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## Research Article

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### State Ownership, Corporate Governance and Firm Performance: A Note on Pakistani Firms

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#### ABSTRACT

While the association between state ownership, corporate governance and financial performance of firms has been extensively debated, the mixed results have been provided by the empirical evidences. Panel data regression techniques were applied in this study to investigate the association between state ownership, corporate governance and firm performance. To reach the objectives, the required data, ranging from 2008 to 2014 was gathered from annual statements of 25 listed firms at Karachi Stock Exchange of Pakistan. State ownership and corporate governance were used as independent variables and firm performance as dependent variable. The results indicated that the state ownership had significant impact on the financial performance of firms and corporate governance had no impact on firm financial performance. Size of firm and debt ratio was negatively related to the firm performance. The present study gives proof and discloses that a state ownership's higher level plays positive role in increasing the financial performance of firms. In the context of Pakistan, protection of investor is very poor and enforcement of law is also quite weak. The government or state, as the largest shareholder, can give support in terms of resources and financing.

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**Key words:** State ownership, Corporate Governance, CEO Duality, Board Ownership, Firm Performance

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#### INTRODUCTION

Organizational ownership structure is accepted as the key determinant of firm performance and play important role in their profitability. In addition to institutional ownership, insider ownership and public ownership, state ownership is also considered as main source of ownership. State ownership is given much importance in the ownership structure of firms throughout the world especially in underdeveloped or developing countries. Therefore in these countries state ownership is higher in the ownership structure of the public listed firms.

State ownership can be defined as ownership and control of any assets, enterprise and industry at any level, nationally or internationally. Sometimes it is also known as government ownership and public ownership or state assets truths. Similarly State ownership can also be said a property interest devolved in government relatively than individual and private societies.

Many researchers have studied the state ownership and their findings produced mixed results. Most of the researches compare the government ownership and firm ownerships and their impacts on firm value. Some

researchers produced arguments in favor of state ownership and other are against state ownership and favor private ownership structure. Shelfier and Vishney (1997) found that private ownership increase the firm performance through innovation and increasing business efficiency. But Hart et al., (1997) argued that state ownership improves firm performance. Similarly Shelfier and Vishney (1997) proved that privatized ownership is not in the favor of all stockholders of firms and affect the firm value. Wei and Varela (2003) while examining the performance of state owned firms found that government ownership has negative effect on firm performance. Wang (2004) checked the association between state shareholding and operating performance and found that neither government shareholding nor concentration of shareholding is linked with firm performance. Naceur, Ghazouani and Omran (2007) concluded that privatized companies display significantly less leverage than state control firms. Gunasekarage, Hess and Hu (2007) checked the effect of degree of government ownership and the ownership concentration on the value of listed companies and result shows that the firm's value is negatively affected by the state ownership.

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Corporate governance can be said as framework of rules and practices which ensures transparency and accountability in the organizations and also protect the interest of all stakeholders. Corporate governance has become very important phenomenon of today's business world and a lot of discussion has been done on the corporate governance and its influence on the firm value. Many countries have make regulations regarding corporate governance and force the firms to follow those corporate regulations and improve their governance structure. In developed countries of world corporate governance practices are followed and similarly in some of the developing countries but in developing countries like Pakistan more work is required to implement the corporate governance.

Many researchers have worked on the corporate governance and its influence on firm value around the world. Rehman and Mangla (2010) studied the corporate governance impact on banks and found that it has significant and positive effect on performance of both conventional and Islamic banks. On the other hand Fooladi and Chaleshtori (2011) examined the quality of corporate governance and concluded that chairman-CEO duality negatively influence the firm value. Similarly Varshney, Kaul and Vasal (2013) found that corporate governance positively affect the firm performance. Bhagat and Bolton (2008) measured corporate governance through CEO duality and remuneration of board and found that CEO duality has positive impact and remuneration of board has negative effect on the firm performance.

The objective of the study is to examine the impact of state ownership and corporate governance on financial performance of listed firms in the country and this research will add to the existing literature. Many researchers have studied the state ownership and its effect on firms and provide mixed results. This study will try to explain this association in framework of Pakistan.

