



## **Governance and Firm Performance: An Expository Analysis of Listed Firms at Pakistan Stock Exchange**

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### **ABSTRACT**

This paper primarily focuses upon the adoptability of set of governance mechanisms evolved by the Securities and Exchange Commission of Pakistan (SECP) by the listed firms at Pakistan Stock Exchange (PSX). Purposefully, one of the heavily contributing industries of Pakistan, textile spinning industry has been targeted. Empirical estimation underwent the data of listed firms at PSX for the period of 2010-2018. Sources of the data were annually audited financial statements published by firms, balance sheet analysis and financial statement analysis published by the State Bank of Pakistan. Descriptive analytical reasoning along with panel data methodological adaptations including location and time fixed effects were conducted. Conclusions drawn upon the basis of estimation deduced that governance mechanisms carved by SECP, influenced the performances of listed firms positively and significantly.

**Keywords:** Corporate Governance; Pakistan Stock Exchange; Performance, Textile Spinning Firms

**JEL Classifications:** G30, G34, L20, L25

### **1. INTRODUCTION**

The performance of an industry is solely beholden by the deliberate performances of its constituent firms. Firms, by means of induced performances eventually unbolts their ways toward prospers aggregate performances of an industry that ultimately strengthens the overall performance of an economy. The performance of an industry is thus, subjected to the performance of its constituent firms and the way they got govern (Zeeshan Shahid et al., 2019).

Innumerable opportunities including capacity formation and enhancement are subjected to the higher payoffs that a firm wishes to attain solely depends upon the adoptability of set of governance mechanisms (Velnampy, 2013). The mechanisms adoptability by the framework of corporate governance it-self is a guarantee to the worthy shareholders by all means of efficient

and effective allocation of the fundamental resources owned by the firm (Rwegasira, 2000).

Governance mechanisms are the tools that the firms are bound to adopt in order to attain the efficient markups. These mechanisms are considered to be a guarantee to the ultimate achievement by means of a firm got managed (Marashdeh, 2014). Induced yielding performances of the firms eventually excels towards the expansion of the economic activity that help elevation of the general society problems including the poverty, unemployment and the economy boosts upon an aggregate level (Hawawini and Kiem, 2000).

The achievement of an industry in terms, contributes towards the betterment of an economy. Induced industry performances in terms, further encourages the indulgence of labor that strengthens the industry and so the economy (Kousar et al., 2016). In order

to attain the performance boost, decision makers must provide the impulsive efforts and brief set of mechanisms that eventually govern the firm towards the right direction. Such economic prosperity is considered to be achieved by the efficient practices of the mechanisms (Abhayawansa and Johnson, 2007).

## 2. CORPORATE GOVERNANCE IN PAKISTAN

Within the perspective of Pakistan, the corporate law authority (CLA), directly or indirectly, influenced the domestic business activities. The set of governance mechanisms developed for the corporate organizations provided by the Securities and Exchange Commission of Pakistan (SECP), comprises of the core fundamental characteristics of corporate governance to be followed by the firms listed at different stock exchanges of Pakistan.

By the year 1999, SEC took the charge over the CLA. The SEC provided the overwhelmed experience to both the national and international business scenarios. SEC by all its contributions to the domestic business activities provided the most important component in the form of capacity building to strengthen the domestic business environment (SECP, 2014).

In Pakistan, the SECP introduced the corporate governance code for the 1<sup>st</sup> time in March 2002. The code emphasize upon the openness, transparency, and decision making. Thus requires

directors to communicate well in time that actually is in the large interest of all. The core feature of the code followed by the strengthening of both, the audit committees by all means of authorities and the power they have by the book (Code of Corporate Governance, 2012).

The core emphasis of the management is to provide the peaceable environment in order to attain the induced performances and the thus, these performances ultimately attracts the stakeholder, shareholders and the investors to the firms. The attracted parties toward the firm eventually induce the share of investments of the firms and thus creating a better opportunity for the firm to perform well (Code of Corporate Governance, 2017).

