterogeneity in profitability is due to competitive advantages caused by unique characteristics of the firm. This would lend support to the predictions of firm effect models where markets function competitively and can be seen as an indicator that performance differences across firms are not necessarily linked to market failure that would justify competition policy (Andreas Stierwald, 2010).

The analysis verifies the predictions of firm effect models that firm-level effects determine differences in profitability and that sector-wide effects have little impact. This has implications for welfare analysis because in firm effect models high firm profitability is the result of competitive processes and not market failure. The design of competition policy should be The growth is a subject to various dynamic restraints of which financial, demand and managerial restraints will be crucial (Barthwal, 2004).

The investment industry demands that managers maximize sales and earnings growth over time. This prescription is based on the presumption that growth is synonymous with shareholder value creation. Our empirical results indicate that maximizing growth does not maximize corporate profitability or shareholder value. On the contrary, companies with moderate growth in sales or earnings show the highest rates of return and value creation for their owners (Ramezani, 2002).

The conclusion, therefore, is that the corporate strategy construct defined in this study using growth strategy variables were not found to be significantly related to firm performance as measured by return on equity as well as free cash flow per share. The above confirms that growth strategies do not help explain a significant amount of variance in firm performance. Growths are essential for firms, but are growth strategies value-adding strategies,
which result in improved firm performance? The answer to this research question posed at the beginning of this study is that growth strategies may not be value-adding strategies, as tested and reported in this study (Chathoth, 2007).

The investment industry demands that managers maximize sales and earnings growth over time. This prescription is based on the presumption that growth is synonymous with shareholder value creation. Our empirical results indicate that maximizing growth does not maximize corporate profitability or shareholder value (Jung, 2002).

Research Methodology:

This study can be well thought-out as a descriptive study because the main point is on a finding of victory aspects of Pakistan. The list of firms of Karachi Stock Exchange was the most important machine of the study.

Research Design:

Balance sheets of the firms of Karachi Stock Exchange listed companies are under the boundary of the sample frame.

Population and Sampling:

A research population is also recognized as a distinct compilation of folks or objects identified to include comparable uniqueness. All individuals or items inside convinced inhabitants frequently comprise a general, obligatory attribute or feature. The sample is depicted thoroughly in terms of clinical and demographic characteristics in the methods section of a research article so that others can draw conclusions, apply the results, and compare one investigation with another. It is not the target population, but rather a group of patients or individuals who are actually studied.

Population:

All of the listed firms of Karachi Stock Exchange 250 firms are taken as population. In these firms’ textile, cement, agricultural, automobile, and parts industry, Beverages, Chemicals, Commercial Banks and Electricity industries are included.

Sampling and sampling method:

The data type is panel data; the use of panel data may reveal the true relationship between dependent and independent variables that may not be possible or reliable with only cross-sectional, time-series, or average data. In other words, statistical methods using panel data are more robust and sound than using other types of data.

Sample selection:

In order to select the sample the convenient sampling technique is followed, and The sample firm names and associated tickers were first collected through the primary sources available on Karachi Stock Exchange website and web site of State Bank of Pakistan.

Procedure for data collection:

Data is collected from the balance sheets obtained from the website of each firm and some from KSE annual reports

Model:
F.P = β₀ + β₁(Liv) + β₂(FL) + β₃(Act) + β₄(Gr) + β₅(Prof) + β₆(Div) + β₇(BD) + β₈(GD) + β₉(sz) + ε

Where Firm performance (FP) is dependent variable and independent variables are liquidity (Liv), financial leverage (FL), activity (Act), growth (Gr), profitability (Prof), size(sz), dividend payout (Div), business diversification (BD), and geographical diversification (GD).

β₀ = constant
β₁ – β₉ = coefficients
ε = error term
Figure-1  

Model

- Financial leverage
- Size
- Growth
- Activity
- Liquidity
- Dividend Policy
- Business diversification
- Geographical diversification
- Profitability
In the above figure-1 the Firm Performance is taken as the dependent variable and the other the financial factors are liquidity, financial leverage, activity, growth, profitability, size, dividend payout, business diversification, and geographical diversification. Liquidity is corresponding to by the current ratio, prepared as current assets in excess of current liabilities. Debt ratio, which is cleared as total debt divided by total assets, characterizes financial leverage. Assets revenue ratio, a commotion factor, is total sales to total assets. Growth in sales, calculate as the annual proportion varies in total sales signify the growth variable. Profit edge, which is net profits over total sales, is working as the variable for profitability.

