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Impact of Corporate Governance on Firm Performance: An Empirical Study on Different Sectors in Pakistan

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ABSTRACT

In this era of globalization, the business world requires an outstanding system of governance. Many large and listed companies are increasingly concerned about these issues. Practicing good corporate governance can attract investment, improve organizational performance, and reduce investor risk. It is important to carefully consider the factors may affect the relationship between corporate governance and profitability. The purpose of this thesis is to examine the impact of specific variables of corporate governance on profitability using 10years of data (2010-2019) from 22 listed companies on the Pakistan Stock Exchange. The results indicates a positive impact of board meetings, gender diversity and board size on stock returns and Tobin's Q, while showing a negative impact of leverage, board composition and audit committee members on Tobin's Q and Stock return.

Introduction

At the present time it is an undeniable that corporate governance is one of the biggest issues in the business world. There was a time when this subject doesn't matter but after the failure of many businesses due to corporate governance, it has taken place in every business discussion (Siromi & Chandrapala, 2017). As organization with effective application of corporate governance are directly proportional with effectiveness of net profit margin (NPM) (Mohan & Chandramohan, 2018) therefore the organization composed, conduct and make strategies to enhance the wellbeing of the organization (Rouf, 2012). To increase profitability managers and other internal customers take appropriate steps of corporate governance. These mechanisms give surety to the customers in organizations that they will be given sufficient profits on their reserves (Mohan and Chandramohan, 2018). Through relevant implementations of corporate governance and performance corporation boost benefits, become better in competitiveness and become more reliable which increases its relations with investors, customers, stockholders, business partner and many more (Amin, 2017). But if this system did not survive, external customers would not provide to buy their equity securities therefore, company would be required to depend completely on their possess within initiative cash flows and collect monetary income to finance continuing operations more over money-making asset opportunities (Halimatusadiah et al., 2015). Good corporate governance reduces corruptions, risk and mismanagement to increase in profitability moreover with better monetary resources and earnings firms can achieve their goals therefore be cautious for the factors that affect the profitability of the firm (Ajanthan, 2013; Salman et al., 2024; Zhu et al., 2024; Hanif et al., 2024). In both developed and developing nations powerful corporate governance is important because it plays an important role in management of the firm (Shahzad et al., 2025). There are many studies which aim to verify the effect of joint control on benefit (Abdullah & Tursoy, 2019). Before the crises every organization was not running with proper corporate governance and through this they were not earning profits as well as there was a downsizing in the companies which causes a high rate on unemployment (Vo & Nguyen, 2014). There is also a poor risk management through which companies cannot raise capital effectively and efficiently. This crisis highlights the importance corporate governance which is the main factor of increasing profitability (Ciftci et al., 2019). Organization having proper board size, board composition, managerial remuneration, board meetings, gender then a large number of investors, stockholders, share-holders and others can easily make investments in any organization and earn profits (Kumar et al., 2023). A large number of researches have been done on impact of corporate governance on profitability but as such no study has been made in which both organization and banks our studied together in Pakistan (Aggarwal, 2013). Abundance of researches has been done in the globe to find the relation between them but the results are varied and uncertain. So, this study is to determine the effect of corporate governance on firm performance from different organizations and banks with different variables so that they can take benefits from it and improve their corporate governance (Aggarwal, 2013).

Research Questions

- What is the effect of board size on firm performance?
- What is the effect of board composition on firm performance?
- What is the effect of gender on firm performance?
- What is the effect of audit committee member on firm performance?
- What is the effect of leverage on firm performance?
- What is the effect of board meetings on firm performance?

Objectives of the Study

1) To ascertain the impact of board size on firm performance.
2) To ascertain the impact of board composition on firm performance.
3) To ascertain the impact of gender on firm performance.
4) To ascertain the impact of audit committee member on firm performance.
5) To ascertain the impact of leverage on firm performance.
6) To ascertain the impact of board meetings on firm performance.

