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   INTRODUCTION

   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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- Bowersox, Donald J., Closs, David J., (1996), "Logistical Management." Tata McGraw, Hill, New Delhi.
- Hunker, H.L. and A.J. Wright (1963), "Factors of Industrial Location in Ohio" Ohio State University, Nigeria.

CONTRIBUTIONS TO BOOKS

- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

JOURNAL AND OTHER ARTICLES

- Schemenner, R.W., Huber, J.C. and Cook, R.L. (1987), "Geographic Differences and the Location of New Manufacturing Facilities," Journal of Urban Economics, Vol. 21, No. 1, pp. 83-104.

CONFERENCE PAPERS

- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

UNPUBLISHED DISSERTATIONS AND THESES

- Kumar S. (2011): "Customer Value: A Comparative Study of Rural and Urban Customers," Thesis, Kurukshetra University, Kurukshetra.

ONLINE RESOURCES

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WEBSITES

- Garg, Bhavet (2011): Towards a New Natural Gas Policy, Political Weekly, Viewed on January 01, 2012 http://epw.in/user/viewabstract.jsp

RELATING CORPORATE GOVERNANCE WITH MARKET VALUATION AND ORGANIZATIONAL PERFORMANCE: AN EMPIRICAL STUDY ON KSE PAKISTAN

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ABSTRACT

The idea of this paper is to empirically test the impact of corporate governance measures on organizational performance of listed companies at 100-index of Karachi stock exchange (KSE). Like many other developing countries, ownership concentration and weak investor protection, especially protection of minority share holders, are the main characteristics of Pakistani market, which affect firm's performance. So the examination and exploration of link between corporate governance and organizational performance is the main area of this research. The research methodology used is ordinary least square regression analysis. Statistical significance is checked by using accounting measures of financial performance i.e. Return on equity, Return on assets, earning per share, net profit, sales growth and Herfindahl-Hirschman Index (HHI) for ownership structure. Company valuation is measured through Tobin's Q ratio. Based on a sample of KSE-100 index, the result reveals that there is a positive and significant relationship between organizational performance and corporate governance practices and there is positive and very significant relationship between company Valuation and corporate governance. Our results are consistent with organizational theory and Agency theory of corporate Governance. This is the first study of its own type that measures the relationship between organizational performance, company valuation and corporate governance practices of KSE-100 index companies in Pakistan by using cross-sectional data.

KEYWORDS
Company valuation; Ownership concentration; ownership structure; Return on equity; Role Duality.

INTRODUCTION

Like most of the developing countries, ownership concentration and weak investor protection especially of minority share holders, are the main characteristics of Pakistani market. So the determination of relationship between ownership concentration and organizational performance is the main area of this research. Corporate Governance has been defined in various ways by different authors depending on one's view of the world. Shleifer and Vishny (1997) defined corporate governance as assurance for investors on their investment. While, Gillan and Starks (1998) identified the laws, rules and the controlling factors of the company's operations as corporate governance. However La Porta *et al.* (2000) defines it as the means of the protection of the outside investors' interest. The Securities and Exchange Commission of Pakistan defined corporate governance as;

"Corporate governance lead to the basic idea, which refers to the system by which companies are directed and controlled, focusing on the responsibilities of directors and managers for setting strategic aims, establishing financial and other policies and overseeing their implementation, and accounting to shareholders for the performance and activities of the company with the objective of enhancing its business performance and conformance with the laws, rules and practices of corporate governance."

Moreover, authors added that corporate governance is a way to resolve the agency problem and it can be achieved by the "independent monitoring of management, transparency as to corporate performance, ownership and control Manual of corporate governance by SECP (2003).

According to manual of corporate governance by SECP poor governance hinders economic development and investment. Organizational performance consists upon actual results of an organization measured against its intended output. According to Richard *et al*. (2009) organizational performance encompasses three specific areas of firm outcomes as (a) financial performance consists of (profits, return on assets, return on investment, etc), (b) Product market performance i.e. (sales, market share, etc) and (c) Shareholder return i.e. (total shareholder return, economic value added, etc). Recently, balance score card methodology is used to measure the performance of organization where performance is measured in multiple dimensions like financial performance, customer services, social responsibility etc.