**Delimitations of the study:**

In our Pakistan there is very little work on firm-wise financial factors, some researchers have determined only a few factors of finance which affect the firm’s performance in Pakistan. As there are many other factors which affect the firm performance in Pakistan, and yet it is not completely know how about all these firm-wise financial factors due to this lack of information many problems present in the measurement of firm value in Pakistan.

**Assumptions:**

Only financial factors are taken for observation, and nonfinancial factors are not discussed in this research. The firm performance in this research the use of panel data may reveal the true relationship between dependent and independent variables that may not be possible or reliable with only cross-sectional, time-series, or average data.

**Panel Data Regression analysis:**

This study used panel data to guesstimate a regression reproduction to classify the liaison between firm-wise financial causes and firm performance. As pointed out by panel statistics has together cross-sectional and time-series dimensions.

**TABLE1. Firm-wise financial factors and data representations**

<table>
<thead>
<tr>
<th>Financial factor name</th>
<th>Data representation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity</td>
<td>Current ratio (current assets/current liabilities)</td>
</tr>
<tr>
<td>Financial leverage</td>
<td>Debt ratio (debt/total assets)</td>
</tr>
<tr>
<td>Activity</td>
<td>Asset turnover ratio (total sales/total assets)</td>
</tr>
<tr>
<td>Growth</td>
<td>Sales growth (total sales T/total sales T-1 -1)</td>
</tr>
<tr>
<td>Profitability</td>
<td>Profit margin (net income/total sales)</td>
</tr>
<tr>
<td>Size</td>
<td>Log of total assets</td>
</tr>
<tr>
<td>Dividend payout</td>
<td>1 for some dividend; 0 for none</td>
</tr>
<tr>
<td>Business diversification</td>
<td>1 for some diversification; 0 for none</td>
</tr>
<tr>
<td>Geographic diversification</td>
<td>1 for some diversification; 0 for none</td>
</tr>
</tbody>
</table>

Regression using panel data often termed panel regression, can mitigate the measurement problems caused by omitted or unobservable variables; and thus, the results are more reliable and generalize able than using cross-sectional data or time series data alone. There are several types of panel regression models points out that the Ordinary Least Square (OLS) constant coefficients model (also referred to as the pooled regression model) is the simplest, assuming homogeneous or constant interrupt and coefficients for all cross-sectional and time-series observations. Another model, the fixed effects model, assumes that each cross-sectional unit (each Pakistani firm in our study) has constant slopes and variance (error term), and it differentiates one from another by its unique intercepts. Operationally, the fixed effects model to creating a set of dummy variables for each firm to control for its firm difference. A third model, the random effects model (also called error component model) assumes non constant variance or error term among all cross-sectional units (in our study, Pakistani firms) but constant intercept and coefficients.
Model Estimation

When performing a regression analysis using panel data, previous studies have usually started with the estimation of an OLS constant coefficient model and then compare the OLS model with the more appropriate one between the fixed and random effects models to determine the final model. Three tests are involved in choosing an appropriate model.

**Dependent variables:**
- Firm performance is the dependent variable

**Independent variables:**
- FL: financial leverage
- A: activity
- G: growth
- P: profitability
- Size: logarithm of total assets
- D: dividend payout
- BD: business diversification
- GD: geographical diversification.

**Analysis:**
Variable Descriptive Statistics: Two hundred and fifty firms were initially identified by their between 2007 and 2012. Descriptive statistics of all continuous variables are summarized in Table 2. Table 3 shows the frequency and percentages of the dichotomous variables. The current ratio ranged from 0.239 to 3.599, with a mean of 0.922. On average, KSE firms had slightly more current liabilities than current assets, indicating a weak liquidity position.

