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Effects of Duality, Board Size and Board Composition on Corporate Governance Disclosure in Pakistan

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Abstract

Disclosure plays an important role in corporate governance. It permits the investors and shareholders to make better decisions. Corporate governance has not been the focus of previous studies on disclosure. This study examines the effects of smaller and larger board size, executive and non-executive board members and CEO duality on the extent of disclosure practices in Pakistan. The checklist containing 29 items adopted from previous researches in the same field is used to measure the level of disclosure. The items in the checklist are mainly divided into four categories of financial transparency, ownership structure, management structure and CSR. This checklist was then applied to 53 listed companies of different sectors in Karachi Stock exchange by the manual review of the annual reports of 5 years from 2007 to 2011 downloaded from each company's website. The results of the study highlighted that the level of corporate governance disclosure is good in Pakistan. The findings showed that larger board size positively affects the level of corporate governance disclosure whereas CEO duality and board composition doesn't have significant impact on level of disclosure.

Keywords: *Disclosure, Corporate governance, Duality, Ownership structure, Pakistan*

1. Introduction

Corporate governance is the way of making policies by which the companies can govern themselves like sovereign states. This issue of corporate governance is under much consideration after financial

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scandals and collapses which have recently been occurred around the globe. The world has witnessed the major scandals of Enron, WorldCom, Shell, China Aviation Oil and Northern Rock. Most of the economies are also hit by recent financial crisis of 2008. In response to all of these incidents and the increasing globalization of the world economy, there is an intense requirement of disclosing the company information to its investors and stakeholders. The investors are now more involved in company's affairs and they are asking for their rights to be properly informed about the company's matters. It is thought by the public and regulators that better disclosure equates to better governance. The regulatory authorities in most of the countries are now imposing penalties on the companies for misreporting or not reporting the information to its investors. The condition of disclosing the information by businesses is very good in most of the advanced countries like UK and USA where many legislative and non-legislative authorities work for the rights of investors. Corporate governance is not being considered in the developing world in past but the recent financial scandals in the West and adoption of IMF/World Bank-led economic reforms urged the need for using corporate governance practices in the developing countries (Reed, 2002).

The main purpose of this paper is to analyze the impact of corporate governance traits like CEO duality, board composition and board size level of disclosure in Pakistan. The sample contains 53 of different sectors like banking, chemical, cement, food and government owned companies listed in Karachi Stock Exchange. For the purpose of scoring the firms on their level of disclosure a score sheet was formulated. Annual reports of the companies are analyzed for common disclosure and corporate governance disclosure items, grouped into four categories such as board and management structure, financial transparency, ownership structure and social responsibility. There are 29 items in these four categories and companies are scored accordingly to check the level of disclosure. This approach is also used and tested in the previous studies on corporate governance and disclosure such as (2007) and (2002). The primary objective of this study is to examine the disclosure practices in the emerging markets like Pakistan and also addition to literature in this. There are two research questions being answered by this paper such as:

Q1. What are the impacts of board composition, CEO duality and board size on overall corporate governance disclosure?

Q2. What is the condition of corporate governance disclosure in Pakistani listed firms?

The coming section highlights a brief overview of the literature on corporate governance disclosure and the issues in developing world. This is followed by the methodology and theoretical framework of the study. The data and findings on level of disclosure in sample companies are discussed in the subsequent section. At the end, the conclusion of the study is presented.

2. Brief Review of Literature

The meaning of corporate governance has been differently explained by different researchers but any legitimate definition must demonstrate the accountability, transparency and fundamental values of fairness of corporate governance. The most reliable and extensively cited definition of CG is provided by Organization for Economic Co-operation and Development “Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and also spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set and the means of attaining those objectives and monitoring performance”(OECD, 2004).

Disclosure of information in relation to corporate governance has received great attention and several research studies are conducted in both developed (Arcay & Vazquez, 2005; Bauwhede & Willekens, 2008; Garcia-Meca & Sanchez-Ballestabes, 2010; Goodstein, Gautam, & Boeker, 1994; Marston & Polei, 2004) and developing (Barako, Hancock, & Izan, 2006; Ghazali & Weetman, 2006a; Goodstein et al., 1994; Gugler, Mueller, & Burcin, 2003; Hossain, Tan, & Adams, 1994) countries, however very few attention is done in South Asian countries (Ahmed, 1996; Akhtaruddin, 2005; Bhuiyan & Biswas, 2007; Hossain, 2008) in general and Pakistan in particular. The increased level of globalization in the developing countries calls for special attention on corporate governance issues and practices(Reed, 2002). Poor economic performance and rise in international debts became the reason for the intervention of international financial bodies to advocate developing countries for better implementation of corporate governance practices. Meanwhile, improved corporate governance practices can also bring foreign direct investments in the developing countries (Ahunwan, 2002).

