Corporate governance and financial leverage impact on the value of firms
(Evidence from Textile Sector Pakistani Listed Companies)

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Abstract:
The purpose of this research is to check out the impact of corporate governance and financial leverage on textile firm’s value in Pakistan. For this purpose a sample of 15 textile companies is selected, out of 180 textile firms which were listed on KSE data for the period of 2007-2011. To accomplish the task correlation and regression are used. Overall correlation results show that there is negative relationship between corporate governance and textile firms in Pakistan but positively correlated with financial leverage. But the regression study discloses CEO duality, Audit committee has insignificant impact on firm’s value and ROA shows also negative but insignificant impact on firm value. However on the other hand financial leverage has positive and insignificant relationship with textile firms. Other findings also show board size has negative but significant impact on value of textile firms of Pakistan. Finally, I am realizing that an organization having very strong management, having good governance it should be very good in its value. This research contribute to the literature on the affairs that effect value of firm the outcome of this research possibly help full for investors, Managers, and financial administration advisor.

1. Introduction:

Corporate governance and financial leverage is very important elements that can provide information regarding how to maximize the shareholder wealth. Good corporate governance plays a very important rule to increasing the market value of the firms. Because, of good governance defines the rights and duties of the stakeholder of the business including shareholders, management, and board of the directors. Good corporate governance helps the manager to having focused to improving the firm’s performance. Good corporate governance also works for the best interest of shareholders, investors, customers, and supplier’s. Corporate governance also helps to overcome the poor image and bad reputation of the organization and point out the fraud and reason failure of the organization.

The maximizing of shareholder wealth is important goal of corporate governance that cannot be ignored at any stage. While Berle and Means (1932) were the first time to introduce the corporate governs theory and that time many authors follow this part and develop new theories Modigliani and Miller (1958) Develop the capital structure theory, Jensen and Meckling (1976). Define the agency theory (Contract among the principles and agent perform services on behalf of principle).

The high leverage can decrease the firm value and lose the public confidence due to increasing trend in bankruptcy situation. Traditionally financial experts believe on that the level of leverage increase in company would increase the value but on the other hand more portion of leverage increase
the cost of capital and decrease its market value. While 60 years, relationships of financial leverage and firm value significant on the other hand hot matter of finance.

Good capital structures have some debt portion but not 100% debt. (Gill, Biger, and Mathur, 2011). It is the best debt/equity Cuong and Canh (2012) found that if the best debt ratio (total debt to total assets) not increase 59.27% its means % that 59.27 portion of assets financed by debt it’s reasonable otherwise the higher ratio create the negative impact regarding firm value.

Corporate governance provides the information regarding protection stakeholder rights and defines the system through which supplier of capital receives reasonable return on investment. Corporate governance is basic element to improving the economic growth as well as the efficiency and creates a positive or negative concept regarding the firm and in this way we can get the public confidence.

Textile sector is working as backbone for the Pakistan country. We really need to set up plan to increase its productivity for the purpose of stable its market environment, sufficient finance for investment and labor force but reduce the level of taxes. There is necessary to develop long term polices and various shareholders in textile industry working towards developing competitive environment. Investors of stock exchange make strategies on the bases of financial statement information particularly earning per share.

Textile approximately 27 percent contribute in total industrial output as well as 38 percent absorb labor force and 60 percent contribute in the shape of foreign exchange earnings but textile and cotton industry lost its export market share 66 percent 2004 to 53.7 percent this shows the textile sector could not get full benefit due to lack of total budget allocated in this sector as compared with our competitors (i.e. India, china, Bangladesh). There are many internal and external factors that impact the market value of shares and performance of the textile sector companies like stock market, Market capitalization, demand and supply forces.

This study places of interest the performance of textile sector and explains how corporate governance impacts firm’s value from years 2007-2011 because the textile sector is a most important sector of Pakistan nation due to more increase employment opportunities. There was a tough period for the textile industry from 2008 to 2009 due to globalization and energy disaster locally the cost of utilities boost (Power, Gas, Transport, and Petrol). We in fact require setting up plan to increase its efficiency for the motive of stable its market environment, sufficient finance for investment and labor force but reducing the level of taxes. There is essential to expand long term polices and a variety of shareholders in textile industry operational work towards developing competitive environment.

There are some determinates that effect the firm growth in firm as well as explore all factors that can affect the value of the firm which include CEO Duality, Board size, Audit committee, Financial Leverage, Firm Size, Return on Assets.

1.1 Problem Statement

The reason of this study is to check whether corporate governance mechanism and financial leverage impact upon corporate value.

