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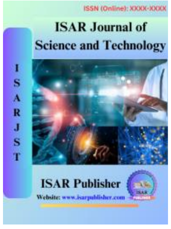

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The Guidance of good corporate governance on investment efficiency: Evidence from manufacturing listed in Pakistan Stock Exchange

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Abstract:

Purpose: The basic motive of business is earned profit and increase per value of shares for investors. It's possible when the pioneers (Management of business) invest the funds in efficient ways, otherwise, the business may go to liquidation, bankruptcy, or insolvency. So, in the study the researcher find out the guidelines of good corporate governance on investment efficiency. The corporate governance segregated into two parts: In a board structure includes board independence, board size, board meeting while in Audit structure includes audit quality, audit committee independence, audit committee meetings.

Methodology: In this study adopted a descriptive research design. For this research selected a 530 observation for the periods from 2010-19. In this study secondary source of panel data were used to collect the data. Quantitative data was analyzed by employing descriptive statistics, Pearson Correlation Matrix and Two-Step System GMM from Social Science (Stata) version 12.

Finding: In this study revealed the positive and significant coefficient 0.1890 (p=0.000) effect of Board Independence that adding some independent directors to the board may increase the investment efficiency of firms. The Negative and significant coefficient – 0.0035 (p=0.014) of board meetings with investment efficiency prevails that arranging quarterly, and yearly does not impact investment efficiency in developing countries. The negative and significant coefficient -0.0129 (p=0.000) of Board Size prevails that a lesser board size would be more effective in reducing problems with free riders, communication breakdowns, monitoring issues, and shortcomings. To put it briefly, managing a firm effectively requires a focus on quality above quantity may increase investment efficiency. The negative and significant coefficient -0.4136 (p=0.029) of Audit committee Independence and Investment efficiency prevails that audit committee independence closely monitors the financial reports and detects management misappropriations. The lessor in size may easily and quickly monitor the financial reports with suggestions for the betterment of investors and other stakeholders. The positive and significant coefficient 0.0069 (p=0.000) of Audit Committee Meeting and Investment Efficiency prevails that meeting of the audit committee may enhance the investment efficiency. It may be quarterly, or twice a year reduces problems in financial reporting. The positive and coefficient 0.0680 (p=0.000) of Audit quality and Investment Efficiency prevail that 4 big firms when audited a company, and then they may enhance the quality of investment efficiency.

Unique Contribution to Theory, Practice and Policy: In this study, the researcher find out the impact of guidelines of good corporate governance in manufacturing sector listed in Pakistan Stock exchange. In order validate the result more; free cash flow theory has been adopted in manufacturing sector of Pakistan.

Keywords: Investment Efficiency, Two-Step System GMM, Board Size, Free cash flow theory, Corporate Governance.

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Introduction

The basic motive of business is earned profit and increase per value of shares for investors. It's possible when the pioneers (Management of business) invest the funds in efficient ways, otherwise, the business may go to liquidation, bankruptcy, or insolvency. Following the impact of the Asian financial crisis of 1997-1998 (Norwani et al., 2011) on several Southeast Asian countries, including Pakistan, has shrunk. Therefore, good corporate governance emerged. Lacks of good corporate governance, companies do not provide transparent financial information to investors. According to the study, transparent financial statements and high-quality financial reporting are just two of the many benefits that strong and effective governance brings to stakeholders. Better investment decisions and an increase in share value can be attributed to good management, as agency costs related to management control and regulation are reduced. Determinants of a responsible business organization Board independence, size and management affiliation can affect the reliability of financial statements. There is evidence that public companies with independent directors have more reliable financial statements. The firm's performance improves when both the number of board members and the share of the firm's shareholders increase. These numbers show that the board has qualified members who closely monitor the company and its finances and operations. Better financial reporting, performance, value and investment efficiency are all objectives of this study.

Maximizing shareholder wealth and return on cost-effective investments is a priority for every company. Although it pays to aim for high returns, it is not without risk and there is always a chance that your investment could end up losing money. This requires monitoring by the company and investment managers to ensure a satisfactory return for shareholders. For people to seize favorable opportunities, they must also actively seek to grow their wealth at lower costs. To attract serious investors, it may be necessary to establish and maintain strict corporate governance systems. Despite the importance of corporate governance and investment performance, there is little research on these topics.