The available literature in the area of corporate disclosure has suggested many ways in which management or companies can get benefits from increased level of disclosure(Frankel, McNichols, & Wilson, 1995; Lang & Lundholm, 1993). Moreover corporate governance disclosure of information is also desirable socially and by the investors of the company (Diamond, 1985). The extensive discussions upon costs and benefits of disclosure can result in partial or no disclosure. Meanwhile, economist also asserted the fact that economic efficiency can be gained through disclosure (Hossain & Reaz, 2007). Firms are used to initiate disclosure practices under two conditions, one when the companies are forced by the legislative authorities and secondly when the direct and indirect costs of disclosure are less than the perceived benefits (Ferguson, Lam, & Lee, 2002). Within this context, the level of corporate governance disclosure has become quite impressive in both local and international companies from last few years due to tight monitoring by Security and Exchange Commission of Pakistan (SECP). Firms are directed and strictly monitored by SECP to disclose the information in the annual reports.

3. Corporate Governance in Pakistan

The emerging markets like Pakistan can gain several benefits by effective use of corporate governance practices. These practices help the developing economies to get sustainable rates of growth and enhance the confidence in national economy. By this the capital markets are more mobilized for better savings. Moreover, it results in protecting the rights of both small and large investors, helps in encouraging the private sectors' growth as the investments rates are raised substantially. This also helps in securing financing for various projects and supporting its competitive capabilities (Javid & Iqbal, 2010).

The code of corporate governance was introduced by SECP in 2002 which is proved to be the major step in the application of corporate governance practices in Pakistan and consequently enhanced the level of confidence of foreign investors. This code of corporate governance was the outcome of joint effort by Institute of Cost and Management Accountants of Pakistan (ICMAP), SECP and three stock exchanges prevailing in Pakistan i.e. Islamabad, Karachi and Lahore stock exchange. The corporate governance code is in line with the international standards and suggested many recommendations accordingly. The major contributions of this code includes the reforms of better disclosure of information, improved external and internal audits and ensuring the companies to be accountable to all shareholders. Meanwhile, director’s independence remained voluntary by the limited provisions of the code and provides no guidance on risk management, board compensation policies and internal controls.

There are three stock exchanges functioning in Pakistan, namely Karachi Stock Exchange (KSE), Lahore Stock Exchange (LSE) and Islamabad Stock Exchange (ISE). All listed companies in any of the three stock exchanges publish statement of compliance of corporate governance in their annual report. The code of corporate governance establishes a system of governances whereas companies are controlled and directed by the board of directors while ensuring the rights of the shareholders in compliance to the corporate governance practices. This code also suggests the firms to redefine their board composition with both executive and nonexecutive directors for the better representation of shareholders and also to protect their rights. In order to encourage the companies for the application of disclosure practices, The Institute of Chartered Accounts of Pakistan (ICAP), ICMAP and the South Asian Federation of Accountants have initiated company reward program for the "top ten reporting firm". The condition of corporate governance in Pakistan is better than the neighboring countries with the help of initiatives taken by SECP. A Corporate Governance Country Assessment for Pakistan (World Bank, 2005) by the Report on the Observance of Standards and Codes (ROSC) has suggested some steps for minimizing the gaps in corporate governance practices such as:

1. Future technical assistance must be focused on high-priority implementation
2. The private sector must be mobilized to improve the corporate governance in Pakistan
3. The key areas of concern like shareholder rights, accountability of directors and strengthening the rules for independent directors should be focused by legislative reform
4. Establish corporate governance enforcement priorities

4. Development of Hypotheses

There are different mechanisms of corporate governance which are proved to be the driving forces behind disclosure. Several researches have been conducted in the past which analyzed various mechanisms. Bauwhede & Willekens(2008) found in their study that ownership structure affects corporate governance disclosure level in the firms. Bujaki & McConomy(2002) argued that presence of independent directors positively affects the corporate governance disclosure. On the other hand, Muhamad et al. (2009) negated the effects of these mechanisms on level of corporate governance disclosure. For the development of the research hypotheses, previous research which suggests relationship between CG mechanisms and disclosure are extensively reviewed. Hypotheses are formulated which are related to board characteristics such as board composition, CEO duality and size of the board.