The answer of above Question it can be positive impact and may be negative impact in both sense. Every stockholder and investor wants to achieve the maximum return against the investment’s I want to check how corporate governs effect the firm Profitability and change its performance. This study combination of corporate governance and financial leverage on firm value in Textile sector because there is very limited research has been conducted and other purpose to research how we can maximize shareholder wealth through the efficient utilizing the business resources. I provide the guide line how Debt burden create the negative or positive in both sense image in the mind of the investors as well as the shareholder wealth.

1.2 Research Question:

- What is the impact of financial leverage and corporate governance on firm value?

1.3 Objectives of the Research:
The objective of this study particularly discover the following objectives

- Board size effect the Firm value.
- Chief Executive Officer (CEO) status effect on Firm Value.
- Audit committee effect on Firm value.
- Financial Leverage effect firm value.

2. Literature Review:
The corporate governs is very important element for the improvement of the firm value and the structure of corporate governance vary from region to region and country to country. This case is also with leverage because in leverage rules and regulations differ from country to country and nation to nation.

Olubukunula & Samuel (2012) conducted a study on the effect of board size on the financial performance of bank. They used regression models to evaluate the impact of board size on the financial performance of bank. They founded that there is negative significant relationship between board size and financial performance of bank in Nigeria. They argued that bank with large board is contributor of agency cost.

A study conducted by Sajid, Abdullah & Musarrat (2012) to find out the impact of CEOduality on capital structure. They used regression model to evaluate the impact of CEO duality on the capital structure and founded that there is positive significant relationship between CEO duality and financial leverage. Also they concluded that there is no change in risk level whether CEO duality exists or not.

Qadir, Rameez & Awais (2010) conducted a study on Pakistani listed firms to check the impact of corporate governance on firm performance. They used regression models to check the impact of corporate governance in firm performance. The outcomes show that there is a momentous impact of corporate governance on ROE while insignificant on ROA. In sector wise analysis, there is an insignificant impact on pharmaceutical sector’s profitability and chemical sector ROA. Whereas there is a significant impact of corporate governance on chemical sector ROE.

Velnampy (2013) conducted a study to investigate the impact of corporate governance on firm performance in Sri Lanka for the period of 2007 to 2011. He used regression model to analyze the data and return on assets and return on equity is used as proxy of firm performance. He concluded that the determinants of corporate governance are not correlated with company’s performance.

Amarjitgill & Neilmathur (2011) conducted a study to check the impact of board size and CEO duality on the value of Canadian manufacturing firms. They used regression model to achieve this goal. They had taken firms value as dependent variable and board size and CEO duality as independent variables and with the help of regression model. The empirical results show that larger board size (large number of directors) has a negative impact on the value of Canadian manufacturing firms. The findings also show that the CEO dualism has a positive impact on the value of Canadian manufacturing firms. In addition to, firm size, firm performance, and potential growth of the firm positively impact on the value of Canadian manufacturing firms.

Yinusa & Badalona (2012) directed a study to check the impact of corporate governance on capital structure of Nigerian firms and they used regression model. They had taken capital structure as dependent variable and corporate governance as independent variable. They found that there is positive significant relationship between corporate governance and capital structure of Nigeria firms and they found that the corporate governance has positive significant impact on firm’s profitability.

Chugh, Joseph & Ashwani (2011) conducted a research on the impact of corporate governance on firm’s performance. For this purpose they used regression model to evaluate the impact of corporate governance on firm’s performance. They had taken firms performance as dependent variable and corporate governance as independent variable. They found that there is positive significant relationship between corporate governance and firm’s performance and corporate governance has positive impact on firm’s performance.

Humera, Maryam, Khalid & Sundas (2011) conducted a study to examine the impact of corporate governance on firm performance. For this purpose they used regression model. They had
taken return on assets and return on equity as independent variables. The result of this research shows that the leverage and growth has positive significant relationship with Tobin’s Q and ROA.

Anthony, kyereboach, Coleman & Nicholas (2005). They showed the impact of board size, board composition and CEO duality on firm performance. For this purpose they used regression model. They took firm performance as a dependent variable and board size, board composition, and CEO Duality as an independent variable. In the regression model they found that there is positive & significant relationship between board size and firm performance.

Andres & Eleuterio (2008) have conducted a research to check the impact of corporate governance on commercial bank performance. For this purpose they use corporate governance as an independent variable and commercial bank performance as a dependent variable to evaluate the impact of corporate governance on commercial bank. They found that there is positive & significant relationship between corporate governance and commercial banks performance. And they also found that if the board is efficient than the governance is good.

