The Impact of Corporate Governance on Financial Performance: An Empirical Investigation

Author's Details:

Corresponding Author: [(1)]Muhammad Rizwan, Assistant Professor Dow University of health Sciences **[(2)]Humera Asrar**, Lecturer Dow University of Health Sciences **[(3)]Noman Alam Siddiqui**, Director Dow University of Health Sciences **[(4)]Waqar uddin Usmani,** Assistant Professor, BizTech institute

Abstract

Pakistan is an emerging economy which is based on financial performance of business organization. Sustainable financial growth of corporations depends on effective board performance. The study aimed to reflect the presence of effective principle based corporate governance in Pakistan and its impact on financial performance of a company. The reason to select this topic is, that in Pakistan as yet the complete model of financial performance have not been used to find out the above said relationship. The data was collected from top 20 companies which got registered in the Karachi Stock Exchange during the period 2007 to 2014. Financial performance of these organizations were measured by different financial ratios like Tobin's Q, ROA, MB, ROE and etc. while the inside ownership, board size, board independence, board diversity, presence of audit and remuneration committees and dividend payout ratios were taken as indicators of the corporate governance under the guide lines of the code of corporate governance 2002 and 2012 regulated by the Security and Exchange Commission of Pakistan (SECP). Results revealed that the inside ownership, board size, presence of independent/non-executive directors, dividend payout ratio and presence of audit committee had significant impact on organization's financial performance while the presence of remuneration committee and board diversity had no impact on firm's financial performance.

Key words: *corporate governance. Financial performance, Pakistan, SECP*

Introduction

La Porta, et al. (2000) defined, "Corporate governance is, to a certain extent, a set of mechanisms through which outside investors protect themselves against expropriation by the insiders." They defined "the insiders" as both managers and controlling shareholders.

Pakistan came into being in 1947 and since then the country failed to achieve economic stability and even after 67 years of independence the financial performance of the corporate institutions is not very promising. There are multiple factors for this poor finical performance but out of these the most important is the lack of effective principle based corporate governance (Javed & Iqbal, 2004).

Corporate governance is the process and structure which is used to direct and manage the business and affairs of the company towards enhancing business prosperity. Corporate governance refers to the mechanism, process and relations by which corporations are directed and controlled. In every country there is regulatory body which formulates the rules and guidelines for effective corporate governance. All corporates are bound to follow these rules. In case of any non-conformity the corporations are penalized according to the specified rules of the regulatory authority (Reddy, 2010).

Many of the large companies collapsed in the recent financial crises of 2007-2010 even in Europe (Reddy, 2010). These crises and the preceding Asian financial crises of 1997 have exposed the problem areas in the corporate governance and also revealed the inability of boards to monitor and control the overall company performance and also the remuneration and performance of the individual managers (OECD, 2009).

The process of corporate governance in Pakistan is very recent. The Securities and Exchange Commission of Pakistan was established in 1999 in pursuance of Securities and Exchange Commission of Pakistan Act 1997. The code of corporate governance for listed companies was issued in March 2002 in order to strengthen the regulatory mechanism and its enforcement. The code of corporate governance is the major step in corporate governance reforms in Pakistan. The code includes many recommendations in line with international

good practices (Ibrahim, 2006). The major areas of enforcement include reforms of board of directors in order to make it accountable to all shareholders and for better disclosure including improved internal and external audits for listed companies. However, the code's limited provisions on director's independence remain voluntary and provides no guidance on internal controls, risk management and board compensation policies (Javid & Iqbal, 2004).

The code was met with criticism from corporations and commentators. Corporations believed that complying with the Code's provisions would be very expensive (Ibrahim, 2006). They also argued that there were numerous practical difficulties in implementing and enforcing the Code. Indeed, one of the legitimate problems pointed out by corporations was the lack of relevant expertise in Pakistan to enforce the code's provisions. In addition, some commentators believed that the code was defective, outdated, and had "no utility to stakeholder". However, despite these criticisms, the code in many ways has been ground-breaking and sharing a new era of corporate governance in Pakistan (Ibrahim, 2006).

The compliance with principle based corporate governance according to the Security Exchange Commission of Pakistan guidelines is essential to improve the corporation financial performance in Pakistan.

In 2012, the revised version of Pakistan's code of corporate governance was issued to align the corporate practices in Pakistan with best international practices. In 2014 there were certain amendments that were made in the code to make it more practical for the listed companies in Pakistan.