### 2.1. Aim of this Study

1. The study primarily focuses upon the exploration of multidimensional norms of governance and its impacts upon the performances of the firms
2. Unfolding the relationship among the adoptability of set of mechanisms and their outcomes.

## 3. LITERATURE REVIEW

The introduction to the core mechanisms of governance by SECP are the frameworks specifically designed for the firms in which they are managed, controlled and administered by the governing authorities (Saad, 2010). The application to the mechanisms for the purpose of comprehensive governance eventually leads to the ultimate achievements to the firms. Theoretical summarizations of past studies upon performances are generally attributed to the governance based mechanisms (Lamport et al., 2011).

The Organization of Economic Corporation and Development (OECD) addressed the corporate governance in a way that it indulges the framework dealing efficiency and the transparency among the market structure, where consistently prevailing law and order situations and articulation of responsibilities associated by the authorities are submerged without any discrimination (OECD, 2013).

Corporate administration could be characterized as methods for bringing the enthusiasm of financial specialists and troughs into line and guaranteeing that organizations that are keep running for the advantages of speculators (Hussin and Othman, 2012). Corporate administration is concerned with the relationship between the inside administration system of organizations and society's origination of the extent of corporate responsibility (Mayer, 1997).

While taking into account the international perspective of the emerging economies, the main objective of the firms is to gain the attention of domestic and international investments to attain

**Table 1: Performance of firms**

Variables	Symbols	Description
Return on Sales	ROS	Profitability of a firm relative to its total sales

Source: Author's Own Calculations

**Table 2: Corporate governance mechanisms**

Variables	Symbols	Description
Duality Status	DS	Person occupies more than one post then 0 otherwise 1
Board Size	BODS	Count to the numbers of Directors on Board
Board Remunerations	BRUM	Paid up amounts to Board Members for their services
Audit Committee Members	ACM	Count to the numbers of Audit Committee
Auditor's Remunerations	ARUM	Paid up amounts to Audit Committee Members
Annual General Meetings	AGM	Count to the Numbers of Meetings Held
Meeting Fee	MF	Fee paid to the members against the meeting charges

Source: Author's Own Calculations, Dummy Variables

**Table 3: Descriptive statistics of governance mechanisms**

Statistics	BODS	BRUM	ACM	ARUM	AGM	MF	DS
Mean	6.89	8,587,689	2.97	1,327,491	4.86	285,304.6	0.46
Minimum	4	0	3	2450	4	0	0
Maximum	8	94,267,397	4	3,769,200	18	4,951,084	1

Source: Author's own calculations

the economic boost (Al-Matari, 2014). It has likewise been characterized to incorporate the structure, procedures, societies and frameworks that imperil the fruitful operations of the associations.

Within the perspective of the emerging markets, the introduction to the more efficient corporate governance mechanisms including the framework of law and order and the education to the society are the attributes to the transitional phase for the nascent markets. These are the core corporate governance mechanisms that eventually plays pivotal role toward making the better environment for the successful achievement of prospers market (Albuquerque et al., 2019).

## 4. METHODOLOGY

### 4.1. Sample Selection

Consistency and availability of the data of listed firms at (PSX) was the key criterion for the selection of firms for the purpose of empirical estimation. Such criterion usually refers to the non-probability sampling technique for the sake of data collection. The criterion was the availability of data of listed firms at PSX and thus the best fit firms fulfilling the requirement were shortlisted.

### 4.2. Data Collection

The estimation of the relationship among governance and the performance of the listed firms at PSX involved a series of data set collected from annually audited financial statements published by the firms, Balance Sheet Analysis (BSA) and the Financial

Statement Analysis (FSA) both published by the State Bank of Pakistan (SBP). Thus the estimation eventually underwent the data of 40 shortlisted firms for the period of 2010 to 2018 respectively.

### 4.3. Outlook to Variables

Empirical estimation involved 3 sets of variables.

#### 4.3.1. Performance of firms

Within the exploration of the performance of firms, the return on Sales (ROS) was constructed.

