

Corporate Governance Factors Drive Firms' Earning Per Share: Evidence from Pakistan Stock Exchange Listed Companies

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Abstract

The aim of this study is to examine the corporate governance factors that drive the firms' earning per share (EPS) sample of firms listed on Pakistan Stock Exchange (PSX) over the period of 2011 to 2016. This paper analyzed the impact and relationship of dependent variable (Earning per Share) and independent variables (Board Independence, Ownership concentration, CEO duality and Board diversity). The panel data collected from the sample of top 20 companies (market capitalizations) listed in Pakistan stock exchange. To investigate the relationship between variables the Pearson correlation and regression applied and to identify the impact of independent variables (board independence, ownership concentration, CEO duality and Board diversity) on dependent variable (earning per share) used regression tool. The study result of correlations and regression result revealed that board independence, ownership concentration and Board diversity have significant impact on performance while CEO Duality has negative impact on Firm financial performance.

Key words: *Earning per share, Board Independence, CEO Duality, Market capitalizations and Firm Performance.*

1. Introduction

To revitalization the shareholder confidence in firm's operation, firm should declare the require amount of dividend that shareholders expected because shareholder invest their money in stocks in return of dividend and capital gain. These two outputs are stimulates the investors and some common factors that drive the dividend and capital

gain. Hence, the corporate governance factors are considered the most prominent factors that drive the firm earning per share (Marxi Oli & Selvam, 2013). Since 1970's the great depression the corporate governance became a terrific subject of economist, researchers, investors and academician. Such crisis drifts the well-known corporations like Enron, Parmalat and Coloroll. Most of researchers and analyst argue that the main reason of failure of these firms was lack of good corporate governance. Thus, from last decade most of the scholars are trying to investigate the relationship of corporate governance with different firm performance measures. Corporate governance describes set of rules that erect the relationship between principle/s (Shareholder and other stakeholders) and agents (Chairman, Board director and other management). Board Independence, Ownership Concentration, CEO Duality and Audit fee are the corporate governance factors that analyzed in this study. Previous studies show a significant relationship of these factors with firm earning per share and other performance measurement (Marxi Oli & Selvam, 2013) (Najjar, 2012). The independent board has significant positive effect on firm earning per share. It means in board composition when non-executives directors that have no relation with firm and do not own share in corporation, included the firm earning per share travel positively (Meyer & Wet, 2013). They also explained that ownership concentration has significant negative correlation with firm earning per share. The study shows that in firm ownership when directors hold large number of stock in their ownership it has negative correlation and effect on earning per share.

In addition to the discussion another study explore by Georgiana on the relationship of CEO duality with firm performance. CEO duality refers the one individual who holds CEO and board chair also. The study suggests that CEO duality has positive and also negative relationship with firm performance (Georgiana, 2013). Another corporate governance factor that has a significant effect on firm earning per share is known as audit fee. The study reveals that audit fee has negative correlated with earning per share (Marxi Oli & Selvam, 2013).

1.1 Significance of Study

The study of corporate governance factors has great importance in regard of shareholder, stakeholder and investor community. To analyze the relationship and effect of CG factors with firm earning per share the investor can secure their investment. The earning per share is leading indicator of firm performance, therefore high earning per share indicate well perform business that also a positive indication for good economy.

1.2 Objectives of the Study

Usually most of the investor believes that the only prominent factor that effects the earning per share is the investor behavior rather than the other internal factors that are playing a major role in earning per share while there are more internal organizational factor as well exist that mold the earning per share and attract these investor investing behavior so the aim of the study is to investigate the internal organizational factors that affect earnings per share and to find out the relationship of these variables with EPS. The main objectives of the study are:

- i. To ascertain the effect of corporate governance factors on Earning per Share (EPS) firms listed on Pakistan Stock Exchange (PSX).

- ii. To ascertain the relationship between CG factors and firm Earning per Share (EPS) listed on Pakistan Stock Exchange.

2. Literature Review

Numbers of studies described and investigate the importance and relationship between corporate governance and firm performance measures. Every researcher tried to demonstrate the different characteristic of corporate governance in different scenario. Corporate governance is set of rules that ensure to provide the fair position of the firm to interested parties about their investment. Actually it states a system that highly influence on managerial decisions in respect of shareholder investment and firm performance (Roy, 2016). Due to scandals of Enron, Tyco, WorldCom and Parmalat the experts induce to provide the secure way to protect the corporations from such bad situation. Thus, in United Kingdom the Cadbury report (1992), Sarbanes-Oxley Act (2002) in America and Code of Corporate Governance (2002) in Pakistan came into existence. All these reforms basically aim to resolve the agency problem (Meyer & Wet, 2013).