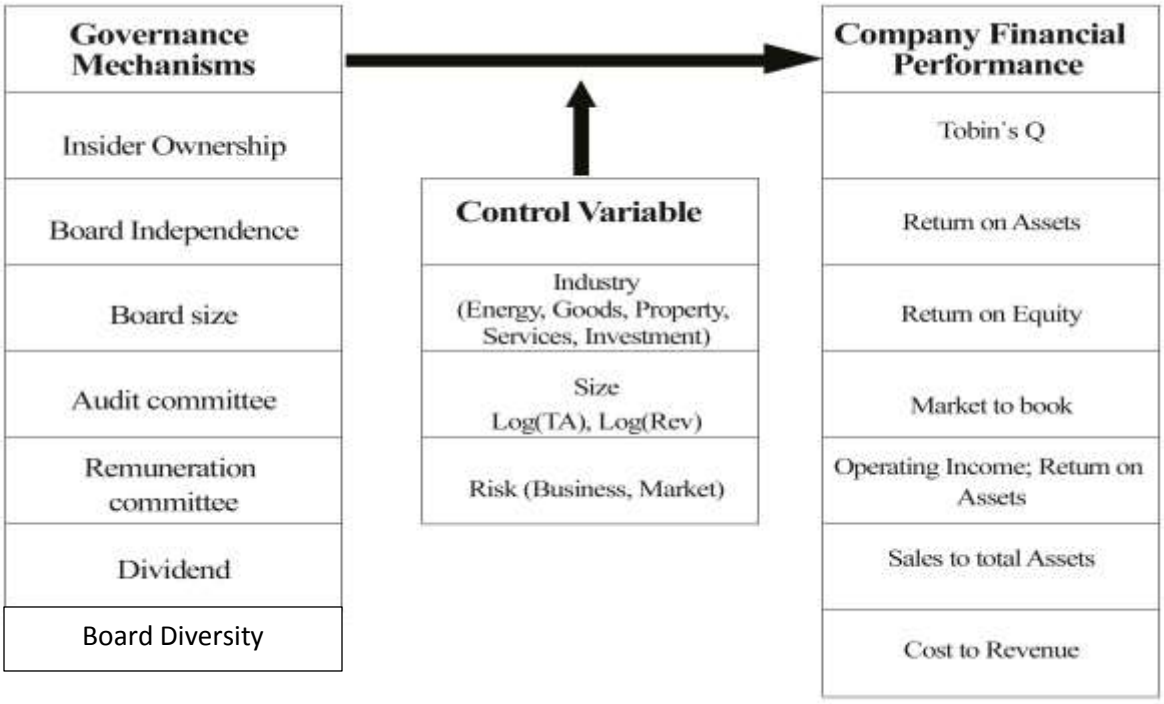
Following are the core benefits of corporate governance in economy of country (Anda et al., 2005).

- ✓ It reduces vulnerability of the financial crises
- ✓ Reinforcement of property rights
- ✓ Reduces transaction cost and cost of capital
- ✓ Leads to capital market development.

Problem Statement

There is a strong need to improve the financial performance of corporations in Pakistan to strengthen the national economy. The firm's financial performance reflects the effectiveness of the management and the evaluation of their board of directors. The aim of this research is to evaluate that whether or not the firm's financial performance is dependent on effective corporate governance.

Conceptual framework



Source: Reddy (2010) Conceptual framework

This conceptual frame work is designed to identify whether the corporate financial performance is measured by principle based governance practices

Hypotheses

The following are the hypotheses to meet research objectives:

Ho: Financial performance of a firm is not dependent on effective corporate governance.

H1: Firm`s financial performance has a significant relationship with insider ownership.

H2: Firm`s financial performance has a significant relationship with presence of audit committee.

H3: Firm`s financial performance has a significant relationship with non-executive directors.

H4: Firm`s financial performance has a significant relationship with dividend payout ratio.

H5: Firm`s financial performance has a significant relationship with presence of remuneration committee.

H6: Firm`s financial performance has a significant relationship with board diversity.

Significance of the Study

This study is important because, it will explore whether the selected variables measure the financial performance or not. The study will provide the evidence of relationship between corporate governance and financial performance of the corporations in Pakistan.

Objective of the study

Objective of the study is to identify the impact of corporate governance practices on financial performance of listed companies of the Karachi Stock Exchange, Pakistan. To achieve these following objectives were established:

- To find out the relationship between corporate governance practices and financial performance measured by Tobin`s Q, Market to book, Return to Assets and Return on Equity.
- To verify whether principles of SECP has an effect on financial performance of corporation or not.

Literature Review

Inside ownership

Agency model forwarded by Jensen and Meckling (1976) states, that the separation of ownership and management in modern enterprises gives rise to the conflict of interest between the two stakeholders. Managers often engage in an opportunistic behavior which maximizes their own interests rather than that of firm because they obtain the full reimbursement of such activity but stand far less than their full share of the costs. Again it was Jensen (1986) to explore that managerial ownership have negative association with firm performance at fairly high levels of managerial ownership (managerial entrenchment hypothesis).

Demsetz (1983) came up with the different hypothesis that the ownership of employees' would negatively impact the financial performance of an organization. In large organizations the major shareholders have an edge on minority shareholders in decision making (Maher & Anderson, 1999).specially in those companies where the block ownership exist, this is very common situation (Faccio & Lang, 2002).

The Jensen & Murphy(1990) referred to common areas of managerial ownership, first is the alignment of managers' interest by making them shareholders, as when these managers work for their own financial interest would also benefit stakeholders financial interest as both the interests are common and aligned(Perry &Zenner, 2000) Secondly, the control by the stakeholders can be asserted through focused group such as appointing Board of Directors(Agrawal&Knoeber, 1996; Bethel, Liebeskind&Opler, 1998; Dalton, Daily, Ellstrand& Johnson, 1998).

Block Ownership

Prowse (1994) proposed concentrated shareholding as a way of controlling managers. He identified two kinds of concentrated shareholding found in literature; one is by institutions and the other is by blockholders.

