# Impact of Corporate Governance and Board Composition on Strategic Decision and Profitability

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# Impact of Corporate Governance and Board Composition on Strategic Decision and Profitability

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## Impact of Corporate Governance and Board Composition on Strategic Decision and Profitability

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**DEDICATED**

**TO**

**MY FAMILY, FRIENDS AND TEACHERS**

*Strong and gentle souls who taught me to trust in Allah, believe in hard work and that so much could be done with little.*

# ACKNOWLEDGEMENT

Allah, the Almighty, is the only one deserving all praise and glory, for He is the one who can set our paths straight and makes us able of doing it. Muhammad (P.B.U.H), the last Prophet of Allah Almighty, who urges his followers to “seek knowledge from cradle to grave”. He (P.B.U.H) is the one who shows the practical way to the enlightenment and to success in both domains.

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# Abstract

This study examines the impact of corporate governance, board composition on strategic decision and profitability of the non-financial firms from the period of 2005-2015. The 100 non-financial firms enlisted on Pakistan Stock Exchange has been examined by using multivariate regression analysis under fixed effect model approach, measures the corporate governance include board size, board meeting, directors attendance, board composition, board independence, non-executive directors, CEO duality, institutional and directors shareholdings. Capital structure and dividend payout are taken as the proxy of strategic decisions and return on assets is used to measure the firm performance. It has been observed that corporate governance and board composition have diversified impact on the strategic decisions. However, board independence, attendance of directors and debt have a significant impact on the firm performance. These findings have the significant implication for company managers and regulatory authorities.

Keywords: Corporate Governance, Board Composition, Strategic Decision, Profitability.

# CHAPTER 01

## INTRODUCTION

### 1.1. Theoretical Background

Corporate governance and board composition is considered as important factors which are responsible for the firm's position in the market as these are responsible to direct the firm in the particular situation to generate profits and sustain existence in the market.

Corporate governance mechanism is the mechanism which is to protect the shareholders right. Corporate governance is executed through board of directors, of course, their exposure, experiences affect the decision making body. According to (Steger et al., 2008) the term corporate governance is coined in the mid of 1980s while the governance mechanism of firms in modern scenario has been under consideration in 1840s. In Pakistan the code of corporate governance has been introduced through the Pakistan Corporate Governance code in 2002 to provide a regulatory framework. Fifteen years since the introduction of Pakistan corporate governance code, it is certainly the right time to give an in-depth appraisal and to make sure the availability of the answers for the above questions that how is the code received by the companies in making strategic decision and how it is significant in company's profitability?

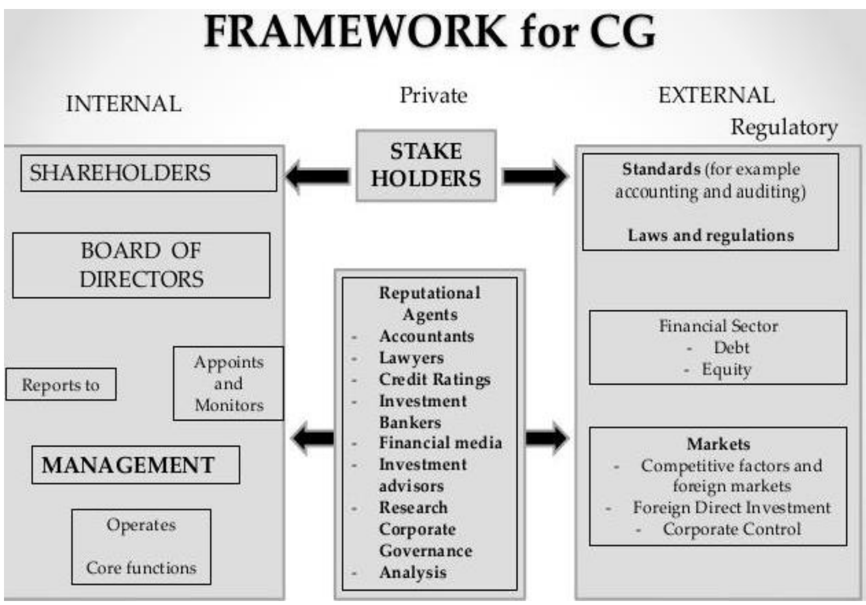
The word 'governance' in Latin means to steering of the ship which is used for the impartation of directions rather than just controlling the entity (Solomon, 2004). CG is the mechanism which gives the layout of governing and directing the activities of the corporate for safeguarding the interest of the all the stake holders that aims to improve the financial performance of the firm. It is the set of rules and regulations set by the authoritative body (Searcy, 2012). It is broadly comprised of all national, international principles at good to make the management of the company a vigilant one ("Aktiengesetz").

Corporate governance is the lay out that involve such structure and processes which acts as a mediator in establishing the shareholder's value by managing the company/corporations activities. It adopts such an approach which ensures the concerns of the individual and collectively the concerns of connected groups. Principles of CG are lying its bases to build the confidence of trust between lenders and investors. Sound implication of

CG practices have substantial influence on the strategic decision in devising the firm such as on the dividend payout and leverage decision, which are taken by the board. Therefore CG variables like board composition, board size, board independence, CEO/Chair duality, director's ownership may have impact on strategic decisions and profits of the firm (Butt, 2008).

The CG framework identifies the rules, regulations and relationships to which the companies are restricted/authorized by the regulating body to follow. An ample attempt is made to develop the understanding of corporate governance system through this figure 1.1. This figure exhibits the corporate governance system which demonstrates the separation of ownership and controlling body as well as the monitoring figures role as the coordinator among stakeholders and controllers.

**Figure 1.1: Separation of Management and Ownership**




Note: This figure demonstrates the separation of control and ownership as well as the monitors' role acting as a liaison among the stakeholders and controllers ( Kim et al., 2004).

Mechanism of CG is associated with the agency issues in general and its roots can be found to the parting of ownership and control of the firm. This problem occurs because of the conflict of interest between the shareholders and management. Similarly, the counter preferences in interests between the director owners and (outside) minor owners have the principal attention in the corporate governance literature.

The effect of deprived CG of the single firm can have contribution in the overall economy in the developing and developed countries as well, which leads to crisis and adversely affect the investment, employment, stock market and slowdown the economic growth (Acharya and Volpin, 2009). The empirical study of (Mitton, (2004)) which takes the sample of 398 firms including Korean, Malaysians, Philippines, Indonesians, Thailands have found the firm level differences in variables are related corporate governance has strong impact firm performance during east Asian crises in 1997 to 1998. The results suggest that firms with higher disclosure and higher outside ownership have better price performance.

The sound practices of governance has very grave imprints on the economies. Many of the policy makers believe that there exist a very strong bond between the CG, organization and growth of economy. Sound practices of CG increases the performance, return, credit worthiness of the firms which contributes into economic growth in the long run. Since 1990s, CG has become the sparkling topic in the growing economies. Improvement in this discipline has reduced the chances of financial distress. Sound implementations of corporate governance principles will influence/established lower the transaction, property rights, and capital cost. Corporate governance ponders light on the linkage among directors of board, stakeholders, shareholders and management (Javid and Iqbal, 2010) corporations are most eminent institutions in todays' society. Corporate governance role is very significant in effective and efficient decision making at the management level. Efficient CG will lead to reduce the chances of default because uniform availability of information will mitigate the agency cost between the firm and its creditors (Bhojraj & Sengupta, 2003).

Corporate finance theories suggest that agency cost is the detrimental of gearing level. Although the practical evidences of IJBM (2009) on CG have not provided any courageous evidence on the actuality/presence of bondage between the financial mix and governing mechanism of the corporations.

For research in management CG is the most vibrant topic to explore. A detailed evaluation of previous works discloses that most of the done researches in this area have focused on the impact of CG and ownership concentration on company's outcome and impact of ownership structure on the firm's value (Claessens, 2002). Though, the relation between CG on strategic decision has not been pursued widely. Only a few researches has pondered the light on this correlation Berg (1997), (Friend and Lang, 1988; Wen et al., 2002; Abor, 2007; Wen, 2002).

Kowalewski et al., (2007), Gugler and Yurtoglu (2002), Farinha (2003) discuss the impact of CG on the financial mix and dividend payout decision of firms in developed and developing markets. But here in Pakistan there is few evidences available which are covering the present market behavior of corporate governance towards profitability and strategic decision.

## 1.2. Gap in Research

Massive research is available for estimating strategic decision and profitability, but factors of corporate governance and board composition are less observed in case of Pakistan and these variables of corporate governance are very influential/important in profitability and strategic decisions. Thus, if we ignore the variables of corporate governance and board composition then corporate would definitely face failure to achieve its goals of sustaining its existence.

## 1.3. Research Question

There are four main questions that need detail empirical investigation in the context of corporate governance and board composition with profitability and strategic decision:

a) What is the impact of board composition on profitability?

b) What is the relation of corporate governance with profitability?

c) What is the effect of board composition on strategic decision?

What could be the recommendations for strategic decision by considering corporate governance?

## 1.4. Objective of the Study

In order to address the issue regarding relationship among corporate governance, board composition on strategic decision and profitability, in the literature for the case of Pakistan this study has the following objectives:

a. To explore the role of corporate governance and board composition as determinants of strategic decisions.

b. To explore the role of corporate governance and board composition as determinant of profitability.