Remaining part of this paper is structured as following: Section two discusses the literature review of relevant papers. Section three describes the model and explain the variables used in this research paper. Section four and five describes the empirical results and conclusion respectively.

### Review of Literature

Barry, Lepetit and Tarazi (2011) examined the ownership structure and risk in publically held and private banks. Companies with public equity face different agency problems than private firms. They observed that ownership structure is significant in explaining risk differences but mainly for privately owned banks. Seifert, Gonenc and Wright (2005) checked the global proof on performance and equity ownership by insiders, block holders and institutions. They used piecewise linear regression and sample of four countries with a deviation of Tobin's Q and indicated that the effect of insider ownership depend very much on local laws.

Tsai and GU (2007) examined the relationship between institutional ownership and casino firms' performance. In their study management is separated from ownership. A proxy for Tobin's Q is used as dependent variable and firm size is used as independent variable. By

using simultaneous equations model and found that institutional shareholding is a significant and positive determinant of casino firm's performance.

Cornett, Guo, Khaksari and Tehranian (2009) analyzed the effect of state ownership on profitability differences in privately-owned versus state-owned banks. They used separate regression models for different samples and result showed that the gap between the private-owned & state-owned banks were the largest for the countries with government interpolation in their banking system.

Wei and Varela (2003) examined the association between state equity ownership and firm value facing a problem of lack of incentives that positively motivate the firm's management. Ordinary least square method is used in their study. They analyzed that government ownership has negative influence on firm value. Wang (2004) observed the linkage between state ownership and operating value of Chinese Initial Public Offerings. This study faced the problem where legal protection and other mechanisms are weak. He highlighted that neither state ownership nor concentration of ownership is associated with firm performance.

Yu (2013) analyzed the association between government ownership & organization performance. The data were taken from China Stock Market & Accounting Research and applied panel data regression technique to 10,639 firms that include repeated measure of one or more variable on one or more firms and used firm characteristics as independent variable and ROA, ROE and Tobin's Q as dependent variables. He expressed that government ownership has U-shape association with organization performance and makes non tradable shares legally tradable.

Rafiei and Far (2014) examined the impact of government ownership on organization performance and dividend payout strategy. State ownership is used as independent variable, firm performance as dependent variable, EPS and Industry as control variables. They quantified that government ownership has positive and significant association with organization performance and dividend payout.

Gunasekarage, Hess and Hu (2007) checked the effect of performance on state owned companies listed in China Stock Exchange by using the data from 2000 to 2004. They reported that the performance of firm negatively affects the state ownership. Ng, Yuce and Chen (2009) studied the determinants of state ownership and its effect on firm profitability by using leverage and firm's market value as dependent variables. They found that the state ownership is strongly associated with firm's profitability.

Ahmed, Sehrish, Saleem, Yasir, Shehzad (2012) observed the impact of ownership on firm performance and found that there is no significant impact of state ownership on financial performance of firms. Latif, Shahid, Zia ul haq, Waqas, Arshad (2013) analyzed the impact of corporate governance on firm profitability. They used return on asset and board size as dependent variables, and board constitution as independent variable. They suggested that there is significant impact of corporate governance on firm profitability.

Azeem, Hassan, Kouser (2013) examined the effect of quality corporate governance on firm profitability by using fixed effect estimation method of panel data. Firm size and leverage were used as independent variables and financial & stock market as dependent variables. They found that quality corporate governance significantly determined the firm's financial performance. Yasser, Entebang, Mansor (2011) scrutinized the association between corporate governance and firm profitability. They used return on equity and profit margin as dependent variables and board size and audit committee as independent variables. They reported that there is a significant positive relationship between return on equity and board composition.

Osuji and Odita (2012) have analyzed the effect of capital structure on firm financial performance of the Nigerian firm listed in the Nigerian Stock Exchange for the period of 2004-2010. To analyze the results they have used ordinary least squares (OLS) method for the selected firms. They found that capital structure measured by debt ratio has significant negative effect on the financial performance of firms measured by return on equity or return on asset.

Kipsha, E. F. (2013) determined the effect of firm's age and size on the financial performance of microfinance institutions in Tanzania. They observed a positive effect of firm's size on the financial performance of microfinance institutions in the country. Furthermore, a negative effect of age on firm financial performance is found in microfinance institutions of Tanzania.