Bushee (1998) though the theory does not specifically address different kinds of equity holders, the resent research, however reflects the implications vary since the objectives of different owners may also vary. According to Agrawal & Mandelker (1990) that the majority of shareholding of institutions and blockholdes gives them the power to influence management decisions in their favour, which improves the financial performance of the organization.

Board Independence

The formation of board varies from country to country. In Germany the board comprises a management and non-executive supervisory board; on the other hand Japanese companies Board have thirty or more members (Denis, 2001). He also argued that at an average, the functions of board of directors in monitoring firms are badly performed.

Davis, Lukomnik and Pitt-Watson (2006) stated that the board lacks in information, apply unnecessary pressure and at times they are incapable as well. Most of the time the information, vital for proper decision making is kept off from the non-executive directors as it rests with the CEO.

Fama and Jensen (1983) suggested that the source of organization-specific information is the executive directors and these executive directors are vital in effective decision making.

Board Size

According to Reddy, Locke, Scrimgeour & Gunasekarage (2008) the financial performance of a company is directly related to the size of the board of directors. Jensen (1983) suggested that ideally a board should have seven to eight members for effective functioning. Hackman (1990) shared the same view that as the board size increases in any company it makes firm performance poor. Forbes and Milliken(1999) also favoured the thought by arguing that the large boards lack coordination between members and strategic decision making thus becomes difficult. Lipton and Lorshe(1992) also gave the reason for ineffectiveness of large board that due to time constrains in meetings the members could not share their ideas and concerns fully.

On the other hand Dalton, Daily, Johnson & Ellstand(1999) contradicted by putting their weights in favour of large Boards by arguing that in a large board diversified expertise and higher number of linkages provide leverage of growth to companies. To add Anderson, Mansi and Reeb (2004) shared the same view by arguing that members get higher degree of freedom in larger boards which optimizes the performance of committees thus affecting the quality of monitoring in a positive manner, however, Bonne, Field, Karpoff and Raheja (2005) argued that the board optimization is situational and depends on the type of company and the need.

Audit Committee

SECP (2012) referred to the recommendations of companies having audit committees for the auditing financial statements and a remuneration committee for setting the financial packages of executive officers and directors; it is presumed that the formation of such committees would have positive impact on financial affairs of a company. According to McMullen (1996) the research studies suggest that the presence of audit committee had resulted in lesser number of finance related reported problems. Similarly, John and Senbet (1998), while referred to benefits of audit and monitoring committees which have been ascertained by the research studies. Independent audit committees ensure transparency by reducing the chances of management errors and corruption (Klein, 2002) however, Baxter (2006) found no such connection between audit committee and finances.

Remuneration Committee

Main and Johnston (1998) Weir and Laing (2000) reported a positive effect of remuneration committee on financial performance of the firms. Klein (2002) also found a positive contention between the two, however it was not significant. Ellstrand and Johnson (1998) were of the view that more research is needed in this regard.

The literature on corporate governance also suggests other ways along with the above mentioned which can be effective in raising the standards of board monitoring, these may include CEO compensation, debt, dividends, corporate control, labor market competition, product market competition and legislation(Klein,2002)

Board Diversity

There has been a continuous debate whether board diversity improves board performance or not (de Andres, Azofra& Lopez, 2005; Dulewicz& Herbert, 2004). But it is desirable to have board members from different back grounds and genders who enrich the board monitoring and evaluating activities (Knippenberg, De Dreu& Homan2004). The group dynamics and sharing of ideas increases the board performance (Schippers, Hartog, Koopman& Wienk2003).Diversity is a tool to create organizational value by effective board performance (Carter et al., 2003).

Gender diversity also plays a significant role in board performance; however there is absolutely different evidence of female directors in board of directors (McGregor, 2008). The presence of female directors in company's board and impact of their presence on board performance is the attractive aspect for governance researchers (Kang, Cheng & Gray, 2007). The presence of females in board can increase the board's efficiency due to many reasons, like females generally do not have influencing friend's connections and they are more sensitive about customer needs (Brennan &McCafferty, 1997)

Dividend

Miller and Modigiliani (1961) argued that under perfect market conditions the dividend policy does not remain relevant; however, it becomes relevant according to Hughes (2008) in an imperfect market.

Role of dividend is indispensible in monitoring of organizational performance. It facilitates to oversee the equity issues (Easterbrook, 1984). It exhibits the company's financial position whether the company is able to manage capital market through the sale of common stock or not (Fluck, 1998).Myers (2000) constructed the model related to dividend related elements like dividend attitude. The consistent flow of dividend payment breaks the unnecessary investment in business by mangers (Jensen, 1986)

Corporate Governance and Performance

Corporate governance is complex and multifaceted phenomena, which has enormous impact on executive performance but not easy to explain (Zingales, 1998) Multiple studies of corporate governance exist which estimated the effect of corporate governance on organizational performance, but still there is no definite answer of it (Yermack, 1996; Claessens et al., 2000; Klapper and Love, 2002; Gompers et al., 2003; Black et al., 2003; Anda et al., 2005).