The rest of the paper is organized as section 2 is based on literature review. Section 3 presents the hypothesis. Data and methodology is presented in section 4 and the last section discusses the analysis results and includes concluding remarks.

LITERATURE REVIEW

Corporate Governance has received the attention of investors, practitioners and regulators after the wave of corporate scandals such as financial scams of Enron, WorldCom and Marconi. These incidences emphasized the need of improved Corporate Governance and led the way towards Sarbanes-Oxley Act (2002) and more stringent conditions from corporate regulatory authorities and stock exchanges around the globe. Such moves has been started properly in Pakistan from 2002 by the incorporation of the first Code of Corporate Governance in March 2002 and after establishment of institute for corporate governance in 2004 by Security and Exchange Commission of Pakistan (SECP). Corporate Governance has been recognized as a mechanism for aligning the interest of principal and agent after keeping outsiders influence on decision makers through improving the quality of financial information and taking care of the interest of all stakeholders. In the developed markets, a lot of empirical research has been done to find the relationship between organizational performance and corporate governance like studies of Anderson and Reeb (2004); Black *et al.*(2003); Bradley (2004); Bahjat and Black (1999, 2001); Drobetz *et al.* (2004); Roe *et al.* (1996); Gompers *et al.* (2003) etc. From these studies it is evident that good corporate governance on one hand results in increase in sales, productivity and profitability and on other hand decrease in systematic risk of failure. Some other researches like Klapper and Love (2003); Mir and Nishat (2004), Javid and Iqbal (2006) identified that corporate governance is also becoming an important area of research in emerging markets like Pakistan. Mir and Nishat (2004) examined the relationship between corporate governance and firm performance and found a positive link between measures of organizational performance and corporate governance structure.

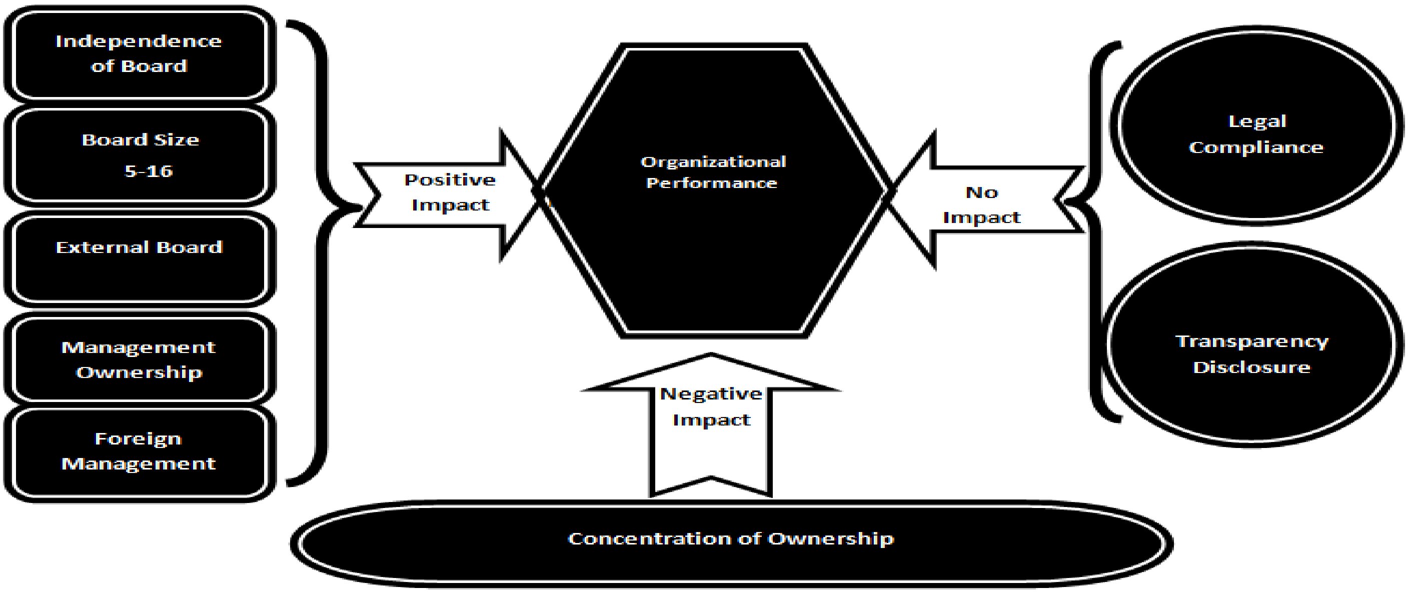
As most of the current literature on corporate governance comes from USA, UK and continental Europe and suggests that relationship exists between board structure, board composition, ownership structure and corporate performance. The firm performance is usually measured by two market level measure;: Tobin Q and dividend payout ratio and two accounting measures: return on assets (ROA) and return on equity (ROE) (Shaheen and Nishat, 2005). As rich data is available for developed economies which are characterized by tight corporate control and low ownership concentration so exploration of the relationship between corporate governance and firms' performance is not as much difficult as in the developing economies (Bohren and Odegaard, 2001). The issue of corporate governance is important for developing countries because it is central to financial and economic development of a country (Javid and Iqbal, 2010). Through theoretical and empirical researches on corporate governance and organizational performance in Pakistan, it has been found that the relationship between corporate governance variables and performance measures is although positive, negative or none.