Nets, Moral & Hazard (2008) conducted a study to check the impact of board size on bank. They use bank efficiency as a dependent variable and board size as an independent variable to check the impact of board size on bank efficiency. For this purpose they use regression model. They found that there is negative impact of board size on bank.

Milad, Aliakbar, Zohreh & Esmail (2012) to check the impact of CEO duality on capital structure. For this purpose they use regression model. They had taken capital structure as a dependent variable and CEO duality as an independent variable. They found that CEO duality has positive significant impact on capital structure.

Ahmad, Jafri & Hamza (2012) conducted a research to check the impact of corporate governance on capital structure. For this purpose they had taken capital structure as a dependent variable and corporate governance as an independent variable. They use regression model to evaluate the impact of corporate governance on capital structure. They found that there is positive relationship between ownership concentration, board size internal auditors, and capital structure but negative relation between institutional share ratio and capital structure.

3. Theoretical framework:

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Dependent Variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee</td>
<td>Firm's value</td>
</tr>
<tr>
<td>Board Size</td>
<td>(Tobin’s’ Q)</td>
</tr>
<tr>
<td>CEO Duality</td>
<td></td>
</tr>
<tr>
<td>Financial Leverage</td>
<td></td>
</tr>
</tbody>
</table>

4. Methodology:
This data provides the information regarding the textile industry and also gives the information of its performance. And the source of that data collects from period 2007-2011 available on KSE and the financial statement of Textile companies. Textile sector corporate governs related data publish from 2007-2011. This study consists of the some specific working of textile companies in Pakistan.

4.1 Sample Selection:

The sample selected for this paper was textile sector of Pakistan which identifies how corporate governance and financial leverage impact on value of textile industry. All those firms which were selected for sample are listed from Karachi stock exchange. The group of 15 textile firms was selected out of 180 textile listed companies. Because the non-availability of information regarding firm value as well as corporate governance of other firms.

4.2 Types of data:

Present research had been stability of panel data. Firms listed KSE (Karachi Stock Exchange) data of these firms had been chosen from 2007 to 2011 were collected.

4.3 Data Collection Sources:

This segment identifies the sources of all the data which is require for current study. The data was developed from a collection of about 75 annual-reports of those companies that were traded publicly on KSE from 2007 to 2011 data have been taken from the selected textile Company’s website as well as stock exchange.

4.4 Variables Specification:

In this step both dependent as well as independent variables that were selected for the purpose of identify/investigation factors that how affect the firm value.

4.4.1 Independent variables
Board Size
CEO Duality
Financial Leverage
Audit Committee
4.4.2 Control Variables
Firm Size
ROA
4.4.3 Dependent Variable
Tobin Q
4.5Model:

The Regression and Correlation analysis model were applied to conduct this research.

4.5.1 Firm value:

\[ Q = \alpha + \beta_1 CD_{it} + \beta_2 BS_{it} + \beta_3 AC_{it} + \beta_4 Fl_{it} + \beta_5 FS_{it} + \beta_6 ROA_{it} + \mu_{it} \]

4.5.2 Variables & their measurement:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tobin Q</td>
<td>Market value of Equity + Book value of debt (Long term + Short term) / Total assets</td>
</tr>
<tr>
<td>CEO Duality</td>
<td>Assigned value 1 if same person taken the position of the chairperson and the CEO and assign 0 for if not.</td>
</tr>
<tr>
<td>Board Size</td>
<td>calculated as total number of directors serve on board</td>
</tr>
<tr>
<td>Audit Committee</td>
<td>Measured as total number of audit committee members</td>
</tr>
<tr>
<td>Financial Leverage</td>
<td>Calculate by Total liabilities / Total assets</td>
</tr>
<tr>
<td>Size of firm</td>
<td>Measured through natural logarithm of total assets</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>Calculated by Net income/Total Assets</td>
</tr>
</tbody>
</table>

i=1 to 15 Textile companies
t=2007 to 2011
\( \mu = \) the error term.

4.6 Research hypothesis:
“There are two factors that define relationship those are (First corporate governance and second financial leverage.

H₁: There is positive association between Board Size and firm value.
H₂: There is positive association between CEO Duality and value of the firms.
H₃: There is positive association between Audit Committee and firm’s value.
H₄: There is positive association between Financial Leverage and firm’s value.

