Nexus of Corporate Governance Practices and Financial Performance: Evidence from Listed Corporates of Pakistan and China

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Abstract

The objective of this study is to perform a comparative analysis of the ways in which corporate governance systems and practices influence the financial performance of companies based in Pakistan and China. This study employs the multidimensional Corporate Governance Index (CGI) as a metric to evaluate the effectiveness and caliber of governance practices. The CGI, which includes stakeholders such as shareholders, the board of directors, audit procedures, financial disclosure, employee involvement, and societal factors, functions as a comprehensive indicator of the efficacy of an organization's governance. An assortment of financial performance metrics—including Return on Assets (ROA), Return on Equity (ROE), Market-to-Book Value Ratio (P/B), and Price-Earnings Ratio—are examined for their impact by the empirical model utilized in this study. Fifty firms hailing from Pakistan and China were included in the sample developed using this model. A nuanced relationship appears to exist between CGI scores and financial performance metrics, according to the findings. The CGI scores demonstrate a moderate correlation with ROA, ROE, and P/B ratios for Pakistani firms. However, a significant correlation is observed with P/E ratios. On the contrary, the CGI ratings exhibit a robust and statistically significant correlation with every evaluated financial performance indicator in the case of Chinese firms. The distinction can be ascribed to China's implementation of governance models that are more resilient and adaptable. The significance of effective governance mechanisms in improving financial outcomes is highlighted by these results. These insights provide significant value to organizations aiming to improve their governance frameworks and procedures, potentially resulting in heightened profitability and enhanced shareholder wealth.

Keywords: governance metrics, governance index (GI), market capitalization, return on firm equity (ROE), return on firm assets (ROA), price to book ratio (P/B)

Introduction

Corporate governance is the term used to describe the framework created by both public and private institutions, including rules, laws, and generally accepted business practices, to regulate the interaction between corporate executives (also referred to as "corporate insiders") and those who provide financial support for

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businesses in a market economy. Investors can be providers of debt financing (creditors), providers of equity financing (shareholders), providers of human capital that are largely firm-specific (workers), and providers of additional physical and non-tangible resources that firms might utilize to run and expand. (Salvi et al. 2021; Zheng, Piao and Park, 2021). The definition of corporate governance may be seen from many different angles. The definition might have a specific or general emphasis. For instance, some people refer to corporate governance as a formal framework in which the controlling managers are exclusively answerable to the corporate owners. Others lure a very broad line and talk about the manager's duty to the entire community (Gupta, Krishnamurti and Tourani-Rad, 2018). The numerous kinds of creditors and shareholders are often the main focus of the American based model of firm governance (Aguilera, Marano and Haxhi, 2019; Ciepley, 2020; Mahanti, 2021).

Following notable scandals involving corporate behemoths such as Enron and WorldCom, interest in corporate governance grew (Enriques and Zetzsche, 2020). Although the concept of corporate governance existed, it was not applied to its primary goals, which resulted in the emergence of such corporate scandals. A moderator was needed to fill this vacuum and serve as a bridge between these important stakeholders after such business crises since shareholders and management have different and conflicting interests (Guerras-Martín et al. 2020). In this case, the board of governance, which not only protects shareholder interests but also has jurisdiction over organizational management, was the ideal solution.

Since SECP's 2002 issuance of the "Rules of Corporate Regulations" for publicly listed businesses, this area of study has become increasingly important in Pakistan's business world. Most of the recent econometric studies of corporate governance have concentrated on determining whether or not there is a correlation between executive compensation and various categories representing firm performance (such as board size and composition, accounting standards, and financial disclosure laws) (Villanueva-Villar, Rivo-López, and Lago-Penas, 2016; Baysinger and Butler, 2019). Corporate governance was not a notion in the early seventeenth century. This is because the control concentration was divided into a limited numeral of individuals (partnership) who also took part in the operational activities to manage and protect their interests (Means, 2017). In his article "The Shape and Operation of corporate polity," Richard Eells introduced the concept of corporate governance to academia in 1960. In it, he covered how agency costs affect the firm's financial resources and suggested ways to cut them. Corporate governance (CG) refers to the interactions between the board of directors, management,

shareholders, and other stakeholders. According to Kovermann and Velte (2019), corporate governance is the means by which banks and other lenders to businesses secure a satisfactory return on their investments. CG's primary mission is to protect the company's stakeholders and stockholders, as described above.

The examination of corporate governance, specifically its importance in developed nations, has been the subject of academic investigation by regulatory organizations. The studies presented empirical evidence that emphasizes the critical significance of corporate governance. Significant contributions to this discipline have been made by renowned committees, including the Cadbury Committee (1992), Greenbury Committee (1995), Hampel Committee (1998), and Turnbull Committee (especially in 2003). The synthesis of their findings has established a standard by which the global community evaluates corporate governance. The aforementioned reports have played a crucial role in influencing the development of internationally renowned corporate governance codes.

The recognition of corporate governance's significance has grown in contemporary business practice, predominantly as a result of its direct impact on the financial performance of specific companies and the economies as a whole. Corporate governance reforms are progressively being adopted with the objective of protecting the interests of stakeholders and enhancing the performance of organizations. The reforms in question aim to achieve a harmonious equilibrium between the concerns of stakeholders, both individually and collectively, as emphasized in the scholarly contributions of Afsharipour (2016), Gadinis and Siazad (2020), and Lund and Pollman (2021). These types of initiatives are critical for improving the strategic and operational management of business organizations.

Ammann et al. (2011) and Brown & Caylor (2006), among others, have demonstrated an empirical correlation that is positive in nature, between financial performance and corporate governance. On the contrary, an investigation conducted by Akbar et al. (2016) indicates the possibility of an inverse correlation. Notwithstanding these discoveries, a discernible dearth of research exists regarding the influence of corporate governance on the achievement of businesses, specifically in the Asia Pacific region and with regard to China and Pakistan.