Literature Review

Theoretical Perspective

Corporate governance is becoming more important, particularly in relation to the oversight provided by the board of directors. Much of the research in this field is based on agency theory. Corporate governance has mainly focused on addressing problems associated with the separation of ownership and control in modern corporations. An agency relationship constitutes a contractual agreement in which one or more individuals (referred to as the principal) enlist the services of another (known as the agent) to carry out specific duties on behalf of the principal. In this arrangement, the agent is entrusted with certain decision-making powers. Consequently, agency theory directs its attention to the division of authority between ownership and management. It argues that establishing a robust board structure can mitigate the conflict of interest between managers and business owners, a challenge commonly known as the Agency problem. Addressing this problem has driven the evolution of corporate governance worldwide, as researchers have sought solutions through empirical evidence

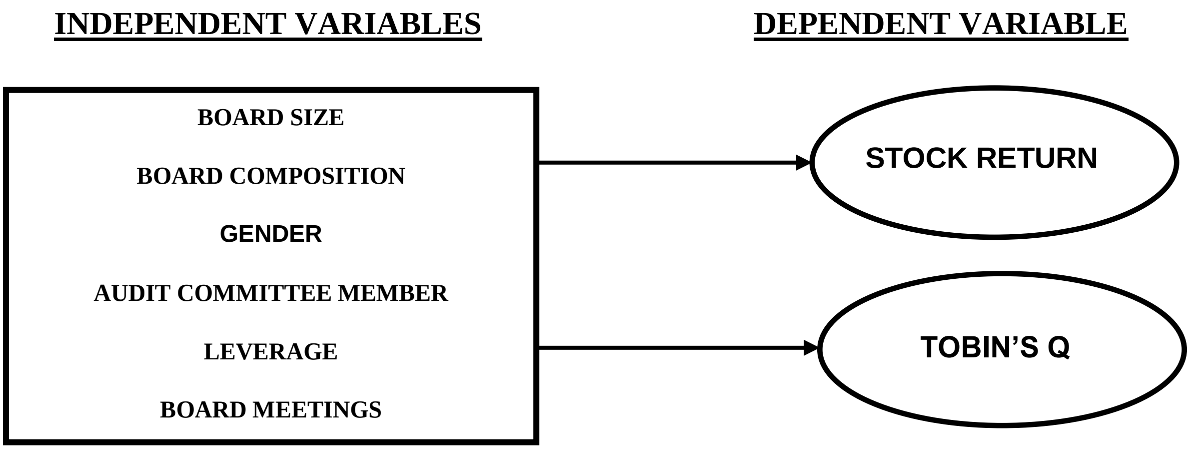
Review of the Empirical Studies

The recent studies focused on the significance between corporate governance and firm performance as most of the variables deals with direct relationship where as some have indirect relationship between them (Peters & Karibo B. Bagshaw, 2014) Corporate Governance refers to the processes and structures that manage a company while safeguarding stakeholders' interests. It centers on principles like transparency, accountability, fairness, and responsibility. Effective governance improves a firm's performance and competitiveness, leading to business excellence (Mohan & Chandramohan, 2018). Current growth in corporate governance awareness in Sri Lanka has led to mandatory adherence to rules integrated into the Colombo Stock Exchange regulations. This prompts evaluation of governance implementation's impact on company performance and capital structure (Siromi & Chandrapala, 2017) Practice of good corporate governance is necessary in reducing the risk of capitalist venture, reconstructing the action of the company and fascinating the capital investment. Due to difference in economic, social, cultural and political contexts, there is a difference in corporate governance of different countries (Heenetigala & Armstrong, 2012). This importance of corporate governance has witnessed a global surge over the past decade, underscored by its adherence to legal standards and guiding principles. This study steps into this discourse by embarking on an investigation into the intricate relationship between corporate governance and company performance within the dynamic realm (Ahmed et al., 2020)**.** Many researches in the past decade have revealed significant relationships between various aspects of corporate governance and corporate performance however, recent studies emphasize that specific attributes of corporate governance make it challenging to establish a universally applicable link between corporate governance and performance (Abdullah & Tursoy, 2023). It may not be feasible to determine a direct correlation between corporate performance and a particular governance feature unless that feature is considered in the context of other governance elements (Peters & Karibo B. Bagshaw, 2014) .