The different elements of corporate governance have different impacts on performance, like board of directors has little effect on company performance (Adjaoud et al., 2007). Some studies found that CG and corporations performance has direct relationship in between. Bhagat et al., 2000: Weir et al., 1999). However (Albeit et al., 1998) identified an inverse relation among them. Similarly, shareholders are important pillar of corporate governance; they provoke and monitor the Performance of top management in favor of organizational performance (Friend and Lang, 1998). Shleifer et al. (1997) ascertain that the shareholders having large shareholding patterns are more influencing to monitor the organizational performance to keep their assets save. This monitoring is not beneficial to keep assets save only but also to have effective conflict resolution and to solve issues with mutual consensus, which is very important to keep organization secure (Williamson, 1988).

Corporate governance not only manages the management but also work for financial stability of the organization (Jensen, 1986).CG affects the financial value of firm directly or indirectly and positively add value to the firm (Driffield et al.,2007). It improves the accounting ratios of the company and equity returns especially in longer span of time (Gompers et al., 2003; Rob et al., 2004)

Methodology

To find out the effect of principle based corporate governance on corporation's financial performance the quantitative approach was adopted. Through in-depth survey of research literature independent and dependent variables are constructed.

Depended Variable

Tobin`s Q is a dependent variable a commonly used measure for financial performance. The dependent variable – Tobin‟s Q is commonly used in governance studies as a proxy for company performance of publicly listed

companies (Agrawal & Knoeber, 1996; Bhagat & Black, 1998; Bhagat & Jefferis, 2002; Reddy et al., 2008a; Weir, Laing & McKnight, 2002; Yermack, 1996).

$$Tobin`s\ Q = \frac{Market\ Value\ Estimation}{TotalAssets}$$

Where MVE is the product of company`s share price and common stock outstanding

The accounting based performance measure; ROA was also used in this study.

$$ROA = \frac{NetIncome}{TotalAssets}$$

Tobin`s Q is greatly influenced by a wide range of unstable factors such as investor perception and market forces considering this concern both measures of financial performance were used in this study.

The ratio of market value to book value was also used in this study:

$$MB = \frac{Stock\ price * No.of\ shares}{Total\ Equity}$$

Where Total Equity is equal to net assets that is assets less debt (TE=A-L)

The commonly used accounting measures of company performance such as, Return on Assets (ROA), Return on Equity (ROE), Operating Income Return on Assets (OPROA), Total Sales to Total Assets (S2TA) and Total Cost to Net Revenue (C2REV) are appropriate choices for the dependent variable.

A high ratio represents a favorable financial performance apart from C2REV where a low ratio represents greater efficiency.

These ratios were selected because they are commonly used in empirical studies that tend to focus on the stakeholder viewpoint. Public sector entities do have a stakeholder focus, so it is deemed appropriate to use measures that reflect stakeholder attributes. The dependent variables were estimated as follows:

ROA - is computed by dividing net income by book value of total assets

$$ROA = \frac{NetIncome}{TotalAssets}$$

ROE is calculated by dividing net income by Total share`s Holders Equity

$$ROE = \frac{NetIncome}{Share`sholdersEquity}$$

OPROA - is computed by dividing EBITDA by total assets

$$OPROA = \frac{EBITDA}{TotalAssets}$$

EBITDA= Earnings before interest, Tax, Depreciation and Amortization

Total Assets turnover is calculated by dividing Net Revenue by Total Assets

$$Total\ Assets\ Turnover = \frac{NetSales}{TotalAssets}$$

Cost to Revenues is computed by dividing total cost by total revenue

$$C2REV = \frac{Revenue - EBITDA}{NetRevenue}$$

Independent Variables

In this study the independent variables are the factors which are discusses in literature review and conceptual framework like; IOWN, NED, BDS, FD, ACOM and RCOM. These variables have either positive or negative influence on company's financial performance. Insider ownership also known as member ownership is the presentation of the % of shares held by the members of the board of directors.

Table-1
Governance and Performance Variables

VARIABLES	MEASUREMENT TECHNIQUE
Dependent	
Tobin's Q	Ratio of MVE (market value of shareholders" equity) to book value of total assets.
ROA	Ratio of net income to total assets.
MB	Ratio of the market value of equity to total shareholders" equity (Total Assets – Total Liabilities).
ROE	Ratio of net income to total shareholders" equity.
OPROA	Ratio of EBITDA (earnings before interest, tax, depreciation and amortization) to total assets.
S2TA	Ratio of net revenue to total assets.
C2REV	Ratio of net revenue less EBITDA (earnings before interest, tax, depreciation and amortization) to net revenue.
Independent (Explanatory)	
IOWN	Proportion of shares held by insider.
NED	Proportion of non-executive/independent directors on the board.
BDS	Log of board size.
FD	Proportion of female directors on the board.
ACOM	Equals to "1" if the company has audit committee, otherwise "0".
RCOM	Equals to "1" if the company has remuneration committee, otherwise "0".
LEV	Long term liabilities plus short-term liabilities divided by total assets.
DIV2TA	Dividend paid per year to total assets.