**TABLE2. Descriptive statistics of the continuous variables**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Number</th>
<th>Mean</th>
<th>Std. dev.</th>
<th>Max.</th>
<th>Min.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity</td>
<td>250</td>
<td>0.933</td>
<td>0.550</td>
<td>3.599</td>
<td>0.239</td>
</tr>
<tr>
<td>Financial leverage</td>
<td>250</td>
<td>0.223</td>
<td>0.149</td>
<td>0.721</td>
<td>0.000</td>
</tr>
<tr>
<td>Activity</td>
<td>250</td>
<td>1.692</td>
<td>0.537</td>
<td>3.841</td>
<td>0.659</td>
</tr>
<tr>
<td>Growth</td>
<td>250</td>
<td>0.120</td>
<td>0.152</td>
<td>1.105</td>
<td>−0.260</td>
</tr>
<tr>
<td>Profitability</td>
<td>250</td>
<td>0.034</td>
<td>0.059</td>
<td>0.142</td>
<td>−0.422</td>
</tr>
<tr>
<td>Size</td>
<td>250</td>
<td>19.252</td>
<td>1.730</td>
<td>24.053</td>
<td>15.164</td>
</tr>
<tr>
<td>Proxy Q</td>
<td>250</td>
<td>1.823</td>
<td>1.073</td>
<td>7.575</td>
<td>0.480</td>
</tr>
</tbody>
</table>

Note: Size is the logarithm of total assets.

**TABLE3. Frequency and percentages of the Dichotomous variables**
The business was without due contemplation leveraged with a usual debt ratio of 0.223. The industry’s weak liquidity spot may demand light confidence on debt utilize to diminish the in general monetary risk. The assets taking ratio varies from 0.659 to 3.841. The regular assets return, at 1.692, demonstrated that Pakistani firm revenue was about 71% more than assets value per year, indicating realistic assets executives’ good organization. The Proxy Q fell between 0.480 and 7.575 with an average of 1.823, involve that Pakistani firms in the money marketplace were on a regular value other than their substitute cost. Reasonably small proportions of firm/year remarks were connected with dividend distribution (23.6%), business diversification (22.5%), and geographical diversification (14.7%). The correlation coefficient among the Proxy Q and each independent variable is obtainable in Table 4. There was no association linking the Proxy Q and activity and dividend payout at the 0.05 significance level. While financial leverage was radically and negatively associated with the Proxy Q, significant and positive relationships were originated among the Proxy Q and liquidity, growth, profitability, size, business diversification, and geographical diversification.

**Regression Analysis:**

Table 5 recapitulates the regression results. In our primarily likely OLS constant coefficient model, five variables, namely liquidity, activity, growth, profitability, and size were significant and optimistically linked with the Proxy Q, the firm performance variable. They exhibit that larger KSE firms with higher liquidity, assets turnover, profitability, and faster growth be liable to include superior firm standards. Financial leverage variable was established to comprise a significant but unenthusiastic effect on KSE firm performance, entail that important gratitude have a tendency to decrease KSE firm importance in the capital marketplace from 2007 to 2012. Among the three dichotomous variables, dividend payout and business diversification were found to be significant. The negative coefficient of dividend payout of KSE firms that paying no dividends outperformed their dividend-paying equivalents.

**TABLE4. Independent variables as correlated with proxy Q**

<table>
<thead>
<tr>
<th>Independent variable</th>
<th>Correlation (r)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Liquidity</td>
<td>0.213**</td>
</tr>
<tr>
<td>Financial leverage</td>
<td>−0.377**</td>
</tr>
<tr>
<td>Activity</td>
<td>0.015</td>
</tr>
<tr>
<td>Growth</td>
<td>0.322**</td>
</tr>
<tr>
<td>Profitability</td>
<td>0.336**</td>
</tr>
<tr>
<td>Size</td>
<td>0.334**</td>
</tr>
<tr>
<td>Dividend payout</td>
<td>0.020</td>
</tr>
<tr>
<td>Business diversification</td>
<td>0.176**</td>
</tr>
<tr>
<td>Geographical diversification</td>
<td>0.223**</td>
</tr>
</tbody>
</table>
### TABLE 5. Results of regression