**Hypothesis 1:** State Ownership influence Financial Performance of Firms.

**Hypothesis 2:** Corporate Governance influence Financial Performance of Firms.

## MATERIALS AND METHODS

This study covers the period of 2009 to 2014 and focuses on 25 financial and non-financial companies listed at Karachi Stock Exchange of Pakistan. These firms include those which have fully or partially owned by government. The market data was collected from business recorder and other data was collected from the firm's official sites and annual financial statements. The dependent variable is firm performance and the independent variables are state ownership and corporate governance. The study also employs two controlling variables defined in Table 1. Regression model is used to analyze the effect of state ownership and corporate governance on firm performance.

### Design of the model

Panel data regression model is used to test the association between state ownership, corporate governance and performance of firm. It consists of measures of one or more than one variables on one or more than one firms. Panel data is highly informative (high degrees of freedom, high variability, low collinearity), and results are well-organized. It is also used to control of individual unnoticed heterogeneity (Woodlridge, 2003).

In order to test the hypothesis, following econometric model is developed:

$$\text{Perf}_{it} = \beta_0 + \beta_1 \text{SO}_{it} + \beta_2 \text{BS}_{it} + \beta_3 \text{BO}_{it} + \beta_4 \text{CEOD}_{it} + \beta_5 \text{FS}_{it} + \beta_6 \text{DR}_{it} + \varepsilon_{it}$$

Where;  $\text{Perf}_{it}$  is performance of firm  $i$  at time  $t$ , measured by Tobin's Q (TQ), return on assets (ROA) and return on equity (ROE). SO is state ownership, BS is board size, BO is board ownership, CEOD is CEO duality, FS is firm size and DR is debt ratio.  $\beta$  indicates the coefficients to be estimated and error term is the  $\varepsilon_{it}$ .

The study uses the techniques of panel data analysis to analyze the impact of state ownership and corporate governance on the financial performance of firms. The panel data consist of random effects (RE) and fixed effects (FE) estimators. The study considers these two substitutes in the framework of Huasman test, fitting both models, and comparing their common coefficient estimates. In this study, random effects (RE) and fixed effects (FE) are compared by using the Huasman test and the outcomes are presented.

## RESULTS AND DISCUSSION

In this section, the study has presented the outcomes of descriptive and inferential statistics for all of the major explanatory variables under study to analyze the impact of state ownership and corporate governance on financial performance of firms.

### Descriptive Statistics

Table 2 explains the result of descriptive statistics for all the variables. From Table 2, it can be seen that total number of observations for all of the variables are 125. The mean value of state ownership (SO) is 29.47368, have demonstrated the highest value in all the variables. The median value of CEOD is 0.0000 which is minimum value among all the stated variables of the study. At the same point in time the value of Board Size (BS) is 10.0000 which is highest value of median. The mean value of CEO duality (CEOD) is minimum in all the values, which is 0.120000 and maximum value is 93.88 for state ownership. The value of standard deviation in all the stated variables of the study is minimum for Return on Assets (ROA) which is 0.116175 and maximum for state ownership (SO) which is 34.11016.

### Correlation analysis

While doing further analysis, it is quite significant to check the strength and direction of association between all the variables of the study; the problem of correlation or so called multicollinearity. In order to analyze either existence high, low or moderate level of correlation we have formed the correlation analysis by using E-views. The outcomes of strength and direction of correlation among all the variables are presented in Table 3.

Table 3 describes the outcomes of correlation matrix for all the variables under study. Here the study has experienced both negative and positive correlations among the variables. A low level and negative correlation between Board Size and Board Ownership is found. The correlation between CEO Duality and Board Ownership is

**Table 1:** Variables description

Category	Variable Name	Description
Dependent	Firm performance:	
	a. Tobin's Q (TQ)	a. (Equity on Market Price + Total Debts) / Total Assets
	b. Return on Assets (ROA)	b. Net Income / Total Assets
Independent	c. Return on Equity (ROE)	c. Net Income /shareholder's equity
	State ownership:	
	a. State Ownership (SO)	
	Corporate Governance:	a. Percentage of shares Capital held by the state or government
	a. Board Size (BS)	a. Log of number of directors in board
Controlling	b. Board Ownership (BO)	b. Percentage of shares Capital held by board members
	c. CEO Duality (CEOD)	c. "1" if the CEO and chairman are same and "0" otherwise
	a. Firm Size (FS)	a. Logarithm of Total Assets
	b. Debt Ratio (DR)	b. Total Debts / Total Assets

Note: This table provides a brief description of all the variables used in this study.

