Effect of Corporate Governance and Financial Leverage on Market value Added in Pakistan

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ARTICLEDETAILS
History
Revised format: May 2016
Available Online: Jun 2016

ABSTRACT
This paper examines the impact of corporate governance rules and regulations and financial leverage on the market value added in Pakistan. Market value added (MVA) is our dependent variable and corporate governance and financial leverage are our independent variables and examine their combined effect on the market value added. This study will help the Pakistani firms who are going to lever their firms and going to practicing the corporate governance rules and regulations. For this purpose we have taken the listed non-financial companies of Pakistan from 2006-2015 because they are actively practicing the corporate governance rules and regulations. The results indicate that the proxy variable of corporate governance which is board size also have the significant and negative impact on the MVA in Pakistan. Interest coverage ratio indicates that if the firm’s ability to pay its interest expenses increases as results MVA also increases. Debt ratio is the proxy variable of financial leverage which is our next independent variable. By the help of our regression model we concluded that Debt also have the positive significant effect on the market value added on the firms in Pakistan. It means if a firm wants to increase their market value they should go for the debt instead of equity. Debt will help firms in Pakistan to increase their market value.

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1. Introduction

The main aim of any company is to maximize the wealth of its shareholders. The shareholder’s wealth is mainly dependent on the market value of its firm. Both the factors Corporate Governance (CG) and Financial Leverage (FL) play an important role in maximizing its shareholder’s wealth. While on the other hand higher financial leverage will decrease the firm value and also increase firm’s Bankruptcy risk. Because shareholders demands more return due to high risk. Therefore, we need a good and sound CG and an optimal capital structure to enhance the shareholders’ wealth and market value of its firm. We can define the corporate governance as a system or manner by which the business corporations are controlled and directed. We can define an optimal structure is a structure which is not 100% either based on debt or equity rather it is the mixture of debt and equity that increase the firm value, reduces its bankruptcy risk and also minimize the cost of financing. Another theory presented by Myers and Majluf (1984) known as the “Pecking Order Theory”, this theory indicates that the firm should first use internal finance to raise its capital, then later it can use Debt to finance its capital and in the end it can use the equity to raise its capital.

The first theory of corporate governance was presented by Adolf Berle and Gardiner Means in (1932) this term was coined by Berle and Means. They wrote a book in (1932) named as “The Modern Corporation and Private Property”. In this book they presented the concept of corporate governance for the first time in the field of finance. The theory of capital structure is presented by the Modigliani and Miller in (1958). They also presented a concept that in the absence of the corporate taxes the value of a levered firm (which is based on taxes) is also same as the unlevered firm if they are same in their nature. This theory also called MM1 preposition. Later they also presented MM2 preposition in which they have taken the concept of the corporate taxes. In which a levered firm gain a tax shield (benefit).

To increase the shareholder’s wealth the growth in any firm is very necessary, it is also necessary to achieve the organizational goals and objectives; it also helps to explore and to find out those important factors which help to increase the value of the firm. The value of any firm is highly affected by those factors of the corporate governance and the financial leverage. Therefore this study has been conduct to examine the impact of the corporate governance and the financial leverage on the market value added firms in Pakistan.

The MVA is known as the Market Value added the MVA is basically a mathematical calculation which shows the difference is a company’s Market value and its capital invested by its investors it includes both the bondholder plus shareholder means the portion of debt and equity. So we see the difference of all capital claims which is held against the company and the market value of its debt & equity. This value of MVA is calculated by an accounting formula which shows an amount and that amount can either be positive or negative. MVA shows us that how much value is added to the company, its firm market value is increased or decreased. A good company have its MVA in positive due to their effective operations their value is increased and which is a good indicator of shareholder’s wealth.

Massive researches have done on corporate governance and financial leverage. But the study of their effect on MVA with this proxy is very scarce in Pakistan. So we took PSEX 100 index non-service companies. We want to determine that either in Pakistan the corporate governance and Financial leverage affects the MVA or not?