Control	
CR	Ratio of current assets to current liabilities.
Log(TA)	Proxy for size which is the natural log of total assets.
Log(REV)	Proxy for size which is the natural log of total revenue.
BUSRISK	Standard deviation of the 5-year return on assets.
COMPLIED	Equals to "1" if the company has non-executive/independent directors, audit Committee and remuneration committee, otherwise "0".
IND1	Dummy variable equal to "1" if the company is in the energy industry,
IND2	Dummy variable equal to "1" if the company is in the goods industry,
IND3	Dummy variable equal to "1" if the company is in the services industry,
IND4	Dummy variable equal to "1" if the company is in the investment industry, otherwise "0".

Population of Study

Since the study was conducted in Karachi, therefore all the listed companies in the Karachi Stock Exchange were the population of study. According to KSE website there are 580 registered companies in Karachi Stock Exchange from 35 different sectors.

Sample of Study

In current study the researcher selected top 25 companies from KSE 100 index. Top 25 companies' secondary data was taken out from the published annual reports as secondary data. But, 05 company's data was not available or in some cases companies were registered as corporations two years back but the study was conducted for the period of 2007 till 2014, so finally the top 20 companies were selected through non probability convenient sampling method.

Model Specification

Most of the literature used univariate or multivariate regression analysis to test the relationship between corporate governance factors and company financial performance. These studies consider ownership as an exogenous variable. Based on these prior studies, an ordinary least squares regression (OLS) is employed to establish if governance and control mechanisms have an effect on company financial performance. The model estimation is:

$$FP = \alpha_{1+}\beta_1 IOWN+\beta_2 NED+\beta_3 BDS+\beta_4 DIV2TA+\beta 5 \log (TA) +\beta_6 ACOM+\beta_7 RCOM+\beta_8 BUSRISK+\beta_9 COMPLY+\beta_{10} IND1+\beta_{11} IND2+\beta_{12} IND3+\beta_{13} IND4$$

Where FP = Company Financial Performance measured by Tobin"s Q, MB and ROA

The equation determines the relationship between financial performance and governance mechanisms of companies.

Data Analysis &Results

This section is about presenting the results of the relationship among corporate governance and the 20 selected companies' financial performance; these are listed companies of the Karachi Stock Exchange. Initially the top 25 companies from KSC 100 index were taken but due to the unavailability of companies' data. The Companies like Engro foods and Engro fertilizers, Fatima fertilizer were excluded because these were listed in 2011, 2012 and 2013 respectively while the rest of data was of the period 2007 to 2014.

Table-2
Descriptive Statistics

Variable Depended	Mean	Median	Minimum	Maximum	Inter Quartile Range	
Q	3.551106	0.887242	0.0364	37.6783	0.287090	2.655768
MB	2.222256	0.129780	-0.0801	26.2139	0.031337	0.292468
ROA	5.151417	0.274954	-0.3716	99.3287	0.169462	0.468637
ROE	7.816764	2.379310	0.0618	58.0395	1.347839	4.596725
Governance						
IOWN	0.064214	0.000000	0.0000	0.6740	0.000000	0.071925
NED	2.01	1.00	0	11	0.00	3.00
FD	0.29	0.00	0	3	0.00	0.00
BDS	9.54	9.00	6	16	8.00	11.00
ACOM	1.00	1.00	1	1	1.00	1.00
RCOM	0.38	0.00	0	1	0.00	1.00
DIV2TA	0.872786	.537600	0.0000	10.0000	.351250	0.830000
Control						
LOGTA	4.975535	4.777270	3.5961	6.2711	4.442664	5.651611
BUSRISK	0.000000	-.000303	-7.9334	6.7653	-0.0308	0.037295
IND1	0.30	0.00	0	1	0.00	1.00
IND2	0.80	1.00	0	1	1.00	1.00
IND3	0.20	0.00	0	1	0.00	0.00
IND4	0.20	0.00	0	1	0.00	0.00

Descriptive Statistics

Table 1 is showing the summary of descriptive analysis for the data of the 20 top companies of the Karachi Stock Exchange. The data is for the period of 08 years, so it is considered as pooled data. This includes minimum, maximum values, mean, median and inter-quartile ranges. The Tobin's Q mean value is 3.55, while median is 0.88; the greater than 1 mean value of Tobin's Q is the strong indication that company is productive for shareholders in term of value. However median value is 0.88. It is an evidence of shareholder's value destruction during period of 2007 to 2014.The mean of MB is 2.22 which is also above 1 and shows the value creation for shareholders. The mean value of ROA is 5.1% while ROE is 7.8% and both values are in positive it is an indication of company performance that the top twenty companies have created value for listed companies during seven years (2007-2014).

In terms of corporate governance, the mean of inside ownership is only 06% (median =0.00). The mean for directors and top management ownership is lower because most of the stock in 50% companies is owned by government, other institutions or general public. Mean for independent director 2.0 (Median=1.0) whereas Krishna Reddy reported NED 3.8 which is slightly higher than Pakistan. The average of board size is 5 to 9 on

average, however the female directors mean is only 0.29 which is very low and there is strong need to increase the board diversity in terms of gender. This is same as New Zealand where the mean is only 0.25. While of independent director is 02% which is good example of independent monitoring of board performance. On an average all the companies have audit comities. That's why 100% companies are complied with audit committees, however three percent companies having remuneration committees. This is because of SECP code of corporate governance (2012) started, before that only few companies had the HR & remuneration committees. Instead of it in New Zealand 77% companies have remuneration committees. The mean of dividend is 08% hence inter-quartile range is between 3 to 83%. The mean Log(TA) is 4.49 (Median=4.7) .Very interesting results are seen in case of business risk which is having mean of 0.00 .which is different from New Zealand where business risk is 18% or 13%. This is because the ratio of inside ownership is less in Pakistan as compare to New Zealand so the risk factor is also very less.

