

# Impact of Corporate Governance on Performance of Firms: A Case Study of Cement Industry in Pakistan

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Received July 26, 2013; Revised July 28, 2013; Accepted July 30, 2013

**Abstract** This research paper throws light on the relationship between the corporate governance and Firm financial performance in Cement industry of Pakistan. This study gives attention to three variables which include board Size, Family controlled firms, and CEO duality. Firm's performance is measured through return on equity, return on assets, and earnings per share, debt to equity and current ratio. Positive relationship between corporate governance and firm performance has been observed.

**Keywords:** corporate governance, firm financial performance, ROA, ROE, EPS, current ratio, debt to equity, board independence, CEO duality and audit committee independence

**Cite This Article:** Cheema, Khaliq Ur Rehman, and Muhammad Sadat Din, "Impact of Corporate Governance on Performance of Firms: A Case Study of Cement Industry in Pakistan." *Journal of Business and Management Sciences*, 1, no. 4 (2013): 44-46. doi: 10.12691/jbms-1-4-1.

## 1. Introduction

Corporate governance is "the system by which companies is directed and controlled". More simply we can say that "it is the framework by which the interests of various stakeholders are balanced". It shows a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance provide the mechanism by which the problems of corporation stakeholders, which include the shareholders, creditors, management, employees, consumers and the public at large are framed and resolved.

Corporate governance also includes the relationships among the many stakeholders involving external stakeholders and internal stakeholders. In contemporary business corporations, the main external stakeholders are shareholders, debt holders, trade creditors, suppliers, and customers. Internal stakeholders are the board of directors, executives, and other employees. Good and proper corporate governance is considered imperative for the establishment of a Competitive market. Corporate governance practices stabilise and strengthen good capital markets and protect investors. They help companies to improve their performance and attract investment. Corporate governance enables corporations to attain their corporate objectives and to protect the rights of shareholders.

### 1.1. Cement Industry in Pakistan

The cement industry of Pakistan plays a vital role in the socio economic development of the country. The development of cement sector has made rapid stride both in public and private sectors during the last two decades. At the time of independence there were only four units in the country having the capacity of 470,000 tons per annum,

these units were located at Karachi, Rohr, Wan and Dandot. The country at present has almost attained self-sufficiency in the supply of cement with very little imports whatsoever during the last few years. But now it has exceeded 36.841 million tons per annum as a result of establishment of new manufacturing facilities and expansions by the existing units. The competitive environment in the cement sector contributes to the common benefits of the industry and the end users. Infect the frame work of mixed economy is today truly evidence in cement sector leading to the maximization of social and economic advantages.

Pakistan has remained a net importer of the cement but due to the privatization of the units operating under state control and subsequent expansion programs by the new owners supported by financial institution has pushed the industry to a point where the country is bound to reach an oversupply situation. However, the recent increase in the energy cast provides opportunity sustain the situation for a relatively longer period. It would be possible because the expansion by the existing units and establishment of new units are being delayed.

### 1.2. Family and Non-family Firms

Family-owned companies are the organizations in which the shareholders (or) members belong to the same family and they take part in the management of the company and direct and operate the company. It is general concept that each family possess certain rules, has their own values, & histories, and communication styles.

Some families have a number of unique characteristics which serve as a strength to a family business, which include love, care, emotion, closeness, loyalty, stability, relationships, growth and development, safety, support, customs and traditions. Families may also have a number of negative aspects such as anger, tension, confusion and

competitiveness, which can affect a company. These qualities can support or harm a company. Family and Non-family businesses, is a burning issue in all over the world. Family own businesses are increasing day by day according to analysis that 60% of the businesses are family own and remaining 40% are the non-family controlled businesses. There is no application of principles and rules of corporate governance in family own businesses that are major part of the economy.

There is a shortage of research studies on family own and non-family own businesses in Pakistan, so there is wide gap of research on these businesses in Pakistan. The aim of the study is to fill this gap. In this study cement industry in Pakistan judged in term of earning per share (EPS). The firm performance has been judged on accrual basis system as well as on cash base system. For the purpose of accrual bases system, statement of profit & loss is analyzed and for cash basis system, cash flow statement is analyzed.

### 1.2.1. Problem Statement

What is the impact of Family & Non-family controlled firms, CEO duality, and board size on the performance of cement industry in Pakistan. To know the performance of the business, many factors can be kept in mind like profitability (cash basis profitability and accrual basis profitability), productive efficiency, and earning per share of the firm. In a study of impact of CG, Klapper and Love (2004) have argued that CG is more relevant in firms that employ intangible assets.