The main objective of this research is to determine whether the firms in Pakistan have any value addition due to corporate governance practices and the financial leverage. Is their market value increased or decreased by these two factors. We will examine their effect on the Market value added in Pakistan.
In relation to research objectives, these are the primary research questions that we have to answer through the help of our research.

What is the effect of corporate governance on Market value added?
What is the effect of Financial Leverage on Market value added?
What is the major impact of corporate governance and financial leverage on the market value of the firms in Pakistan?

This study can be used by firms in Pakistan who is going to lever their firm and they also want to examine that is there any impact of corporate governance rules and regulation on their organization. Their Market value increased or decreased if they use debt in their organization and what benefit and cost an organization will face if they apply corporate governance rules and regulations in their firm? So it will help the organizations to build their effective capital structure so they can increase their market value.

This paper combines the following parts including an introduction and background. The part II presents the review of previous studies in the relationship of the hypothesis. The parts III provide the information about appropriate data and model, while last part represents the results and its discussion.

2. Literature Review

A massive amount of researches has been conducted on the relationship between the corporate governance and firm performance. And some of the researches also have been done on the financial leverage and firm performances. But their accumulated effect on the firm performance has not yet been seen in any Pakistani firm. A sound and good corporate governance play a vital role in enhancing the value of the corporate firms. But the influence of the corporate governance (CG) varies from country to country this is just because of that each country has its own corporate structure. This results from the different and dissimilar economic, social and the regulatory conditions (Rouf, 2011). This is the same case with the Financial Leverage. Because there is different tax laws and different tax Brackets in different countries so the financial leverage impact varies from country to country. In this study context the Corporate Governance is basically defined as the processes, laws, custom, policies and the institutions which affecting the way by which a firm is directed and controlled (Rouf, 2011). Kajola (2008) said that under the direction of the board of directors the business of a firm is managed and they also delegate the CEO and other staff of the upper management (which managed daily affairs of the firm). The director is one who has an experience, leadership skills and manages the affairs of the firm the high sense of commitment and integrity to the firm, its long term business plan and the shareholder’s value.

The theory which is presented by Mayers and Majluf is known as the Pecking Order Theory. In which they described that the firm should use or firm should prefer the internal source of the financing while raising any money for the company which is commonly known as equity. The logic behind using the internal source of financing is that it reduces the bankruptcy cost. And if the internal financing is not sufficient for the firms to meet it demands then it should go for the external financing. The last option which a firm should use to raise its funds is Debt, which is the least preferable mode of raising the funds for the firm.

Two authors Afza and Hussain through their research work examined that the debt is the best way if a firm wants to highlight the trust of the investors in the firm. It gives a positive signal in the market if a firm issue the debt, because in the future the firm is expecting some positive Cash flows. So, the firm who issue the more debts it shows that it’s manager have more confidence in the future cash flows. But
if a firm issue more equity for its projects then the debt it means it will give a negative signal to the market and to the investors.

Another theory presented by the Jensen and Meckling is known as the Agency theory. Agency theory arises when there is a conflict of interest between the mangers and the shareholders interest. Because the mangers are the agents of the company’s shareholders and they have to protect the rights of the shareholders. But the agency problem arises when the interest of the managers are different from the interest of the shareholders. Fama and French (2002) identifies that the excessive use of the debt in any firm creates the agency problem between the creditors and the shareholders of the firm.

The firm profitability is highly affected by the capital structure decision. We should know those variables by the firm capital structure can be influenced. Gill and Mathur (2011) described some variables which can affect the capital structure choice of the firm. It includes collateralized assets, non-debt tax shield, growth opportunity and income tax. These variables play an important role while determining that what capital structure a firm should use. As Roden and Lewellen (1990) by using the data of US firms (1981-1990) and found a significant and the positive relationship between the Leverage and the firm’s MVA.