### Descriptive Statistics

<table>
<thead>
<tr>
<th></th>
<th>TQ</th>
<th>ROA</th>
<th>FS</th>
<th>FL</th>
<th>BS</th>
<th>AC</th>
<th>CD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>.8205</td>
<td>6.2524</td>
<td>8.6233</td>
<td>.5962</td>
<td>7.4400</td>
<td>3.0667</td>
<td>.2667</td>
</tr>
<tr>
<td>Maximum</td>
<td>1.96</td>
<td>42.73</td>
<td>10.30</td>
<td>1.12</td>
<td>10.00</td>
<td>4.00</td>
<td>1.00</td>
</tr>
<tr>
<td>Minimum</td>
<td>.08</td>
<td>-10.71</td>
<td>6.08</td>
<td>.07</td>
<td>7.00</td>
<td>3.00</td>
<td>.00</td>
</tr>
<tr>
<td>Std.Dev.</td>
<td>.28388</td>
<td>8.44317</td>
<td>1.38925</td>
<td>.18386</td>
<td>.77529</td>
<td>.25112</td>
<td>.44519</td>
</tr>
<tr>
<td>Observations</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
<td>75</td>
</tr>
</tbody>
</table>

Table 1 shows the analysis of descriptive statistics sample of 15 textile firms of Pakistan. In this table results consist of average of all values dependent as well as independent variables and standard deviation describe the space from mean value, table show Min, Max and values of variables.

This can be noted from above table that the mean of BS is 7.44 maximum persons in board were 10 and the minimum 7 members setting in board of textile firms. Descriptive statistics also indicate the number of persons who were setting in audit committee about 3. This table provides the information that 75% in textile firms having sampled separate persons who occupied the position of CEO and the chairman on the other hand 25% persons who work on same positions CEO and the post of Chairman in textile Sector. Basically this study shows Tobin Q for the purpose of measure the Accounting Performance and the Market Value of firm. Table 1 average of Tobin Q is .28388

### Correlation Analysis

<table>
<thead>
<tr>
<th></th>
<th>TQ</th>
<th>ROA</th>
<th>FS</th>
<th>FL</th>
<th>BS</th>
<th>AC</th>
<th>CD</th>
</tr>
</thead>
<tbody>
<tr>
<td>TQ</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>-.248</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FS</td>
<td>-.242</td>
<td>.243</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FL</td>
<td>0.453</td>
<td>-.180</td>
<td>0.203</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BS</td>
<td>-.089</td>
<td>-.017</td>
<td>0.101</td>
<td>.130</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AC</td>
<td>0.008</td>
<td>0.007</td>
<td>.055</td>
<td>0.108</td>
<td>-1.53</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>CD</td>
<td>-.009</td>
<td>0.129</td>
<td>-.030</td>
<td>0.058</td>
<td>.360</td>
<td>-.161</td>
<td>1</td>
</tr>
</tbody>
</table>

The Pearson Correlation is used for the purpose of measure degree of liner relationship between Independent as well as dependent variables it is used how two variables closely related like (CD and TQ) the correlation results shows that how much variables correlated impact like CEO Duality positively correlated with Board Size and Firm value on the other hand there is negative correlated with Tobin Q (see Table.2). I found during correlation analysis there is negative correlation firm size with Tobin Q.

Audit committee also negatively correlated with textile Firms value, but the financial leverage creates a positive relationship with the value of textile firms in Pakistan. Overall finding shows that there was negative relationship between CEO duality, Firm size, as well as ROA with the value of firms but positively correlated with financial leverage.
Regression Model

Table 3

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>1.438</td>
<td>.479</td>
<td>3.000</td>
<td>.004</td>
</tr>
<tr>
<td>ROA</td>
<td>-.002</td>
<td>.004</td>
<td>-4.99</td>
<td>.619</td>
</tr>
<tr>
<td>FS</td>
<td>-.071</td>
<td>.022</td>
<td>-3.280</td>
<td>.002</td>
</tr>
<tr>
<td>FL</td>
<td>.847</td>
<td>.161</td>
<td>5.262</td>
<td>.000</td>
</tr>
<tr>
<td>BS</td>
<td>-.035</td>
<td>.039</td>
<td>-9.08</td>
<td>.367</td>
</tr>
<tr>
<td>AC</td>
<td>-.073</td>
<td>.113</td>
<td>-6.45</td>
<td>.521</td>
</tr>
<tr>
<td>CD</td>
<td>-.070</td>
<td>.068</td>
<td>-1.031</td>
<td>.306</td>
</tr>
<tr>
<td>R-squared</td>
<td>.364</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R squared</td>
<td>.308</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F-statistic</td>
<td>6.488</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.6.1 Regression Analysis, Finding, Discussion:

This study was used for data analysis multiple regressions because this is very helpful for find out the control of more than one independent variable on dependent variable (Zainodin et al., 2011) and provide the information to the researcher how much control other factors have over all together dependent variable multiple regression also helpful to test the relationship among the independent with dependent variables.