## 1.5. Significance of the Study

The motivation of this study to get insight of corporate governance and board composition which explains the negative performance of firms in corporal governing perspective in emerging markets (Stiglitz, 1999). This study will helps to identify the affect CG on profitability, debt ratio and dividend payout. In south Asia Pakistan is an emerging market and has shown a remarkable performance by initiating very crucial projects like one belt one road has attracted a significant (FDI) foreign direct investment. I opine that it is prime time to examine the impact of CG and board composition on company's decision making and profitability. Pakistan is the emerging market due to strategic presence and bestowed workforce, people are taking interest in this growing economy .Investors are ready to make decisions about their investment.

According to Claessens and Yurtoglu (2012) one reason for the inevitability of CG system for present is the eruption of financial scandals and tragedies over last few decades. Such as Enron Vinten (2001), Maxell Corporation (1991), Daewoo (1998), Barings Bank (1995), Flowtex (1999), Tyco (2002), WorldCom (2002), Allied Irish Bank (2002), Volkswagen (2005) that are examples of high profile corporate fraud scandals.

These crises arises the need of such system which acts as a mediator for economic growth which later become essential for the policy issues and economic prosperity. Following these events, government go over new guidelines to restore the confidence in the market, among which Sarbanes-Oxley Act legislated in 2002 is the most substantial one (Steger & Amann, 2008).

Recent studies has shown that cost of submission was substantial with SOX. SOX has offered such changes to CG principles like changes at the presentation of financial and auditing record to make it more clear to all stakeholders, inclusion of directors who represent the minor shareholders and could provide more diligence and expertise along with executive members and the act involves changes at the disclosure and transparency (Clark, 2005). The main purpose behind this act is to decrease the chances of fraud and protect the interest of stakeholders (Nofsinger, 2004).

CG scandals generally related with the agency problems which occurs due to the conflict between the managers and shareowners which are to safe the interests of manager on the cost of shareholder's interest. It is on board to make strategically decisions about the corporate while if the quality of decision making is weak then it would definitely lead to the poor allocation of resources at firms which will definitely discount the market.

Main objective of financial managers is to maximize the wealth of their owners. It is interested to see the problems related to strategic decision and profitability in perspective of corporate governance and board composition.

Firms do face problems in financing their operations but at the same time the Pakistani market is underdeveloped. Hence the scope at which a firm is able to access external financing is all depends on the quality of decision made by representatives of corporate and stakeholders. Researches could help the institutions in sorting out the problems as students are the unbiased stakeholders so they can provide the better insight to the issue.

## 1.6. Organization of the Study

This study is comprised of five chapters

The first chapter is introduction, second chapter is comprised of theoretical and empirical literature, third chapter contains data and methodology, fourth chapter is analysis and discussions, fifth chapter concludes the study.

# CHAPTER 02

## LITERATURE REVIEW

In this chapter researcher will review previous studies relevant to the topic. At first researcher aims at reviewing the theories relevant to the topic. Next the empirical studies around the globe and Pakistan are included. Before reaching the conclusion researcher has tried to ponder relevant studies of all variables.

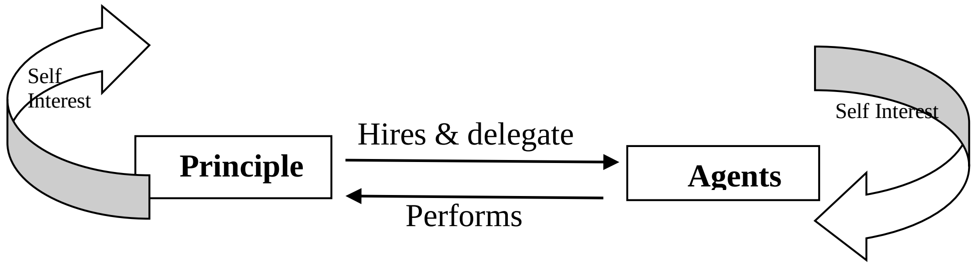
## 2.1. Theoretical Review

Theories are the important to get the deep insight of the existing topic. Theories give strength to the variables.

### 2.1.1. Agency Theory

It is believed that the principal-agent theory is necessary for fundamental understanding of corporate governance arising from classical thesis on the private property and Modern Corporations as well (Berle and Means, 1932). According to (Coleman, 2007) in modern firms the major reason behind this problem is the separation between the management and finance. Because of this conflict between the owners and control the firms are managed by professionals (agents) who could not be held responsible by disseminated shareholders. Hence the question arises how the interest of shareholders can be ensured to reduce the agency cost? Here principals are exposed with two kinds of problems one is moral hazard and the right incentive to agents to make their decision align to shareholders ‘interest. (Jensen and Meckling, 1976) further strengthen this argument by describing the agency conflict as a contract which involves a principal which engages the agent to perform services on their behalf that involves entrusting the agents as the decision making bodies. Thus, there exist clash of interests in this scenario between the managers (controlling shareholders) and minority or outside shareholders it leads the opportunity that the former may take perquisite from the firm and be less interested to pursue the interests of the minor or outside shareholders. By the principal agency cost include auditing, controlling and budgeting while on part of agent it includes compensation system and bonding expenditure. The price of share that is paid to shareholders (principal) pay reflects such agency costs. The agency cost must be reduced to increase the value of the firm.

**Figure 2. 1: The agency model**




Note: the agent may be succumbed to opportunistic behavior and self-interest between the aspirations of the agent's and the principal pursuit (Abdullah and Valentine, 2009).

Easterbrook (1984), concludes that dividend is important role in controlling the agency conflict as it indicates the firm's activities and performance in the capital market. The higher dividend payouts may seem that firm is selling their common stock in primary markets. This leads to investigation of agents by securities exchange, investment banks and capital suppliers. Moreover studies carried by Donaldson & Davis (1991), Crutchley, & Hanse (1989), jain & Kini (1999), Hansen and Torregrosa (1992) have acknowledged the importance of being watched out by the investment banks in the issuance of new equity. Furthermore, the studies by Myers (2001), Fluck (1998) also proposed that models of agency theory where agents pay dividend to avoid the disciplinary action by shareholders.

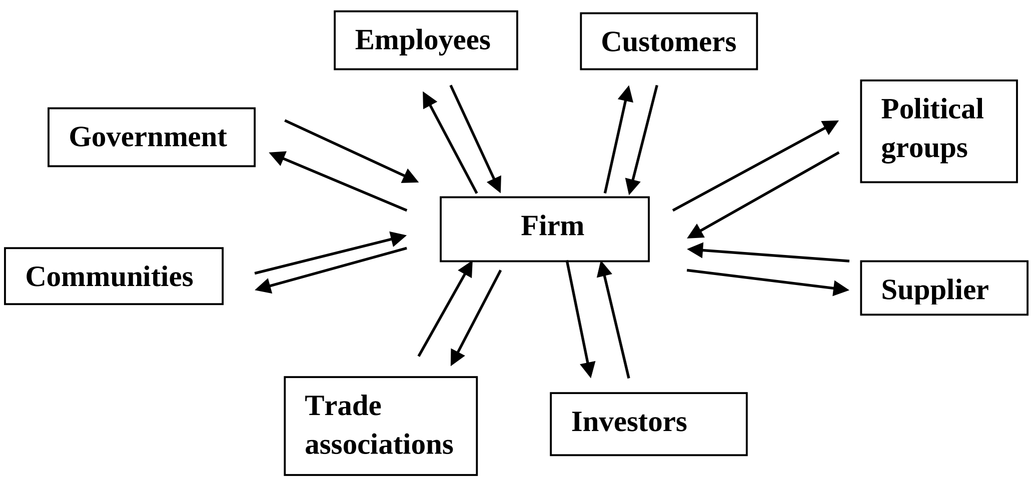
### 2.1.2. Stakeholder Theory

Freeman and Reed (1983) elaborated the term stakeholder as "any individual or group of individuals who can influence the organization and can be influenced by the performance of the organization". This theory stresses upon the each group that analyst concludes that none of the group is preferred over the interest of others interest.

Islam and kalyebara (2014) documented that this theory scope to which the managers give favor to their stakeholders claim. According to this theory stakeholder and shareholders are effected by the organizations events and decisions.

This theory widen the scope of interests of the organization against just focusing on the interest of the shareholders. This theory broadens the range of interest that organization works invariably to provide satisfaction to all its stakeholders (Abrams, 1951). Therefore stakeholder theory gives the impression that it is better for the explanation of the corporate governance variables. Thus, all the influenced groups and entities are the related stakeholders. John and Senbet (1998) elaborates the comprehensive debate about the stakeholder' theory of CG which points that there are many parties which are combating about their interest in the firms' operations. They also viewed the Board of the organization and its impact on firm. Many of the researchers have agreed on this point that impact of corporate entities are on the wider audience hence its accountability should be on broader prospect not just on the shareholders. Furthermore, McDonald and Puxty (1979) debated that companies are existing not only for the interests of shareholders rather they exist within the society hence, have the responsibilities of that society. (Freeman et al., (2004)) proposed that economic value is created by the people who voluntarily come forward to improve everyone's position

**Figure 2. 2: The stakeholder model**




Note: Figure shows that stakeholder theory focuses on managerial decision making in addition to all stakeholders' interests have intrinsic value, furthermore no sets of interest is assumed or expected to dominate the others (Donalson & preston, 1995).

(Freeman and Evan (1990); Jensen (2002)) come to conclusion that all the stakeholders are essential for the success of the organization. The argument of Jensen (2002) advocates that the performance of a firm is not only should be measured by gains to its stakeholders. Other key issues such as flow of information from top to bottom/internal to external, coordination, work setting, etc are all grave issues that should be considered (Abrams, 1951).