The company Capital structure is commonly based on two things; one is debt and the other is equity. A small or a large company is not solely based on either fully debt or equity. The capital structure of a company is a mixture of both debt and equity. So there is a problem that which is best optimal capital structure for a company. How much a company can be lever itself? Weather a company should lever or not? Its market value is increased or decreased due to taking debt or not. Many authors have worked on capital structure theory to know the best optimal level of capital structure. Pandey (2004) worked in Jordanian Firms and argued that the firm value is dependent on the capital structure. So firms can adopt an optimal level of capital structure to increase firm’s value. In 2006 Ward and Price conduct a research and they found that the leverage has a significant positive impact on the firm’s market value. In 2006 Sharma found a positive relationship between the leverage and the market value of the firm. Conversely, Ebaid (2009) concluded that there is no relationship between the structure of the capital and the performance of the firms. In 2007 Tian and Zeitun was also working on the capital structure and they examined that there is significant negative relationship between the leverage and the firm’s value.

Majumdar and Chhibber gathered some sample data on Indian firms and they came to know that there is a significant negative relationship between the value of the firm and leverage. Further, Abor(2007) collected data of Ghana listed firms and found that there is significant positive relationship between the leverage and the company market value. While Gill et al., (2011) conduct a research on the some listed firms of the America and he found that the in America the firm’s profitability is negatively related to the debt.

Al-Qaisi(2010) gathered data from the United Arab Emirates (UAE) and he came to know that there is a significant negative relationship between the leverage and the firm’s profitability while on the other hand the leverage have a positive impact on the size of the firm.

Odit and Gobardhun (2011) worked on Mauritius firms and they concluded that there is a significant positive relationship between the firm’s market value and the leverage.

McConnell and Servaes (1990) conduct a larger survey on the Non-US financial companies. By his research he concluded that the firm who uses debt in their capital structure have negative impact on their market value.

Barkat (2014) gathered some financial data on the Saudi Arabian firms. His results indicate that there is a positive association or relationship between the Leverage and market value of the firms in Saudiian.
Adenugba et al., (2016) examine the relationship between financial leverage and firms’ value, by using a sample of firms listed on Nigerian Stock Exchange (NSE) from 2007-2012. Data were sourced from annual reports of selected firms. The Ordinary Least Square (OLS) statistical technique was used for data analysis and hypothesis testing. The results indicate that there is significant relationship between financial leverage and firms’ value and that financial leverage has significant effect on firms’ value. The study concludes that financial leverage is a better source of finance than equity to firms when there is need to finance long-term projects. However, various economic factors may have despicable effects on the profitability of Nigerian firms, as such the use of debt financing in such firms may yield negative impact such as bankruptcy as well as low firm value. It is concluded that financial leverage be optimized by firms to aid maximization of firms’ value.

Okiro & Omoro (2015) investigate the effect of corporate governance and capital structure on performance of firms listed at the East African securities exchanges (Kenya, Tanzania, Uganda, Rwanda and Burundi) from 2009-2013. Based on the agency theory this study builds a comprehensive framework to answer the research question on whether good corporate governance affects firms performance by integrating capital structure into the governance model. The results indicate that the there was a significant positive relationship between corporate governance and firm performance. The study also confirmed a positive significant intervening effect of capital structure (leverage) on the relationship between corporate governance and firm performance. From a theoretical viewpoint, this study not only explains how corporate governance affects firm performance, but also uncovers the importance of capital structure in a corporate governance system.

3. Determinants of Market Value Added: Evidence from Pakistan PSEX Firms

Market Value Added (MVA) is taken as a dependent variable. MVA shows that how much is the market value of a company; it shows how much value is added to the firm’s. It also shows what is the net present value of the companies’ all projects (past and present). The more it will be the more it will show the profitability of the company. Generally the MVA is calculated as

\[ \text{MVA} = \text{Market value of equity capital} - \text{Book value of equity capital} \]

If it is positive it means there is a value addition in the company assets. If it is negative it means there is no value is added in company’s assets. The more it will be the more it will be good for the company.