4.1. Board Size

It depicts the total members of the board either executive or non-executive directors. If the board size is larger than there are least chances for the dominancy of the company's management. Moreover, larger board size brings diversity of expertise in the board in financial and managerial terms (Laksmana, 2008). Previous literature also supports the phenomenon that larger board size leads to higher disclosure level and there is positive relationship between size if the board and level of firm's disclosure (Barako et al., 2006). Some of the researchers (Goodstein et al., 1994) suggested that the motivation of the board members strategic decision making is negatively affected by the larger board size and eventually there come negative association between disclosure and board size. Based on the results of previous studies, the first hypothesis is set as:

H1. The larger is the size of the board, the higher level of corporate governance disclosure will be in the firm

4.2. CEO Duality

Duality is the situation when the Chief Executive Officer of the firm is also having the role of chairman of the board of directors. Role duality enhances individual power of CEO and which can affect the performance efficiency of board in the perspective of agency theory. Previous researches have mixed views about the association of role duality and level of disclosure. Some of the studies (Eng & Mak, 2003; Gul & Leung, 2004; Laksmana, 2008) concluded that the firms having the situation of role duality of the CEO are intended to disclose less information. Meanwhile, other researchers (Ghazali & Weetman, 2006b; Ho & Wong, 2001; Khodadadi, Khazami, & Aflatooni, 2010) argued that there is no association between CEO duality and the level of corporate governance. While having these two opposite schools of thoughts, this study set the second hypothesis as follows:

H2. The degree of corporate governance disclosure is less in the firms having CEO duality

4.3. Board Composition

The members of the board represent the shareholders and are there to protect their rights and the elected board members are said to be the internal control mechanism. Many researchers (Fama & Jensen, 1983; Weir & Laing, 2003) concluded that the monitoring over firm’s management is efficient by the boards which have higher proportion of non-executive or independent board members. There are many reasons which support this phenomenon as the non-executive board members are not the permanent paid employees of the firm and they can easily give justified opinions and can protect shareholders’ rights better than executive directors. Some studies (Beasley, 1996; Shah, Zafar, & Durrani, 2009) suggested that there are less chances of fraud in the organization by having more non-executive members on the board. There are some other benefits of having higher proportion of non-executive board members as they have the ability to assert the firm to comply with the rules of legislative authorities and also ensure the disclosure of financial position of the firm (Samaha, Dahawy, Hussainey, & Stapleton, 2012). On the basis of these diverse claims, the third hypothesis of this study is set as:

H3. There is positive relationship between the degree of corporate governance disclosure and the proportion of non-executive directors on the board.

5. Research Methodology

5.1. Data and Sample

This study is based upon the data gathered from the annual reports of the companies listed in Karachi Stock Exchange. The sample constitutes the companies from financial, chemical, food, cement industries and different public sector corporations. The annual reports of the fiscal years 2007 to 2011 are analyzed. The reports are downloaded from the websites of the companies. Analysis is limited to 53 listed companies due the fact that disclosure measurement of companies requires considerable time and effort and meanwhile most of the companies only put the annual reports of recent years and it is very hard to find their annual reports of previous years. The study uses corporate governance disclosure checklist which includes 29 items to score the firm's level of disclosure (for example, S&P disclosure scores) and the same approach was also used by Patel et al.(2002). The checklist is based upon four categories which are ownership structure, board and management structure, corporate social responsibility and financial transparency and information disclosure (Table 1).