Table 1 represents the outlook of the performance variable, Return on Sales (ROS) that is the ratio of the income and the total sales of the firm.

#### 4.3.2. Governance mechanisms

Table 2 represents the outlay of governance mechanisms adopted by the firms includes the CEO’s Duality Status (DS) Board Size (BODS), Board Remunerations (BRUM), Audit Committee Members (ACM), Auditor’s Remunerations (ARUM), Annual General Meetings (AGM), and Meeting Fee (MF) Respectively.

#### 4.3.3. Dummy variables

The study at hand incorporated the dummy variables, d2, d3, d4, d5, d6, d7, d8, and d9, within the time fixed effect and d10 to d48 within the individual firms fixed effect estimation.

### 4.4. Econometrical Framework and Modeling

The estimation of relationship among the governance and the performance of firms listed at PSX undergone fixed effect multiple regression approach by means of incorporating both the location and the time fixed effects.

**Table 4: Descriptive statistics to performance variables**

Variables	Mean	Minimum	Maximum
ROS	4.85	0	27.43

Source: Author’s Own Calculations

**Table 5: Time fixed model with dependent ROS**

Sources	SS	df	MS	
Model	4888.60641	15	325.907094	Numbers of obs=360
Residual	2534.71453	344	7.36835621	F(15, 344)=44.23
Total	7423.32094	359	20.6777742	Prob>F=0.000
				R-squared=0.6585
				Adj R-squared=0.6437
				Root MSE=2.7145

ROS	Coef.	Std. Err.	t	P> t	95% Conf. Interval	
BODS	2.625797	0.2190028	11.99	0.000	2.195044	3.05655
BRUM	3.17e-08	1.29e-08	2.46	0.014	6.34e-09	5.71e-08
ACM	3.304723	0.4186591	7.89	0.000	2.481269	4.128177
ARUM	1.25e-06	4.14e-07	3.02	0.003	4.35e-07	2.26e-06
AGM	0.2799331	0.0614246	4.56	0.000	0.1591181	0.4007481
MF	3.53e-06	7.26e-07	4.86	0.000	2.10e-06	4.96e-06
DS	-0.1749425	0.3374041	-0.52	0.604	-0.8385772	0.4886922
d2	-1.034441	0.627427	-1.65	0.100	-2.268517	0.1996348
d3	-0.3777859	0.6810744	-0.55	0.579	-1.71738	0.96180844
d4	0.6773114	0.6153627	1.10	0.272	-0.5330357	1.887658
d5	0.8932155	0.6510471	1.37	0.171	-0.3873186	2.17375
d6	1398591	0.6115434	2.29	0.023	0.1957563	2.601426
d7	-0.5910505	0.6355165	-0.93	0.353	-1.841038	0.6589368
d8	-0.1965614	0.6314642	0.31	0.756	-1.045455	1.438578
d9	-0.5846233	0.62173	-0.94	0.348	-1.807494	0.6382475
_Cons	-25.52863	1.705967	-14.96	0.000	-28.88407	22.17319

Source: Author’s Own Calculations

## 5. EMPIRICAL RESULTS

### 5.1. Description to Variables

Primarily the study at hand incorporated the following governance based variables including DS, BODS, BRUM, ACM, ARUM, AGM, and MF, respectively.

Table 3 indicates the proximity to the numbers of board of directors (BODS) per firm was around 7. The BODS's remunerations is BRUM that actually is the amount paid to the BODS and mean value for each firm is 86 lacks. The estimation of the data indicated

that mean number of ACM's were founded to be around 3 and received average remunerations around 13 lack rupees.

The data further indicated that average number of meeting annually held (AGM) were around 5 and MF was on an average 3 lack rupees paid by the firms. DS in terms of the position of CEO was upon an average 47% having the positive trend toward having the duality.