By employing the governance index methodology to obtain a more comprehensive understanding of the concept of corporate governance in Pakistan and China, this study aims to address this deficiency. Addressing a gap in the existing literature, the purpose of this study is to investigate the correlation between the corporate governance index and financial performance in these two countries.

The structure of this research is as follows: an extensive review of relevant literature is conducted, followed by an explanation of the methodology and techniques used for developing and analyzing the Corporate Governance Index (CGI). The study then progresses to the key findings before culminating in a conclusive summary. This approach ensures a thorough and comprehensive exploration of corporate governance's impact within these specific economic contexts

Purpose of the Study

The foundational objective of corporate entities revolves around safeguarding the interests of all stakeholders. The adoption of corporate governance reforms is pivotal in ensuring that stakeholder benefits are optimally realized through the strategic decisions and actions undertaken by business management. It is critical to recognize that the implementation of these reforms does not inherently lead to diminished profitability. In fact, the integration of robust corporate governance principles can potentially elevate an organization's financial performance, simultaneously fostering equity and fairness among stakeholders.

This research endeavors to elucidate the influence of corporate governance practices on organizational performance. It specifically examines the empirical relationship between Corporate Governance Index (CGI) practices and the financial performance of firms within the contexts of China and Pakistan. Corporate governance, in its conceptual essence, presents as a multifaceted and subjective phenomenon. Despite its elusive definitional boundaries, its profound impact on the operational efficiency and financial success of businesses in the economic realm is undeniable. The adoption of advanced corporate governance models is not only integral to the proficient management of corporate entities but also holds the potential to significantly enhance their performance metrics. Corporate governance is inherently dynamic, continually evolving in response to new developments, regulatory changes, and emerging models, reflecting the shifting paradigms within the global business landscape.

Significance of the Study

The study's findings will help enhance policymakers' and investors' awareness of the significance of corporate governance while considering emerging and developing economies. The study adds to the body of knowledge for readers, academics, and business professionals. The analysis has been made thorough by including several business aspects from both Developing and Emerging Countries.

Review of the Empirical Studies

In recent years, significant failures have been observed within numerous large companies, with these failures often being attributed to considerable scandals. An extensive analysis of these failures has unveiled that the fundamental reason behind these calamities was a deficiency in corporate governance protocols. Consequently, the worldwide economy experienced a significant disruption, prompting shareholders and investors to adopt precautionary strategies, including the implementation of corporate governance practices within firms. The acknowledgement was compelled from them that corporate governance stands as the most effective solution in this domain for mitigating shareholder risk, therefore necessitating its consideration for adoption in firms. In 2007, El Mehdi was involved in the aforementioned event. Consequently, the researchers were motivated to delve deeper into corporate governance matters with the aim of implementing strategies that could potentially enhance the performance trajectory of corporate organizations.

According to Srivastava (2009), corporate governance is defined by its adherence to principles of legitimacy, responsibility, and competence, as well as its commitment to upholding legal frameworks and safeguarding human rights. The Cadbury report, published in 2002, provides an overview of how corporate governance influences and oversees the operational procedures of corporations, offering a simplified understanding of this idea (Cadbury, 2002). However, it is well acknowledged that governance can vary in quality, ranging from great to horrible, and in effectiveness, depending on the inclusion of certain elements in the governing procedures and the corresponding feature or quality values.

The corpus of scholarly research exploring the nexus between corporate governance structures and firm performance has expanded significantly, particularly focusing on the dimension of ownership concentration. In the realm of small and medium-sized enterprises (SMEs) in Ghana, Abor and Biekpe (2007) identified a statistically significant, positive correlation between insider ownership and profitability. Kumar and Singh (2013) extended this inquiry, uncovering a notable association between promoter ownership and firm performance in their study. Buallay et al. (2017) delved into the

context of Saudi Arabian enterprises listed on the stock exchange. Their research highlighted the pivotal role of the ownership held by largest shareholders in influencing the firm's Return on Assets (ROA) and Return on Equity (ROE). Arora and Bodhanwala (2018) undertook a comprehensive analysis of 407 Indian enterprises to examine the impact of promoters' equity on the Corporate Governance (CG) index. Their findings underscored a statistically significant and positive relationship between Return on Net Worth (RONW) and the studied outcome variable. Further expanding the geographic scope of this research, Ciftci et al. (2019) investigated the ownership-performance linkage within emerging market contexts. Analyzing a sample of 234 publicly traded companies in Turkey, their study provided empirical evidence supporting the proposition that a higher concentration of ownership positively influences the Return on Assets (ROA). Collectively, these studies contribute to a nuanced understanding of the interplay between ownership structures and firm performance, offering valuable insights into governance dynamics across diverse economic landscapes.

The scholarly discourse on corporate governance underscores its critical role in facilitating investment returns for investors, as posited by Shlidfer and Vishney (2020). They emphasize the agency dimension within corporate governance, which pertains to the mechanisms through which shareholders influence managerial decisions to attain desired financial outcomes. For example, businesses might offer additional benefits to customers to secure their investment and enhance profitability. Prior research demonstrates that the implementation of corporate governance practices universally enhances firm financial performance, irrespective of geographic location, whether in developed or developing nations. A contrasting relationship has been observed between financial performance and ownership concentration. Li et al. (2015) investigated smaller Australian firms and found that concentrated ownership adversely affects financial performance. Merendino and Melville (2019) similarly argued that concentrated ownership, despite increased monitoring, might not always benefit business performance.

Hecht, Benson, and Finegold (2007) explored the relationship between corporate board performance and firm financial success, concluding that corporate board regulations positively impact business

performance. Sen (2021) also examined the quantifiable aspects of corporate governance, finding that board mechanisms significantly affect performance. Aslam, Kalim, and Fizza (2019) suggested that firms might underperform where corporate governance practices are inadequate. Z.A. Shah (2009) analyzed the impact of corporate governance on financial performance in China and Pakistan, finding a positive correlation in both contexts. The dissemination of information is consistently shown to influence organizational financial success, though evidence is mixed (Dagilien, 2013). Cantele and Zardini (2018) found that increased transparency among European SMEs correlated with improved financial outcomes. Hardiningsih et al. (2020) observed that information disclosure significantly influences Indonesian and Malaysian companies' ROA, ROE, and P/E ratios. However, Haat et al. (2008) and Daglien (2013) found no significant correlation between disclosure levels and financial performance in Malaysian and developing economies, respectively. Azman et al. (2020) and Abba et al. (2018) also found no significant correlation between disclosure quality and the success of Nigerian listed firms.