### 2.1.3. Resource Dependency Theory

This theory leads approachability to resources, in order to the separation of the role of control and ownership, as it is a very dire aspect to discuss on corporate governance. By the keen observation, this theory points out that organizations usually inclined to reduce the improbability from outside influences by confirming that resources are available to organization are for their growth and endurance. This theory suggest that separation between the non-executive and executive directors is irrelevant to the efficiency of the firm rather it depends upon the asymmetry of information and board independence. Government machinery is to protect the all the stakeholders. Now in changing corporate governance environment directors are held responsible for, because all decision making is in their hands. Hence, it is on their part to ensure the benefits of shareholders Jensen(1993). Monks and Minow (2001) believe that board composition acts pivot between the owners and inside controllers and regarded as the most important element of the CG Blair (1995). Studies have presented that boards of directors are active tool for efficient observation of managers Byrd and Hickman (1992), Fama and Jensen (1983). Again Fama and Jensen (1983) prolonged the argument that boards will be able to monitor management more efficiently when there are more non-executive directors (NEDs). Several explanations are made to make it comprehensible that the problem lies in the availability of information which leads to such inconsistencies (Gani and Jermias, 2006). According to (Bathala and Rao,1995; Hutchinson,2004) that there exist a negative relation between the between the firm performance and corporate governance or they there is not any link (Prevost *et al*., (2002); Shin and Chang,(2003); Jiraporn,(2006)) While a number of researchers found the positive relationship between performance of the firm and CG (Akhtaruddin,2009; Brickley et al.,1994; Rosenstein and Wyatt,1990; Byrd and Hickman1992; Weisbach,1988).

### 2.1.4. Trade-Off Theory

One of the important factor which is highly influenced by the corporate governance and board composition is the ratio of debt for the smooth run of operations of corporate, detrioting returns occur with the benefit of tax shield the tradeoff theory undertakes that there are benefits to debt within a capital structure up to the optimal leverage level. This theory identifies that the tax benefit from interest costs. Studies suggest, however, that most companies have less debt than this theory would suggest is optimal. The theory of optimal debt structure is the substance of an enormous contracting literature that abstracts from taxation (Hackbarth, *et al*., (2007)). People attached with the corporate feel comfortable with the static tradeoff story because it sounds plausible and yields an interior optimum debt ratio. It rationalizes “moderate” borrowing Stewart (1984). Haris and Raviv (1991) argued that capital structure is related to the tradeoff between costs of liquidation and the gain from liquidation to both shareholders and managers. So firms may have more debt in their capital structure that is suitable as it gain benefits for both shareholders and managers. Hence it is the most critical decision made by the corporate management to generate maximum results.

A number of authors have suggested that leverage ratios may be related to firm size. Warner [41] and Ang, Chua, and McConnell [1] provide evidence that A number of authors have suggested that leverage ratios may be related to firm size.

### 2.1.5. Pecking Order Theory

In capital structure the pecking order theory of is among the most dominant theories of corporate leverage (Frank and Goyal (2003)). According to Myers (1984) due to distress situation firms make choices to run their operations by the choice of debt to continue its operations because of low cost association with debt than the cost of equity.

The pecking order theory is from Myers (1984) and Myers and Majluf (1984). Since it is well known, that there are three modes of financing (1) retained earnings (2) debt (3) equity. Retained earnings have not problematic association. Debt has a minor association as the adverse decision While is equity is considered as the worst choice of financing. From this point of view for an outside investor, equity is highly associated with risk than debt. Though both have hostile selection risk premium, but that premium is largely associated with equity. Therefore, investors demand a higher rate of return on equity than on debt. Therefore, considering this perspective retained earnings are far better source of funding than that of leverage and debt financing is better than equity financing. According to this theory the firm will fund all projects using retained earnings. If there is insufficient availability of retained earnings, then debt financing will be used. Thus, for a firm in normal operations, equity will not be used as the mode of financing

Frank and Goyal (2003) argued that the pecking order theory originates much of its effect from a view that it adjusts naturally with a number of facts about how companies use external finance. Myers (2001) reports that external financing covers only a minor proportion of capital development and that equity issues are minor, with the bulk of external financing being done with debt. While Franka & Goyal (2012), argued that externally availability of finance often exceeds the investment and equity finance is important element of external finance.

## 2.2. Empirical studies

Empirical studies provide evidence to the under observation variables. It strengthens the research with practical examples from the market across the world.

### 2.2.1. Corporate Governance and Financial Mix

Poor Corporate Governance not only leads to poor performance of firms but also contributes to macroeconomic crises (Claessens *et al*., 2002) as happened during 1997 in East Asia crisis. Barca and Becht (2002) ponder the attention towards number of factors why corporate governance is important for firm's performance. The Cadbury committee highlights a governance system as "the system by which the companies are directed and controlled" (Cadbury, 1992).

Abor and Biekpe (2007) examined multivariate regression analysis between corporate governance attributes and debt ratio decision of Ghanian SMEs. They got the results negative relationship between size of board and low leverage ratios and SMEs with larger boards generally have low level of gearing level. Berger et al., (1997) firm with larger board size has low debt ratio. Larger board size exerts pressure on management to enhance the performance by keeping the gearing level low. While, (Jensen, 1986) gives arguments that firm with high debt ratio have larger board size. The findings of Wen *et al*., (2002) results insignificant relationship between board size and leverage. Their findings advocate that larger boards which are embedded with monitoring authorities and because of diverse opinions at board results in poor corporate governance which tends to high leverage. Anderson *et al*., (2004) argues that cost of debt is lower for bigger boards and creditors assumes these firms being monitored effectively in financial accounting proceedings. Experimental study reveal that lager boards have larger high debt as smaller size leads to reduce in the number of NED at the audit committee (Beasley and Salterio,2001; Klien,2002).

Friend & Lang (1988) carried the debate on the manager's role in the capital structure decision. They concluded there is negative relation between the director's shareholding and debt ratio. This shows that the top inside directors continue the tendency of keeping the debt ratio low in the company. Jensen and Meckling (1976) argue that managerial shareholding reduces managerial motivations to consume extras and confiscate wealth of shareholders and results in clash of the interests of management and shareholders. It also reduces the inclination behavior of management to involve in non-maximizing decisions. Fama and Jensen (1983) and Demsetz (1983) debates that managerial shareholding may arise agency conflicts that it may ingrain the present management to increase the opportunities for themselves. Jensen (1986), in sighted the agency conflicts and presented it as the managers make hard work for their personal interest to expand the business thus this probably leads to increase in the leverage. These efforts of expanding the business may elevate the status of the business but this will create the negative impact of the efficiency of the from González & Garay (2003) that BOD meetings have positive influence on the decision making of the firm as it can leads to more chances to review the issue.

High proposition of independent directors may lead to high debt. Wen *et al*., (2002) they argued outside directors monitor the firm performance more vigilantly which leads the managers to go for less leverage, they find the negative association between the outside directors and gearing level. While, (Jensen,1986; Berger *et al*.,1997) creates the counter argument that firms with large number of outside directors relatively have high leverage than the boards which are off smaller size. Pfeffer and Salancick (1978) bring attention towards the inclusion of the NEDs at the board that it gives the good repute/recognition to the company. Which further strengthen company position to generate funds externally. They conclude that more number of non-executive members leads to higher leverage ratio.

Jensen (1986) and Berger *et al*., (1997) find that companies with higher debt ratio relatively have number non-executive members on board while companies with low debt ratio have less number of representation of NEDs. Abor and Biekpe (2007) Ghanaian SMEs that have more outside directors and a diversified set of skills at board generally have higher level of gearing. (Myers and Majluf, 1984) find that profitable firms generally have low debt to equity ratio levels because these firms prefer internally generated funds over external financing. In approach of resource dependence (Pfeffer,1973; SALANCICK and Pfeffer,1978) make an attempt to convince that NEDs increases the creditability of the firm to withstand against the external environment, and make the firm to generate the ability to raise funds and recognition in the market.

Abor and Biekpe (2007) provide the evidence about the presence of positive relationship among gearing levels and CEO duality. Fama and Jensen (1983) stressed upon the separation of firm's decision management (purpose is to make and execute proposal for the resource allocation) and decision control (approve those proposals).

Fama and Jensen (1983) debates that firms decision control (board of directors) and decision management (management of the firm) functions should be separate. Decision management function involves the right to start and execute new proposals for the allocation of firm resources while the decision control comprises the right to approve and monitor those proposals. This separation facilitates the cautious exploitation of firm's resources. Chairman position of board is the principal level of decision control so it must not be shared and control by the CEO. While role duality presents the incongruity of the separation of these roles which results in agency problem. (Fosberg, 2004) finds the firms with separate chairman and CEO dare to take the definitive amount of debt in their capital structures. He learns though his findings that firms with separate CEO and chairman generally have higher debt ratio. (Abor and biekpe, 2007) also give indication about the existence of positive relationship between gearing level and CEO duality.