According to Mir and Nishat (2004), corporate governance structure variables have positive impact over firm's performance. As previous researches show relationship between corporate governance and corporate performance that has been widely studied by researchers but reached no consensus. There is widely held view that good corporate governance practices are associated with better firm's performance. Prior research has linked corporate governance to firm valuation. There are also some studies in which corporate governance indices and financial performance have been correlated. Shaheen and Nishat (2005) explore relationship between corporate governance and firm's performance. They have however found association between corporate governance and firm's performance but not causality.

Javid and Iqbal (2006)**,** while analyzing the effect of corporate governance on firm's performance in Pakistan conclude that not every element of corporate governance enhances firm's performance. They further added that good corporate governance measures uncover low production and bad management practices through transparent disclosure and transparency standards. Javid and Iqbal (2008**)** concluded that ownership concentration is sign of poor corporate governance. Corporate Governance reforms started with the introduction of Corporate Governance Ordinance in 2002 in Pakistan. Small board size has positive link with performance. Company's performance is better if Size of board of directors is at least six but not more than 15 members (Shaheen and Nishat, 2004)

Little work is done to study the connection between corporate governance and corporate ownership pattern in case of Pakistan. In most of developing markets including Pakistan, the strongly held firms (family or state controlled firms or firms held extensively by corporations and by financial institutions) rule the economic landscape. Greater parts of the firms are owned by the family or institution in case of Pakistan (Cheema *et al.* 2003). Similarly Javid and Iqbal (2008) explored that concentration of ownership is another major issue in poor corporate governance for companies in developing countries like Pakistan**.** As Cheema *et al.* (2003) have spotted only the nature of corporate ownership arrangement in Pakistan without investigating its impact on corporate performance. According to Shaheen and Nishat (2004) firms with relatively poor governance are less profitable, less valuable and pay out less cash to their shareholders. Bauer *et al.* (2008), found that well-governed firms significantly outperform than poorly governed firms by up to 15% a year. On the other hand, result of Aintablian and Boustany (2008) study shows that performance of banks is weakened with concentrated ownership. From the previous theoretical and empirical researches on corporate governance and organizational performance in Pakistan, it has been found that not all the variables of corporate governance have positive impact on firms' financial performance. As the relationship is positive, negative or none. Figure-1 summarizes the link between corporate governance variables and organizational performance in Pakistan.