Researcher uses both quantitative and qualitative technique. By using these techniques, they can gather the results of the research questions and hypothesis (Danoshana & Ravivathani, 2013). Analyzing the data, the study found that smaller board size negatively affects performance in listed firms aligning with agency theory, managerial ownership has an adverse and significant connection to firm performance consistent with agency theory and there is an insignificant link between audit committees and performance, indicating a lack of clear influence (Ahmed et al., 2019). Few studies consider that profitability consists of other factors too such as sales, upgraded technologies; output resources and other factors are needed for the increase in profitability. The organization did not depend only on corporate governance for the profitability but also focus on different factors which are also needed for the betterment of the company (Peters & Karibo B. Bagshaw, 2014) Moreover to enhance corporate governance granting greater independence and authority to oversight committees within firms and strengthening the functions of remuneration and audit committees which have direct influence on financial decisions (Siromi & Chandrapala, 2017)

The researcher concluded the thesis with that to make the companies more profitable, the organization should make good strategies as raise their standards and performance (Drašković & Lojpur, 2013). There should be a high level ownership which will encourage improving the performance of company and have equal rights to members of the organization which will help in increase in profit (Vo & Nguyen, 2014). Another way of increasing firm performance there should be an extra care of investors by having trust on them, good environment, transparent and fair results (Aggarwal, 2013)

Conceptual Framework



Methodology

This research analysis is based on secondary data collected from the financial statements of a sample of organizations and banks listed on the Karachi Stock Exchange (KSE). The sample consists of 22 companies from Karachi Stock Exchange and data from the years 2010 to 2019 were analyzed to ensure reliability. Additionally, relevant articles from academic journals were also reviewed. A convenient sampling technique was employed to simplify data collection without the complications of a randomized sample. Since historical data is being used, quantitative analysis is appropriate for this study. The variables considered to determine the impact of corporate governance on profitability are as follows:

Measurement of Variables

To determine the impact of corporate governance to profitability, the variables are listed below:

Board size	Total number of board of directors.
Board composition	Dividing no. of independent or non-executive directors by total number of board of directors.
Gender	0 for male and 1 if both male and female
board meeting	no. of board meeting held during year
audit committee members	no. of audit member during year
leverage	value of debt ratio

$$\text{STOCK RETURN} = \frac{(\text{INITIAL STOCK PRICE - ENDING STOCK PRICE}) + \text{DIVIDEND}}{\text{INITIAL STOCK PRICE}}$$

$$\text{TOBIN'S Q} = \frac{\text{TOTAL MARKET VALUE OF THE FIRM}}{\text{TOTAL ASSET VALUE OF THE FIRM}}$$

Results

Descriptive Statistics

Table 1:

Variable	Mean	Median	SD	Skewness	Kurtosis
Tobin's Q	1.76	0.655	3.34	3.72	19.26
Stock Return	3.84	0.14	12.97	3.84	17.50
Board Size	9.14	9	1.611	0.66	2.89
Board Composition	0.70	0.75	0.211	-1.52	5.64
Gender	0.386	0	0.488	0.466	1.21
Board Meetings	5.34	5	1.188	1.03	4.06
Audit Committee Member	4.022	4	0.85	0.39	2.34
Leverage	3.71	0.755	8.80	3.73	16.4

Tobin's Q & Stock Return with having dependent variables i.e., board size, board composition, gender, board meetings, audit committee member and leverage having 220 observation each respectively with mean values 1.76, 3.84, 9.1, .78, .38, 5.3, 4.0 & 3.7 having sd of 3.3, 12.97, 1.61, .211, .48, 1.18, .85, & 8.88. Except board composition all variables are positively skewed which means it will lie at the right side of the bell. Except board size, gender & audit committee member the value of kurtosis is greater than 3 i-e 19.2, 17.5, 5.6, 4.06, & 16.4 respectively which means it has a thick tail in the graph while board size, gender & audit committee member is less than 3 which shows thin tail. The following table shows the descriptive statistics of variables. The mean value of Tobin's Q is 1.76 percent. However, the mean of Stock Return is 3.84% which shows that approx. 4 percent of firms' profitability is generated by stock return and approx. 2% from Tobin's Q. The mean value of board size is 9.14, board composition is .70, gender is 0.386, board meeting is 5.3, audit committee member is 4.02 and leverage is 3.71 which show that board size has the highest % i.e., 9.1percent which will generate the performance of the firm.