Statement of the problem: In this study find out the value of good corporate governance in guiding business and investment strategy and other functions. In other words, agency problems are mitigated in the presence of stable management structures because management cannot hide the value of its investment from shareholders and other stakeholders. Based on this motivation, this study aims to analyze how corporate governance affects the investment efficiency in manufacturing sector firms in Pakistan. This study examines several aspects related to the board (board independence, board size, board meeting), and audit (audit quality, audit committee independence, audit committee meetings) There are several ways in which this study adds to existing knowledge. First, it helps answer the question of whether or not there is a relationship between the measures of Good Corporate Governance and the investment performance of companies. Second, this study educates shareholders, directors, board members and creditors about the state of corporate governance and the profitability of investments in Malaysian companies. Third, the results would help companies monitor and manage their operations, demonstrating the value and importance of corporate governance.

Objective of the study:

1): To investigate the guidelines of good corporate governance on investment efficiency in manufacturing companies of Pakistan.

2): To investigate the guidelines of good corporate governance of audit on investment efficiency in manufacturing companies of Pakistan.

3) To investigate the theoretical contribution in the light of the mentioned theories that has affected the guidelines of good corporate governance on investment efficiency.

Research Questions:

1): What are the effects of guidelines of good corporate governance on investment efficiency in manufacturing companies of Pakistan?

2): What is the impact of the guidelines of good corporate governance of audit on investment efficiency in manufacturing companies of Pakistan?

3) What is the theoretical contribution in the light of mentioned theories that affects the determinants of corporate governance on investment efficiency?

Literature Review

Underlines theories

Free cash flow theory:

As per the statement of this theory mostly, there are two main parties involved in a business (Jensen & Meckling, 1976). One is the owner of the business (Principal) and the second one is a runner of the business. Agents in the shape of experienced personnel perform various tasks in the interest of the organization and receive high remuneration from owners. The cause of conflict arises when the management is involved in useless projects that do not maximize the investor's wealth. As a result, the management fails for high returns.

Investment Efficiency (Dependent Variable)

According to Li and Wang (2010), an organization's investment efficiency is determined by the positive net present value (NPV) of projects it undertakes under a predictive scenario, free from market frictions like adverse selection or agency cost. According to McNichols and Stubben (2008), a company's decision to invest is mostly based on a number of preset factors, such as expected returns and interest from investments, such as anticipated market demand for the product and projected future growth. To optimize return on investment, a company must build a robust capital structure. Ensuring a company can finance or fund a solid investment opportunity when it presents itself is crucial (Verdi, 2006). Resilient capital structure, on the other hand, forbids a company from abandoning a profitable project because of a company's inability to fund it. As a result, a company will find itself underinvesting (Hubbard, 1998). In the worst case, even when a company has capital wealth, it may still be underinvesting. This happened as a result of resource expropriation by unethical and badly managed managers who made inept and inefficient investments because of their interests and motives (Verdi, 2006).

Board Independence

Within the context of corporate governance, an independent director is a member of a board who is not directly connected to the firm, does not serve on its executive team, and is not involved in day-to-day operations. Khanchel (2007) analyzed the involvement of independent directors in critically monitoring the rules and regulations of corporate governance because they do not personal interest in the physical and financial of a company's resources. Basley, (2007) also investigated that Board independence prevents the Top management from misusing of resources and investing in useless projects.

H1: There is a positive relationship between board independence and investment efficiency.

Board size

Board size is a panel of expert in their field. The compromise of directors is to monitor the top management for the interest of investors. Kiel & Nicholoss, (2003) analyzed that a bigger board size is having distinct knowledge, utilized for the sake of the company's investors and critically monitoring the expenses and investment in useless projects. To run the business more efficiently the workload may divided among directors (Abidin et al., 2003).

H2: There is a positive relationship between board size and investment efficiency.

Board Meeting

The board meeting is an important strategic plan for which all the directors achieve the goal. Generally, board meetings direct the rules and regulations of a company to invest the funds efficiently. Mostly, in advanced countries, there is a positive relationship found between board meetings and investment efficiency (Khanchel, 2007; Gavrea & Stegerean, 2012; Liang et al., 2013) while in developing countries like Pakistan, some authors found a positive relationship between board meeting and investment efficiency (Saeidi et a., 2015; Sahu & Manna, 2013; khan & Javed, 2012; Kang & Kim 2011) but there is some author is found a negative relationship between board meetings and investment efficiency (Noor. M 2011; Al-Najjar B, 2014)

H3: There is a positive relationship between board meeting and investment efficiency

Audit Quality

Cahen et al., (2006) argued that most investors demand audited firms from high-profile audit companies (such as Big 4). Sahafi & Motamadi (2011) determined that investing in advanced growth opportunities depends upon audit quality. They found a positive relationship between audit quality and investment efficiency. Furthermore, Jarboui (2017) argues that audit specialization may increase investment efficiency. On the contrary, Marachno (2013) reveals a negative association between audit quality and investment efficiency. Islami (2017) also reveals a negative association between audit quality and investment efficiency because audit quality specialization does not affect the investment efficiency of companies.