Agency problems are correlated with the financial performance of public bodies. Corporate governance is posited as a solution to the challenges and costs associated with agency problems (Jurakulovna & Bahodirovich, 2021). Management's objectives often diverge from those of the board, depending on management's remuneration. Addressing these issues involves compensating management and shareholders, thereby increasing shareholders' confidence in management. The board of directors plays a crucial role in mitigating agency costs (Hutchinson & Gul, 2003; Kee et al., 2003). The presence of independent directors on a board is linked to greater objectivity and effectiveness in overseeing management. Ferrib and Ertimura (2010) studied the impact of CEO duality on board assessments, finding that a CEO also serving as board chairman can lead to biased decision-making and reduced organizational effectiveness. Chen, Li, and Yi (2008) noted that many firms have separated the roles of CEO and board chairman, moving from a duality to a non-duality structure. Fama and Jensen (1983) argued that dual board responsibilities reduce oversight and monitoring of management.

Board education is essential for effective evaluation and decision-making (Kiel & Nicholson, 2014; Dwekat et al., 2020). Professional competencies of directors are crucial for informed judgments. Despite extensive research on diverse corporate governance systems and firm performance analysis, findings vary. Porfirio and Carrilho (2020) emphasized incorporating corporate governance practices into all corporations. Fenwick & Vermeulen (2019) noted the impact of board members' age on decision-making quality. Wegge et al. (2018) argued that experienced and up-to-date board members make advantageous decisions. The financial performance of organizations is a critical metric for evaluating their operational effectiveness (Herly & Sisnuhadi, 2011). Dahya and McConnell (2007) and Fitri et al. (2019) examined the influence of board characteristics on company performance. Song et al. (2017), Arayssi, Dah, and Jizi (2016), and Herrera-Cano and Gonzalez-Perez (2019) highlighted the importance of board skills and diversity.

Research has explored factors influencing organizational performance, such as board composition, CEO duality, and audit committee effectiveness (Afande et al., 2015; Lappalainen & Niskanen, 2012). Abor and Biekpe (2007) and Afrifa and Tauringana (2015) identified factors influencing public entity profitability. Bauer et al. (2010) and Aboagye and Otieku (2010) examined the relationship between corporate governance and financial performance, with mixed results. Renders et al. (2010) and Reddy et al. (2010) found a positive association between corporate governance ratings and performance, moderated by institutional quality. A lack of consensus exists on the impact of corporate governance on financial performance (Ehikioya, 2009; Gruszczynski, 2006; Gemmill & Thomas, 2004; Drobetz et al., 2003; Alves & Mendes, 2002; Yermack, 1996; Aboagye & Otieku, 2010; Sueyoshi et al.). Maassen (1999) suggested that corporate governance might indirectly influence performance, indicating a need for further investigation.

Research Strategy and Empirical Model

For this research, a randomized sample comprising 50 corporations listed on both the Shanghai Stock Exchange and the Pakistan Stock Exchange (PSX) was meticulously selected. The data collection spanned a period of seven years, from 2015 to 2021,

focusing on variables related to corporate governance and financial performance. This information was meticulously gleaned from the annual reports of these publicly listed entities.

The study observes the evolution of corporate governance in Pakistan, noting the implementation of the SECP Code of Corporate Governance in 2002 and subsequent amendments aimed at bolstering transparency and effectiveness within the corporate sector. This initiative parallels global trends in corporate governance reform, notably in the United States following high-profile corporate scandals involving companies like Enron and WorldCom. In response, the U.S. reinforced corporate governance structures with the introduction of the Sarbanes-Oxley Act of 2002 and other measures by the Securities and Exchange Commission (SEC) to ensure strict adherence to these regulations by publicly traded companies.

Similarly, the regulatory framework of the Securities and Exchange Commission (SEC) in China imposes rigorous governance standards, exerting a profound impact on companies listed on the stock exchange. In both Pakistan and China, listed companies are observed to be actively enhancing their governance structures, thereby safeguarding stakeholder interests.

The methodology employed in selecting the sample for this study involved a random sampling technique, which did not account for specific industry attributes or individual characteristics of the firms. To control for the potential confounding effects of firm size, a variable representing company size was incorporated as a control variable in the analysis. This methodological approach ensures a broad and representative understanding of the corporate governance landscape across these diverse economic environments.

Governance Index Model

The primary objective of this study is to conduct a thorough examination of the empirical data pertaining to the execution of corporate governance practices and the resultant influence on the financial performance of organizations. In contrast to the easily quantifiable nature of financial performance as determined by analyzing the accounting and financial statements of publicly traded companies, corporate governance is characterized by its qualitative nature. One of the primary obstacles faced in this research was the development of a rigorous methodology to assess the efficacy of corporate governance in a variety of organizations. This process entailed the identification of precise criteria that could differentiate organizations with robust governance frameworks from those with less robust governance structures.

The evaluation of corporate governance quality as either

"excellent" or "poor" is a complex task due to the absence of universally recognized standards. However, it has been noted that organizations that implement strong governance protocols tend to achieve favorable and constructive results. The efficacy of the corporate governance practices implemented by the chosen firms is primarily assessed through this research using these observable outcomes. The present study's methodological approach is influenced by the conceptual frameworks that Mohanty (2003) and Butt (2008) have put forth. These academicians espouse the notion that a streamlined strategic process may result in the attainment of particular advantageous consequences. This methodology facilitates a comprehensive comprehension of the complex correlation that exists between corporate governance practices and the financial performance of organizations.