FIGURE-1: LINK BETWEEN CORPORATE GOVERNANCE ELEMENTS AND ORGANIZATIONAL PERFORMANCE BASED ON CONCLUSION DRAWN FROM LITERATURE REVIEW



Impact of corporate Governance Elements on Organizational Performance Derived from literature Review

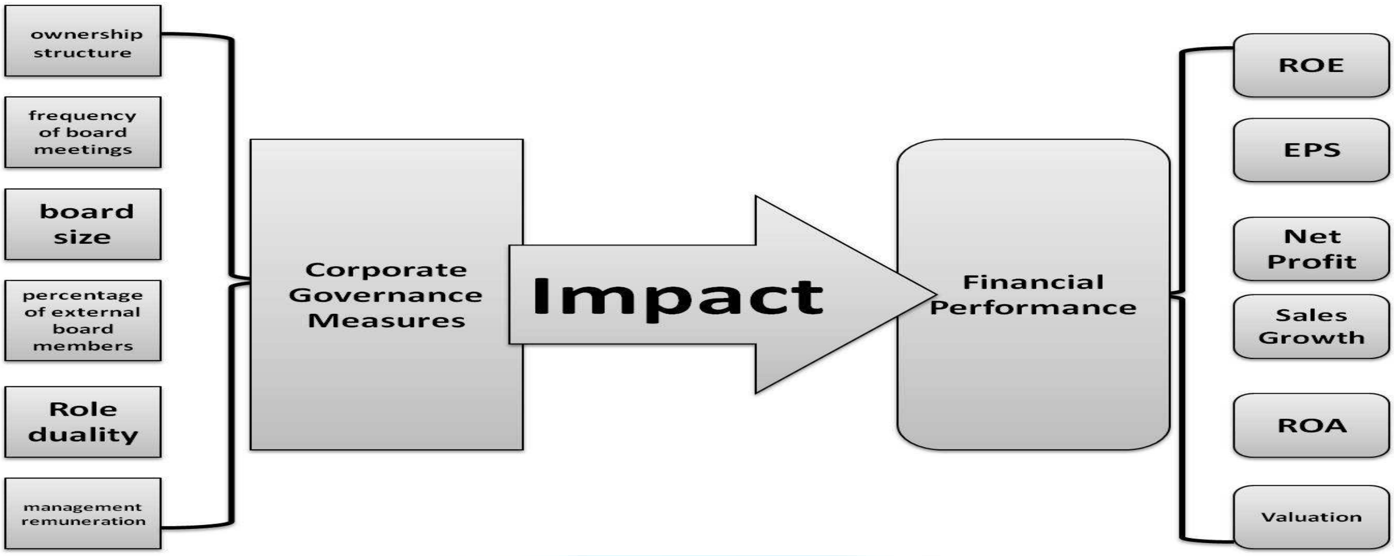
CONCLUDING REMARKS ON LITERATURE REVIEW

A comprehensive review of literature shows that the researchers have not reached on any consensus and document that some studies find significant impact of corporate governance on financial performance, while others demonstrate no association between corporate governance and organizational performance.

These mixed results prompt the researchers to investigate the role of corporate governance in organizational performance. Like many developing countries, ownership concentration and weak investor protection, especially of protection of minority share holders are the main characteristics of Pakistani market. One of the major problems in Pakistan is the agency problem that exists between the management, which is usually the owners as most of the firms are owned and managed by families and minority shareholders (Shah *et al.,* 2009). This problem is the main hurdle in practicing good corporate governance in Pakistan. For this reason we have chosen those corporate governance variables which affect the agency costs.

CONCEPTUAL FRAMEWORK

FIGURE-2: PROPOSED CONCEPTUAL MODEL OF THE STUDY



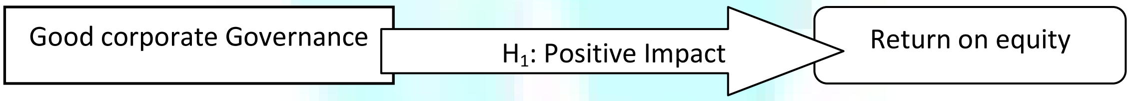
OBJECTVES

1. To empirically test the impact of corporate governance variables on the financial performance of listed companies at KSE-100 index.
2. To check whether better corporate governance leads to better sales growth of an organization. That would ultimately lead the organization towards success.
3. To explore the key success factors of the organization by the way of corporate governance measures.

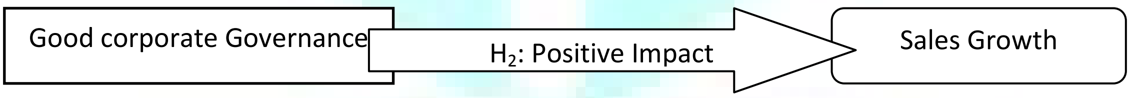
HYPOTHESES

To study the impact of corporate governance of KSE-100 index companies researchers have developed following hypotheses are developed.