The corporate governance mechanism tries to ensure a good relationship between shareholders and their agents known management. Hence most of studies show the effect of corporate governance factors on firm's performance measures. Brown and Caylor (2004) and Gompers, Ishii and Metrick (2003) studied and investigate that a good and active system of corporate governance increase the profitability and produce higher return for shareholders. The relationship between independence board and firm performance has become divisive. Some studies suggest that these variables have positive relationship while some studies show negative or no relationship. Hence, the study of (Iwu-Egwuonwu, 2010) revealed that the impact of independent directors/board on firm performance is not only mixed phenomena, it also a culture-bound. He explained that in US, there is no relationship found between independence board and firm performance while those structured and conducted studies shows positive relationship.

The study of (Baghat & Black, 2000) on "The Non-Correlation between Board Independence and Long Term firm performance" showed that the degree of board independence is correlated with performance measures but there is no evidence that the large number of independent directors increase the firm's profitability, in contrast they found the undesirable effect of independent directors on firm's profitability. While the study of (O. S, Olusola, & Abiodun, 2013) explores that board independence has significant relationship with organizational measures. They examine the relationship of three corporate governance factors (BI, BS and CEO duality) with organization measures (EPS). Their results revealed that board size and executive duality have negative relationship and board independence has positive significant relationship with organization measures. Another study of (Gull, Akram, Bilal, & Muzaffar, 2013) supports that board independence positive effect on performance measures (return on equity and earning per share). They investigate the impact of board independence on banking performance in context of Pakistan. The study results show that board independence has a positive significant impact on banking performances and also suggests that banks having independent board will perform better than having dependent board.

2.1 Board Independence

Most of previous studies argue significant relationship between concentration ownership and firm performance. Jensen Mackling (1976) stated to reduce the agency cost by managerial ownership that lead to better firm performance. Similarly, (Shleifer & Vishny, 1986) suggested that the agency problem can be manage and improve the firm performance by concentration ownership. They mentions the concentrations ownership as decree for governing the firms. The study of (Hill & Snell, 1988) argued that concentration ownership encourage innovation strategy that increase the value of firm and also mention a positive relationship between ownership structure and organization performance. The study of (Omran, 2009) on the role of private ownership concentration reported that ownership concentration and firm performance is directly correlated. The ownership structure has statistically significant impact on performance measures specially earning per share (Mousa & Desoky, 2012). Sheikh & Karim (2015) studied “effects of internal governance indicators on performance of commercial banks in Pakistan” and argued that there is negative relationship between ownership concentration and earning per share.

2.2 Ownership concentration

In organization there are two key positions (Chief Executive Officer and Board Chairman) that are considers the responsible body of the organizations management and operations. Chief Executive Officer (CEO) is the governing body of firms that manage, supervise and conduct the resources in such way to achieve the organization common goals. While Chairman of board is another key body that responsible for the strategy and policy making for the organization (Miller, 2005). Hence, person who holds the both position at a time is known as CEO duality. Previous literatures examine the relationship between CEO duality and performance measure. Jensen, (1993) explained that CEO duality and two other characteristics of board affect the corporate board monitoring potentials. According to (Yermack, 1996) CEO duality has no effect on firm performance. Recent study supports these results. They did not find evidence that CEO duality has significant effect on discretionary accruals (Kamran & Shah, 2014). O. S, Olusola, & Abiodun (2013), found a significant negative relationship between CEO duality and organizational performance. They also suggest that these two position should be occupied by different personnel. Alike (Ong, Heng, Ahmad, & Muhammad, 2015) studied relationship of CG attributes and performance and revealed that CEO duality significantly inverse relationship to firm performance. Modum, Ugwoke, & Onyeonu, (2013) also argued that duality has statistically significant effect on firm performance of qouted companies in nigeria. They recommend that these two positions should not be unified. While the study of (Joshua, 2007) and some other researchers found a significant and positive relationship between CEO duality and firm performance (Bhagat & Black, 2002).