*2.2.1.1. Hypotheses Related to Capital Structure*

$H_1$: There is significantly positive association between the NED and debt to equity ratio.
$H_2$: There is significantly positive association between the board independence and gearing level.
$H_3$: There is significantly positive association between the board size and gearing level.
$H_4$: There is significantly positive association between the CEO duality and gearing level.
$H_5$: There is significantly the positive association between the board meeting and leverage.
$H_6$: There is significantly the positive association between the attendance of directors and leverage.
$H_7$: There is significantly the positive association between the institutional shareholding and debt ratio.
$H_8$: There is significantly the negative association between the ownership structure and debt ratio.
$H_9$: There is significantly the negative association between the dividend and debt ratio.
$H_{10}$: There is significantly the negative association between the ROA and leverage level.

### 2.2.2. Corporate Governance and Dividend

Grossman & Hart (1980), concludes his views that agency conflicts can be reduced by reducing the availability of free cash flows through paying the dividend as the managers do not act responsible towards shareholders.

Similarly, (Jensen,1986) giving dividend payout is the better option than investing into the zero NPV projects as paying dividend tends to mitigate the agency conflicts. (Fenn & Liang,2001) provided evidence that there exist the positive relation between the managerial shareholding and dividend payout. They found managerial stockholding mitigate the agency conflicts. (Mitton, 2004) concludes that corporate governance is positive in those countries which offer strong investor protection and such countries pay high dividend. Claessens et al., (2000), La Porta et al., (2000), Tabalujan (2001) suggest through their empirical studies that it is common practice that big shareholders tend to suppress the minor shareholders. The best practice to protect the minor shareholders is implementation of corporate governance mechanism.

Empirical evidences on the corporate governance and dividend policy are attention grabbing studies. Examining the UK panel data set, Short et al., (2002) found the insignificant relationship between the ownership structure and dividend payout. Farinha (2003) found that ownership structure is of 30 percent and coefficient move from negative to positive after entrenching the managerial ownership. He concludes that dispersion of ownership structure has a positive impact on the dividend policy.

Another component in the empirical studies is the relation between the institutional shareholding and dividend payout. Han et al., (1999) and Short et al., (2002), examined the institutional ownerships positive impact on dividend payout. Gugler and Yurtoglu (2003) also examined the ownership, control structure and dividend payout of the firms in Germany. Evaluating 736 announcements of the dividend changes over the period 1992-1998. They found the negative effect on the wealth of the firm. Where directors ownership and control structure makes the expropriation of the minor shareholders are more prominent than the other firms. They found that the top large shareholding concentration reduces the dividend payout, while the dividend payout is increased by the second largest shareowners.

La Porta et al, (2000) observed the agency problems and decision of dividend policy around the globe with a sample of 4000 firms from 33 countries. They derived two alternative agency models of dividend. In the first model they suggested that due to improved principles of protection rights of minor shareholders, such firms distribute high dividend. With strong shareholding investors are willingly ready to wait for their dividend when company is counter with good opportunities for investment while in the substitution model of agency theory shows that the firms with weak shareholders right tend to pay lesser dividend, here shareholder seem to take dividend whatever they are offered.

La Porta et al., (2000) resented in their empirical evidence a cross sectional study of 4,000 firms from 33 countries in support of the outcome of the model of dividend with different levels of minority shareholding rights. According to this minority shareholder prefer the dividend over retain earnings. Bebczuk (2005) argues that comprehensible understanding of this theoretical body suggests that high dividend payout shows that better corporate governance practices are being carried out in the company.

According to Mitton (2004) it is the matter of fact that dividend is an important for investors, especially among less practicing of corporate governance practices. La Porta et al., (2000), Mitton (2004) minor shareholders prefer dividend over reinvestment. (Lauterbach, 1999; B. & Vaninsky, 1999) finds in their study that those firms which are managed by owners are less efficient in generating net income than the firms which are managed by outside managers(non-owners) while the firms managed by family owned performed worst. Corporate governance has significant role in dividend payout Abor & Fiador (2013); Al-Najjar & Kilincarslan (2016) conclude that ownership structure has no influence on dividend payout while the ownership of foreign investors also reduces the paying of dividend in Turkish markets.

Aoki (2010) and Lowenstein (1996) conclude that institutional shareholders have the strong writ to force the corporations' management to continue for the long run existence and benefits of the firm. While because of less satisfactory performance they sell their stocks and now it is difficult to sell the stocks but now they take part in board to decision making when returns are not up to expectations. CG has raised the different role of institutions. Institutions get benefit at economies of scale that is why they have more information and expertise analysis.

McConnell and Servaes (1990) propose that managers' stronghold would be milder with the presence of institutional shareholders. Therefore, with the occurrence of institutions shareholding then the firm is less expected to use dividends as a source of reducing agency costs. McConnell and Servaes (1990) hypothesized that higher the shareholding held by institutions lower or higher will be the dividend because of the tax exemption in the dividend payout Klausner (2005) find that institutions may held pressure on firms to pay more dividend as it would solve the issue of free CFs (cash flows) (Jensen 1986). Jensen (1986) favors dividend payments as it reduces the overinvestment in non- value maximizing projects by the managers.

*2.2.2.1. Hypotheses Related to Dividend policy*

$H_1$: There is significantly positive association between the NEDs and dividend payout.

$H_2$: There is significantly positive association between the board independence and dividend payout.

$H_3$: There is significantly positive association between the board size and dividend giveaway.

$H_4$: There is significantly the positive association between the separation of the status sharing as of CEO and chairmanship of the board committee.

$H_5$: There is significantly the positive association between the board meetings and dividend payout.

$H_6$: There is significantly the positive association between the attendance of directors and dividend payout.

$H_7$: There is significantly the positive association between the institutional shareholding and dividend payout.

$H_8$: There is significantly the negative association between the ownership structure and dividend payout.

$H_9$: There is significantly the negative association between the leverage and dividend payout.

$H_{10}$: There is significantly the positive association between the ROA and dividend giveaway.

### 2.2.3. Corporate Governance and Board Composition on Profitability

Corporate governance mechanism denote the scope ethical practices practiced by the companies (Goel & Ramesh, 2016). The evidence provide that firms with efficiently practicing corporate governance regulations show low risks on returns (Koerniadi et al., 2014). The research in the discipline of corporate governance has been started nearly about 30 years (Dao & Pham, 2015). (Todorovic, 2013) finds that if the company vigilantly follows the principles of corporate governance it can create the probability of profits. The parting of the roles of the CEO and chairman in corporate governance has been observed from different perspectives around the globe. (VINTILĂ & DUCA, 2013; Kholeif, 2008) in their study revealed that performance of companies with low top ownership structure and larger board size are negatively affected by the CEO duality but positively affected by the institutional ownership structure.

Vo and Phan (2013) empirically examined the determinants of corporate governance such as CEO duality, working experience of board members, female inclusion at board has positive effect on the business while size of board has negative effect on the corporate performance. Sheikh *et al*., (2013) examined the internal configuration on firm's performance as tenure of CEO and management at board that their decisions are contributing into firm's performance.

CEOs entrenched at two positions select low leverage to lessen the pressure of performance because of the association of debt. CEO duality affects the financial decision of the firm. Inline to two-tier leadership structure in which chairman of the board and CEO position is not held by the same person .The rationale for dual role of CEO was suggested by (Fama and Jensen, 1983) who describe management of decision as the tool to initiate and implement the new proposals for the operations of the firm and control decision to approve and monitor those proposals.

For the purpose to restrict the CEO duality that it would hampered the management's attention from opportunities. For independent decision, board must be free from CEO strict control. If board is controlled by CEO this would give the gesture of absence of independence of board in decision making regarding policies and controlling the proposals. Since the chairperson has more influence and control over the actions of the board, therefore the decision of the board will be compromised. Hence there is dire need of the separation above posts to save the agency problems which leads to hamper the firm performance. According to (Fama and Jensen, 1983) concluded through empirical evidences that there is high debt ratio is under the two tier leadership structure than the uninary leadership where both the positions are shared by the same person. Due to this the small external stakeholders are at risk of expropriation while capital transferred to larger stakeholders (Dwivedi and jain, 2005) the corporate governance is inevitable to performance of the firm. Corporate governance greatly impacts the organizations by infusing good management practices, strong internal auditing and new strategic outlook by the inclusion of NEDs. Corporate governance has clear impact on profitability of small and medium sized organizations (Abor and Biekpe, 2007).

*2.2.3.1. Hypotheses Related to Profitability*

$H_1$: There is significantly positive association between the non-executive members and profitability.

$H_2$: There is significantly positive association between the board independence and profitability.

$H_3$: There is significantly positive association between the board size and profitability.

$H_4$: There is significantly positive association between the separation of CEO and chairman status and profitability.

$H_5$: There is significantly positive association between the board meeting and profitability.

$H_6$: There is significantly positive association between the directors attendance at board committees on profitability.

$H_7$: There is significantly positive association between the institutional ownership and profitability.

$H_8$: There is significantly positively association between the ownership structure and profitability.

$H_9$: There is significantly positive association between the leverage and profitability.

## 2.3. Empirical Review from Pakistan

In Pakistan there is very minor research done with corporate governance variables on dividend pay pot and capital structure. Cheema *et a.,* (2003) has studied the nature of ownership structure of corporations in Pakistan, Ghani *et al*., (2002) examines business groups and their impact on corporate governance during 1998-2002. Hassan and Butt (2009) examined the impact of ownership and corporate governance on capital structure from 2002- 2005. Ashrah and Ghani (2005) examine the origin, growth and the development of accounting practices, disclosure and influential factors in Pakistan. Mir and nishat (2004), nishat and shaheen (2004), Tariq and butt (2008), Javed and Iqbal (2010), Iqbal (2006), Khatab *et al.,*( 2010) studied the relationship between corporate governance and profitability.