1. Debt to Equity Ratio

This ratio is used to measure the Financial Leverage of the firm. It is calculated by dividing the firm’s total liabilities (Current and Non-Current) by its stockholder’s Equity. The more higher the D/E ratio, it will indicate that how much a company is using the amount of debt to finance its total assets (current and non-current) in contrast to the amount which is shown in the shareholder’s equity.

**H₁**: There is a significant effect of Debt to Equity and Financial Leverage on the MVA of listed companies on Pakistan stock exchange.

2. Interest cover Ratio

This ratio is also the indicator of the Financial Leverage. This interest cover ratio (INTC) measures that company have enough ability so it can pay the cost of its debt or to meet its interest expense. It can be calculated as Earning before the interest and taxes (EBIT) which is also known as operating income divided by the companies interest Expense

**H₁**: There is a significant effect of Interest cover Ratio on MVA of listed companies of Pakistan stock exchange.

3. Debt Ratio

Debt ratio is another measure of company’s financial leverage measurement tool. Debt ratio indicates that how much assets in a company or a firm is financed through the debt. It is also called to asset ratio.
**H₁**: There is a significant effect of Debt Ratio on MVA of listed companies of Pakistan stock exchange. Following variables to measure the corporate governance (CG) will be studies:

1. **Board Size**
   The board of directors are responsible for every decision making and they control and leads the company. A good and effective board size can create a good value for the company and leads the company to success. In (1992) Lipton and Lorsch find out that the smaller board is more effective than the larger one. This is just because there are some free riders in the board so they free ride on the efforts of the other. So if we lemmatise the board size the overall performance of the firm will be increased. In (1993) Jensen examined the board and their functions become less effective, when the board gets larger. In (2009) Ehikioya collected some data on Nigerian firms and from his study he found that the return on asset (ROA) has a positive relationship with the board size.

**H₁**: There is a significant effect of Board Size on MVA of listed companies.

2. **Outside Director**
   Outside director is another variable to measure the Corporate Governance (CG). The outside director is basically the Board of director (BOD) of the company or the firm. But he does not have any stake holding in the company nor is he an employee of the company. He is annually paid by the company. Corporate governance standards in some of the public companies require the outside director so they have an unbiased opinion about the company’s strategies and the company’s decision making. He also has the ability to judge the performance of the organization independently and also have the knowledge about the organizational activities.

**H₁**: There is a significant effect of Outside Directors on MVA of listed firms.

3. **CEO duality**
   Basically, CEO duality is related to a situation when the CEO in a firm is performing the same duty as a Chairman in the firm. It is also suggest by the agency theory that the CEO duality minimizes the board monitoring effectiveness over its management. In (1983) Fama and Jensen explained that the CEO role should be separated from the role of the Chairperson in the organization otherwise the person who is holding the both positions in their hand will make ineffective monitoring and managerial decisions. In (1997) Brickley et al. suggest that there is not an ideal and optimal structure of leadership, The CEO duality and the separation both have some of its own costs and benefits. So, for some of the organization the CEO duality is valuable, and likewise for some other firms the separation is valuable.

**H₁**: There is a significant effect of CEO Duality on MVA of listed companies of Pakistan.

4. **Audit Committee**
   When the corporate governance principles are implemented in a firm then the audit committee plays a major role to enhance that firm value. According to the rules and regulations of audit committee in Pakistan it suggests that the audit committee should work independently and they also should perform their duty with the professional care. To minimize the agency problem the audit committee should improve the quality of information and their flow between the management and the shareholder’s. The first and foremost function of any audit committee is to analyse the financial reports of the company and also analyse the system of the internal controls and other rules and regulations.

**H₁**: There is a significant effect of Audit Committee on MVA of listed companies.

**Methodology:**

**Population and Sample**
   The aim of this research is to examine the effects of CG and FL on MVA. For this purpose we will extract the data from the annual reports of the firms listed on Pakistan Stock Exchange (PSEX) Pakistan. Because every listed company is bound to prepare its financial statements and to follow corporate governance rules and regulations (Nadeem&Zongjun, 2011). For this study, the population is the non-financial and non-service companies from PSEX 100 index and study time period is Ten (10) years from the year 2006-2015.
Model
To determine the effect of corporate governance and Financial Leverage on MVA, we purposed the following equation.

$$\text{MVA}_{it} = \alpha + \beta_1 \text{BOSIZE}_{it} + \beta_2 \text{DOUT}_{it} + \beta_3 \text{CD}_{it} + \beta_4 \text{AC}_{it} + \beta_5 \text{DEBT}_{it} + \beta_6 \text{DTE}_{it} + \beta_7 \text{ICR}_{it}$$

Where;

- $\text{MVA}_{it}$ is market value of firm $i$ in time $t$;
- $\text{BOSIZE}_{it}$ is Board Size of firm $i$ in time $t$;
- $\text{DOUT}$ is Outside Directors of firm $i$ in time $t$;
- $\text{CD}$ is CEO Duality of firm $i$ in time $t$;
- $\text{AUDIT}$ is Audit Committee of firm $i$ in time $t$;
- $\text{CG}$ is corporate governance of firm $i$ in time $t$;
- $\text{FL}$ is financial leverage of firm $i$ in time $t$;
- $\text{DEBT}$ is debt Ratio of firm $i$ in time $t$;
- $\text{DTE}$ is Debt to Equity Ratio of firm $i$ in time $t$;
- $\text{ICR}$ is Interest Cover Ratio of firm $i$ in time $t$.

Table 1: Descriptive Statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Mean</th>
<th>Median</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>DOUT</td>
<td>3.106</td>
<td>3.000</td>
<td>1.894</td>
</tr>
<tr>
<td>MVA</td>
<td>7.73</td>
<td>7.71</td>
<td>1.93</td>
</tr>
<tr>
<td>ICR</td>
<td>33.74</td>
<td>32.22</td>
<td>11.3</td>
</tr>
<tr>
<td>DTE</td>
<td>1.188</td>
<td>1.086</td>
<td>20.20</td>
</tr>
<tr>
<td>DEBT</td>
<td>0.534</td>
<td>0.536</td>
<td>0.289</td>
</tr>
<tr>
<td>CD</td>
<td>0.056</td>
<td>0.000</td>
<td>0.231</td>
</tr>
<tr>
<td>BOSIZE</td>
<td>9.53</td>
<td>9.00</td>
<td>2.195</td>
</tr>
<tr>
<td>AUDIT</td>
<td>4.24</td>
<td>4.00</td>
<td>1.150</td>
</tr>
</tbody>
</table>

Table 2: Correlation

<table>
<thead>
<tr>
<th>Variable</th>
<th>MVA</th>
<th>ICR</th>
<th>DTE</th>
<th>DEBT</th>
<th>BOARD</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICR</td>
<td>0.074628</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DTE</td>
<td>0.125391</td>
<td>0.012736</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DEBT</td>
<td>0.172453</td>
<td>-0.078665</td>
<td>-0.031984</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BOSIZE</td>
<td>0.521308</td>
<td>0.040795</td>
<td>0.052272</td>
<td>0.148375</td>
<td></td>
</tr>
<tr>
<td>AUDIT</td>
<td>0.132164</td>
<td>0.112201</td>
<td>-0.049886</td>
<td>0.061990</td>
<td>0.207630</td>
</tr>
</tbody>
</table>