### 1.2.2. Objectives of this Study

1. To examine the impact of CG on the Family and non-family own businesses in cement industry of Pakistan.
2. To show the impact of board size and CEO duality on performance of business of cement in Pakistan.
3. To view the true picture of Cement industry and corporate governance in Pakistan.

## 2. Literature Review

In 1999 it is stated by the World Bank that corporate governance includes two mechanisms. One is internal corporate governance and other is external. The internal focus on giving priority to shareholder's interest and operates the board of directors to monitor top management. Where as external corporate governance monitors and controls manager's behaviors by means of external regulatory bodies like debtors, suppliers, accountants, lawyers and professional institutions.

Corporate governance is a necessary ingredient for the firm performance as well as for the overall growth of the economy of the country [1,2]. Stress that corporate governance is about ensuring that the business is running well & investors receive a fair return. It is also referred by [3] that corporate governance either it is external or internal, it plays an important role in enhancing the performance & value of the firm. According to [4] corporate governance is an umbrella term that includes specific issues from interactions among senior management, shareholders, board of directors & other corporate stakeholders.

### 2.1. Board Size

[5] Show in the context of board size that larger board size leads the firm towards the development of financial markets and on the other hand small board size lead the firm towards the developed financial markets, board size is significantly & negatively related to firm performance as if the board size is larger the insider's opinion diversity shows a negative impact on decision making, related to board size conclude that board size exists correlation with firm value [6]. Examine that board size has no any impact on firm performance, found that board size is negatively related to EPS.

### 2.2. CEO Duality

CEO duality is negatively and significantly related to firm performance [6]. Show that there is adverse effect on performance of firm if CEO also acts as a chairperson of board of directors [7]. Assumes that corporate governance is affected if the same person act as chairman and also CEO and it has impact on firm performance [8]. Attest that CEO duality deteriorates the firm performance.

### 2.3. Family Controlled Firms

Family controlled companies have higher sale growth and great improvement in net margin as compared to non-family businesses [9]. It is found by that family owned firms are more efficient and valuable in contrast to non-family own companies. A study made by [10], that family control firms have high profitability as non-family constitute low profitability. There is no difference regarding performance between family and non-family controlled firms [11].

## 3. Methodology

### 3.1. Sample and Data Collection

For the purposes of this study, panel data set covers data of fifteen companies of the cement industries of Pakistan including family and non-family from the period of 2007 to 2011. The required data has been gathered from the annual reports of these firms. All the financial data has been mentioned in terms of Pakistani rupees.

### 3.2. Model

This study constructs a regression model for carrying out empirical analysis.

Model: The relation between governance mechanism and firm performance

$$\text{Performance} = a_0 + a_1 \text{Boardsize} + a_2 \text{Duality} + a_3 \text{FCF} + \varepsilon_i$$

Where

Performance is the earning per share.(EPS)

Board size; represents the board size of firm  $i$  in year.

Duality; is a dummy variable for CEO duality of firm in year

Fcf ; represents the family person as the owner of the business.

### 3.3. Variables, Definitions and Measurements

### Hypothesis

- a. H1: Board size is negatively related to firm performance.  
 b. H2: CEO duality is negatively related to firm performance.  
 c. H3: Family control firms have high profitability.

Dependent Variables EPS	Description/Measurement It serves as indicator of company' profitability
ROE	The amount of net income returned as a percentage of shareholders equity.
Independent Variables Board size	No's of executive & non- executive directors on the board of the firm.
CEO duality Family control firm- FCF	CEO is also the chairperson of the board. Own & controlled by the family members likewise there is blood relationship among directors.

## 4. Results & Conclusions

### Descriptive Statistic:

This study takes earning per share to measure the earning on per share. Table 1 show that average earning on per share is 1.67 (in rupees).

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
EPS	60	-12.7	19.7	1.678	5.7028
CEO Duality	60	0	1	.13	.343
F & Non-F	60	0	1	.60	.494
B Size	60	6	10	7.47	.965
Valid N (list wise)	60				

### Regression Analysis:

Table 2. Regression Analysis

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	4.944	5.674		.871	.387
CEO Duality	6.356	2.011	.382	3.160	.003
F & Non-F	2.487	1.469	.215	1.693	.096
B Size	-.754	.713	-.128	-1.057	.295

On the base of data available it results that CEO duality has impact on firm performance. So CEO duality is negatively and significantly related to cement industry performance, as the performance indicator for firm is

EPS...Family and non family firms has also impact on cement firm's performance. It reveals that family own cement firms have high profitability and high earning on per share as compared to non-family cement industries. Similarly board size shows insignificant results. Its shows that board size do not affect the performance of a firm. So here our hypothesis of negative relation of board size to firm performance is rejected. It reveals that board size has positive relation to cement industry performance in Pakistan.

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