In Pakistan the agency problem is not between the manager and shareholder rather is the exploitation of minor shareholders by the dominant shareholders (Javed & Iqbal, 2010). Corporate governance accounts for good performance in Pakistan's firms. However all the variable do not account for firm's performance (Javed & Iqbal, 2010; Cheema et al., 2006) in Pakistan find that the companies' shares are commonly concentrated in the hands of largest shareholders.

Javed and Iqbal (2010) reported that in 2002 the code of corporate governance practically improved the governance and the process of decision making of listed companies at Karachi stock exchange. It is observed by (Javed and Iqbal,2010) that the corporate governance of recognized organizations are considered as less appreciative towards outside investors and capital markets in Pakistan but there exist a strong support on financial institutions and inside investors to increase the productivity of corporate sector.

Sajid *et al,*. (2012) discussed that higher director and institutional ownership reduces the agency cost, board independence has positive association with asset utilization and separation of ceo and chairmanship status also has lowers the agency cost. Yasser (2011) provide evidence from karachi should be the size of limited board members and must be a mixture of executive and non-executive directors for the better performance of the firms. Cheema *et al,*. (2003) providing overview of the ownership structure, state of financial market and market dynamics, studies in context of corporate governance importance and ownership concentration.

Khattab (2010) provide evidence that firms with corporate governance perform better than the firms with less corporate governance. He studied the performance with ROA and ROE with multiple regression models, the results show that leverage and growth have positive relationship with Tobin’s Q, which confirms a significant effect in measuring performance of the firm.

By reviewing the literature it has been concluded that incorporation of the principles of the corporate governance has contributed a lot in the generating the firms market capitalization and image in the market.

# CHAPTER 03

## RESEARCH METHODOLOGY

Previous chapter ponder the deep insight on the literature of relevant subject matter which was to observe the impact of CG on the strategic decision making and profitability of firms around the globe and in the Pakistan context. In this chapter discussion on the data, sampling size, variables and methodology adopted to conduct this study is briefed.

## 3.1. Data/ Sample

This study examines the relationship between CG on strategic decision and profitability for non-financial firm enlisted on 100 index PSX. Duration of sample is 2005-2015.which is right after the three years after the introduction of code of corporate governance in Pakistan. Data used here is panel data, comprised of 1094 observations for 100 companies. Board Size, Board Composition, Proportion of Non-Executive Directors, CEO/Chair Duality, number of board meetings, director's attendance at meetings, Institutional Shareholding and Shareholding of Board Members are used as measures of Corporate Governance. Similarly, impact of control variables like Return on Assets and dividend policy and capital structure have also been studied.

The key source of CG variables data set used for this study is secondary, taken from the published annual reports of corporate firms listed in Pakistan stock exchange. The data for all dependent variables is collected from financial statement analysis of financial and non-financial corporate firms published by state bank of Pakistan.

**Variables Included in Study have been Measured as Follows:**

There are certain measures to calculate the variables under study. Sometimes these variables are calculated directly other the other way round as it is the entity which is liable to change and we examine the impact of independent variables on the dependent variables.

## 3.2. Dependent Variable

Dependent variables are the variables of the interest which indicate the direct relation to the topic.

### 3.2.1. Strategic Decision Capital Structure – Leverage

Leverage is the dependent variable and it is calculated by using debt to equity ratio. Debt to equity ratio can be calculated either by using book value or market value. In this study book valued is preferred for the calculation of debt ratio. The prime purpose behind taking the debt is determined by tradeoff between the benefits of financing with debt and cost of debt. It is by law that the key benefit of the leverage is debt-tax shield which is only available on the book value of the debt.

Secondly, debt can be calculated either by using total debt or by using long term debt as a percentage of total equity. Long term debt is better option because of advance CG practices as increased institutional shareholdings, tax shields and diversified board of directors (NEDs, INEDs) have increased the credibility of the firms as these are enlisted on the Pakistan Stock Exchange and comes under the law by SECP that makes the debt more feasible for the companies. The leverage is measured as under

Leverage= long term debt/ total equity

### 3.2.2. Strategic Decision – Dividend Policy

The dependent variable is calculated by the dividend paid by the company divided by the outstanding shares. Profitability is another factor which is influencing dividend payout as it is being paid by net income.

Dividend = dividend paid/ outstanding shares

### 3.2.3. Profitability

Corporate governance is the vigilantly controlling and managing approach to run a company. It reduces the chances of default and helps in increasing the profitability. Profitability indicates of smooth operations being carried out by the company. ROA is the dependent variable which is quantifiable an it is calculated by net earning divided by total assets

ROA= net income/ total assets

## 3.3. Independent Variables

Independent variables are believed to affect the dependent variables. These variables give the deep insight into the topic that what are the factors affecting the dependent variables.

### 3.3.1. Board Size

The board of directors is crucial factor in the corporate set up, playing central role in a firm's strategic decisions like financial mix and dividend payout and in generating profits. It is therefore considered an important variable to study the impact of corporate governance on performance and in decision making. The variable Board size is measured as total number of board members.

### 3.3.2. Board Independence

Existence of NEDs on the company's board committee gives the notion to the market that company is being monitored efficiently so creditors consider the company more credit worthy and feel confident that it can male bold decision of giving dividend to shareholders and investment decision. In turn, this makes it easier for the company to raise long term funds through debt financing. Board Independence represents the proportion of non-executive directors on board and it is calculated as:

Board Independence = number of non-executive directors /total number of directors.

### 3.3.3. CEO/Chair Duality

If a person holds both the titles of chief executive officer and chairmanship of the board committee than it may create agency problems. Higher level of control by CEO may lead to managerial opportunistic behavior and can lead to lower gearing levels under entrenchment hypothesis.. The variable CEO/Chair duality is included as a dummy variable. It is taken as 1 in case of separation of roles of CEO and chairmanship and it is taken 0 if CEO is chairman.

### 3.3.4. Board Meetings

Number of board meetings annually is included in the corporate governance code to make sure the information impartation to the director's representatives of shareholders and share the concern for interest of shareholders. It is measured by from the information available in annual reports of the companies.

### 3.3.5. Directors Attendance at Board Meetings

Attendance is the important constituent towards showing the concern towards decisions and interest in the firm affairs. Attendance is taken 1 if the attendance by directors held greater or equal to the average of the total of the total number of meetings otherwise it is 0. Data is collected from the annual reports.

### 3.3.6. Institutional Share Holding

Existence of institutional shareholding in a company helps it to raise long term finance at an advantageous cost. Firstly, these institutions themselves act as a source of fund provider as they are willing to provide debt to a company over which board they enjoy the influence. Secondly, these institutional shareholders/investors serve as an effective monitoring instrument over the company's strategic decisions. Institutions act as mediators which brings down the company's agency costs and also reduces managerial inventiveness. This gives confidence to general public and other lenders. Institutional Shareholding is measured from annual reports as by the percentage of shares held by the institutions or it is calculated by the addition of institutional shareholding by total outstanding shares.

### 3.3.7. Managerial Shareholding

Bankruptcy threat is increased with high debt so managers may reduce the borrowing level for the manager's concern in long run sustainability/existence of the business. Director's shareholding calculated from shareholding pattern disclosed in the annual reports as the percentage of shared held by the executives.

## 3.4. Models Specification

This study follows multivariate regression approach in structured panel data set to measure the dependency of return on asset, leverage and dividend on the attributes of corporate governance. Panel data set helps to examine time series data and cross-sectional data simultaneously.

General form of panel data regression is like this

$$Y_{it}=\alpha + \beta X_{it} + \epsilon_{it} \ldots\ldots \text{(eq.1)}$$

Hausman test is used to observe the panel data which recommended fixed effect model is to be used. The study use the regression model by following the studies of (Van et al., 2006), (Ofoeda, 2017). In order to study the impact of corporate governance attributes on strategic decision and on leverage is as follows:

**Model # 01**

In order to test the effect of corporate governance attributes on leverage, we change the dependent variable in the above model, all other variables are same as just the inclusion of variable ROA and DIV in the above model and our empirical regression model are as follows:

$$lev_{it} = \beta_o + \beta_1 NED_{it} + \beta_2 CEO\ DUAL_{it} + \beta_3 BRD\ IND_{it} + \beta_4 DBAC_{it} + \beta_5 BRD\ MEET_{it} + \beta_6 INS\ OWN_{it} + \beta_7 BRDSIZE_{it} + \beta_8 OWN\ STR_{it} + \beta_9 Div_{it} + \beta_{10} ROA_{it} + \varepsilon_{it}$$

Where

Brd Size = Board size

NED = Non-Executive Directors

BRD IND= board independence

DUALITY= CEO/Chair Duality

INSTSH = Institutional Shareholding

Ownership structure = Managerial Shareholding

BRD MEET= board meeting

Dbac= directors attendance at board committee

ROA = Return on Assets

LEV = Leverage

DIV= Dividend

$\beta 0$ = Intercept of the equation

$\varepsilon$ = Error Term

$\beta = \beta$ is the slope which are same across all the firms and years in the model.