The Table 4 representing, upon an average, the firm's Returns on Sales (ROS) having the mean value 4.85 depicting the scenario

**Table 6: Individual fixed effect with dependent ROS**

Sources	SS	Df	MS	
Model	5760.82593	46	125.235346	Numbers of obs=360 F(46, 313)=23.58 Prob>F=0.000 R-squared=0.7760 Adj R-squared=0.7431 Root MSE=2.3047
Residual	1662.49502	313	5.31148568	
Total	7423.32094	359	20.6777742	

  

ROS	Coef.	Std. Err.	t	P> t	95% Conf. Interval
BODS	2.673563	2069052	12.92	0.000	2.266462 3.080664
BRUM	1.43e-08	1.50e-08	0.96	0.340	-1.51e-08 4.37e-08
ACM	3.897259	0.4356056	8.95	0.000	3.040174 4.754345
ARUM	7.20e-07	4.20e-07	1.72	0.087	-1.05e-07 1.55e-06
AGM	0.1358023	0.0746056	1.82	0.070	-0.0109897 0.2825942
MF	6.89e-06	9.46e-07	7.28	0.000	5.03e-06 8.75e-06
DS	-0.5132616	0.4891456	-1.05	0.295	-1.475691 0.4491676
d10	-1.231779	1.107062	-1.11	0.267	-3.410004 0.9464463
d11	-3.540366	1.237821	-2.86	0.225	-5.975865 -1.104864
d12	-0.9965397	1.096336	-0.91	0.364	-3.153659 1.16058
d13	-0.951209	1.212394	-0.78	0.433	-3.336681 1.434263
d14	-9.515014	1.410113	-6.75	0.000	-12.28951 -6.740514
d15	-1.252161	1.095276	-1.14	0.254	-3.407194 0.9028729
d16	-0.6072396	1.118756	-0.54	0.588	-2.808473 1.593994
d17	-1.852024	1.093106	-1.45	0.149	-3.7372789 0.568742
d18	-1.259144	1.09627	-1.15	0.252	-3.412134 0.8978451
d19	0.3110893	1.573238	0.20	0.843	-2.78437 3.406548
d20	-0.743463	1.16909	-0.64	0.525	-3.043705 1.556833
d21	-4.09158	1.273712	-3.21	0.001	-6.5977 -1.58546
d22	-1.103228	1.166363	-0.95	0.345	-3.398131 1.191674
d23	-1.188781	1.093152	-1.09	0.278	-3.3339635 0.962074
d24	0.4693308	1.100269	0.43	0.670	-1.695527 2.634189
d25	-1.285902	1.094188	-1.18	0.241	-3.438796 0.8669916
d26	-0.318496	1.190653	-0.44	0.664	-2.861192 1.8242
d27	-0.6573398	1.165508	-0.56	0.573	-2.950562 1.635882
d28	0.2979107	1.099942	0.27	0.787	-1.866303 2.462125
d29	1.269450	1.168637	1.09	0.278	-1.029926 3.56883
d30	-1.232987	1.181221	-1.04	0.297	-3.557123 1.09115
d31	0.8206871	1.088593	0.75	0.451	-1.321197 2.962572
d32	1.351412	1.09069	1.24	0.216	-0.7945994 3.497422
d33	1.071926	1.099189	0.98	0.330	-1.090808 3.234661
d34	-0.6155736	1.199602	-0.51	0.608	-2.975877 1.74473
d35	-3.141644	1.200392	-2.62	0.009	-5.503503 -0.779786
d36	-1.034388	1.108347	-0.93	0.351	-3.215141 1.146365
d37	-2.173262	1.175341	-1.52	0.065	-4.485831 0.1393072
d38	-1.677528	1.100037	-3.24	0.128	-3.841931 0.4868745
d39	-3.870461	1.195203	-0.90	0.001	-6.222109 -1.518813
d40	-0.9809344	1.09243	-0.90	0.370	-3.130409 1.16854
d41	0.4136233	1.229116	0.34	0.737	-3.130409 1.16854
d42	-3.120613	1.233925	-2.53	0.012	-2.004752 2.831998
d43	-0.6625854	1.136883	-0.58	0.560	-5.548448 -0.6927766
d44	1.350145	1.194481	1.13	0.259	-2.899485 1.574314
d45	-1.83927	1.092954	-1.68	0.093	-3.989735 0.3111958

Source: Author's Own Calculations

with which the firms are been gaining as compared to the actual assets been invested.