2.3 CEO Duality

Various studies identify the relationship and effect of auditor’s committee and company performance. The study of (Ashbaugh, LaFond, & Mayhew, 2003) revealed that firm financial leverage and consulting committee of independent auditor are correlated. According to (Moutinho, Cerqueira, & Brandao, 2012). Significantly to firm performance

increases (decreases). Sayyar, Basiruddin, Abdur Rasid, & Elhabib, investigated the impact of audit quality on firm performance. They argued that audit committee (proxy as audit quality) has insignificantly related to return on asset while significantly and positively relationship with Tobin's Q. According to (Behbid & Madrakian, 2014) earning management and audit committee have no relationship. They investigated the relationship between audit committee and earning management and revealed that there is no significant relationship between audit committee and earning management.

2.4 Board Diversity

Board diversity or board composition tell us and reflect that how a board reflect its society in term of genders, ethnicity and professionalism. Milliken & Martins (1996) argued that board must be having members, who composed of both male and female. The same kind of study conducted by Biggins (1999) and found that diversity in board is very essential. Thompson & Wright (1997) carried out research and found that shareholders should maintain a diverse type of board structure. It is also worthwhile as Burton (1991) found and argued that diversity does not mean that the society should have same equal representation but it must be on the principles of merit. Robinson and Dechant (1997) argued that board diversity is helpful in maintaining good relationship with the outer world, it can improve the problem solving in the organization, bring creativity and help in decision making and better decisions.

Board diversity signify the jumble of male and female component in board of director of a company but board diversity analyze the impact of female member in board and her existence on board efficiency. Basically the sated analyses are ambiguous and not clear so far. According to Smith (2006) the female directors have effects on firm performance slightly having dependency on her education, subject of study and qualification. Some researchers are very much in favor of Gender diversity and its importance. According to Agency theory all the struggle and work should result maximizing profit for owner. While in practice it is noted that as and when managers who act as director of the boards doing their own domain and gain for themselves. To avoid agency problems there should be balance between inside and outside manager and the power much vested with a balance way in board to the directors. Mostly organizations are controlled by the persons who govern the board so they are making majority decisions for their own interest and benefits. According to Hampel (1998) as diversity of board is concern there should be a balance between directors so the board will be independent and in this way no one can dominate the board decision.

Keasey (1997) argues that diverse boards are better being the presentation by the all the stakeholders in developing decisions of the firm. The resource dependence theory state that the board is basically firm's internal resource, and the firm's external resources are environment. For survival and better performance these resources play a vital role such resources are to be provided by the board members also it give a connection in firm and in firms environment. Many researchers have same opinion that board diversity has positive and significant effect on firm's performance. While some have adverse opinion like inverse relationship between women directors and performance of the firm. Rose (2000) analyzes Denmark firms in which he found that there is an insignificant and negative relationship in between. Enobakhara (2010) explain the Board diversity as the

combination of men and women, diverse age groups, different and ethnic surroundings. According to Anastasopoulos et al (2002) corporate Governance board diversity stress on, gender diversity that the insertion of women on firm boards of directors, measured as a device to perk up board assortment. The theme put more accentuation on the firm board size and the board containing the women in it in a stipulated time period.

The board diversity has a positive effect directly as well as indirectly on corporate governance of a firm. While Goodstein viewed the board diversity as a constraint, even so the diverse perspectives are essential for effectiveness of board (Ogbechie & Koufopoulos, 2009). Dutta and Bose (2007) indicated that there is restricted existence of women inboards of directors, still mostly study show that the existence is slow but steady rise of the women existence on corporate boards all over the world. The relationship in gender diversity and firm financial performance are contrasting , taking into consideration the United states, Zahra and Stanton (1988) argues that there is no significant correlation in-between gender diversity and firm financial performance.

2.5 Hypotheses

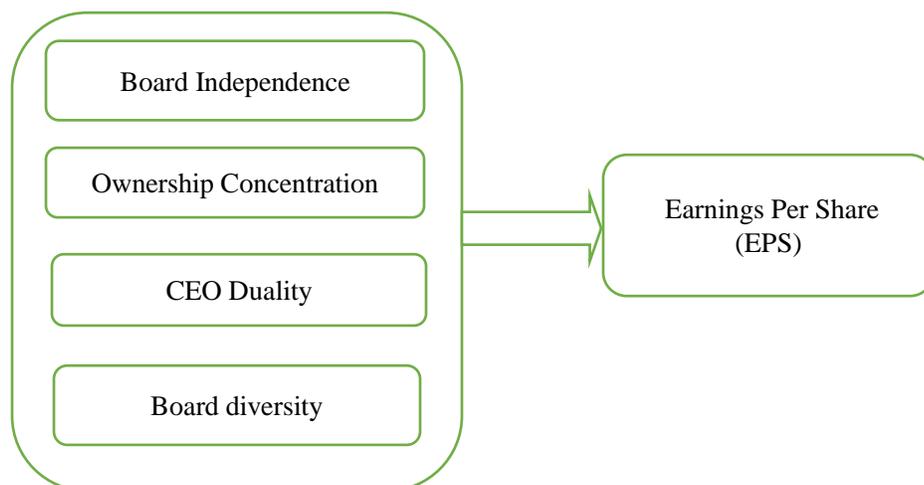
To achieve the above objectives of the study the following hypotheses has been applied.