**Model # 02**

In order to test the effect of corporate governance attributes on dividend, we change the dependent variable in the above model , all other variables are same as just the inclusion of variable ROA and leverage in the above model and our empirical regression model are as follows:

$$DIV_{it} = \beta_o + \beta_1 NED_{it} + \beta_2 CEO\ DUAL_{it} + \beta_3 BRD\ IND_{it} + \beta_4 DBAC_{it} + BRD\ MEET_{it} + \beta_6 INS\ OWN_{it} + \beta_7 BRD\ SIZE_{it} + \beta_8 OWN\ STR_{it} + \beta_9 LEV_{it} + \beta_{10} ROA_{it} + \varepsilon_{it}$$

Where

Brd Size = Board size

NED = Non-Executive Directors

BRD IND= board independence

DUALITY= CEO/Chair Duality

INSTSH = Institutional Shareholding

Ownership structure = Managerial Shareholding

BRD MEET= board meeting

Dbac= directors attendance at board committee

ROA = Return on Assets

LEV = Leverage

$\beta 0$ = Intercept of the equation

$\varepsilon$ = Error Term

$\beta$ = $\beta$ is the slope which are same across all the firms and years in the model.

**Model # 03**

In order to test the effect of corporate governance attributes on ROA, we change the dependent variable in the above model, all other variables are same, and the empirical regression model are as follows:

$$ROA_{it} = \beta_o + \beta_1 NED_{it} + \beta_2 CEO\ DUAL_{it} + \beta_3 BRD\ IND_{it} + \beta_4 DBAC_{it} + \beta_5 BRD\ MEET_{it} + \beta_6 INS\ OWN_{it} + \beta_7 SIZE_{it} + \beta_8 OWN\ STR_{it} + \beta_9 LEV_{it} + \varepsilon_{it}$$

Where

Brd Size = Board size

NED = Non-Executive Directors

BRD IND= board independence

DUALITY= CEO/Chair Duality

INSTSH = Institutional Shareholding

Ownership structure = Managerial Shareholding

BRD MEET= board meeting

Dbac= directors attendance at board committee

ROA = Return on Assets

LEV = Leverage

$\beta 0$ = Intercept of the equation

$\varepsilon$ = Error Term

$\beta$ = $\beta$ is the slope which are same across all the firms and years in the model

## 3.5. Estimation Technique

Two specification techniques are used in the current study. To estimate the influence of CG attributes is fixed model technique is adopted as estimation technique which is recommended by the hausman test. Here the hypothesis are generated for making the decision between the appropriate estimation approach

$H_\circ$= the preffered model is random effect model

$H_1$=the preffered model is fixed effect model

**Fixed Effect Model**

In fixed effect model error term ($\varepsilon it$) varies non-stochastically with respect to t or i. making fixed effect model directs towards dummy variable model towards one direction.

Individual specific term $\alpha i$ that determines the unique intercept for each individual while the slope of $\beta$ is same for all individuals; Sheytanova (2015).

# CHAPTER 04

## EMPERICAL RESULTS AND DISCISSIONS

This Chapter deals with the description of details of the collected sample. This chapter review the empirical results for the effect of CG attributes on the strategic decision and profitability on 100 index companies listed on the Pakistan Stock Exchange. The empirical study is carried out by using fixed effect model as estimation technique. First, it finds the descriptive statistic of CG and then correlation estimates of explanatory variables is given. This chapter presents the results of regression of CG on the debt-equity ratio, dividend payout and ROA by using the fixed effect model.

## 4.1. Descriptive Statistics

In table 1 results reveal that the average debt ratio of the 100 index companies listed on Pakistan stock exchange is .56 which means the arithmetic mean of the debt ratio of these companies is positive and .57 which is quite a big number in itself but as these companies market capitalization is very large it means they are generating their own capital. Median of the debt ratio of 100 index companies is .55 which shows half of the value of debt ratio is equal or less or greater than .5. std. dev of 100 index companies is 0.4 which shows the deviation from mean Minimum value among the companies in debt is 0 in 10 years and maximum value is 5.18 which is of sanofi-Aventis Pakistan Limited.

DIV The mean value of the dividend of the 100 index companies listed on Pakistan stock exchange is .35 which means the arithmetic mean of the dividend of these companies is positive and .35. Median of the dividend of 100 index companies is .22 which shows half of the value of dividend is equal or less or greater than .05. std. dev of 100 index companies is 0.6 which shows the deviation from mean which is almost zero.

ROA The mean value of the return on asset of the 100 index companies listed on Pakistan stock exchange is .06 which means the arithmetic mean of the return of these companies is positive and .57. Median of the dividend of 100 index companies is .05 which shows half of the value of dividend is equal or less or greater than .05. std. dev of 100 index companies is 0.1 which shows the deviation from mean which is almost zero. Minimum value among the companies in debt is

-.49 of Mirza Sugar Mills Limited in 2010 in 10 years and maximum value is .85 of Wah Nobel Chemical in 2015.

NED The mean value of the Non-executive directors NED of the 100 index companies listed on Pakistan stock exchange constitute 57% of boards which means the arithmetic mean of the proportion of NEDs presence at board of these companies is positive, the part of non-executive members on board should be at least 50% (Khan& Jain,(2011)while 57% is fairly a good representation. However, it cannot be said with certainty that all the NEDs are also independent. Median of the dividend of 100 index companies is 5 which shows half of the value of NEDs is equal or less or greater than .05. std. dev of 100 index companies is 2.7 which shows the deviation from mean. Minimum value among the companies in NED is 0.00 in 10 years and maximum value is 14.

Results reveal that average size of board in Pakistan listed companies is 84% with the largest board of 15 members of Fauji Fertilizer Company Limited and minimum size of board is 5. (Which is the legally the lower limit for a public company). Results exhibits the board independence of 100 index companies listed on Pakistan Stock Exchange is 65% which shows the quite satisfactory figure in the Pakistani firms since the introduction of CG mechanism in Pakistan.

Results reveal that number of meetings held annually by the Pakistan's listed firms is 56% with the largest number of meetings are observed 33 by the Bestway Cement limited in 2009 and minimum number of meetings are 4 which are as per instruction of SECP. whereas the board of directors should meet at least four time in a year while the average attendance remain 37%.

CEOD The mean value of the separate positions held by the directors as per chairmanship of board committee and CEO of the 100 index companies listed on Pakistan stock exchange is 74% which means the arithmetic mean of the dividend of these companies is positive and Median of the CEO of 100 index companies is 1.std. dev of 100 index companies is 0.4 which shows the deviation from mean which is almost zero. Minimum value among the companies in debt is .00 in 10 years and maximum value is 1. Descriptive statistics shows the average of institutional shareholding 49% which is very encouraging figure while the managerial ownership is 46%.

*Table 4. 1*

| | DEBTRATIO | DIV | ROA | NED | BRDSIZE | BRD-IN | BRDMEE | DBAC | CEOD | INS_OWN | OWNER_STR |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Mean** | 0.564 | 0.503 | 0.061 | 5.767 | 8.426 | 0.658 | 5.675 | 0.377 | 0.745 | 49.921 | 0.465 |
| **Median** | 0.553 | 0.222 | 0.052 | 5.000 | 8.000 | 0.710 | 5.000 | 0.000 | 1.000 | 54.235 | 0.069 |
| **Max** | 5.180 | 14.00 | 0.854 | 14.00 | 15.000 | 1.000 | 33.00 | 1.000 | 1.000 | 98.840 | 45.350 |
| **Min** | -0.430 | 0.000 | -0.499 | 0.000 | 5.000 | 0.000 | 4.000 | 0.00 | 0.000 | 0.000 | 0.000 |
| **Std. Dev.** | 0.414 | 0.616 | 0.109 | 2.760 | 1.989 | 0.213 | 2.920 | 0.485 | 0.435 | 32.639 | 2.521 |
| **Skewness** | 4.149 | 8.784 | 0.245 | 0.897 | 1.542 | -0.831 | 5.251 | 0.504 | -1.126 | -0.168 | 11.788 |
| **Kurtosis** | 34.49 | 135.7 | 7.997 | 4.100 | 4.744 | 3.302 | 42.74 | 1.254 | 2.269 | 1.606 | 170.168 |

**Note:** *The descriptive statistics table shows the summary of each variable in the table.*

## 4.2. Correlational Matrix

The table 2 presents whether there exist the multicollinearity among the regressors' or not. Technique for detecting multicollinearity is through correlation matrix. The matrix results shows the negative correlation between the debt and the dividend that as the debt increases the decrease in dividend will occur. There also exist the negative correlation between the ROA and positively correlated to NED, board size, board independence and board meetings while there is negative correlation exist between the attendance of directors, CEOD, institutional and managerial ownership.

There is positive correlation between the dividend and profitability and also exist the positive correlation with the variables of corporate governance as NED, board size, board independence, attendance of directors at board meetings, separation of CEO and chairman position holding, and institutional shareholding. While it is negatively correlated to managerial shareholding.

ROA is negatively correlated to number of board meetings and ownership structure while all the independent variables are positively correlated to independent variables of the corporate governance.

Relationship between NEDs, board meeting and ownership structure is negative which shows that concentration of ownership leads to reduce the presence of NEDs on boards. While other independent variables are positively correlated with NED presence.

The size of board is found negatively correlated with managerial ownership indicating larger boards may belong to diversified groups and do not hold ownership in the firm rather they are working more independently without being biased in interest of some shareholders.

Number of board meetings are negatively correlated to the presence of directors which shows that though the meeting are being held but the presence is very low and the separation of CEO and chairman position are also negatively relation to board meetings. Which gives notion that Independence of board is negatively correlated to board meeting that NEDs attendance at the board meeting are less observed. Attendance of directors is negatively correlated to ownership structure that shareholders directorship is not positively associated to attendance of meetings.