H1: Firms with Better governance have more return on equity

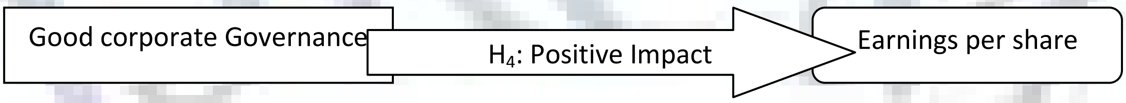


H2: Better governed firms have more sales growth.

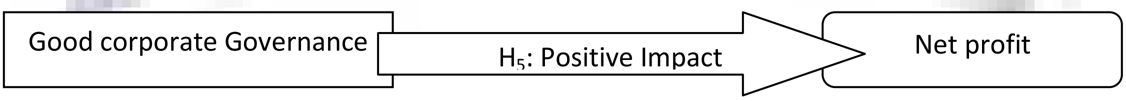


H3: Firms with good corporate governance have more return on assets.

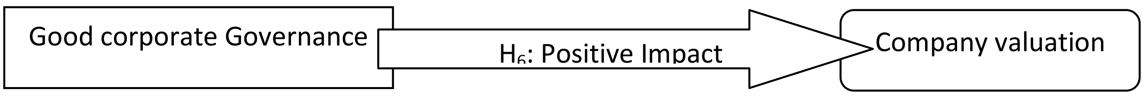
H4: Firms with good corporate governance have more earning per share.



H5: Firms with good corporate governance earn more Profits.



H6: Firms with good corporate governance have more company valuation.



SAMPLE AND RESEARCH METHODOLOGY

I. SAMPLE AND DATA

A random sample of 33 companies listed at KSE-100 index is selected; keeping in view that most of them are following the code of corporate governance. Secondary data is used for this purpose which is collected from company's audited annual reports of 2010.

II. DEPENDENT VARIABLES

Financial Performance**:** Literature uses a number of different ways to measure financial performance. These include return on assets (ROA), return on equity (ROE) (Latif *et al*., 2012), net profit, earning per share, sales growth etc. This study uses all of the above measures to evaluate the firms' financial performance. For company valuation single measure Tobin's Q ratio is used (Latif *et al*, 2012).

Annual Sales Growth: To calculate annual sales growth a formula is used i.e.

$$\frac{\text{Current Sales-Previous Sale}}{\text{Previous Sales}} \times 100 = \text{Percentage Growth}$$

III. INDEPENDENT VARIABLES

Corporate Governance: As a proxy of corporate governance, ownership structure, frequency of board meetings, board size, percentage of external board members, Role duality and management remuneration are used. Ownership concentration is measured by calculating Herfindahl-Hirschman Index (HHI). According to the Index value less than 1500 indicates the diluted ownership, value between 1500 and 2500 indicate moderate concentration and value of index greater than 2500 means highly concentrated ownership Chin (2001) (revised December 2010).It is computed by taking the square of percentage of 5 block holder's shares and by summing them all.

IV. CONTROL VARIABLE

Firm size, as measured through natural log of total assets, is taken as control variable.

V. DATA ANALYSIS

Data was entered, edited and analyzed by using SPSS version 19 and Microsoft Excel 2007. To understand the dynamics of CG and its impact on financial performance, it would be advantageous to apply regression model on the dependent and independent variables. The regression line gives an estimation of the linear relationship between a dependent variable and one or more independent variables or covariates. By applying the technique of OLS Regression, the significance of proposed hypotheses is tested.

RESULTS AND DISCUSSION

Corporate governance is very important issue in the modern corporate world. In the whole world a lot of work has been done on this issue which shows the importance of corporate governance. In our study we have tried to generate link between some important variables of corporate governance with the organization's financial performance variables. As to perform well financially is the utmost important goal of every business organization. For this purpose we have selected KSE-100 index because this index has companies with highest market capitalization. The evidence presented here is based on regression analysis. Measures of financial performance are taken as net profit, return on equity, return on assets, earning per share. Tobin's Q is taken as a measure of company valuation. All assumptions of Ordinary least square regression analysis are fulfilled. Independency in the data is proved as all the data is taken from different business bodies. There is no autocorrelation and multicolinearity in data. Values of Durbin Watson for all models lie in the range of 0.5 to 2.5, which confirms the absence of autocorrelation in the data.