The companies in pool data belong to four different industries. Like 30% from energy, 80% from goods, 20% from services industry and 20% from investment industry.

Table -3

Pairwise correlation matrix for the independent variables

	IOWN	NED	FD	BDS	ACOM	RCOM	Div2TA	LOGTA	BURISK
IOWN	1								
NED	-.045	1							
	.569								
FD	.246**	-.178*	1						
	.002	.024							
BDS	-.057	.432**	-.102	1					
	.477	.000	.199						
ACOM	.[a]	.[a]	.[a]	.[a]	.[a]				
	.	.	.	.					
RCOM	.009	.174*	-.005	.046	.[a]	1			
	.910	.028	.950	.567	.				
Div2TA	-.070	-.070	-.087	-.035	.[a]	.016	1		
	.378	.377	.271	.657	.	.839			
LOGTA	.165*	.198*	-.258**	.142	.[a]	.158*	-.180*	1	
	.038	.012	.001	.073	.	.046	.023		
BUSRISK	.003	.011	.071	.063	.[a]	.024	-.016	-.019	1
	.966	.890	.372	.431	.	.766	.840	.807	

Pairwise Correlation between Independent Variables

A pairwise correlation matrix for the independent and control variables is provided in Table 5.2. The highest correlation is between Log (TA) and DIV2TA at -0.18. It shows that there is an inverse relationship between both independent variables. It states that if company reinvests the profit in the form of Total assets the dividend payout ratio is; minimum. The second highest correlation is between FD and NED at -0.178. It shows that there is an inverse relationship between no-executive directors and female directors. None of the pairwise correlations between independent variables are above -0.18, indicating that the likelihood of multicollinearity issues arising in the OLS regressions is very low.

Table-4

OLS Regression of Tobin's Q. MB, ROA and ROE on Explanatory and Control Variables

	Tobin's Q		MB		ROA		ROE	
		Std. Error		Std. Error		Std. Error		Std. Error
Constant	8.897	3.7	18.332	8.117	14.599	3.281	10.793	9.331
	(2.4)		(2.259)		(4.45)		(1.157)	
IOWN	1.047	3.65	7.656	8.012	-13.19	3.239	-34.809	9.212
	(0.28)		(0.955)		(-4.072)		(-3.779)	
NED	2.28	0.23	2.903	0.513	-0.454	0.208	-0.354	0.59
	(9.72)		(5.655)		(-2.187)		(-0.599)	
FD	-0.48	0.7	-2.524	1.542	0.448	0.623	7.941	1.772
	(-0.68)		-(1.637)		(0.718)		(4.481)	
BDS	0.29	0.2	1.124	0.441	-1.148	0.178	-1.775	0.508
	(1.45)		(2.546)		(-6.433)		(-3.497)	
RCOM	0.26	0.93	2.222	2.047	-1.191	0.827	1.422	2.353
	(0.28)		(1.086)		(-1.439)		(0.604)	
DIV2TA	0.415	0.27	1.743	0.607	-0.434	0.245	0.01	0.698
	(1.49)		(2.871)		(-1.767)		(0.015)	
LOGTA	-2.13	0.68	-5.229	1.499	-0.409	0.606	1.884	1.723
	(-3.11)		(-3.489)		(-0.675)		(1.094)	
BUSRISK	-0.02	0.27	-0.124	0.598	1.109	0.242	3.085	0.687
	(-0.08)		(-0.207)		(4.589)		(4.489)	
COMPLIED	-4.5	1.31	-5.696	2.885	5.515	1.166	3.669	3.317
	(-3.41)		(-1.974)		(4.73)		(1.106)	
R	.693		.585		.599		.547	
R^2	.449		.342		.359		.257	

OLS Regression of TOBIN'S Q, MB, ROA and ROE on Explanatory and Control Variables

Table-3 presents the OLS regression of equation. Columns 2, 4, 6 and 8 of Table-3 provide coefficients of independent variables that are used in equation. Table-3 column 2 provides coefficients of the independent variable using Tobin's Q as a dependent variable. The independent variables NED has positive coefficient, indicating that this variable has a positive effect on companies‟ financial performance measured by Tobin's Q it is statistically significant at a 5% level. The Log (TA) and complied are also statistically significant and their coefficients has negative value which shows inverse relationship. On the other hand overall the relationship between Tobin` Q and independent variable is highly significant.

The results support the hypothesis H_3 that firm financial performance has a positive relationship with non-executive directors.

The OLS regression between the MB and independent variables is highly significant as p value is .000. The results using MB as the dependent variable found DIV2TA supporting the hypothesis (H_4). The coefficient

of DIV2TA is positive and statistically significant at the 5% level, indicating that dividend payment is regarded by the market as a better utilization of free cash flows.