The primary objective of the Corporate Governance Index (CGI) is to mitigate the difficulty associated with distinguishing organizations that possess effective governance structures from those that do not. In order to address this issue, a particular subset of organizations is the target audience for this index. The development of the index was predicated on the supposition that particular outcomes will faithfully reflect the ultimate reality when all processes are operating at their maximum capacity. On the basis of the subsequent delineation of good governance, the CG index was developed. Complementary to maximizing shareholder value, the primary aim of corporate governance is to safeguard the interests of all other stakeholders. Society, shareholders, debt holders, employees, suppliers, and the government are the primary stakeholders of any organization.

The Composite Governance (CG) index was established through the amalgamation of thirty distinct criteria pertaining to several aspects of corporate governance, including the Board of Directors (BOD), shareholders/investors, auditors, debtholders, employees, and society. The selection of the criterion was based on the guidelines outlined in the SECP code of corporate governance and the SEC China bylaws of corporate governance. These regulations serve as the legal framework or code of conduct that firms must adhere to in order to be recognized as well-governed entities. The research work employed

- 9 elements for firm directors (BOD)
- 3 elements for owners & capital contributors
- 5 elements for external auditors
- 8 elements for the reporting function
- 2 elements for debtholders

- 1 element for workers
- 2 elements for the general public

The data relating to selected elements are taken from the publicly issued reports of listed firms from Pakistan & China.

Index-Based Grading Criteria

In this study, a systematic scoring system was employed, assigning values to various criteria on a scale from 0 to 5, where 5 represents the most favorable outcome and 0 signifies the least desirable. Consider, for instance, a corporate board consisting of eight members, with six serving as non-executive directors. In accordance with this framework, such a composition would be awarded a score of 5, reflecting the high proportion (75%) of non-executive members.

This scoring methodology was developed following extensive consultations with subject matter experts. For example, the research assigned a score of 5 to an unqualified audit report, indicating a positive assessment. Conversely, a score of 3 was attributed to negative audit reports, while reports containing disclaimers received a score of 1.

To account for the differential importance of various metrics, a weighted scoring system was introduced. This system assigns values between 1 and 5 to each parameter, recognizing that some aspects hold greater significance and, thus, exert more considerable influence on the overall assessment. For instance, the current status of the audit report was deemed critically important and thus was assigned the highest weight of 5. In contrast, the practice of modifying or rotating board members after a period of five years was assigned a weight of 3, reflecting its lesser but still notable importance.

Furthermore, the study allocated a weight of 4 to the ratio of independent and non-executive directors on the board, acknowledging their critical role in governance. Meanwhile, the representation of minority shareholders within the board was assigned a weight of 2, underscoring its relative importance but secondary to the imperative of maintaining a balanced board composition. This nuanced weighting approach underscores the vital role that independent directors play on the board, extending beyond mere representation and into the realm of effective governance.

Measurement of Financial Performance

The assessment of a company's performance through various analytic techniques serves as a benchmark for gauging its success. The research by John H, S. Brown, and L. Davison highlights that key financial metrics, such as Return on Equity (ROE) and Return on

Assets (ROA), are often prioritized by investors in evaluating a firm's financial health. This study, building upon their findings, will primarily utilize ROA and ROE ratios to assess the financial performance of firms in China and Pakistan. Additionally, Price-to-Book (P/B) and Price-to-Earnings (P/E) ratios will be employed as tools to appraise market performance.

The frequent observation of the Market-to-Book (M/B) ratio exceeding 1.0 indicates investor propensity to value a company higher than its accounting book value. The book value provides a historical perspective, detailing the past investments made by shareholders. In contrast, the market price is a forward-looking indicator, reflecting investor expectations about future cash flows. This difference underscores that businesses leveraging more rigorous methods, as indicated by the Market Book ratio, may seize greater opportunities.

Moreover, the enforcement of corporate governance regulations can potentially restrain companies from enhancing their earnings, impacting their ROA and ROE. This effect often arises from strategic maneuvers employed by firms aiming to maximize profits, sometimes through the minimization of tax liabilities and other societal costs. It is important to recognize, however, that this impact is typically short-term. Over the long haul, companies engaging in such practices may struggle to optimize their returns and, consequently, their profitability. This nuanced understanding of financial metrics and corporate governance practices highlights the complex dynamics governing corporate performance in the contemporary economic landscape.

Financial Variables

Financial variables/measures used in the study are as follows.

1. Return on Total Assets (ROA) = Earning_after_Taxes / Total Assets
2. Return on Shareholders' Equity (ROE) = Earning_after_Taxes / Shareholders' Equity
3. Market Price to Book Value (P/B) Ratio = Market price of the share / Book value of the share
4. Market Price to Earnings Ratio (P/E) Ratio = Market value of share / Earnings per share
5. Firms Scale = Natural log of Total Assets

Market prices can be utilized as year-end closing prices for computation purposes. Because the companies are from different

industries and countries, their fiscal years are also not the same. Using the same date price for all firms defeats the objective and may have an impact on the outcomes. If the fiscal year of the company ends on June 30, we used the share price at that time; if the fiscal year ends on December 31, we used the closing price on December 31.

Econometric Model: Linear Regression Model

To rigorously explore the impact of robust corporate governance and its effective execution on the financial performance of selected enterprises, this research adopts a regression analysis methodology to gather pertinent data. The hypothesis underpinning this inquiry posits that the deployment of sound corporate governance strategies or a comprehensive governance framework substantially affects a firm's financial outcomes. Consequently, this investigation is anchored on the following hypothesis.

The analytical frameworks employed herein incorporate corporate governance metrics extracted from the scholarly works of Abdullahi, Rohami, and Kuwata (2016), Joseph and Ahmed (2017), Irine and Indah (2016), Osundina, Olayinka, and Chukwuma (2016), Irine and Indah (2016), and Karam and Sonia (2015). These metrics include Board Size (BDS), Board Activism (BDA), and Committee Activism (COA). This study evaluates two models, referred to as FZ, which are influenced by the organizational scale. The primary objective of this research is to empirically scrutinize and validate hypotheses concerning the relationship between governance practices and financial performance.