<table>
<thead>
<tr>
<th>Variable</th>
<th>OLS</th>
<th>FE-AR(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>L</td>
<td>0.269**(2.35)</td>
<td>0.180 (1.69)</td>
</tr>
<tr>
<td>FL</td>
<td>-2.265**(-5.94)</td>
<td>-2.276**(-3.12)</td>
</tr>
<tr>
<td>A</td>
<td>0.267**(2.32)</td>
<td>0.607*(1.70)</td>
</tr>
<tr>
<td>G</td>
<td>1.454**(4.05)</td>
<td>0.327 (0.78)</td>
</tr>
<tr>
<td>P</td>
<td>2.893**(2.86)</td>
<td>-0.060 (-0.08)</td>
</tr>
<tr>
<td>Size</td>
<td>0.296**(6.23)</td>
<td>-0.111 (-0.38)</td>
</tr>
<tr>
<td>D</td>
<td>-0.625**(-4.44)</td>
<td>0.118 (0.52)</td>
</tr>
<tr>
<td>BD</td>
<td>0.451**(3.59)</td>
<td>-0.451 (-0.82)</td>
</tr>
<tr>
<td>GD</td>
<td>0.057 (0.32)</td>
<td>-0.325 (-0.54)</td>
</tr>
<tr>
<td>Constant</td>
<td>-4.232**(-4.10)</td>
<td>3.380 (0.86)</td>
</tr>
<tr>
<td>R2(Adj-R2)</td>
<td>0.461 (0.441)</td>
<td>0.909 (0.854)</td>
</tr>
<tr>
<td>Overall Significance Test</td>
<td>F(9, 256)= 22.52**</td>
<td>F(9,135)= 3.19**</td>
</tr>
<tr>
<td>Housman Specification Test</td>
<td>Chi(6)= 17.82**</td>
<td></td>
</tr>
<tr>
<td>Incremental F Test</td>
<td></td>
<td>F(55,135)= 5.56**</td>
</tr>
</tbody>
</table>

**and *represent the 0.05 and 0.10 significance levels, respectively. L: liquidity;
FL: financial leverage; A: activity; G: growth; P: profitability; Size: logarithm of total assets;
D: dividend payout; BD: business diversification; GD: geographical diversification

### Conclusion:

Our panel data regression analysis has escorted to the fixed effects model as the ultimate right model with two momentous variables, financial leverage, and activity. The conclusion should be strained stands on our fixed effects sculpt, which symbolize a methodological resonance approach for our firm's data. These conclusions can be tired from the fixed effects model. Firstly, it is prudent for Pakistani firms to lesser their liability leverage. Financial leverage was exposed to include an unenthusiastic contact on all firms performance during 2007–2012, suggesting so as to the expenditures of by means of liability in the business offset its remunerations. Consequently, falling debt money would advantage the business.

This study conveys to a secure that by means of additional conserve profits for core financing would be a pleasing strategy. If interior preserve incomes money is pooped and new exterior financing is compulsory, KSE firms at rest have to be vigilant as regards using novel debts. Our results suggest a fastidious inference for Pakistani firms working in the less-stable trade section. They might use low-debt leverage to counteract the elevated company risk and improve firm value in the capital marketplace. Secondly, to pick up firm performance, Pakistani firms be supposed to deliberate on operating offered possessions to spawn additional sales returns or to elevate the assets proceeds, relatively than growing profits via increasing into new bazaars. The presence of assets revenue as an important and optimistic variable and growth as an unimportant variable in our fixed effects model proposes that elevating sales returns with on hand possessions is extra significant than growth with new channels.
Finally, nonfinancial firm-wise aspects are worthy of KSE firms’ consideration in their endeavor to get better firm performance in the principal marketplace. To increase firm value in the capital marketplace, KSE firms may require barely to inferior debt leverage and amplify the sales activity supported on accessible resources other than too to reinforce their nonfinancial dynamics, such as business civilization, human capital, technology, on hand wealth, and so forth.

First, our search only measured firm-wise financial factors as potential variables that may affect Pakistani firm performance. The resulting fixed effects model showed that this pre-assumption was questionable. The significant role represented by the intercept in our fixed effects model implies that nonfinancial factors may also be important in explaining firm performance variation and thus they could be included in the analysis.

A study that incorporates both financial and nonfinancial factors of KSE firms may yield a model with a less significant role played by the intercept but more significant explanations of performance variation provided by identified specific variables.

Second, as the data period of our study witnessed an economic downturn, our results may not be immune from the impact of this particular business cycle. Therefore, the future study may select a longer time frame that incorporates both economic downturns as well as upturns to neutralize the impact of a business cycle and obtain results that can be generalized across different time periods. More than one financial variable can represent a factor. For example, liquidity can be measured by the quick ratio. Profitability may be represented by return on assets or return on equity.

References:


