Role of Corporate Governance in Shareholders Value Creation

Muhammad Atif Khan, Department of Commerce, University of Kotli, Azad Jammu and Kashmir, Kotli, Pakistan
Muhammad Asif Khan, School of Economics, Huazhong University of Science and Technology (HUST), Wuhan, China & Department of Commerce, University of Kotli, Azad Jammu and Kashmir, Kotli, Pakistan
Idrees Liaqat, Riphah International University, Rawalpindi, Pakistan

ABSTRACT

The mechanism of governing corporate affairs in line with strategic goal of shareholders’ value creation (SVC) has been pivotal debate among academic and institutional scholars over last few decades. Most of the studies in developing countries including Pakistan, have considered more conventional measures, like firm financial performance to examine the impact of corporate governance (CG). Theoretically, firm financial performance optimization has little role in maximizing SVC, that rarely streams to shareholders’ exchequer. Therefore, the study is unique in its nature that identifies market capitalization, the most appropriate measure of value creation for shareholders over long run. The authors gathered panel and longitudinal data pertaining to PSX-100 listed firm over the period of 10 years ranging from 2006-15, which is analyzed using multivariate regression. Hausman and Likelihood tests guide the process of appropriate econometrics model selection. Empirical findings reveal that CG dimensions such as audit committee independence (ACI), managerial ownership (MO) and ownership concentration (OC) have positive impact on SVC, except board size (BS) and board independence (BI). The study offers valuable policy recommendations to make CG practices more effective, however, application of the model proposition at macro and micro level can be a substantial extension to literature incorporating some controlling dimensions.

KEYWORDS
Audit Committee Independence, Board Independence, Board Size, Corporate Governance, Managerial Ownership, Shareholders Value Creation

INTRODUCTION

Corporate governance (CG) indicates the ways and methods used by firms to attain their desired objectives, missions and visions with regard to all the stakeholders both internal and external, whereas, shareholders’ wealth maximization is considered as the prime objective of governance. In corporate finance literature, the area of CG has been focused since long time and wide range of studies are undertaken in developed countries. The discussion started in early 1930s since the separation of ownership and control theory was postulated (Berle and Means, 1932). Moreover, the collapses of

DOI: 10.4018/IJSDS.2017040105
some big corporations like Enron followed by massive regulations made it a very popular debate for empirical research in both developed and developing countries. The Securities and exchange Commission of Pakistan (SECP) has issued “Code of CG” in 2002. The promulgation of the code of CG has made it very popular area for empirical research in Pakistan.

However, mainly the research in CG in context of Pakistan aimed at studying the relationship between different variables representing CG and various conventional measures of financial performance i.e. return on assets (ROA), return on equity (ROE), profit margin (PM) and earning per share (EPS). Yasser, Entebang and Mansor (2015) argue that BS, BI and ACI significantly and positively influence the ROE and PM of 30 listed firms with PSX, although this is relatively recent study on CG and firm performance in context of Pakistan, but data used for analysis is pertaining to subprime crises of 2008. Theoretically, firm financial performance optimization has little role in maximizing SVC, that rarely streams to shareholders’ exchequer, therefore, the study is unique in its nature that identifies market capitalization, the most appropriate measure of value creation for shareholders over long run. As this area is unnoticed so far, thus current study is a valuable contribution in corporate finance literature.

The aim of this study is to test empirically and provide fresh evidence regarding the impact of CG; board size (BS), board independence (BI), audit committee independence (ACI), managerial ownership (MO) and ownership concentration (OC) on SVC from non-financial sector of Pakistan. Moreover, the study is intended to suggest best CG practices to the stakeholders those would enhance the SVC and to enrich the literature with comprehensive findings of the study.

To translate stated objective, data for CG and SHV proxies is sourced from secondary sources such as audited annual reports of respective firms and statistical division of State Bank of Pakistan. Hausman test suggests that fixed effect econometric model is the appropriate choice according to data properties, which are further tested for stationarity and multicollinearity. We find the series stationery at level, using Levin, IM-Pesaran and ADF-Fisher panel unit root; however, correlation matrix and VIF propose that multicollinearity is at tolerance level. Our empirical findings reveal that CG dimensions such as ACI, MO and OC have positive impact on SVC, except BS and BI that are negatively associated.

Rest of the sections of study consists of relevant literature review, research methodology, discussion of results, conclusion and policy recommendations respectively.

LITERATURE REVIEW

This section of the study contains, comprehensive review of literature regarding importance of corporate governance, CG measurement, measurement of financial performance, and various elements of CG (BS, BI, ACI, MO and OC) that provides theoretical basis to this study.

CG AND FIRMS FINANCIAL PERFORMANCE

Number of researchers have attempted to explore the relationship between quality of CG and financial performance of firms and evidenced inconclusive results e.g. (Ntim, Lindop and Thomas, 2013; Bhagat et al., 2000). Wire (1999) evidenced some positive nexuses between CG practices and firms’ financial performance. Black, Kim, Jang and Park (2015) claim that better governance practices moderate the adverse effect on firm value and increase the firm profitability. While, Zanglein (1998) viewed a negative association between CG and corporate performance. Al-Najjar (2014) explains
Mining in Music Databases
*Processing and Managing Complex Data for Decision Support* (pp. 340-374).
www.igi-global.com/chapter/mining-music-databases/28157?camid=4v1a

Application of Spatial and Temporal Predictive Analysis for Energy Network Optimization
www.igi-global.com/chapter/application-of-spatial-and-temporal-predictive-analysis-for-energy-network-optimization/107900?camid=4v1a