**Table 2:** Descriptive statistics

Variables	BO	BS	CEOD	DR	FS	TQ	ROA	ROE	SO
Mean	4.328958	9.904000	0.120000	1.694573	7.845705	1.453861	0.050957	0.211851	29.47368
Median	0.010000	10.00000	0.000000	1.249939	8.002399	1.007639	0.019254	0.165400	3.193400
Maximum	63.41000	16.00000	1.000000	9.859729	9.234333	16.65927	0.334106	6.052124	93.88000
Minimum	0.000000	5.000000	0.000000	0.647463	5.815398	0.174957	-0.364994	-2.097723	0.000000
Std. Dev.	11.15004	2.329419	0.326269	1.153432	0.761745	1.812084	0.116175	0.727786	34.11016
Skewness	3.155510	0.650769	2.338738	3.655605	-0.431289	6.480732	0.312176	3.862835	0.552608
Kurtosis	13.26009	2.997101	6.469697	22.38738	2.813743	50.17163	4.342008	36.41650	1.633840
Sum Dev.	15416.11	672.8480	13.20000	164.9704	71.95172	407.1724	1.673592	65.67946	144274.3
N	125	125	125	125	125	125	125	125	125

**Table 3:** Pearson's correlation matrix

	BO	BS	CEOD	DR	FS	TQ	ROA	ROE	SO
BO	1.000000								
BS	-0.212966	1.000000							
CEOD	0.376562	-0.196939	1.000000						
DR	-0.123162	0.075924	-0.028203	1.000000					
FS	0.055950	0.152022	-0.018893	-0.043289	1.000000				
TQ	-0.061171	-0.164187	-0.000392	0.038642	-0.126555	1.000000			
ROA	-0.040798	-0.107998	0.407361	0.451943	-0.017568	0.099505	1.000000		
ROE	-0.006899	-0.007642	0.215995	-0.000863	-0.003289	0.003681	0.218054	1.000000	
SO	-0.320477	-0.010263	-0.282263	0.158484	0.139052	0.050813	-0.033301	0.003984	1.000000

**Table 4:** Regression results

Variable	Dependent Variable								
	Tobin's Q (TQ)			Return on Assets (ROA)			Return on Equity (ROE)		
	Coefficient	t-value	p-value	Coefficient	t-value	p-value	Coefficient	t-value	p-value
Constant	49.2235	20.8774	0.0000***	0.3619	2.1602	0.0334**	-1.6604	-0.7218	0.4723
SO	-0.0478	-2.5221	0.0134***	0.0008	0.5842	0.5606	0.0326	1.7653	0.0809*
BO	-0.0244	-1.1767	0.2424	0.0015	0.9978	0.3210	0.0023	0.1135	0.9099
BS	-0.1686	-2.1116	0.0375**	-0.0010	-0.1740	0.8622	0.1062	1.3632	0.1762
CEOD	-0.1519	-0.3059	0.7604	0.0469	1.3298	0.1869	0.0854	1.763	0.8605
FS	-5.5639	-19.4636	0.0000***	-0.0287	-1.4114	0.1616	-0.0444	-0.1591	0.8739
DR	-1.2456	-2.1734	0.0324**	-0.1517	-3.7257	0.0003***	0.3617	0.6469	0.5194
R <sup>2</sup>	0.9199			0.9015			0.3231		
Adj. R <sup>2</sup>	0.8896			0.8643			0.0674		
F-value	30.3843			24.2375			1.2636		

Note: \*\*\* Significant at 0.01; \*\* Significant at 0.05; \* Significant at 0.10 level.