Ho: *There is no relationship between good corporate governance practices and financial performance*

H1: *There is a relationship between good corporate governance practices and financial performance.*

The following are the regression equations for statistical tests:

$$ROA = a1 + b1CGI + b2\,Ln\,(TA) \ldots\ldots\ldots 1$$
$$ROE = a1 + b1CGI + b2\,Ln\,(TA) \ldots\ldots\ldots 2$$
$$P/B = a1 + b1CGI + b2\,Ln\,(TA) \ldots\ldots\ldots 3$$
$$P/E = a1 + b1CGI + b2\,Ln\,(TA) \ldots\ldots\ldots 4$$

Empirical Findings

Descriptive Statistics Results

The results of the Chinese and Pakistani businesses are displayed in Tables 1.1P and 1.1C, respectively. firms in Pakistan receive an average CGI score of 3.34 out of 5, or 64.2%, compared to 4.87 out of 5, or 97.1%, for Chinese firms. If we consider a grade of 2.50 to be acceptable, it means that our chosen firms are doing better

in terms of the calibre of their corporate governance. Chinese companies are outperforming Pakistani companies in comparison because of strict regulation and performance-improving efforts by regulatory bodies. At a 5% level of confidence, our chosen businesses are outperforming the norm, so we may reject the null hypothesis and accept the alternative one. The characteristics or measures of strong corporate governance may be the cause of both Chinese and Pakistani companies performing better than average.

Table

1.1P

Stats	1	2	3	4	5	6
Average	3.21	7.06	12.67	1.31	7.54	22.62
Stand Error	0.06	1.31	2.53	0.24	3.04	0.21
Median	3.41	6.31	12.79	1.08	7.89	20.22
Standard Deviation	0.6	9.26	17.56	1.65	21.32	1.34
Minimum	2.05	-23.81	-23.41	-0.38	-64.81	16.95
Maximum	4.43	31.79	82.15	10.5	67.49	25.63

Note: Corporate Governance Index (1), Return on Assets (2), Return on Equity (3), Price to Book (4), Price to Earning (5), Log of Total assets (6)

Table

1.1C

Stat	1	2	3	4	5	6
Average	4.87	9.72	18.78	3.88	11.76	26.67
Stand Error	0.09	2.44	5.75	1.78	7.06	0.44
Median	7.34	8.34	14.43	4.01	11.12	26.23
Standard Deviation	0.91	15.65	21.54	2.23	20.65	4.51
Minimum	4.43	-5.78	-12.34	2.35	-20.45	10.95
Maximum	10.34	45.56	45.56	12.45	70.56	90.76

Note: Corporate Governance Index (1), Return on Assets (2), Return on Equity (3), Price to Book (4), Price to Earning (5), Log of Total assets (6)

The financial indicator demonstrates that Chinese businesses are better off than Pakistani businesses. The average ROA and ROE for enterprises in Pakistan are 7.06% and 12.67%, respectively. For Chinese businesses, the average ROA and ROE are 9.72% and 18.78%, respectively. The results might have been slightly impacted by the fact that both Chinese and Pakistani enterprises had a rather large range between the lowest and highest value. The standard

deviation shows that the P/E has the most variation between the minimum and maximum value.

Table 2.1P

Correlation Index

Variable	1	2	3	4	5	6	7
2	0.57	1					
3	0.49	0.68	1				
4	0.36	0.49	0.66	1			
5	0.63	0.63	0.75	0.68	1		
6	0.16	0.19	0.14	0.08	0.12	1	
7	0.61	0.46	0.36	0.34	0.46	0.18	1

Note: Corporate Governance Index (1), Return on Assets (2), Earning per Share (3), Return on Equity (4), Price to Book (5), Price to Earning (6), Log of Total assets (7)

Table 2.2C

Correlation Index

Variable	1	2	3	4	5	6	7
2	0.89	1					
3	0.75	0.81	1				
4	0.73	0.70	0.76	1			
5	0.83	0.78	0.81	0.77	1		
6	0.62	0.48	0.51	0.35	0.48	1	
7	0.81	0.56	0.73	0.45	0.65	0.45	1

Note: Corporate Governance Index (1), Return on Assets (2), Earning per Share (3), Return on Equity (4), Price to Book (5), Price to Earning (6), Log of Total assets (7)

The correlation between the CGI score and financial performance indicators is documented in Correlation Matrix 2.1P and 2.2C. Regarding Pakistani enterprises, there exists a discernible association between CGI and the natural logarithm of total assets, with the former exhibiting a substantially elevated correlation. Conversely, CGI displays a comparatively diminished correlation with other financial performance indicators. This suggests that the impact of corporate governance effectiveness is influenced by the size of the company. There exists a robust correlation between the CGI scores of Chinese enterprises and two key factors: the size of the firm and several measurements of financial performance. This suggests that Chinese enterprises are diligently adhering to corporate governance principles in order to improve their financial performance and raise the value of their stakeholders and organizations.

The correlation matrix indicates a significantly weaker association between the P/E ratio and CGI in comparison to Pakistan's P/B ratio. The price-to-earnings (P/E) ratio is a significant financial indicator as it quantifies the valuation that an investor is willing to assign to a company's earnings. If all other variables were constant, corporations experiencing rapid growth would exhibit higher P/E ratios, while hazardous organizations would have lower P/E ratios. In instances where investors express dissatisfaction, they may regard a governance framework or a series of practices as posing risks, resulting in a decline in the price-to-earnings (P/E) ratio, as exemplified by the situation in Pakistan. The proliferation of corporate governance standards has resulted in a strong correlation between the price-to-earnings (P/E) ratio and the Corporate Governance Index (CGI) in the Chinese context, reflecting the level of investor confidence in companies.