MODEL 1

$ROE= \beta1 + \beta_2 OWNSCON + \beta_3 BM + \beta4 INDDIRCTR + \beta5\ RLD + \beta_6\ BSIZE + \beta_7\ MNGRMNTN + \beta_8\ FIRMSIZE$

After applying regression it is found that Return on equity is positively related with corporate governance measures and its results are statistically significant. Value of R-square is 0.53 (more than 50% explanatory power) while taking firm size (log of total assets) as a control variable. But relation between ROE and CG becomes less significant after excluding firm size(R-square=0.328). The F-statistics gives significant support to accept the H_1 i.e. 3.402.

Model	R	R Square	F-value	Durbin-Watson
1	.728[a]	.530	3.402	2.277

MODEL 2

$Sales\ Growth=\beta_1+\beta_2 OWNSCON+\beta_3 BM+ \beta4 INDDIRCTR + \beta5\ RLD + \beta_6\ BSIZE+ \beta_7\ MNGRMNTN+ \beta_8\ FIRMSIZE$

There is a positive relation between company's sales growth and corporate governance but its relation is less significant. Value of R-square is 0.241(having explanatory power of 24.1%).It means better governed firms have more sales turnover than the poor governed firms. The F-statistics gives significant support to accept the H_2 in the presence of control variable. So H_2 is accepted here.

Model	R	R Square	F-value	Durbin-Watson
2	.491[a]	.241	.1.95	1.894

MODEL 3

$ROA= \beta1 + \beta_2 OWNSCON+ \beta_3 BM+ \beta4 INDDIRCTR + \beta5\ RLD + \beta_6\ BSIZE+ \beta_7\ MNGRMNTN+ \beta_8\ FIRMSIZE$

There is a positive relation between return on assets and Corporate governance but its relation is less significant, R-square is 0.227(having explanatory power of 22.7%).and after excluding firm size this relations becomes more insignificant. (R-square=0.173). The F-statistics gives significant support to accept the H_3 in the presence of control variable. So H_3 is also accepted.

Model	R	R Square	F-value	Durbin-Watson
3	.476[a]	.227	1.715	1.814

MODEL 4

$EPS= \beta1 + \beta_2 OWNSCON+ \beta_3 BM+ \beta4 INDDIRCTR + \beta5\ RLD + \beta_6\ BSIZE+ \beta_7\ MNGRMNTN+ \beta_8\ FIRMSIZE$

Corporate governance and earnings per share are positively related, but the relation is less significant as inferred through value of R-square=0.248 (having explanatory power of 24.8%). It means better governed firms announce more earnings for share holders as compared to poorly governed firms. After excluding firm size value of R-square becomes 0.23 which means that firm size also affects the relation between corporate governance and firm performance. The F-statistics gives significant support in the presence of control variable to accept the $H_{4.}$

Model	R	R Square	F-value	Durbin-Watson
4	.498[a]	.248	1.008	2.285

MODEL 5

$NETPROFIT=\beta_1+\beta_2 OWNSCON+ \beta_3 BM+ \beta4 INDDIRCTR + \beta5\ RLD + \beta_6\ BSIZE+ \beta_7\ MNGRMNTN+ \beta_8\ FIRMSIZE$

From the following research it is also proved that better governed firms earn more profits than poor governed firms. Net profit is positively related with corporate governance and this relation is very significant as shown by the higher value of R-square=0.769(having explanatory power of 76.9%). The F-statistics gives highly significant support to accept the H_5 i.e. F-value is 10.904.