4.6.2 Regression Analysis and results:

Table (3) regression results shows for textile firms. F-statistics shows the overall significance of model and the explanatory power of adjusted R² explained approximately 30.8% variation of the textile firm’s performance when used TQ as a dependent variable. That’s means selected independent variables create 30.8% variation on dependent variable (TQ) and 69.2% variation through other factors. If R² are .308 means that if there is 1% change in independent variables then 30.8% change in dependent variable (TQ).

Both researcher (Ramdani and Witteloostuijn, 2010) describe if the CEO is the chairman of the board then the value of the firm improve because the person can make decision quickly and some time according to the current market trends. Millar and Schulman, (2003) also found CEO duality negatively create impact on the value of firm. Overall finding shows that Board size was negatively relationship but significant relationship with firm value.

Singh and Davidson (2003) prove that there is negative relationship between board size and firm value. Hermalin and Weisbach (2003) also prove that larger board size less effective and audit committee was negative significant impact on the value of textile sector. According to (Chan and Li 2008) said higher the level of expertise in the member on audit committee can increase the value of firm. Other results found (Table.3) positive relationship with financial leverage and Firm value and statistically show positive insignificant impact on the value of textile firms in Pakistan.

According to Beiner and Dchmid, 2005) increase the level of financial leverage can create negative impact on the value of firms and also move bankruptcy. Other results shows ROA negatively correlated but not significant impact on the value of firms and Firm size show there were negative significant relationship among value of textile sector of Pakistan. This point out that 30.8 % (R² = 0.308) variation in the value of Pakistan textile firms due to Board size, Audit Committee, CEO Duality, Firm Size, Financial Leverage, and ROA correspondingly and 69.2% other factors that create variation in the value of Pakistani Firms.

5. Discussion and Conclusion:

The numerous studies have been perform for the reason of find out the relationship between corporate governance and financial leverage with the value of firm but the outcome of these studies
were miscellaneous. This study examines the relationship that exists between textile performance through corporate governance (BS, AC, CD,) and financial leverage and ROA, FS). This study check the empirical association between value of Pakistan textile firms and corporate governance system.

Overall results shows Audit committee, Firm size, and CEO duality was negatively correlated with the value of textile firms in Pakistan but on the other hand financial leverage positively correlated with the value of textile firms of Pakistan. Result also shows that ROA negative but not significant relationship with value of textile companies and other finding shows that Board size was negatively correlated but not significant impact on the value of firm.

In conclusion, as already supposed in hypothesis one positive relationship of board size with firm value but the analysis exposed there is negative insignificant relationship between board size and firm value and this is entirely opposite the previous studies conducted on mentioned topic as there result showed that positive relationship but not significant impact on textile firm value in Pakistan. For instance, many studies has been conducted and concluded this result consistent with previous research Sanda et al., (2003) verify that large board size positively related with the firm performance and finally Mak and Kusnadi (2005) also find out there were positive relationship with small board size and firm value this was through regression analysis there is no negative relationship board size with firm value and also shows positive impact but not significant positive.

In a second hypothesis it is founded by this research, that there is negative insignificant relationship between CEO duality and firm value this result not consistent with Both researcher (Ramdani and Witteloostuijn, 2010) describe if the CEO is the chairman of the board then the value of the firm improve because the person can make decision quickly and some time according to the current market trends. But this result consistent with this research in organization CEO and chairman dual role show insider power which think about weak corporate governance structure (Yermack 1996).

As a researcher in the third hypothesis it is founded that there is a negative insignificant relationship between the firm’s value and audit committee this result also not match with previous research. According to (Chan and Li 2008) said higher the level of expertise in the member on audit committee can increase the value of firm.

And in the last hypothesis analysis result was shown that financial leverage creates positive significant relationship among firm value. Cheng and Tzeng (2011) found that there were positive relationship among financial leverage and firm value when his analysis on Taiwan listed companies.

5.1 Limitations:

- The size of this study sample was small.
- This study just limited to textile firms of Pakistan.

5.2 Future Research and Recommendations:

Further study might be possible by including more corporate governance determinants like Board meeting, Board composition, Family ownership structure, and the size of sample increase and this may include combination of other sectors. And also can include women roll in board and on firm value.

References: