

# An Intermediary Perspective of Corporate Governance with Firm Performance and Economic Growth: Do Ownership Structure Initiates in Reforming Public Sector?

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## Abstract

A general perception of growth for any economy is considered by following the governance indicators in a positive direction. But governance is not enough when it comes to the matter of reforming a public sector in developing country like Pakistan. The study aims to inquire beyond the governance indicators in assuring economic growth but also incorporating the role of ownership structure as a foundation for any firm performance and country's economic growth with an intermediary body of Governance indicators provided by World Bank through simple random sampling technique. In terms of economic growth, governance indicators plays a major role but when reform is concerned structure has to be considered that contributes most towards firm performance and economic growth. For data analysis quantitative technique is implied for research strategy and statistical SPSS tool for Correlation and Regression analysis have been applied in testing hypotheses developed by available and previous studies and literature. The study concluded that political instability plays a major role as intermediary in reforming public sector that effect the overall structure and performance

of firm and economic growth. The proposed relational model contributes towards the public sector organizations and statistically indicates the intermediary role of corporate governance indicators between ownership structure, firm performance and economic growth.

**Keywords:** Ownership structure, corporate governance, economic growth (GDP), firm performance, Public Sector Reform, Pakistan.

## 1. Introduction

In recent times, Governance has been a worldwide most focused concept being used a core indicator for measuring the country's health and issues. Through extensive research of available literature, the researchers have defined four most important dimensions related to Corporate Governance in this attempted study and discussed in the literature review section. Governance shows a link with economic growth of any country, and it is conceived as rise and acceleration in the amount of goods

and services over a certain period of time frame produced by a country. Achieving the ultimate goal of economic growth and prosperity by increasing and raising the economic growth rate is the ultimate aim of any country (Zubair & Khan, 2014). Economic landscape dominates the firms that are closely held i.e. owned by family or controlled by state or even firms apprehended by many financial institutions and corporations in most of the developing countries' market as well as in Pakistan. From previous studies and evidence suggests that small shareholder have lesser opportunity and lesser incentive as compare to large owners in dealing and exercising control in managerial affairs when corporate governance is concerned. Still most of the literature exists on the functioning of already developed market firms and as a result deduces a broader distribution in a matter of ownership structure as compared to the markets where prominent share belongings are coarse like Pakistan (Claessen et al., 1996, 1999). Family or institution owned the firms in majority in case of Pakistan (Cheema et al., 2003). In a firm having corporate governance institution in effort to make certain the control and ownership division and frequently creating a domino effect in problems of principal agent (Byrnes et al., 2003; Jensen & Meckling, 1976). Prior studies have mostly paid attention towards countries of developed world, while more recent studies have been linked to countries of developing world. With such scenario; the study attempted to provide strong empirical evidence on the relation between corporate governance indicators,

ownership structure and performance of firms in Pakistan.

### 1.1 Importance of Governance in Public sector

The first and foremost purpose of corporate governance is the need for country's sustained and maintained political system. Economic growth becomes inevitable when country has stable political system. Evidently, good governance is truly significant at macro level also necessary for micro level apart from even while running a small shop or running a company at national company. In today's environment of academics and political slogans, good governance agenda establishment is extremely talked about. As several studies are concerned, corporate governance is considered a precondition for economic growth but the association of the two is not considered entirely collective. Ownership structure and firm performance also plays there part in reforming public sector or shaping the firm in the context of developing economy as per literature suggest.

### 1.2 Objectives of the study

- To explore the association between ownership structure, firm performance and economic growth
- To investigate the intermediary role of corporate governance indicators between firm performance and its ownership structure in perspective of Pakistan
- To investigate the corporate governance indicators on economic growth of developing environment of Pakistan

### 1.3 Significance of Study

The understudy provides the focus for corporate governance four mentioned and discussed dimensions. In theory, the indicators for governance have their own respective implication a sthe concept emerged in developed countries, but for developing countries like Pakistan having several issues already exists with governance mechanism this research study will help and support the incorporation of ownership structure and its key role should be deal more in a matter of assuring economic growth and performance of firm level.

## 2. Literature Review

As indicated by Aguilera & Cuervo-Cazurra (2009) that corporate governance codes are spread worldwide and have prominently risen over the past decade. Governance codes have been universal key principles that are considered general to many countries for corporate governance effectiveness. Many Corporate governance and economic growth studies have been conducted until now. Much of the studies concerned with it have shown positive relation. Such study like “higher level of governance is necessary for higher per capita income”(Kaufmann & Kraay, 2002). In addition, the governance concept is not seems to be easy or uncomplicated that can be linked with the process of development. The vital memo is to work for corruption countering, reduction in poverty and the factors other than those two that becomes hindrance in the process of development

concerned with the governance mechanism (Grindle, 2004).