Model	R	R Square	F-value	Durbin-Watson
5	.877[a]	.769	10.904	2.276

MODEL 6

TOBIN Q= + β_1 +β_2OWNSCON+ β_3BM+ β4INDDIRCTR + β5 RLD + β_6 BSIZE+ β_7 MNGRMNTN+ β_8 FIRMSIZE

The relationship between corporate governance and company valuation (Tobin's Q) is positive and very significant. Value of R-square is 0.699(having explanatory power of 69.9%). As High Tobin's q values encourage investors to invest more in the company because they believe company has more "worth" than the price they paid. So here it is also proved that companies having good corporate governance have greater market value and attract more capital. The F-statistics gives significant support to accept the $H_{6.}$

Model	R	R Square	F-value	Durbin-Watson
6	.836[a]	.699	1.770	1.770

In sum, from all above findings we conclude that firm's performance and valuation is positively influenced by the good practices of corporate governance. Firms having good corporate governance practices have higher return on assets, higher return on equity, enjoy more profits, attracts more capital, have better sales growth and have more earnings for shareholders.

CONSISTENCY OF RESULTS WITH THEORIES OF CORPORATE GOVERNANCE

AGENCY THEORY, ROLE DUALITY AND BOARD INDEPENDENCE

Board of directors cannot control the CEO if he is also the chairman of board, even he underperforms, which increases the agency cost so the role duality is negatively related with firm performance. From our research it is also proved that mostly companies who have separate CEO and chairman show better performance than others. With the inclusion of more outside directors board becomes more independent, which enhances the performance of board and consequently financial performance. This is also proved from our research.

BOARD SIZE AND ORGANIZATIONAL THEORY

Organizational theory suggests that larger groups take more time in decision making and it makes group performance less effective. From our research it is also proved that companies having optimal board size of 7 and 9 directors have better performance than the others.

CONSISTENCY OF RESULTS WITH CODE OF CORPORATE GOVERNANCE OF PAKISTAN

Some of the main objectives of code of corporate governance are to :"(a) Stimulate the performance of companies, (b) Limit insider's abuse of power. (c) Monitor manager behavior to ensure corporate accountability and protection of interest of investors and society.(d) Propose restructuring of the board of directors to introduce board based representation by minority shareholders and by executive and non-executive directors.(e) Emphasize honesty and clearness in corporate affairs and the decision making procedure.(f) Require directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent, and timely manner." The main focus of this study is on these points of the code of corporate governance presented above.

RECOMMENDATIONS

As in Pakistan most businesses are family owned and family members hold key managerial positions, so code of governance is poorly implemented. Pakistan has made major steps for improving the governance of its corporations in general. This results in an increase in the firms' performance. However, more efforts need to be made in terms of improving levels of compliance with the Code. More prominently, laws are here but their well-timed and full enforcement is extremely challenging. In addition, outsider financial exposure (in terms of significance and trustworthiness) of listed firms is of poor quality. There is no reason to expect that firms where ownership is concentrated disclose more, however board composition has positive and significant role.

The development of an appropriate corporate governance culture is contingent upon the adoption of a regulatory framework based upon clear bright line rules tailored to the particular legal and economic environment prevalent in Pakistan. There is also a need that regulatory bodies should keep check on the companies. SECP should ensure effective implementation of corporate governance practices. Stock exchanges must implement listing rules relating to corporate governance.

CONCLUSION AND FUTURE IMPLICATIONS

In this article, authors investigate the relationship between corporate governance variables and organizational performance and the impact of good corporate governance on the annual sales growth along with its impact on company's valuation of sample organizations in Pakistan. By constructing the HHI index of well governed organizations (Diluted ownership structure) and poorly governed organization (Concentrated ownership structure) along with their board size, role duality, management remuneration, frequency of board meetings and percentage of outside directors on the board, we find that those Companies at KSE-100 index have better financial performance in terms of ROE, ROA, EPS and profit margins which are following the code of corporate governance. Organizations with good corporate governance also having better valuation in terms of Tobin's Q

Further authors have empirically tested that the organizations with good corporate governance have better annual sales growth. Findings of this study substantiate with results of Shaheen and Nishat study (2004), Aintablian and Boustany (2008), Bauer *et al*. (2008), and Javid and Iqbal (2008). Especially there is a need to do lot of work in the field of corporate governance in developing countries. The study's finding could not be generalized broadly based on limited number of variables as there are a large number of variables that can affect the performance of an organization.

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