- H1: There is significant relationship between Corporate Governance and firm Earning per Share.
- H1a: Board independence has significant positive impact on firm financial performance lead to earnings per share.
- H1b: Ownership concentration has strong favorable effect on earnings per share.
- H1c: CEO duality has negative effect on firm performance caused earnings per share.
- H1d: Board Diversity also caused significant positive trend in firm financial performance that effect earnings per share.

2.6: Theoretical Framework

Corporate Governance Factors

Earning per Share



3. Methodology of the Research

This research is an empirical study to determine the relationship between Corporate Governance factors and firm performance. The data was collected from firms listed on Karachi stock exchange. For this purpose the require data collected for the period of 2010 to 2015 from listed companies annual reports. The listed companies of Pakistan stock exchange are the population while top ten companies of Pakistan stock exchange has been selected as sample of the study.

Manufacture sector companies listed in Pakistan stock exchange

Annoor Textile Mills Ltd.
 Ansari Sugar Mills Lintied.
 Apex Fabrics Ltd.
 Apollo Textile Mills Ltd.
 Arif Habib Investment Limited
 Arif Habib Limited
 Arif Habib Sec Ltd
 Arpak International Investment Ltd.
 Artistic Denim Mills Limited
 Aruj Garment Accessories Limited
 Asfhaq Textile Mills Limited.
 Asia Insurance Co. Ltd.
 Asian Stock Fund Company Ltd.
 Asim Textile Mills Limited

3.1 Statistical Tools

The following statistical tools have been used for the purpose of analysis and conclusions will be drawn on the empirical results.

- Correlation Analysis
- Regression Analysis

4. Data Analysis

4.1 Pearson Correlation

In order to find out the relationship and strength of association between Earning Per Share and Firm Performance.

Table 4.1: Correlation Analysis

| | EPS | Board Independence | Ownership Concentration | CEO Duality | Board Diversity |
|-------------------------|--------|--------------------|-------------------------|-------------|-----------------|
| EPS | 1.000 | | | | |
| Board Independence | 0.6920 | 1.000 | | | |
| Ownership Concentration | 0.390 | 0.337 | 1.000 | | |
| CEO Duality | -0.245 | -0.282 | 0.251 | 1.000 | |
| Board Diversity | 0.226 | 0.311 | 0.215 | 0.211 | 1.000 |

The above results of correlation shows that both Earning per share is positively significantly correlated with Board Independence having values 0.6920, similarly ownership concentration has also positive significant impact on earnings per share as result shows positive value of 0.390. CEO Duality are negatively correlated to Earning Per Share but the impact is significant. Board diversity has positively significantly correlated to Earning Per Share.

Table 4.2: Regression

| | Co efficient | Standard Error | T. Value | P. Value |
|-------------------------|--------------|----------------|----------|----------|
| Board Independence | 0.300212 | 0.1334 | 2.25 | 0.0421 |
| Ownership Concentration | 0.362001 | 0.1265 | 2.86 | 0.0201 |
| CEO | -0.28672 | 0.1592 | -1.83 | 0.0705 |
| Board diversity | 0.4213 | 0.2600 | 1.62 | 0.0676 |

F=5.65, R-Square: 0.275

The above table 2 shows the results of regression effect. The R-square shows the changes in dependent variable firm performance caused by the independent variables. The F value shows the overall significance of the model. The F-value calculated =5.65 suggest that the overall model is significant, as it is above the critical value F=4. The results shows that Board independence has positive significant impact on EPS as its t=2.25 is above its tabulated value, i.e t=2. Ownership Concentration and Board diversity both shows significant Positive impact on the firm performance. As its T values are positive significant.

5. Conclusion

This empirical study revealed very strong significant relationship between Board Independence, Board diversity, Ownership Concentration and Firm Performance. It was observed that those companies whose boards are independent and have concentration of owners in business affairs, they perform better than those that have not any system of these areas. It was observed that almost all firms have proper mechanism of these Corporate Governance factors.

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