### 2.1 Corporate Governance, Ownership Structure & Firm Performance

In such perspective as argued by many researchers that different institutional settings is required prior to engaging that national institutions concerning the ownership structure and implementation of corporate regulations or changing of cultural trends be likely to facilitate aside from diverse constrains of corporate governance methods including the better indulgence that board of directors’ role in order to raise responsibility of the board. Keeping in view the ownership pattern, whether “one rule fits all” standard submits to the understudy question for all the firms that needed to be reform in public sector (Aguilera, 2005; Millar et al., 2005).

When ownership structure is concerned the role and influence on firm performance by board of directors demands for more attention as to how in different context the indicators of corporate governance had different affect of effectiveness for different stakeholders. It was argued that in theory and concerned empirical evidence as a matter of fact improves to a more dependent context perspective in case of corporate governance and in return will prove to be useful for policy makers and practitioners in a matter of applying corporate governance in such required circumstances. A more contextual access towards corporate governance provides significance for public policy concerns. In the light of perceived knowledge in governance system reform,

arguments have been raised in a matter of implementation of appropriate corporate governance testimonials are generally based on “Anglo-Saxon” context illustrated by discrete ownership where markets for “corporate control, legal regulation, and contractual incentives” are considered the key governance methods.

The core issue in the literature of corporate governance is the relationship nature of corporate governance and ownership structure. From the perspective of firms, profitability of firm is determined by ownership structure; that is fairly rejoiced by many stakeholders. In detail for reducing the cost of agency that is related with the ownership and management separation to protect the rights of property belongs to the firm that acts an incentive device (Barbosa & Louri, 2002). Many discrete shareholders have owned corporations mostly handled by appointed manager as a result of development of corporate governance. Evidently, owners who own a small portion of outstanding shares dispersed in incorporated firms, be inclined to achieve less (Berle & Means, 1932). This hypothetical relation between ownership structure and performance of the firm was latter examined empirically (Jensen & Meckling, 1976; Shlefer & Vishny, 1986).

Reforms of corporate governance commenced in 2002 with “Corporate Governance Ordinance” introduction. In case of Pakistan, the existing relation between ownership structure and corporate governance very little work done has been examined. Only the nature concerning

between corporate ownership structure have been examined so far in Pakistan irrespective of its impact on corporate level performance in a matter of reforming. The under study attempted to look for gaps in the literature to fill it with appropriate reason and justification of the present needed research area concerning ownership structure and corporate governance and firm performance keeping in focus the conditions of market situation in developing country like Pakistan (Cheema et al., 2003).

The performance of firms however alters differently for different type of owners. Share holdings are ordinary for a developing country like Pakistan; it appears more compelling and concerning in a matter to investigate the relation between ownership structure and its uniqueness with the firm performance factor (La Porta et al, 1999; Cheema et al, 2003).

## 2.2 Ownership Structure, Corporate Governance & Economic growth

In recent times corporate governance related empirical and practical efforts in most advanced countries on the bases of data availability have been gone under noteworthy establishment. Diverse ranges of researchers and theorists have put efforts in examining the relation of good will of firm and corporate governance also indicating the impact and influence of corporate governance on performance of firms. Studies illustrated the association of firm value and ownership concentration structure (McConnell & Servaes, 1990). From an Indian related work also indicated the association of firm performance and corporate governance (Sarkar & Sarkar,

2000). However, there was found no relation of firm performance and ownership concentration by Demsetz and Lehn (1985).

Various previous studies related with corporate governance acknowledged two most generic types of ownership structure; dispersed and concentrated. In a matter of developed economies, the structure of ownership is extremely dispersed. Whereas there exists a feeble legal system in protecting the investors' interests; hence the structure is extremely concentrated in the developing economies like Pakistan. From previous evidences; as a response disagreeing from degrees of protection legally of shareholders in minority from corner to corner of countries moving towards ownership concentration. Maximizing the number of investors other interests of shareholders creating more pressure in engaging management in activities is most done by high concentrated ownership structure. Mixed results are found when examined the performance and concentrated ownership structure in available empirical literature (La Porta & Vishny, 1997; La Porta et al., 1998; La Porta and Lopez, 1999).

On the other hand, many studies provided evidence of positive association between the firm value and ownership concentrated structure (McConnell and Servaes, 1990). Including the studies reported from developing countries like India have positive association with value of firm (Sarkar & Sarkar, 2000; Khanna & Palepu, 2000).

The concept of governance has been publicized interestingly as "idea inflation". While such term questions the idea of linking corporate governance concept with economic growth positively (Grindle, 2010).

### *2.1 Hypotheses*

Following hypotheses are formulated after extensive review of previous available literature:

H1: There is positive and significant relation between ownership structure and firm performance.

H2: There is positive and significant relation between ownership structure and economic growth.

H3: There is a significant relation between Corporate governance indicators and economic growth.