Table 3.1P:

CGI and average return comparison of selected classes

Category	CGI	No of Companies	Mean_ROA	Mean_ROA	Mean_P/E	Price to Book
1	90% & above	3	16.47	24.41	12.56	3.46
2	80 to 89%	6	10.47	20.17	10.89	3.99
3	69 to 79%	16	12.86	27.43	9.78	4.53
4	60 to 68%	17	6.02	8.68	14.32	1.53
5	below 60%	8	-0.05	0.22	-2.72	0.92

Table 3.1C

CGI and average return comparison of selected classes

Category	CGI	No of Companies	Mean_ROA	Mean_ROE	Mean_P/E	Price to Book
1	90% & above	12	25.12	26.17	19.13	9.76
2	80 to 89%	13	15.45	21.22	11.45	7.78
3	69 to 79%	14	18.26	32.12	12.9	7.98
4	60 to 68%	8	10.18	11.12	19.89	8.56
5	below 60%	3	3.01	1.87	5.15	5.35

Enterprises that possess a CGI (Corporate Governance Index) score of 90% or more are classified inside the initial category, while those exhibiting a CGI score ranging from 80% to 89% are placed in the subsequent category. This pattern continues for the subsequent

three categories. The presented table illustrates the distinction in governance quality among organizations categorized as 4 and 5 at the lower end, and Category 1 at the upper end. In Pakistan, a greater number of firms belong to the lowest group compared to China. This implies that Chinese firms are inclined to adopt good governance practices as a means to enhance their financial performance. The average return on assets (ROA) and return on equity (ROE) exhibit a notable increase within category 3 in both Pakistan and China. This trend persists, despite the greater price-to-earnings ratio (P/E) observed in categories 1 and 4 across both nations. This finding suggests that investors exhibit greater trust in organizations that possess robust governance frameworks.

Regression Model Findings

The four regression equations are empirically examined in this part to determine how CGI affects various financial performance indicators.

Equation-1 (CGI Score Against ROA

The impact of CGI scores on Return on Investment (ROI) for both Pakistani and Chinese listed enterprises is regressed in this equation. The results for Chinese firms are presented in the second table after those for Pakistani firms.

Pakistan

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)
0.58	0.35	0.33	13.63	0.000042

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)
0.89	0.71	0.68	13.88	0.000062

The findings suggest that the CG index score accounts for only 35% of the variations observed in the Return on Assets (ROA) for firms in Pakistan, as evidenced by the R square value. In the context of Chinese enterprises, it is observed that the CG index scores, which exhibit a notably superior performance compared to those of Pakistan, explain around 71% of the variations in Return on Assets (ROA). The adjusted R-squared value indicates a decrease of 6 points for Pakistan

and 14 points for China. The aforementioned value elucidates the intricate interconnections among return on assets (ROA), corporate governance index (CGI), and the size of the organization. The findings are consistent with the studies conducted by Mollah et al., Saibaba and Ansari (2012), and Abor and Biekpe (2007). (2012). Similarly, a significant correlation has been shown between the CGI score and ROA, suggesting that companies with higher CGI scores tend to exhibit greater profitability.

Regression Coefficient and P-Value

Pakistan

	Coefficient	SE	t Stat	P-value
Intercept	-38.99	14.37	-3.06	0.01
CGI	8.9	3.21	3.44	0.0018
LnTA	0.69	0.88	0.84	0.42

China

	Coefficient	SE	t Stat	P-value
Intercept	-43.16	17.27	3.88	0.01
CGI	10.01	4.01	4.24	0.0004
LnTA	0.91	0.79	0.91	0.48

The presented statistics demonstrate that, with a confidence level of 5%, the regression model exhibits statistical significance. The importance of the CGI coefficient and incepts is particularly noteworthy at a confidence level of 5%. This methodology fails to account for potential bias related to company size, as the coefficient associated with firm size is quite insignificant. Furthermore, it has been disclosed that the lack of oversight will lead to adverse financial outcomes for investors and other relevant parties. The findings of Gompers et al. (2003), Drobetz et al. (2004), Aboav et al. (2010), and Bubbico et al. (2012) support the notion of a significant association between performance and governance.

Regression Equation 2 (CGI Score Against ROE)

Pakistan

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)

0.48	0.29	0.24	8.46	0.000412

China

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)
0.81	0.65	0.60	10.67	0.000298

In the context of Pakistan, the presence of several variables indicates a modestly positive association between Return on Equity (ROE), Corporate Governance Index (CGI), and company size. The tabulated findings pertaining to China exhibit a significant positive association, suggesting that emerging economies prioritize effective governance as a means to bolster their economic prosperity and protect the interests of many stakeholders. The R-squared values for the goodness of fit test in the regression model are 0.29 for Pakistan and 0.65 for China. This finding suggests that in the case of Pakistan, the CGI score explains just 29% of the variability observed in the Return on Equity (ROE). In the context of China, the proportion of association evidence stands at 65%, signifying its significant importance. Furthermore, the F statistics of the table indicate that the model exhibits statistical significance. The findings are consistent with the studies conducted by Mollah et al., Saibaba and Ansari (2012), and Abor and Biekpe (2007). Similarly, a significant correlation has been shown between the CGI score and ROE, suggesting that companies with higher CGI ratings tend to exhibit more return on equity.

Regression Coefficient against P values

Pakistan

	Coefficient	SE	t Stat	P-value
intercept	-51.37	28.3	-1.72	0.06
CGI	17.23	6.21	2.96	0.0047
Ln TA	0.6	1.69	0.31	0.58

China

	Coefficient	SE	t Stat	P-value

intercept	-52.45	27.99	-1.62	0.01
CGI	18.44	8.19	3.17	0.0039
Ln TA	0.61	0.82	0.41	0.75

The results of the coefficients and P values for the two countries are significant at the 5% level and pretty similar to the first ROA equation. The CGI ratings adequately account for the difference in ROA and ROE. Although positively correlated, the coefficient of business size is statistically negligible for both countries.

Regression Equation 3

In this study, ROA and ROE are the two important financial performance indicators. However, P/B and P/E are also examined to find proof of a connection between the CGI score and market success. We do not utilise any risk-adjusted market return as a performance criterion because stock prices in Pakistan do not solely reflect the worth of the company due to several market and fundamental factors. The value of a stock is influenced by a variety of factors in addition to risk and return. As a result, using stock return as a performance index is useless. Chinese stock prices, which consider all valuation factors, are the true predictor of value in this scenario.

Pakistan

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)
0.68	0.38	0.33	11.13	0.0002

China

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)
0.82	0.69	0.61	13.49	0.0012

The empirical outcomes, as delineated in the accompanying table, reveal that the multiple R value denotes a propitious correlation between dependent and independent variables within the Pakistani context. In the Chinese scenario, there exists a pronouncedly positive association between these elements. The adjusted R-squared values for Pakistan and China stand at 5% and 8%, respectively. Notably, the Chinese corporate governance index (CGI) accounts for 69% of the

variance in the price-to-book (P/B) ratio, in stark contrast to Pakistan, where this figure is significantly lower at 38%, as indicated by the R-squared value. The overall statistical robustness of the model is affirmed by the F statistic at a 5% significance level. These results lend empirical support to the assertions of Al-Matari et al. (2012), Bonn et al. (2004), and Varshney et al. (2012), who have employed the book-to-market value ratio as an indicator of corporate governance's (CG) impact on organizational performance. However, the study's insights regarding the influence of the CG index diverge from the findings of researchers like Abdallah & Ismail (2017), Arora & Sharma (2016), Conheady et al. (2015), and Mohd et al. (2014), who suggest that fluctuations in the CG index exert minimal impact on a firm's financial performance.

Regression Coefficient & P Values

Pakistan

	Coefficient	SE	t Stat	P-value
Intercept	-8.34	2.89	-3.06	0.01
CGI	1.65	0.65	2.91	0.01
Ln TA	0.3	0.19	1.3	0.24

China

	Coefficient	SE	t Stat	P-value
Intercept	-44.78	24.23	-2.28	0.02
CGI	9.19	5.16	3.63	0.0045
Ln TA	0.75	0.89	1.48	0.76

With a 5% level of confidence, the regression coefficient for the CGI score is 1.65 for Pakistan and 9.19 for China. At the 5% level, the business size is minimal.

Regression Equation 4 (CGI Score on Price to Earnings (P/E)

Pakistan

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)
0.39	0.11	0.09	0.61	0.67

China

Multiple_R	R_Square	Adjusted R_Square	F_Test	P_Value (F-Test)
0.68	0.49	0.46	9.98	0.0012

The coefficient of determination (R) for Pakistan is 0.30 in the equation 4 of the CGI score to the P/E table, suggesting a rather weak positive correlation. In a similar vein, it can be observed that the R square value suggests a limited predictive capacity of the model in this particular case. The scenario pertaining to China exhibits a stark contrast. The obtained R-value of 0.68 suggests the presence of a somewhat positive association between the CGI score and the P/E ratio. This implies that the valuation of stocks in emerging countries is more dependable and incorporates all relevant factors. The model also holds significant importance in the context of China. These findings are consistent with the research conducted by Abdallah and Ismail (2017), which also concluded that the corporate governance (CG) score had a detrimental effect on the financial performance of the organizations. The corporate governance (CG) score has been found to have a negative effect on an organization's financial performance, which contradicts the assertions made by Zaman et al. (2015).

Regression Coefficient against P Values

Pakistan

	Coefficient	SE	t Stat	P-value
Intercept	-23.5	41.98	-0.58	0.56
CGI	6.89	8.67	0.69	0.51
Ln TA	0.61	2.43	0.28	0.81

China

	Coefficient	SE	t Stat	P-value
Intercept	-43.22	36.55	-1.23	0.002
CGI	16.35	15.67	1.98	0.0049
Ln TA	0.69	0.89	1.56	0.87

In the case of Pakistan, there is a notable deviation between the price-to-earnings (P/E) ratios and the ratios of return on assets (ROA), return on equity (ROE), and price-to-book (P/B). The regression model pertaining to the price-to-earnings ratio (P/E), which

exhibits equal insignificance, indicates that the CGI score has a minimal explanatory effect on the variability observed in P/E. In a similar vein, the coefficients of CGI scores are determined to lack significance despite exhibiting a considerable association. The descriptive statistics pertaining to Pakistan indicate that the dataset for the P/E ratio has a notable skewness in relation to the mean value. In the case of China, the outcomes demonstrate a complete reversal. According to a study, the price-to-earnings (P/E) ratios serve as indicators of investor confidence in a company's profitability and their willingness to pay in proportion to those earnings. The price-to-earnings (P/E) ratios tend to be elevated for enterprises exhibiting rapid growth, while they tend to be lower for enterprises characterized by slower growth or higher levels of risk. In the event that investors express dissatisfaction with the governance practices of these high-risk corporations, their reluctance to purchase stocks from those companies will consequently lead to a diminished valuation. In the context of Pakistan's capital market, the observed phenomena is relatively infrequent due to the limited consideration of fundamental risk factors in stock pricing, in contrast to more developed markets such as China. This disparity contributes to a diminished level of investor confidence and consequently hinders the maximization of stock value. A lower value or pricing is generally associated with a better rate of return.

The findings of Merendino and Melville (2019), Chang (1975), Feinberg (1975), Demsetz and Villalonga (2001), as well as the conclusions drawn from this study, demonstrate a congruence with the aforementioned earlier research. The source cited is from the year 2003. There is a lack of meaningful correlation between ownership concentration and financial performance. Hence, the presence of concentrated ownership does not result in statistically significant improvements in company performance, as indicated by the findings of Merendino and Melville (2019). Moreover, the issue of agency difficulties may be exacerbated by the presence of concentrated ownership. The results of the analysis provide empirical support for the assertions made by Feinberg (1975). Based on the findings of the research, it is evident that a decline in the overall performance of a company may be attributed to the presence of concentrated shareholding among its owners. This phenomenon arises as a result of the potential for the company's primary stakeholders to engage in self-enrichment activities. There exists a negative correlation between performance and disclosures, indicating the presence of knowledge asymmetry. Controlling stakeholders possess the ability to manipulate privileged information, potentially leading to the exploitation of external shareholders. Moreover, the results substantiate the assertion

that managers, who constitute a significant proportion of the board, seldom prioritize the welfare of all shareholders. Instead, individuals utilize their authority and sway to pursue selfish benefits. The provided data lend support to the expropriation theory proposed by Pandey and Sahu (2019), while also contributing to the existing body of research conducted by Chang (2003).

Conclusion

The central aim of this academic investigation was to examine the nexus between the effectiveness of corporate governance mechanisms and the financial performance of companies in emerging and developing markets, with a specific focus on China and Pakistan. To this end, a comprehensive Corporate Governance Index (CGI) was constructed, encompassing 30 diverse indicators reflective of the interests of primary stakeholders such as shareholders, creditors, employees, and the wider community. The financial health of the selected firms was gauged using metrics such as Return on Assets (ROA), Return on Equity (ROE), Price-to-Book (P/B), and Price-to-Earnings (P/E) ratios, spanning from 2015 to 2021. The data for these variables were systematically extracted from the annual reports of publicly traded companies across varied sectors. The research employed quantitative techniques including linear regression and descriptive statistical analysis to rigorously test the postulated hypotheses.

The empirical results indicate a moderate association of the CGI scores with ROA, ROE, and P/B ratios, while a significant correlation is observed with P/E ratios. Out of the four models scrutinized, the initial three demonstrated statistical relevance, especially in the setting of Pakistan, an emergent economy. The suboptimal performance in these regions is ascribed to issues such as ineffective governance reforms, gaps in the governance framework, rudimentary policy initiatives, and the dominance of family-owned business models. Emerging economies are noted to exhibit more robust governance in the corporate sector compared to their developing counterparts.

In the Chinese context, CGI assessments display a strong and statistically significant correlation with all financial performance indicators. This effectiveness is linked to the employment of progressive governance structures, beneficial to all stakeholder groups, coupled with more mature and efficient financial markets, rigorous regulatory supervision, and constructive policy reforms that foster the growth of the business sector.

The findings of this research underscore the proposition that

both economies and corporations underpinned by sound corporate governance structures and practices not only demonstrate enhanced financial and economic performance but also make a more meaningful contribution to the welfare of stakeholders at both local and global scales. Corporate governance is identified as a pivotal element in the advancement and development of capital markets and in integrating business economies into the international arena.

Practical and Theoretical Implications

The findings of this research offer both theoretical and practical contributions, enriching the academic discourse and providing valuable insights for professionals in various sectors. The study addresses a notable gap in empirical research by employing governance indices to analyze the impact of corporate governance on financial performance, thus enriching the extant literature within the specified timeframe. Theoretically, this research innovatively integrates agency theory and entrenchment theory to construct a framework that evaluates the influence of corporate governance practices on the long-term performance of organizations. This approach provides a nuanced understanding of how governance mechanisms can affect firm outcomes. Empirically, the study substantiates the agency theory's assertion regarding the pivotal role of independent directors and the importance of ownership concentration in mitigating potential negative impacts arising from managerial decisions. Beyond its academic significance, the study's findings have profound implications for a variety of stakeholders, including entities beyond the finance sector, investors, and regulatory bodies. For practitioners and decision-makers, these insights offer guidance on the formulation and implementation of effective governance strategies, particularly in mitigating managerial misconduct and enhancing overall corporate accountability. The research is especially relevant for financial authorities and shareholders who aim to curb unethical practices by managers and CEOs. The derived insights could be instrumental in guiding policy and strategy formulation, especially for financial institutions and regulators in Pakistan and other Asian countries. By adopting improved corporate governance standards, these entities can better navigate through both crisis and non-crisis situations while fulfilling the expectations of their stakeholders. This study, therefore, not only contributes to academic knowledge but also serves as a practical resource for enhancing corporate governance practices, ultimately benefiting a wide range of stakeholders in the corporate and financial sectors.

Limitations and Further Research

This study examined the impact of corporate governance on the financial performance of a sample of 50 Chinese and Pakistani enterprises. Furthermore, the limited sample size of only 100 enterprises evaluated resulted in certain constraints on the selected firm-year observations. The exclusion of the larger industrial sector firms in Pakistan and China from this analysis is justified by the fact that both countries are renowned for their labor-intensive sectors. In addition, it is worth noting that this article primarily focuses on the quantitative dimensions of corporate governance factors, so overlooking certain qualitative aspects that may significantly influence the performance of specific firms.

In addition, the performance of the selected organizations was assessed by considering the Return on Equity (ROE) and Return on Assets (ROA). Furthermore, further insights may be obtained by examining metrics such as Earnings per Share (EPS), Price-to-Earnings ratio (P/E), market risk, and credit risk.

Multiple robust indicators, including earnings per share (EPS), price-to-earnings ratio (P/E), Tobin's q, and the ratio of total assets to total deposits (TA/TD), can be employed to evaluate the performance of the chosen entities. One potential approach to enhance the robustness of the study would involve augmenting the sample size by incorporating a greater number of organizations. Additionally, extending the duration of the study by an additional year could provide further insights and strengthen the validity of the findings. In addition, it is imperative to incorporate other noteworthy financial performance indicators, such as oil prices, inflation rates, and compensation value. Two other statistical procedures that can be utilized to assess the coherence and endogeneity of the observed data are GMM (Generalized Method of Moments) and PSCE (Panel Smooth Transition Regression). In addition, it is suggested that future studies undertake a comparative analysis of inter and intra-industry performance disparities between developed regions and other geographical locations.

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