The coefficient of non-executive/ independent director is also positive and statistically significant while Log (TA) and Complied are statistically significant but their coefficients are negative.

The OLS regression results using ROA as the dependent variable found statistically significant in overall model with the value of p is .000. The variables BUSRISK and Complied has positive coefficient and statically significant at 5% level. IOWN and BDS are also statistically highly significant with negative coefficient

The regression model between ROE and independent variables is statistically significant with p value .000. The variables FD and BUSRISK are statistically significant with 5% level and their coefficients are also positive, while IOWN and BDS are also statically highly significant with negative coefficient values.

Discussion

The current study explored the effect of efficient corporate governance on financial performance of top twenty companies of Karachi stock exchange. The results explored that hypothesis one is failed to reject, that inside ownership has significant relation with firms financial performance is accepted. The results are contrasting with the results of Krishna Reddy (2010) that in New Zeeland there was no effect of inside ownership on firm's financial performance in New Zealand.

Hypothesis 2 is failed to reject that firm's financial performance and presence of audit committee has significant relationship. As all the 20 companies have functional audit committees as it is mandatory by SECP code of corporate governance 2002. This is also contradictory to New Zealand small cap companies which indicated the negative relation with board committees because the presence of board committees incurred cost and decreases the firm's financial performance

The hypothesis five is failed to accept in the current study that there is significant relation between remuneration committee and firms performance.

The hypothesis three is also failed to reject as it was stated that there is a significant relationship among presence of Independent/Nonexecutive directors and firms financial performance.it is observed that the monitoring of firms financial activities is effectively done by independent directors as compare to executive directors. This is similar as study of Krishna Reddy (2010) who also showed the significant positive result between two variables.

The hypothesis four is failed to reject, according to hypothesis there is significant relation between dividend payout ratio and firm's financial performance. This is also similar with scenario of New Zealand which showed the same relationship (Reddy, 2010)

Hypothesis six is failed to accept, Hypothesis stated that firm`s financial performance has a Significant relationship with board diversity. But the data analysis revealed that there is no significant impact of female director on firm's financial performance. This is similar as New Zealand where result shows that presence of female director does not contribute in firm's financial values (Reddy, 2010). It might be because of very limited representation of female directors are seen in New Zealand, Pakistan and even in USA (Carter et al., 2003).

Conclusion

Principle based corporate governance is mandatory for protection of shareholders rights, for safety of valuable assets and eventually for the success and growth of business institutions. In Pakistan, SECP is continuously enforcing valuable guidelines to improve the corporate governance practices and it is reflecting in

financial performance of the organizations, which are complying with SECP guidelines. But still there is room for improvement, specially need to incorporate international best practices to improve the financial performance of corporations and to transform Pakistan in a developed country.

References

Adenikinju O, Ayorinde F (2001). "Ownership structure, corporate governance and corporate performance: The case of Nigerian quoted companies". Paper presented at the AERC biannual research workshop, Nairobi. Kenya.

Aggarwal R, Isil E, Rene S, Rohan W (2007). "Do U.S. Firms Have the Best Corporate Governance? A Cross-Country Examination of the Relation between Corporate Governance and Shareholder Wealth", NBER Working Paper 12819.

Ali Adnan Ibrahim, Corporate Governance in Pakistan: Analysis of Current Challenges and Recommendations for Future Reforms, 5 Wash. U. Global Stud. L. Rev. 323 (2006)

Anderson R, Mansi S, Reeb D (2004). Board characteristics, accounting report integrity and the cost of debt, J. Account. Econ., 37: 315-342.

Baysinger B, Butler H (1985). Corporate governance and the board of directors: performance effects of changes in board composition, J. Law Econ.Org., 1:101-124.

Baysinger B, Hoskisson RE (1990). "The Composition of Board of Directors and Strategic Control: Effects on Corporate Strategy." Acad. Manage. Rev., 15: 72-87.

Bhagat S, Black B (2002). The non-correlation between board independence and long- term firm performance, J. Corp. Law. 27: 231-274.

Black BS, Tang H, Kim W (2003). Does corporate governance affect firm value? Evidence from Korea. Working Paper No. 237, Stanford Law School.

Bokpin GA, Kyereboah CA, Aboagye AQQ (2006). "Corporate governance and shareholder wealth maximization: Evidence from listed companies in Ghana", paper presented at the 3rd Afr. Fin. J. Conf. Ghana, 12th – 13th July 2009.

Brown LD, Robinson JM, Caylor MC (2004). Corporate governance and firm performance. http://www.issproxy.com/pdf/corporate governance. Carline NF, Linn SC, Yadav V (2002). "The Influence of Managerial Ownership on the Real Gains in Corporate Mergers and Market Revaluation of Merger Partners: Empirical Evidence." Working Paper. Cho M (1998). Ownership structure, investment and the corporate value: an empirical analysis, J. Finan. Econ., 47: 103-121.

Coles J, Daniel N, Naveen L (2008). Boards: does one size fit all? J. Finan. Econ., 79: 431- 468.

Demsetz H, Villalonga B (2001). Ownership structure and corporate performance, J. Corporate Finan., 7: 209-233.

Eisenberg T, Sundgren S, Wells M (1998). Larger board size and decreasing firm value in small firms, J. Finan. Econ., 48: 35-54.