Table 1

Items in Checklist for Measuring CG disclosure	
A. Board and Management Structure	
Items to be checked in annual report:	
List of board members	
List of board committees	
Audit committee	
Details of director remuneration	
Separation of chairman and CEO	
Changes in board directors during the year	
Related party transactions	
Detail of Executive and Non-executive Board Members	
Total items	**8**
B: Disclosure of Financial information	

Items to be checked in annual report:	
Accounting policy of the company	
Efficiency indicators (ROE/ROA)	
Value added statement/information	
Risk management	
Financial statements (unconsolidated)	
Market capitalization	
Corporate governance statement	
Share price information	
Five year financial summary	
Consolidated financial statements	
CEO/MD Review	
Ratio analysis	
Total items	**12**
C: Corporate Social Responsibility	
Items to be checked in annual report:	
CSR Initiatives	
Code of Ethics	
Total items	
D: Ownership structure	**2**
Items to be checked in annual report:	
A review of shareholding by type (class)	
Changes in shareholdings	
A list showing the major shareholders	
Number of shareholders in certain class	
Number of shares held by largest shareholders	
Percentage of major shareholdings	
Annual General Meetings	
Total items	
Total Score	**7**
	29

5.2. Theoretical Framework and Model

One overall index (OCGD) and three sub-indexes; ownership structure (OSE), board and management structure (BM), financial transparency (FT) and are formulated to test the relationship between corporate governance attributes and corporate governance disclosure in Pakistan. Table 2 shows the description of dependent and independent variables.

A commonly used approach was adopted for scoring purposes in which every item is given a score of 1 and 0 where one is marked for presence and zero is marked for the absence of any item in the checklist. Figure 1 shows the theoretical model and expected signs of the relationships among dependent and independent variables. The following OLS transformed multiple regressions model is used in the study:

OCGD = β0 + β1 BCOM + β2 BSIZE + β3 DUALT + e

In order to examine the relationship between CG mechanism and CG subcategories, Ordinary Least Square (OLS) multiple regressions are applied to the data for the subcategories of BM, FT and OSE. The regression models used in the study are mentioned below:

OSE = β0 + β1 BCOM + β2 BSIZE + β3 DUALT + e

FT = β0 + β1 BCOM + β2 BSIZE + β3 DUALT + e

BM = β0 + β1 BCOM + β2 BSIZE + β3 DUALT + e

Figure 1: Theoretical Framework

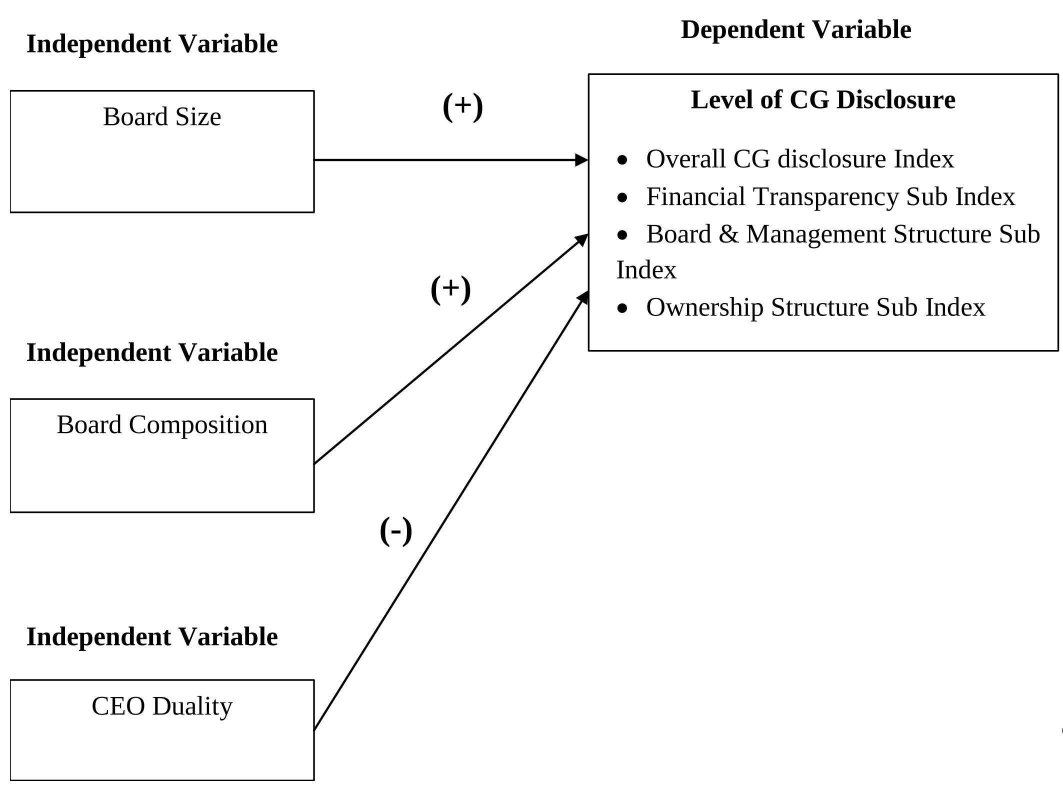

Table 2
Description of Variables

Abbreviated Name	Full Name	Data Source
Dependent Variables		
OCGD	Overall Corporate Governance disclosure score	Annual Report
OSE	Ownership structure disclosure	Annual Report
FT	Financial information disclosure	Annual Report
BM	Board & management structure disclosure	Annual Report
Independent Variables		
BCOM	Board Composition	Annual Report
BSIZE	Board Size	Annual Report
DUALT	CEO Duality	Annual Report

6. Empirical Results and Findings

6.1. Descriptive Statistics

The checklist of 29 items was applied in the study to analyze the present condition of disclosure level in Pakistani companies. Table 3 shows the descriptive statistics of independent variables. There are 265 observations made which constituted the data for five years from 2007 to 2011. By analyzing the board composition from the dataset it can be observed that the maximum proportion of non-executive members in the board is around 92% whereas the data also shows that in some cases this proportion goes also to 0% and at average this proportion is about 62%. These figures depict that in some companies the percentage of non-executive board members goes to zero whereas some of the companies have 92% non-executive members in their board. On average, the percentage of non-executive board member is about 62%. On the other hand, the data shows that in Pakistan, the board size ranges from 7 to 15 and on average the companies have about 8 members in the board of directors. The statistics of CEO duality shows that less duality is observed in companies because mean is more near to zero i.e. 0.2339 which depicts less duality.

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Table 3
Descriptive Statistics of Independent Variables

Variable	N	Minimum	Maximum	Mean	Std. dev
Board					
Composition	26	7.142	100	38.87	27.09
Executive	5	0.00	92.857	3	7
Directors	26			61.08	27.07
Non-	5			8	8
Executive					
Directors					
Board Size	26	7.00	15.00	8.958	2.017
	5				
CEO Duality	26	0.00	1.00	0.233	0.424
	5			9	

Table 4 shows the descriptive statistics of dependent variables. The table depicts the maximum, minimum and average of overall corporate governance disclosure index score along with the values of financial transparency sub-index, ownership structure sub-index and board and management sub-index. The maximum proportionate value of overall score in any of the 53 companies is at 100% whereas the average percentage of disclosure score is 83.16%. This means that in some of the companies the proportionate score of corporate disclosure goes to 100% and these companies have disclosed all the items of checklist in their annual reports. On the other hand, the minimum proportionate score goes to 37% which means that at minimum the companies disclosed 37% of the items in their annual reports. The results of the disclosure level are quite impressive as the proportionate scores of sub-indexes OSE, BM and FT are 92.29%, 92.07% and 76.57% respectively.

Table 4
Descriptive Statistics of Dependent Variables

Variable	Minimum	Maximum	Mean	Std. dev
OCGD index	37.93103	100.0000	83.16200	10.82850
FT sub index	33.33333	100.0000	76.57233	15.56124
OSE sub index	0.000000	100.0000	92.29111	12.42896
BM sub index	62.50000	100.0000	92.07547	9.279639

The sample contains 53 companies which are both national and multinational. This selection was made purposefully to make comparison on the basis of level of disclosure in Pakistani companies and MNCs (multinational companies). It is predicted by the previous researches that the level of corporate disclosure is higher in MNCs than that of local or national companies (Cynthia & Utama, 2012; Tian & Chen, 2009). In this study there were 10 MNCs and 43 Pakistani companies. The results highlighted that the highest proportionate level of disclosure in MNCs is 96% and the average score lies around 84%. The minimum score in any MNC goes to 68%. Meanwhile, in Pakistani companies the average score of corporate disclosure is around 82% but the minimum goes to 37% which clearly confirmed the previous researches that the level of corporate governance disclosure is better in MNCs than that of local or national companies. The results of this study uncovered the fact that level of corporate disclosure in government owned companies is better than non-government companies as the average proportionate level of corporate disclosure is about 88% whereas in non-government companies this figure is round about 82%.