Separation of the decision control and management control is positively correlated to institutional shareholding while it is negatively associated to ownership structure. It shows that where there is separation of roles of chairmanship of directors and chairmanship of management leads to more holding of shares by institutions which is contrary to family owned business.

Institutional shareholding is negatively correlated to ownership structure. Both are contrary to each other. Correlational analysis indicates that ownership structure is negatively correlated to debt to equity ratio. This is in line with other studies which presents that as the managerial ownership increases, it tends to bring down the debt to reduce the cost and risk of bankruptcy. In Pakistan’s context generally the family owned companies are management control companies where families themselves are the owners and management as well, such structured firms are risk averse, avoid the thought of bankruptcy, hence refrain from taking high debt.

Table 4. 2

| | DEBT_ RATIO | DIV | ROA | NED | BRD_ SIZE | BRD_ IN | BRD_ MEET | DBAC | CEOD | INS_ OWN | OWNER _STR |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **DEBT RATIO** | 1.000 | | | | | | | | | | |
| **DIV** | -0.187 | 1.000 | | | | | | | | | |
| **ROA** | -0.346 | 0.237 | 1.000 | | | | | | | | |
| **NED** | 0.039 | 0.160 | 0.095 | 1.000 | | | | | | | |
| **BRD_ SIZE** | 0.047 | 0.154 | 0.077 | 0.819 | 1.000 | | | | | | |
| **BRD_IN** | 0.022 | 0.110 | 0.093 | 0.820 | 0.393 | 1.000 | | | | | |
| **BRD_ MEET** | 0.074 | -0.051 | -0.019 | -0.001 | 0.060 | -0.101 | 1.000 | | | | |
| **DBAC** | -0.073 | 0.122 | 0.032 | 0.316 | 0.212 | 0.297 | -0.017 | 1.000 | | | |
| **CEOD** | -0.137 | 0.155 | 0.175 | 0.157 | 0.119 | 0.171 | -0.005 | 0.114 | 1.000 | | |
| **INS_OWN** | -0.077 | 0.165 | 0.109 | 0.139 | 0.130 | 0.163 | -0.022 | 0.029 | 0.318 | 1.000 | |
| **OWNER_STR** | -0.054 | -0.053 | -0.003 | -0.090 | -0.099 | -0.063 | -0.045 | -0.038 | -0.147 | -0.148 | 1.000 |

**Note:** *The correlation value of each variable is given in the table of correlation matrix.*

## 4.3. Empirical Analysis

These techniques are determined by Housman test which suggest after evaluating the data that fixed effect model is best fit for the panel data set. Hausman test is consider best for the panel data

Hausman Test

*Table 4. 3*

| Test Summary | Chi-Square | p-value |
|---|---|---|
| **Debt** | 26.33 | 0.0033 |
| **DIV** | 25.05 | 0.0090 |
| **ROA** | 27.28 | 0.0024 |

**Note:** *This table presents the results of fixed effects model.*

$H_\circ$= the preffered model is random effect model

$H_1$=the preffered model is fixed effect model

Hausman has the probability value less than 0.05 in the above three models. Therefore we reject the null hypothesis of random effect model and accept the alternative hypothesis. According to which fixed effect model is best fit for our data estimations.

### 4.3.1. Impact of Corporate Governance on the Capital Structure Decision

The results of fixed effect multivariate regression analysis represents the impact of corporate governance on the capital structure of firms by following the above model.

$$lev_{it} = \beta_o + \beta_1 NED_{it} + \beta_2 CEO\ DUAL_{it} + \beta_3 BRD\ IND_{it} + \beta_4 DBAC_{it} + \beta_5 BRD\ MEET_{it} + \beta_6 INS\ OWN_{it} + \beta_7 SIZE_{it} + \beta_8 OWN\ STR_{it} + \beta_9 Div_{it} + \beta_{10} ROA_{it} + \varepsilon_{it}$$

It is observed that model is good fit because the probability (F-statics) is less than 0.05.

The results show the negative significant relation between the debt and dividend. That is why the hypothesis $H_9$ "dividend has a negative significant association with debt" is accepted. As the 1% increase in dividend leads to decrease in 3.7% decrease in leverage.

The results the negative significant relation between the profitability and leverage as 1% increase in debt leads to 53% decrease in leverage which are in line to hypothesis that $H_{10}$:" There is significantly the negative association between the ROA and leverage level" hence $H_{10}$ is accepted.

Presence of NED on the board has no significant impact on decision of financial mix. Which is contrary to hypothesis $H_1$: that There exist the "significantly positive association between the NED and debt to equity ratio" It is expected that due to presence of family held business NEDs are generally the representatives of institutional owners, independent outside members or a few nominees of the controlling shareholders. While board independence has positive significant relationship with the debt financing therefore the hypothesis $H_2$: board independence has significant positive impact on gearing level" is accepted that board independence according to tradeoff theory go for the benefits what the benefits an organization can have by taking decision on strategic scenarios

The results provides evidence about the existence of insignificant relationship between size of board and debt to equity ratio as the p value is .982. The hypothesis of this study $H_3$: "board size is significant positive association with gearing level" is rejected because of its significance.

CEO/Chair separation has negative significant impact on the debt to equity ratio which signify lowering the agency cost and the independent in making decision but this finding is rejecting the hypothesis of this study that $H_4$: "CEO duality significantly positive association between the and gearing level". Which is contrary to the studies of (Fosberg, 2004) that two tier leadership structure have higher debt portion in the capital structure and inline to one-tier system which can arise the agency conflicts (Abor,2007).

The result shows the positive significant relationship between the numbers of board meeting held annually as the number of board meetings increase is observed by 1% it will lead to increase in debt by 0.9%. Hence the hypothesis of this study $H_5$: "board meeting significantly positive association on leverage" is accepted. while the attendance on the board meetings has negative significant effect on the leverage that as the 1% presence increases it leads to reduction of debt by 5.5% results are inline to the to the hypothesis of this study $H_6$: "attendance of directors has significant positive association with leverage" is rejected because of its being positive.

Similarly, institutional shareholding estimation also show insignificant relation with the debt because of their lesser representation as the independent non-executive board of directors to make decisions for the company's decisions. Hence hypothesis of this study$H_7$: "institutional shareholding has positive significant impact on debt is rejected".

Directors ownership is considerably affects financial mix represented by debt to equity ratio. An increase in ownership structure by 1% leads to reduction in leverage by 0.8 %. The result is inline to the hypothesis of this study that $H_8$: "ownership structure is significantly negative to debt ratio". It could be discussed that keeping higher leverage ratio increase the threat/risk of default and management interest for the long term survival persuade them to pursue the debt low in capital structure according to pecking order theory that it the last resort for the organization to take the debt and preferring the earning of the organization to finance its operations. These findings are in line to Friend and Lang (1988) who concluded that lack of any outside substantial shareholding the option to keep the debt level low will continue.

*Table 4. 4*

| **debtratio \|** | **Coef.** | **Std. Err** | **t** | **P>\|t\|** |
|---|---|---|---|---|
| **Div** | -.037 | .016 | -2.33 | 0.020 |
| **Roa** | -.532 | .109 | -4.84 | 0.000 |
| **NED** | -.032 | .021 | -1.50 | 0.133 |
| **Brdsize** | -.000 | .020 | -0.02 | 0.982 |
| **Brdin** | .360 | .179 | 2.01 | 0.045 |
| **CEOD** | -.103 | .040 | -2.56 | 0.011 |
| **Brdmeet** | .009 | .004 | 2.11 | 0.035 |
| **Dbac** | -.055 | .024 | -2.27 | 0.023 |
| **Insown** | -.001 | .001 | -1.46 | 0.144 |
| **Ownerstr** | -.008 | .005 | -1.68 | 0.093 |
| **_cons** | .685 | .171 | 3.99 | 0.000 |

F test that all u_i=0: F(99, 986) = 9.97 Prob > F = > 0.0000

### 4.3.2. Impact of Corporate Governance and Strategic Decision on Dividend Policy

Following table presents the results of fixed effect multivariate regression analysis shows the impact of corporate governance on dividend policy of Pakistan listed firms on Pakistan Stock Exchange.

$$\text{DIV it} = \beta_o + \beta_1 NED_{it} + \beta_2 CEO\ DUAL_{it} + \beta_3 BRD\ IND_{it} + \beta_4 DBAC_{it} + \beta_5 BRD\ MEET_{it} + \beta_6 INS\ OWN_{it} + \beta_7 BRD\ SIZE_{it} + \beta_8 OWN\ STR_{it} + LEV_{it} + \beta_{10} ROA_{it} + \varepsilon_{it}$$

It is observed that model is good fit because the probability (F-statics) is less than 0.05.

The results show the negatively significant relation between the dividend and leverage that as the increase occur in the debt it tend to decrease in the dividend payout. Therefore hypothesis$H_9$: "leverage has significant negative impact on dividend payout" is accepted. This finding is inline to the results of Mayers and Bacon (2004); Fama and French (2002) who provided results the significantly negative results between the leverage and dividend.

The results highlights the insignificant relationship between the profitability and dividend distribution. Therefore the hypothesis of "ROA significant positive impact on leverage" is rejected because of its significance. According to Naeem and Nasr (2007) that companies likely to pay dividend just though profit earning or they pay less dividend because they are on retention mode.