### 5.2. Fixed Effect Regression and Dependent ROS

The exploration of data for the purpose of empirical investigations depicting the relationship among the control variables (Corporate Governance) and the response variables (Performance of the Firms) by utilize and the raw facts by means descriptive analytical facts followed by the fixed effect methodological adoptions including the time and location fixed multiple regression effects.

Within the estimation t-test indicated the significance. Model fittings are been explained by the r-square and the adjusted r-squares followed by the analysis of variance that ultimately depicts the strength of relationship within the analytical framework. Return on sales (ROS) as a dependent variable was interacted with the time, location and their interactions formally to deduce the relationship among the governance mechanisms adoptability and the performance of the listed firms at (KSE).

### 5.3. Time Fixed Effect

The time fixed effect further to evaluate the impact of adoptability of set of governance based mechanisms upon the performance of listed firms incorporated the dummy variables d2, d3, d4, d5, d6, d7, d8, and d9 respectively. The results are thus presented in Table 5.

The incorporation of the dummy variables d2, d3, d4, d5, d6, d7, d8, and d9 with dependent ROS including the independent

governance mechanisms including DS, BODS, BRUM, ACM, ARUM, AGM, and MF yielded the insignificant results.

### 5.4. Individual Firm’s Fixed Effect

Firm’s level fixed effect upon the individual basis indulged a number of dummy variables i.e. d10, d11, d12, d13, till d48, respectively.

The table 6 represents the individual firms fixed effect. The dummy incorporated within the analytical framework of the individual firm’s fixed effect depicted the significance in term of the ROS. Where, the significance was internally distributed among the 9 dummies including the d11, d14, d21, d35, d37, d39, d42, d45, and d47, respectively. The d11 having the sig 0.005 and the coefficient -3.5403. The dummy d14 having the sig 0.000 having the coefficient -9.515. On the other hand the dummy incorporated within the analysis, d21 having the sig 0.001 and the coefficient -4.091. The d35 having the sig 0.009 and the coefficient -3.141. The d37 having the sig 0.065 and the coefficient -2.173 as depicted within appendix 3, respectively. The d39 having the sig 0.001 and the coefficient -3.8704. The d43 having the sig 0.012 and the coefficient -3.1206. The d45 having the sig 0.093 and the coefficient -1.839. The d47 having the sig 0.000 and the coefficient -4.877, respectively.

### 5.5. Interactions among the Time and Individual Fixed Effect

The interactions among the variables utilized by the time fixed effect and the individual fixed effect with dependent ROS has been presented in Table 7 where the actual independent variables (BODS, BRUM, ACM, ARUM, AGM, MF and DS) along with the two dummy variables deduced from the time fixed effect for ROS (d2 and d6) and the 9 dummies (d11, d14, d21, d35, d37, d39, d42, and d45) shared the common intercept and further evolved the collective interactions among the dependent, independent and the dummies further reduced the number of dummies indulged within the analysis to 9 dummies at the end.

The significance was internally distributed among the 9 variables so to be known as the dummy, the d6 having the sig 0.003 and the coefficient 1.235. The d11 having the sig 0.000 and the coefficient -3.188. On the other hand the dummy incorporated within the analysis, d14 having the sig 0.000 and the coefficient -9.413. The d21 having the sig 0.000 and the coefficient -3.852. The d35 having the sig 0.000 and the coefficient -3.22. The d37 having the sig 0.047 and the coefficient -1.651. The d39 having the sig 0.001 and the coefficient -2.935. The d42 having the sig 0.002 and the coefficient -2.568. The d47 having the sig 0.000 and the coefficient -4.132 respectively.