Forsberg R (1989). Outside directors and managerial monitoring, Akron Business and Economic Review. 20: 24- 32.

Friend I, Lang I (1988). "An Empirical Test of the Impact of Managerial Self-Interest on Corporate Capital Structure". J. Fin., 43: 271-281.

Gompers PA, Ishii J, Metrick A (2003). "Corporate Governance and Equity Prices." Quarterly J. Econ., 118(1): 107-155.

Goswami O (2002). "Corporate Governance in India," Taking Action against Corruption in Asia and the Pacific (Manila: Asian Development Bank), 85-106.

Hermalin BE, Weisbach MS (1991). The effects of board composition and direct incentives on firm performance, Finan. Manag.. 20: 101- 112.

Himmelberg C, Hubbard G, Palia D (1999). Understanding the determinants of managerial ownership and the link between ownership and performance, J. Finan. Econ., 53: 353-384.

Javid. Y A, Iqbal. R (2010). Corporate Governance in Pakistan: Corporate Valuation, Ownership and Financing: PIDE working paper 2010:57

Jensen MC (1986). "Agency costs of free cash flow, corporate finance, and takeovers." Am. Econ. Rev., 76: 323-329

Jensen MC (1993). "The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems." J. Fin., 48: 831-880

Jensen MC, WH Meckling (1976). Theory of the firm: managerial behaviour, agency costs and ownership structure, J. Finan. Econ., 2:305-360.

Khalil Ahmed, Shortcomings in Corporate Governance Code—II, THE BUSINESS RECORDER, Sept. 8, 2004, at 19.

Khanna M, Lisa D (1999). "EPA's Voluntary 33/50 Program: Impact on Toxic Releases and Economic Performance of Firms," J. Environ. Econ. Manage., 37(1): 1-25.

Khanna M, Wilma RQ, Dora B (1998). "Toxics Release Information: A Policy Tool for Environmental Protection," J. Environ. Econ. Mgt., 36: 243-266.

Kim D, Hubbard G, Palia D (2004). The endogenous impact of leverage on firm value, working paper, Rutgers University and Columbia University.

Klapper LF, Inessa L (2002). "Corporate Governance, Investor Protection and Performance in Emerging Markets." Social Science Research Network Working Paper No. 303979.

Klein A (1998). Firm performance and board committee structure, J. Law Econ., 41: 275-303.

Klein A (2002). Audit committee, board of director characteristics and earnings management, J. Account. Econ., 33: 375- 400.

La Porta, R., F. Lopez-de-Silanes, A. Shleifer, and R. Vishny (2000) Investor Protection and Corporate Governance. *Journal of Financial Economics* 58, 3–27.

Liang N, Joanne L (1999). "Board Structure and Firm Performance: New Evidence from China's Private Firms", Paper presented at the Academy of Management Annual Conference, Chicago, USA, August 7-10.

Mak Y, Kusnadi Y (2005). Size really matters: further evidence on the negative relationship between board size and firm value, Pacific-Basin Finan. J., 13: 301-318.

Mallette P, Fowler KL (1992). "Effects of board composition and stock ownership on the adoption of "poison pills." Academy Manage. J., 35: 1010-1035.

Miyajima H, Omi Y, Saito N (2003). Corporate governance and firm performance in twentieth century Japan, Business and Economic History. 1: 1-36.

Morck R, Shleifer A, Vishny RW (1988). "Management ownership and market valuation: An empirical analysis." J. Fin. Econ., 20: 293-315.

Palia D (2001). The endogeniety of managerial compensation in firm value: a solution, Rev. Finan. Stud., 14: 735-764.

Pankaj J (1996). "Managing credit for the rural poor: Lessons from the grameen bank." World Development, 24(1): pp 79-89.

Roe M (2002). "Some Differences in Company Structure in Germany, Japan and the United States". Yale Law J., 102(7): 1927-2003.

Sanda AU, Mikailu AS, Garba T (2005). "Corporate governance mechanisms and firm financial performance in Nigeria", AERC Research Paper 149.

Shleifer A, Vishny RW (1997). A survey of corporate governance, J. Finan. Econ., 52(2): 737-783.

Singh A, Singh A, Weisse B (2002). "Corporate Governance, Competition, the New International Financial Architecture and Larger Corporations in Emerging Markets." Working Paper No. 250, ESRC Centre for Business Research, University of Cambridge, UK.

Weir C, Laing D (1999). "The Governance- Performance Relationship: The Effects of Cadbury Compliance on UK Quoted Companies." European Accounting Association Conference, Bordeaux.

Weisbach M (1988). Outside directors and CEO turnover, J. Finan. Econ., 20: 431- 460.

Williamson OE (1988) "Corporate Finance and Corporate Governance", J. Finan., 43: 567-591.

Yermack D (1996). Higher market valuation of companies with a small board of directors, J. Finan. Econ., 40: pp 185-211.

Yuanto K (2003). "Board Size Really Matters: Further Evidence on the Negative Relationship between Board Size and Firm Value", Pulses by Singapore Stock Exchange.

Zingales L (1998). "Corporate Governance." The New Palgrave Dictionary of Economics and the Law. London: Macmillan.