These results reveal the insignificant relation between the determinants of CG like board size, institutional ownership, managerial ownership, number of board meeting, board independence, CEO duality with dividend giveaway. Therefore these empirical results of the model rejects the hypotheses of this study $H_1$, $H_2$, $H_3$, $H_4$, $H_5$, which assumes the positive significant relation among these variables with dividend payout. These results are inline with the findings of (Bokpin,2011) that determinants of CG insignificant to dividend paying. However director's attendance has statically positive impact on dividend payments hence we accept the hypothesis of the study attendance by the directors on the meeting is positively significant with the dividend.

Results reveal insignificant relation of institutional and directors shareholding which leads to the rejection of the hypothesis of this study $H_7$, $H_8$that there exist the positive and negative significant impact on dividend payout respectively.

In Pakistan corporate mechanism are not vigilantly monitored by corporate law authorities that is why controlling authorities tend to pay low dividend to raise the funds for the companies.

There is less representation of the independent board of directors which restrict the institutional shareholding to play significant role in dividend payout. Because of family owned business structure makes the board reluctant towards paying dividend. Jensen (1986) argued that dividend averse management is also reluctant to lose control over earnings.

*Table 4. 5*

| Div | Coef. | Std. Err | t | P>\|t\| |
|---|---|---|---|---|
| **Debtratio** | -.146 | .063 | -2.33 | 0.020 |
| **Roa** | .325 | .220 | 1.48 | 0.140 |
| **NED** | .002 | .043 | 0.06 | 0.951 |
| **Brdsize** | .049 | .040 | 1.21 | 0.228 |
| **Brdin** | .149 | .357 | 0.42 | 0.675 |
| **CEOD** | .016 | .080 | -0.21 | 0.833 |
| **Brdmeet** | -.001 | .009 | -0.17 | 0.862 |
| **Dbac** | .148 | .048 | 3.05 | 0.002 |
| **Insown** | .001 | .002 | 0.76 | 0.449 |
| **ownerstr** | -.012 | .010 | -1.27 | 0.204 |
| **_cons** | -.216 | .343 | -0.63 | 0.529 |

F test that all u_i=0: F(99, 986) = 1.86 Prob > F = > 0.0000

### 4.3.3. Impact of Corporate Governance on Firm Performance

The 4.6 table represents the result of corporate governance and strategic decision on the performance of the particular firms enlisted on PSX

$$ROA_{it} = \beta_o + \beta_1 NED_{it} + \beta_2 CEO\ DUAL_{it} + \beta_3 BRD\ IND_{it} + \beta_4 DBAC_{it} + \beta_5 BRD\ MEET_{it} + \beta_6 INS\ OWN_{it} + \beta_7 SIZE_{it} + \beta_8 OWN\ STR_{it} + \beta_9 LEV_{it} + +\varepsilon_{it}$$

It is observed that model is good fit because the probability (F-statics) is less than 0.05.

Effect of leverage on profitability is observed negatively significant as the debt 1% increases it lead to decrease in profitability by 4.4%. Therefore hypothesis of this study $H_9$ "positively significant impact of debt on profitability" is rejected. It shows that companies 100 index enlisted on Pakistan Stock Exchange prefer internally raised fund for the purpose of financing. This study is contrary to the some of the studies (Zeitan & Tian, 2007) which found that leverage has significant impact on the profitability.

Results presented the positively significant relation between the board independence and returns on the asset that an independent board with inner and outer expertise make good portfolios of their available funds/assets and generate a good return. Therefore$H_2$: "board independence significantly positive association with profitability" is accepted. This result is consistent with the study of (Abor and Biekpe, 2007) in support of inclusion NEDs brings the profitable impact on the returns of assets.

Attendance is the important determinant which shows the interest and concern by the directors towards the organization but this regression result shows the negatively significant relation with the attendee of directors with the returns on asset. Therefore hypothesis of this study $H_6$: "directors attendance at board committees significantly positive impact on profitability" is rejected as the statistically the association of attendance is negative.

The results presents that variables of corporate governance as NED, board size, CEO duality, number of board meet, institutional and directors ownership structure have insignificant relation with the profitability of the firm. Thus, this result leads to the rejection of hypotheses of the study$H_1$, $H_3$,$H_4$,$H_5$, $H_7$,$H_8$ which based on the positive significant association between the above independent variables and profitability. Kumar and Nihalani (2014), found board meetings not significant to company's performance. Olatunji and Stephen (2011), evaluated negative relation of NED with returns on assets. In Pakistan's market the corporate governance is observed weak as it is the emerging market and CG practices are not totally being monitored because of weak legal practice.

*Table 4. 6*

| **Roa** | **coef** | **std.err** | **T** | **P** |
|---|---|---|---|---|
| **Debtratio** | -.044 | .008 | -4.98 | 0.000 |
| **NED** | -.009 | . 006 | -1.60 | 0.110 |
| **Brdsize** | .009 | .005 | 1.54 | 0.123 |
| **Brdin** | . 109 | .051 | 2.13 | 0.033 |
| **Insown** | -.00005 | . 0002 | -0.19 | 0.851 |
| **CEOD** | -.016 | . 011 | -1.42 | 0.155 |
| **Brdmeet** | -.001 | . 001 | -1.17 | 0.240 |
| **Dbac** | -.013 | . 006 | -1.99 | 0.047 |
| **Ownerstr** | -.002 | . 001 | -1.40 | 0.160 |
| **_cons** | . 025 | . 049 | 0.52 | 0.604 |

F test that all u_i=0: F(99, 987) = 7.30 Prob > F = > 0.0000

# CHAPTER 05

## CONCLUSION

## 5.1. Summary

Using the sample of non-financial firms from 100 index companies enlisted on Pakistan Stock Exchange over the period 2005-2015. This study empirically examines the relationship between determinants of corporate governance, strategic decision and profitability by using regression analysis. The results reveal that Pakistan as the emerging market, practices of corporate governance is significant for capital structure while it has not shown the very influential impact on the profitability and dividend which is in the response of weak legal environment and this result is in line with the findings of (La Porta, et al., 1997, 1998, 1999, 2000).

## 5.2. Key Findings

The results reveal there is positive association between the corporate governance determinants and capital structure (Wen *et al.,* 2002; Berger *and* Humphrey, 1997; Pfeffer and Salancick, 1978) but only the few determinants are significant to profitability. While the dividend is being paid less (Dwivedi and Jain, 2005; Al-Najjar and Kilincarslan, 2016; La Porta *et al.,* 2000) because of weak legal implication and family owned business trend makes the corporate governance practices weak to protect the rights of all shareholders.

Role of corporate governance attributes are significant for leverage that inclusion NEDs has increased the creditworthiness of the company, decisions making bodies on the board help the firm in getting loans as trade off theory debt benefits the firm in getting tax shield and decrease the default risk as to run the operations lesser cost than the cost of equity and makes the management optimistic towards taking risk and vigilantly use it because of its terms of giving it back. CEO and chairman seat has open the firms attitude towards market and make it to generate more returns by taking risker decision board meeting has made the information symmetrical to all stakeholders. Hence ownership structure still have the insignificant relation with the capital structure. Which shows that the benefits by law which asking them to take debt while due to family ownership is restricting them to refrain from it.

Dividend is considered important for the shareholders as most observing trend that shareholders prefer dividend over reinvestment in null NPV projects. They do not like to invest which is not adding value to their capital as the sole interest of the investor is to increase in their wealth. Because of family owned business dividend giving trend is observed less in Pakistan's market as they prefer to retain earnings rather than paying dividend. Though attendance by board of directors and more return earning firms are observed significant to dividend payout.

Results reveal board independence, and attendance of directors have the positive impact on the ROA which shows the inclusion expertise opinion on the board and increases creditworthiness of the firm which is showing their vigilant monitoring and confidence to withstand in external environment and capture the market share. ROA shows negatively significant relation with debt that the Pakistan market prefer to finance by its retained earnings and they are more vigilant when they are running finance is their earning one reason on being vigilant at this mode of financing is family owned business that they themselves are the NEDs and shareholders who prefer the expansion of the business by retain earnings.

Corporate governance is a wide spreading issue throughout the world. Sound practices of this corporation governing mechanism is basically affected by the legal, political, financial frame work, economy size, stakeholders understanding of the market, availability of information and structure of capital market. Like many developed economies corporate governance is playing a significant role to transform the economy of the country towards more efficiency. Although it is new to the economy still there need new much attention in this discipline.

Concluding the discussion that results provide evidence that listed companies in PSX where corporate governance practices are in it nascent stage, efforts should be made for information exposure is leading the behavior of the economy towards the efficiency. Pakistan firms have improved a lot after the introduction of law in 2002 but still there is room for the better implementation of these laws. All attributes of the corporate governance code should be insured by the regulatory body to protect the minor shareholders. There is dire need to govern the firms through many others developments like director remunerations and hiring criteria.

Researches could help the institutions in sorting out the problems as students are the unbiased stakeholders so they can provide the better insight to the issue.

## 5.3. Recommendations

Board independence has significant impact on the firm performance hence, NEDs should be increased. Board attendance has significant impact on the firm performance so directors be encouraged to attend and contribute. Inclusion of independent NEDs and increase of institutional can have positive impact on dividend payout. Board size can increase the expertise as it will include the NEDs and INEDs which will have positive impact on the leverage and dividend policy. The above study is only dealing with firms further researches can be carried out to see the results sector wise.

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