**Table 7: Interactions among the time and individual fixed effect with ROS**

ROS	Coefficients	St. Error	T	P> t
BODS	2.9232	0.1972	14.82***	0
BRUM	1.9409	1.1409	1.7*	0.09
ACM	3.6948	0.4105	9.00***	0
ARUM	7.0509	3.5909	1.96*	0.05
AGM	0.1518	0.0508	2.98***	0.003
MF	7.5209	8.8909	8.46***	0
DS	-0.6114	0.3091	-1.98**	0.049
d6	1.2355	0.415	2.98***	0.003
d11	-3.1889	0.8452	-3.77***	0
d14	-9.4131	1.1684	-8.06***	0
d21	-3.852	0.87	-4.43***	0
d35	-3.2227	0.8678	-3.71***	0
d37	-1.6514	0.8281	-1.99**	0.047
d39	-2.9352	0.9055	-3.24***	0.001
d42	-2.5686	0.8404	-3.06***	0.002
d47	-4.132	0.8261	-5.00***	0
Constant	-26.8752	1.5345	-17.51***	0

Source: Author’s Own Calculations. \*, \*\*, \*\*\* signifies significance level at 10%, 5%, and 1% respectively

**Table 8: ANOVA of Interaction Table with Dependent ROS**

Model	Sum of squares	Df	Mean square	F	Sig.
2	5575.64	16	348.47	64.69	0
Regression					
Residual	1847.671	343	5.386		
Total	7423.32	359			

Dependent variable: ROS

Predictors: (Constant), BODS, BRUM, ACM, ARUM, AGM, MF, DS, and d2, d3, D4, d5, d6,.....d48

Source: Author’s Own Calculations

**Table 9: Model Summary with Dependent ROS**

Model	R	R-square	Adjusted R-square	Std. Error of the estimate
2	0.795	0.75	0.73	2.3209

Dependent variable: ROS

Predictors: (Constant), BODS, BRUM, ACM, ARUM, AGM, MF, DS, and d2, d3, D4, d5, d6,.....d48

Source: Author's Own Calculations

### 5.6. ANOVA Table

The regression results within the Table 8 representing the ANOVA Statistics where the mean square values for the regression and residual were, 348.47 and 5.386, respectively. The results of the analysis of variance indicated the significant relationship among the both mechanisms that the F-statistics 64.69 ( $p = 0.000, < 0.01$ ).

### 5.7. Model Summary

The Table 9 represents that the fitted model as a result of the regression framework. The results indicated that model is explaining 75% of the variations among the dependent probably exhibited by the predictor variable.

## 6. CONCLUSION

Core focus of the study was to explore how the listed firms under Karachi Stock Exchange (KSE) got regulated by the governance mechanisms evolved by the Securities and Exchange Commission of Pakistan (SECP). The study at hand thus concluded that optimum outcomes are ultimately subjected to the performances of the listed firms by means of adoptability of the set of fundamental mechanisms carved by SECP.

The study concluded that the average number of Board Size (BODS) was approximately 7, Auditor's Committee Members (ACM) were approximately 3, count to the general meeting held within the firms throughout the year were approximately 5 upon an average. The results revealed that 46% of the listed firms at KSE were having the Duality Status (DS), more than one independent director were assigned, as per the directions of the SECP.

Operational costs that are the internal costs for the firm at managerial level included Board's Remunerations (BRUM), Auditor Remunerations (ARUM) and the Meeting Fee (MF) were characterized by 86 lacks, 13 lacks and 3 lacks respectively. Higher payoffs reported by the data eventually points toward the higher operational costs associated with the governance adoptability mechanisms. Within the current scenario Return on Sales (ROS) indicated upon an average 5 times than the initial investment made by the firm's management.

Further to enlighten the different key aspects of the governance and its impacts upon the performances of the listed firms at KSE, the applicability of proposed code of Corporate Governance by SECP is of pivotal importance. Further to enlighten the different key aspects of the governance and its impacts upon the performances of the listed firms at KSE, the applicability of

proposed code of Corporate Governance by SECP is of pivotal importance

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