Table 5
Descriptive Statistics of OCGD according to nature of organization

Nature of Organization	No. of Obs.	Minimum	Maximum	Mean	Median	Std. dev
Multinational	50	68.96552	96.55172	84.27586	86.20690	9.220117
Pakistani	215	37.93103	100.0000	82.90297	86.20690	11.17275
Govt. Owned	30	75.86207	96.55172	88.50575	89.65517	6.424596
Non-govt.	235	37.93103	100.0000	82.47982	86.20690	11.09259

6.2. Regression Results

Regression outcomes are shown in the table 6. This table shows aggregated scores resulted from the OLS regressions for OCGD and the other subcategories like FT, BM and OSE. By analyzing the board size, it is found that the values of t-statistics in OCGD and in sub-indexes FT and BM suggested that there is strong relationship between board size and corporate disclosure. At the same time, p (probability)-values for OCGD, FT and BM are 0.0025, 0.0236 and 0.000 respectively which show the level of significance of this relationship. The results highlighted the fact that the larger is the board size then the higher level of corporate disclosure is expected. Consequently, the first hypothesis is accepted that the larger is the size of the board, the higher level of corporate governance disclosure will be in the firm. The acceptance of this hypothesis is also supported by

Barako et al. (2006).

By analyzing the results of CEO duality, it is observed that the values of t-statistics for OCGD, OSE, FT and BM are 0.774, -1.23, 1.56 and 0.40 respectively by which there is no significant relationship is evident between degree of corporate governance disclosure and CEO duality. Hence, the results suggested that the second hypothesis should be rejected and this rejection is also suggested by Ghazali et al. (2006a) and Ho et al. (2001).

For the board composition, it is found that the values of t-statistics for OCGD and other sub-indexes do not show any significant relationship. It can be said that either the board members are executive or non-executive that does not affect the level of corporate disclosure. Hence, the third hypothesis is rejected. There can be many other benefits of having non-executive members on the board such as good monitoring, least chances of fraud and protection of shareholders' rights but the presence of non-executive board members does not affect the level of corporate disclosure.

Table 6
Ordinary least squares (OLS) regression results of CG disclosure scores on test variables (N=265)

Dependent Variable	Overall CG disclosure index (OCGD)		Ownership Structure sub index (OSE)		Financial Transparency sub index (FT)		Board and Management Structure sub index (BM)	
Parameter intercept	Coeff. Incld.	t-stat	Coeff. Incld.	t-stat	Coeff. Incld.	t-stat	Coeff. Incld.	t-stat
H1-BSIZE	1.0575	3.047	0.014	0.035	1.142	2.277	1.343	4.801
H2-DUALT	1.253	0.774	-2.326	-1.233	3.657	1.562	0.524	0.401
H3-BCOM	0.506	0.472	-0.795	-0.637	0.267	0.172	0.726	0.840

7. Conclusion

This study examined the relationship between corporate governance mechanisms and corporate governance disclosure. However, very few studies analyzed the phenomenon in South Asian countries, particularly in Pakistan. This study provides the literature on corporate governance practices in Pakistan. In terms of the overall condition of corporate governance disclosure practices in Pakistan, it is found that the situation is quite impressive in Pakistan because of the initiatives taken by SECP and other legislative authorities. Most of the items of checklist to analyze the corporate governance disclosure are mandatory to disclose according to the requirements of SECP for the listed companies and some of the items will be mandatory in the coming years. Hence, it is expected that in coming years, the condition of corporate governance disclosure will be better than now. The previous extensive research to analyze the CG disclosure level in this region was done by Patel et al.(2002). At that time, the condition of corporate governance disclosure was not quite impressive. But the things have been changed in Pakistan after the introduction of corporate governance code in the year 2002. The proper implementation of the code by SECP changed the level of corporate governance disclosure practices in Pakistan. The average score of the sample companies is around 83% which is quite impressive. The results of the study also match the findings of the prior research in the same field. There are also some limitations of the study as the sample contains only 53 companies whereas there are more than 600 companies listed in Karachi Stock Exchange (KSE) but annual reports of most of the companies are not easily accessible. Extensive time and resources are needed to increase the sample size. Prior studies analyzed the relationship and impacts of many other variables like firm size, firm performance, leverage, block holdings and existence of independent audit committees on corporate governance disclosure. Future researchers are also suggested to consider these variables.

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