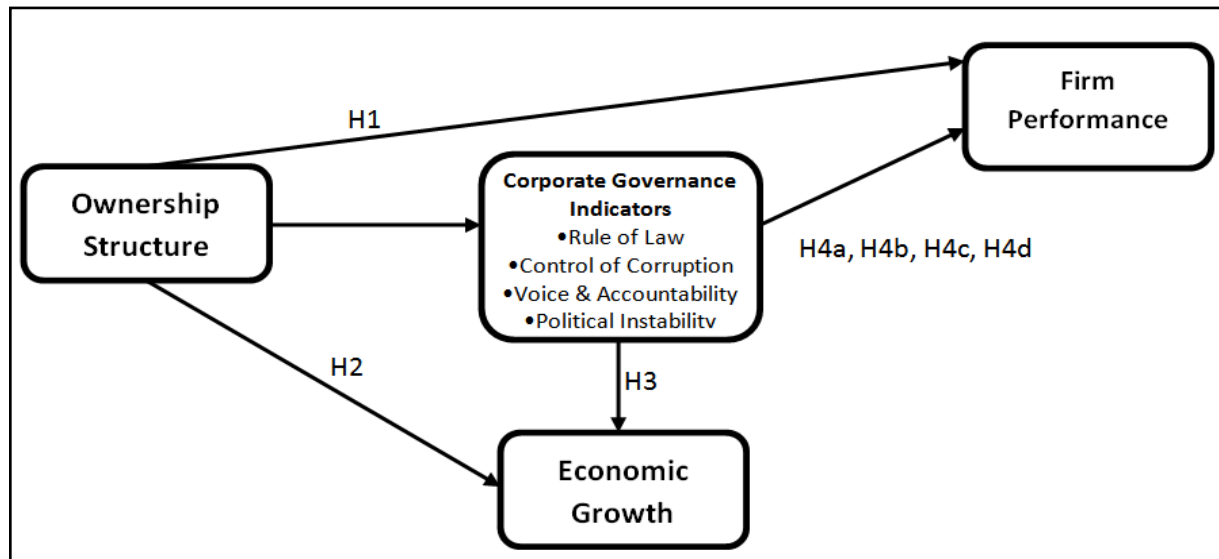
H4a: There exist significant intermediary role of Rule of Law between ownership structure and firm performance.

H4b: There exist significant intermediary role of Control of corruption between ownership structure and firm performance.

H4c: There exist significant intermediary role of Voice and accountability between ownership structure and firm performance.

H4d: There exist significant intermediary role of Political Instability between ownership structure and firm performance.





### 3. Methodology

The understudy purpose is to examine whether the relation between the identified variables are essential towards the reform of public sector having the intermediary role of corporate governance indicators. The under study variables are explained below.

#### 3.1 Research Strategy

For this understudy, Quantitative strategy has been adapted. The main reason for implementing such technique is to investigate the relation and the strength of the relationship of proposed constructs mentioned in this study. For analysis, Correlation and Regression analysis have been conducted.

#### 3.2 Constructs and Data Source

To assess the relationship of corporate governance indicators and ownership concentrated structure at the level of firm,

the data was collected by simple random sampling technique taken from the active firms listed at Karachi Stock Exchange (KSE). The required set of data is taken from the firms starting from 2003 till 2013 for 10 years time line provided in annual reports of full government owned corporations in Pakistan. The Code of Corporate Governance 2002 started implementing from 2003 and the required public information about concerned companies and firms about ownership structure was made available from 2003 in detail for the first time. The information for ownership structure for concerned firm was obtained from the annual reports of precise company under the Code of Corporate governance clause XIX(i) and Company Ordinance, 1984 in form 34. The data and dimensions of corporate governance index; taken from Worldwide Governance Indicators (WGI) developed by World Bank. WGI is a research bases dataset that

comprises the governance quality perceptions that is provided by the huge number of stakeholders; expert opinions, general masses, different think tanks and non-governmental sector. The data source for economic growth is available for GDP from Economic Survey of Pakistan. This data is available in US dollars currency as it is more stable and acceptable worldwide currency like for trade purposes. The dollar values are converted into domestic currency. For firm performance construct the data was obtained from published annual reports by Pakistan Stock Exchange as well keeping the factor of profitability in focus. Hence all these construct data are obtained from the annual reports of the listed companies in the sample.

#### 4. Data Analysis and Results

Prior to the correlation and regression analysis, the data is checked for Normality assumption. Table 1 show the results for normality check of data.

Table 1

Normality check using Kolmogorov-Smirnov Z		
	Statistics	P-Value
<b>Ownership Structure</b>	1.342	.505
<b>Firm Performance</b>	.766	.600
<b>Economic Growth</b>	1.363	.490
<b>Corporate Governance</b>	1.435	.320

Table 1 shows the figures for Normality check for the data on the basis of P-values for all variables, indicating that data is normally distributed. For data to be normal, p-values must be greater than the significance level (0.05) assumption fulfilled. As the normality assumption being fulfilled, it is appropriate to move forward with correlation and regression analysis as suggested by the literature.