Table 3: Unit Root Test

<table>
<thead>
<tr>
<th>Variable Name</th>
<th>Probability</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>MVA</td>
<td>0.0005</td>
<td>1st difference</td>
</tr>
<tr>
<td>Audit Committee</td>
<td>0.0368</td>
<td>Level</td>
</tr>
<tr>
<td>Board Size</td>
<td>0.0006</td>
<td>Level</td>
</tr>
<tr>
<td>Out Side Directors</td>
<td>0.0373</td>
<td>1st difference</td>
</tr>
<tr>
<td>Debt Ratio</td>
<td>0.0000</td>
<td>1st difference</td>
</tr>
<tr>
<td>Debt-to-equity Ratio</td>
<td>0.0026</td>
<td>Level</td>
</tr>
<tr>
<td>Interest Cover Ratio</td>
<td>0.0000</td>
<td>1st difference</td>
</tr>
</tbody>
</table>

4. Empirical Results

Based on our results of regression models (Common constant, fixed effect and Random effect model) we concluded that the fixed effect model is more appropriate model for our data analysis. In our regression analysis we have one dependent variable which is the market value added (MVA) and two independent variable corporate governance (CG) and Financial Leverage (FL) and we regress their impact on our dependent variable. We have the data from (2006-2015) of the PSEX 100 index companies.

Table 4: Pooled OLS Model Results

<table>
<thead>
<tr>
<th>Variable</th>
<th>OLS</th>
<th>Fixed Effect</th>
<th>IV</th>
</tr>
</thead>
<tbody>
<tr>
<td>DOUT</td>
<td>0.191545</td>
<td>0.149805</td>
<td>0.127209</td>
</tr>
<tr>
<td>ICR</td>
<td>0.001557</td>
<td>0.002079</td>
<td>0.001894</td>
</tr>
</tbody>
</table>
Leverage has a positive and significant effect on market value added which is the proxy variable of the financial leverage. Debt ratio (Total debt/Total Assets) also positively affects the market value of the firm. When the firm uses the debt it gives a positive signal to the market that the firm is more worthy or it has a good credibility history that’s why the financial institutions provide them loan. And a firm also gets the tax shield benefit by using the debt in their capital structure. In 2006 Ward and Price found that the leverage has a significant positive impact on the firm’s market value. In the same way, Sharma (2006) evidence a positive relationship between the leverage and the market value of the firm. So the market value of the firm increases because of the debt ratio.

Interest cover ratio is the proxy variable of our independent variable financial leverage. It means that how rapidly or how fast a company is paying its interest expenses. Through or regression model we concluded that interest cover ratio has a significant positive impact on our dependent variable market value added. It means when the Pakistani firm’s ability to pay its interest expenses increases it’s market value is also increased. Because the company only can meet its expenses when it have sufficient amount of cash in hand. And only good profitable company can only have enough cash in hand meet its all interest expenses. These findings are similar to McGahan and porter (1997) that the interest cover ratio has a greater influence on the performance of the firm.

The board size also has the significant negative impact on the value of the firms in Pakistan. Generally this is a believed that the value of a firm is negatively impacts by larger board size. The larger the board size the more negative impact it has on the value of organization. According to the Rouf (2011) believed that smaller board size have a positive impact on the firm value rather than the larger size because monitoring cost is high for the larger board size, there is a poor communication between the larger groups and decision making process is also slow in large board size. Lipton and Lorsch (1992) and Jensen (1993) found that the smaller board size is more efficient and more effective than the larger one. Our results are consistent with Johl & Jackling (2007) and Kiel & Nicholson (2003) findings as board size negatively affect the performance of the firm.