0.3765 explaining the fact that both variables have positive but week correlation. The value of correlation coefficients between Debt Ratio and Board Ownership is -0.1231, explaining a week level of association. Besides this the study has examined that there is moderate level of correlation between Return on Assets and Debt Ratio. Meanwhile the value of correlation in between State Ownership and Board Ownership is -0.3204 which is negative but not a very much high level of association. At the same point in time the value of correlation coefficient between ROA and CEOD is not very much problematic. So from the above table we can conclude that there is no

high degree of correlation between the selected set of variables, has been considered for further panel data analysis.

**Regression analysis**

The study employs Huasman test to recognize whether random effects model is better than the fixed effects model. In this situation, it is, and so the results of fixed effects model are presented.

Table 4 shows that the state ownership (SO) is related negatively with financial performance measured by Tobin's Q (TQ). The outcomes are consistent with Wei

and Varela (2003) and Hu (2007) who have checked the impact of state ownership on firm financial performance and found a negative association between state ownership and firm financial performance. The state ownership (SO) is positively related to the financial performance measured by return on equity (ROE). The results are similar with Rafiei and Far (2014) who found a positive relationship between state ownership and firm performance. Although, the state ownership has no impact on performance (measured in terms of return on assets). These outcomes are same with Wang (2004) and Ahmed, Sehrish, Saleem, Yasir, Shehzad (2012) who have not found significant impact of state ownership on profitability. But the outcomes are inconsistent with Wei and Varela (2003), Rafiei and Far (2014) and Gunasekarage, Hess and Hu (2007). A negative association between board size (BS) and Tobin's Q (TQ) is found at the significance level of 0.05. CEO duality has no impact on the financial performance of firms which is dissimilar with Fooladi and Chaleshtori (2011), Varshney, Kaul and Vasal (2013) and Bhagat and Bolton (2008). So, no impact of corporate governance on the financial performance of firms is found. The results are not same with Rehman and Mangla (2010) and Latif, Shahid, Zia ul haq, Waqas, Arshad (2013) who quantified that there is a significant impact of corporate governance on financial performance. There is significant negative association between firm size and firm performance at 0.01 levels of significance which is not similar with Kipesha, (2013) who found a significant positive association. The linkage between debt ratio and firm performance is also negative and agreed with Osuji and Odita (2012) who also found a negative association between debt ratio and firm performance. Shleifer and Vishny (1997) recognize that concentrated ownership as an important part of system of good corporate governance. Dissimilar diversified investors who own an insignificant fraction of outstanding equity, the large equity positions held by blockholders effectively give them some control over the firms in which they invest. The present study gives further proof and discloses that a state ownership's higher level plays positive role in increasing the financial performance of firms. In the context of Pakistan, protection of investor is very poor and enforcement of law is also quite weak. The government or state, as the largest shareholder, can give support in terms of resources and financing. A greater level of state ownership is superior to a scattered structure of ownership, as the latter bears from a problem of free-rider. At the higher level of state ownership, governance of state-based may be better to governance under scattered structure of ownership (Tian and Estrin, 2008).

### Conclusion

Panel data regression techniques are applied in this study to investigate the association between state ownership, corporate governance and firm performance. To reach the objectives, the required data, ranging from 2008 to 2014 is gathered from annual statements of 25 listed firms at Karachi Stock Exchange of Pakistan. State ownership and corporate governance are used as independent variables and firm performance as dependent variable. The results indicate that the state ownership has significant impact on the financial performance of firms

and corporate governance has no impact on firm financial performance. Size of firm and debt ratio is negatively related to the firm performance.

Shleifer and Vishny (1997) recognize that concentrated ownership as an important part of system of good corporate governance. Dissimilar diversified investors who own an insignificant fraction of outstanding equity, the large equity positions held by blockholders effectively give them some control over the firms in which they invest. The present study gives further proof and discloses that a state ownership's higher level plays positive role in increasing the financial performance of firms. In the context of Pakistan, protection of investor is very poor and enforcement of law is also quite weak. The government or state, as the largest shareholder, can give support in terms of resources and financing. A greater level of state ownership is superior to a scattered structure of ownership, as the latter bears from a problem of free-rider. At the higher level of state ownership, governance of state-based may be better to governance under scattered structure of ownership (Tian and Estrin, 2008).

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