#### 4.1 Correlation Analysis

The correlation analysis for all the under study variables are conducted depicting the proposed relationship strength both positively and negatively in order to determine whether these variables contribute in reforming public sector by having a significant effect on the economic growth and firm performance. Table 2 shows the statistics for proposed variables.

Table 2

Correlations							
	Ownership Structure	Firm Performance	Economic Growth	Rule of Law	Control of Corruption	Voice & Accountability	Political Instability
Ownership Structure	1						
Firm Performance	.512**	1					
Economic Growth	.211*	.460**	1				
Rule of Law	.231*	.427**	-.653**	1			
Control of Corruption	.462**	.818**	-.349**	-.408**	1		
Voice & Accountability	.574**	.691**	.831**	-.511**	-.505**	1	
Political Instability	-.480*	-.523*	-.728*	.225*	.242**	-.315**	1

Note: \*\* $p < 0.01$ , \* $p < 0.05$

Correlation for all under study variables showed substantiated relation as the literature suggest for developing countries. Also the correlation coefficients are significant depicting having an immense effect of ownership structure and corporate governance indicators leading towards authentication of the proposed variables for the developing countries economy.

#### 4.2 Regression Analysis

Hierarchical regression analysis is conducted to identify the significance of ownership structure and the corporate

governance indicators separately for the dependent variable firm performance. As literature suggests that structures need strong governance in order to have better firm performance and corporate governance has being playing the intermediary role in developing countries in many aspects. The regression analysis clarifies that opted few indicators of governance are crucial for any public sector reform by increasing performance of firms. Table 3 shows the regression results of direct relation for hypotheses H1, H2 and H3.



Table 3

Relationship	R <sup>2</sup>	B	Sig.
Ownership Structure --> Firm Performance	.521	.615	.000
Ownership Structure --> Economic Growth	.402	.435	.003
Corporate Governance Indicators --> Economic Growth	.413	.307	.000

Table 3 shows the contribution of variables in R<sup>2</sup> having acceptable level of variance and the significant level.

Table 4 Hierarchical Regression

Regression Analysis for Corporate Governance Indicators			
Predictors	Criterion Variable: Firm Performance		
	R <sup>2</sup>	B	P-Value
Ownership Structure		.198	.012
Rule of Law		-.307	.580
Control of Corruption	.704	-.640	.236
Voice and Accountability		.613	.455
Political Instability		-.590	.003

To test the intermediary effect of corporate governance indicators, hierarchical regression analysis showed R<sup>2</sup> value of .704. Only Political Instability indicator shows significant relation with firm performance as intermediary between ownership structure and firm performance. As the analysis showed according to provided data rule of law, control of corruption and voice and accountability indicators are highly insignificant in the developing economy of Pakistan. Hence hypotheses H4a, H4b and H4c are not supported therefore H4d is accepted.

### 5. Conclusion

In a matter of boosting positive economy in any country, governance is the success key factor. Four indicators of governance provided by World Wide Governance in

relation with Economic growth and firm performance having a predictor variable of ownership structure have been investigated. After an extensive review of literature in the context of developing country like Pakistan, formulated direct relation hypotheses about ownership structure, firm performance and economic growth were accepted as discussed in literature and regarding previous studies. Whereas hypotheses for intermediary role of corporate governance indicators in relation to firm performance were opted in a matter of public sector reform were proposed. From the analysis results rule of law, control of corruption and voice and accountability were rejected in scenario of Pakistan. The results clearly signify that Pakistan is somewhat moving in the same direction as other developed country. According to previous studies

having a low level of corruption is considered beneficial for economic growth, as most economically strong countries are not best governed. As a general view the proposed model and its components provided authentic results as what is important in a matter of performance and growth of a public sector in developing economy. As the regression results indicates that reduction in political instability contribute most and other indicators can be increase by proper system in ensuring growth and performance. Therefore, these corporate governance indicators and others are concerned in the context of Pakistan cannot be ignored as structure and performance highly depend on governance.

## 6. Limitations and Research Implications

The conducted research intended to understand the relationship between few of the governance indicators, economic growth, firm performance and ownership structure. A model was proposed using regression analysis to find out statistically whether ownership structure contributes in reforming of organization by intermediary role of corporate governance indicators with firm performance and economic growth. The present study has its limitations too. The data can be taken more than 10 years keeping in view of other related variables. There can be Cross-economy comparison of governance indicators from developed, developing and underdeveloped economies and conduct a longitudinal study. Furthermore, the factor of modernization can be incorporated for future research.

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