Multicollinearity

Table 2:

	Tobins' Q	**Stock Return**	**Board Size**	**Board Composition**	**Gender**	**Board Meeting**	**Audit Committee Member**	**Leverage**
TOBINS' Q	1.0000							
STOCK RETURN	-0.0510	1.0000						
BOARD SIZE	-0.0070	-0.1022	1.0000					
BOARD COMPOSITION	-0.0426	0.2050	0.0502	1.0000				
GENDER	0.2157	0.0898	0.4230	-0.1258	1.0000			
BOARD MEETING	-001458	0.0964	0.0307	0.0662	0.0034	1.0000		
AUDIT COMMITTEE MEMBER	0.0955	0.0965	0.0307	0.1276	0.0662	0.1134	1.0000	
LEVERAGE	-0.1062	-0.1158	0.0618	-0.5380	-0.0831	0.1078	-0.0366	1.0000

Pearson Correlation analysis is used to measure the strength and direction of linear association among variable. The coefficient[1] of correlation ranges between ±1.0. The pair- wise correlation does not show any evidence of presence of multicollinearity among the variables. The problems of multicollinearity rise at coefficients of 0.80, see Gujarati (2003) and also the value of VIF is less than 10 so I can say that there is no multicollinearity between the variables.

Table 3: Regression Results of Stock Return

Variable Names	**Coefficient**	**T-Value**	**P-Value**
BOARD SIZE	-2.01	-3.58	0.00
BOARD COMPOSITION	-15.51	-3.13	0.002
GENDER	5.19	3.00	0.003
BOARD MEETINGS	3.199	4.02	0.00
AUDIT COMMITTEE MEMBERS	1.22	1.27	0.204
LEVERAGE	-.366	-3.17	0.002

The findings of this study reveal significant relationships between corporate governance variables and stock returns. An increase in board size by one unit leads to a decrease in stock return by 2.01%, suggesting that larger boards may not necessarily enhance firm value. Similarly, an increase in board composition by one unit results in a 15.5% decline in stock return, indicating potential inefficiencies in governance structures. However, gender diversity positively impacts stock performance, with a one-unit increase in gender diversity leading to a 5.19% rise in stock return. Board meetings also show a positive effect, as an additional meeting increases stock return by 3.199%. The statistical analysis further supports these relationships, with p-values confirming the significance of gender diversity (p = 0.003) and board meetings (p = 0.00) in influencing stock returns. While board size demonstrates a significant impact on profitability (p = 0.00), its influence on Tobin's Q is found to be insignificant (p = 0.491), suggesting that larger boards may not necessarily contribute to higher market value. The audit committee member variable shows an insignificant relationship with stock returns (p = 0.204), while leverage presents a significant negative impact, where a one-unit increase in leverage leads to a 0.366% decline in stock return (p = 0.00). These results highlight the complex dynamics of corporate governance elements and their varied effects on firm performance, emphasizing the importance of an optimized governance structure for improved financial outcomes. The value of R-square is 0.16 which means there is 16% variation of independent variables on dependent variable.

Table 4: Regression Result of TOBINS' Q

Variable Names	**Coefficient**	**T-Value**	**P-Value**
BOARD SIZE	.105	0.69	0.491
BOARD COMPOSITION	-1.16	0.86	0.388
GENDER	1.166	2.47	0.014
BOARD MEETINGS	-0.36	-1.68	0.094
AUDIT COMMITTEE MEMBERS	0.400	1.53	0.127
LEVERAGE	-0.044	-1.42	0.157