Other variables in analysis indicate that they have an insignificant impact on the market value added listed firms in Pakistan. Other Statistics (like R-Square F-Statistics and Durbin-Watson test) also indicates the model results. The R square is 0.742478 it means that the 74% change or variance in our dependent variable market value added is due to these factors. It means that the variance is our dependent variable is explained by this purposed model. F Statistical value indicates that our model is fit to explain the effect of corporate governance and financial leverage on the market value added in Pakistan.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient 1</th>
<th>Coefficient 2</th>
<th>Coefficient 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>DTE</td>
<td>0.004157***</td>
<td>0.001148***</td>
<td>0.018569***</td>
</tr>
<tr>
<td>LEV</td>
<td>0.025273**</td>
<td>0.004957*</td>
<td>0.003821*</td>
</tr>
<tr>
<td>CD</td>
<td>-0.143574</td>
<td>-0.158903</td>
<td>-0.108979</td>
</tr>
<tr>
<td>BOSIZE</td>
<td>-0.026223</td>
<td>-0.019568</td>
<td>-0.013069</td>
</tr>
<tr>
<td>AUDIT</td>
<td>-0.046128</td>
<td>-0.038459</td>
<td>-0.030859</td>
</tr>
<tr>
<td>MVA_{t-1}</td>
<td></td>
<td></td>
<td>0.037590</td>
</tr>
</tbody>
</table>

Note: MVA is market value; BOSIZE is Board Size; DOUT is Outside Directors; CD is CEO Duality; AUDIT is Audit Committee; DR is debt Ratio; DTE is Debt to Equity Ratio and ICR is Interest Cover Ratio. *, **& *** indicates that mean comparisons are significant at the 10,5and 1 % level.
5. Conclusion

The main purpose of this study is to examine that whether the corporate governance rules and regulations and financial leverage have any impact on the market value added in Pakistan. For this purpose the data have been taken out from the listed firms of Pakistan stock exchange. We have five proxy variables to measure our independent variable corporate governance (Board size, CEO duality, Audit committee, and outside directors) and to measure independent variable financial leverage, following proxies’ (Debt ratio, Debt-to-Equity Ratio, and interest cover ratio) and we examine their effect on the market value added of firms in Pakistan.

The proxy of corporate governance such as board size, results shows that this variable is also significant. It means it also has the significant negative impact on the market value of the firms in Pakistan. In Pakistan the average company’s board size is varies between 7 to 9 which is considered as a larger size. So it also has the negative impact on the value of the firms in Pakistan, because there is a high monitoring cost and low level of communication. So smaller size is the most efficient and will have a positive impact on the companies’ market value. Two authors named as Mak and Kusnadi collected some sample data from Singapore and Malaysia. In their research both author work on corporate governor rules and principles, and through their work they concluded that there is a negative association between the board size and the market value of the firms. According to Judge & Zeithamal (1992), the larger board size decreases the value of the firms.

Interest coverage ratio is the proxy variable of our independent variable financial leverage. Interest cover ratio indicate that how many times a company pay its interest expanses the more ICR a company have it means that more the company have ability to meet its interest expenses. In our results we also concluded that it has a significant positive impact on our dependent variable market value. It means the more company have ability to pay its interest expense the more market value of the firm will increase. Ramdani&Witteloostuijn (2010) by using interest coverage ratio; they also have concluded that it has a positive impact on the firm’s market value.

Another variable which is having the positive and significant effect on the market value of the firm is the Debt ratio. Debt ratio is the proxy variable of financial leverage. It can be calculated by dividing the total debt by the total assets of the company. In our regression model the debt ratio is significantly positive. It means it is having the significant positive impact on the market value of the firms in Pakistan. It means if a firm is going to lever itself it will have a positive significantly effect on their market value. Their market value will be increased when they will take debt. In 2006 Ward and Price conducted a research and they found that the leverage has a significant positive impact on the firm’s market value.

In 2006 Sharma analysed that there is a positive relationship between the leverage and the market value of the firm. Barkat (2014) find out that there is a positive association or relationship between the Leverage and market value of the firms in Saudi Arabia. Through our study we can conclude that our study is matched with the (Sharma and Barkat) and (Ward and Prince) who also concluded that the leverage have a positive impact on the value of the firms. But our study suggest that in leverage the Debt ratio is more significant ratio which is having the positive significant effect on the value of the firms in Pakistan.

References

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