The interpretation of the beta coefficients in relation to Tobin's Q reveals how corporate governance variables impact firm value, assuming all other factors remain constant. A one-unit increase in board size leads to a 10.5% increase in Tobin's Q, suggesting that larger boards may enhance strategic oversight and firm valuation. Conversely, a one-unit increase in board composition results in a 1.16% decrease in Tobin's Q**,** implying that certain changes in the makeup of the board may not positively influence market perception. The most significant impact comes from gender diversity, where a one-unit increase leads to a substantial 116% rise in Tobin's Q, emphasizing the strong positive market response to greater female representation on boards. On the other hand, an increase in the frequency of board meetings slightly reduces Tobin's Q by 0.36%, possibly due to inefficiencies or signaling internal issues. A one-unit increase in audit committee members boosts Tobin's Q by 40%**,** highlighting the value of enhanced financial scrutiny and governance. Interestingly, an increase in leverage leads to a 0.44% decrease in Tobin's Q, indicating that higher debt levels may negatively impact investor confidence and perceived firm value. The interpretation of p-values helps determine the statistical significance of the relationship between independent variables and Tobin's Q at a 5% level of significance. The p-value for Board Composition is 0.388, which is greater than 0.05, indicating that the relationship is statistically insignificant, and we fail to reject the null hypothesis. Similarly, the p-value for Board Meetings is 0.094, and for Audit Committee Member it is 0.127, both of which are also above 0.05. Therefore, their relationships with Tobin's Q are not statistically significant, and we accept the null hypothesis for both. Likewise, Leverage has a p-value of 0.157, which again exceeds the 0.05 threshold, confirming an insignificant relationship with firm value. However, Gender has a p-value of 0.014**,** which is less than 0.05, indicating a statistically significant relationship. Thus, we reject the null hypothesis in this case and conclude that gender diversity significantly influences Tobin's Q**.** The value of R-square is 0.08 which means there is 8% variation of independent variables on dependent variable.

Discussion on Results

H$_1$: There is any relationship between corporate governance and firm performance.

The study reveals a positive relationship between corporate governance and profitability. Various factors such as leverage, board composition, board meetings, gender, and board size show statistical significance in their relationship with stock returns. However, the presence of an audit committee member is not statistically significant. Most variables positively impact firm performance, except for board composition and leverage, which negatively affect Tobin's Q and stock returns. These finding align with the previous research (Mohan & Chandramohan, 2018)) which is stated that Larger board sizes may be positively correlated with higher Tobin's Q, suggesting the potential for increased firm values. Increased representation of independent directors on boards might contribute to enhanced stock returns, suggesting a link between board composition and financial performance**.** Greater gender diversity on boards might lead to enhanced corporate performance, potentially resulting in higher stock returns and Tobin's Q. Companies conducting more frequent and effective board meetings may experience elevated stock returns and Tobin's Q, highlighting the importance of active board engagement in financial performance. A company's use of leverage may impact its stock returns and Tobin's Q, with excessive leverage potentially reducing firm value. The presence of effective audit committee members positively influences Tobins' Q leading to improved stock returns.

Conclusion

The study concludes that corporate governance plays a crucial role in shaping a firm's profitability. Key governance mechanisms such as board size, gender diversity, board composition, frequency of board meetings, and audit committee presence show varying impacts on firm performance. Gender diversity emerges as a significant factor, positively influencing profitability indicators like Return on Equity (ROE) and Tobin's Q, highlighting the value of diverse perspectives in strategic decision-making. It also suggests that includes more women in leadership positions enriches board discussions and improves governance practices which will result in better financial outcomes. Board size also shows a generally positive effect, suggesting that larger boards may offer broader expertise and oversight, thereby enhancing profitability. Conversely, board composition and frequent meetings exhibit mixed or insignificant impacts, indicating that mere structural changes without effective functioning may not translate into better financial outcomes. Audit committee effectiveness and leverage also demonstrate limited or statistically insignificant influence. The frequency of board meetings shows mixed effects. While more meetings may improve board oversight and response to crises, excessive meetings may hinder strategic focus, reduce efficiency, and increase operational costs, which negatively impacts profitability indicators like ROE. Leverage**,** or the extent to which a firm uses borrowed capital, is found to negatively impact profitability in many cases. Higher debt increases financial risk and interest obligations, thereby reducing the net income available to shareholders and impacting stock returns and overall firm value. Overall, the findings suggest that well-structured and diverse governance, supported by informed and active board members, can significantly enhance a firm's profitability, while ineffective governance practices may limit financial performance improvements.

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