H4: There is a positive relationship between a board meetings and investment efficiency.

Audit Committee meeting

Periodically meeting of audit committee three or four times may reduce the financial problems in companies. Anggarini (2010) reveals that periodically meeting an auditor specialization may enhance the efficiency of businesses and also review the financial reports that have been prepared according to the standards of accounting rules or not.

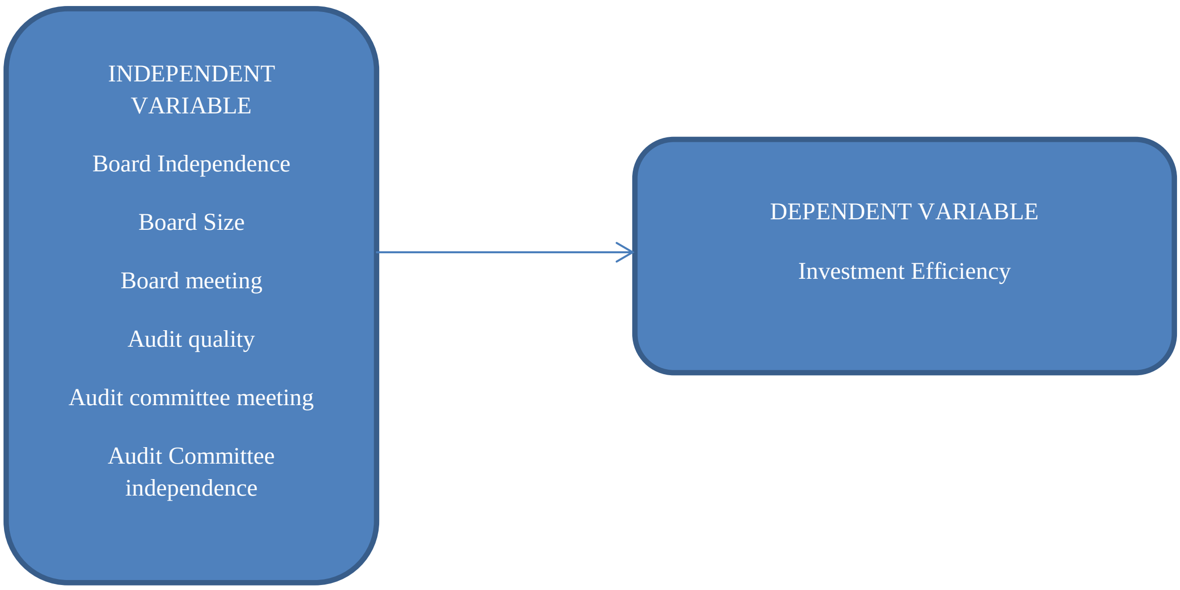
H5: There is a positive relationship between board meeting and investment efficiency.

Audit Committee Independence

The organization's monetary policy is rigorously assessed when independent auditors are present. In light of corporate governance, the independence of the audit committee enhances management efficiency and allows funds to be invested in any profitable project. Azim (2012) examined that the audit independence committee's decisions ought to be devoid of prejudice and self-interest. Moreover, Barua et al. (2010) demonstrate that audit independence constitutions are a crucial determinant factor for a successful monitoring system.

H6: There is a positive relationship between Audit Committee Independence and investment efficiency.

Figure 1: Conceptual Framework



Research Methodology

Research Design

The goals of the study must be taken into consideration while selecting a research design. For this study, the quantitative research type and descriptive research design were selected.

Regression Model

Investment Efficiency = βα + β1 Investment Efficiency-**1** + **β2** Board Independence **+ β3** Board Size **+ β4** Board Meeting **+ β5** Audit Quality **+ β6** Audit Committee Meeting + **β7** Audit Committee Meeting+ **ε,**

Population and Sample

In this study, we examined manufacturing companies listed on the Pakistan Stock Exchange for the periods 2010–2019.

Variable Measurement

In this study, the proxy of the dependent and independent variables is as follow:

S.NO	VARIABLE	EXPECTED SIGN	PROXIES
1	Investment efficiency		Investment in Fixed Asset less asset sold divided by total asset. Li and Wang (2010)
1	Board Independence	+/-	Independence Directors who are not executive officers.
2	Board Size	+/-	Total director (both Dependent plus independent director) of a company
3	Board Meeting	+/-	Board of Director meeting held in a financial year.
4	Audit Quality	+/-	A dummy variable has been created if (4 big's) firms audit 1 otherwise 0
5	Audit Committee Meeting	+/-	the entire annual audit committee meeting of the corporation
6	Audit Committee independence	+/-	Temporal patterns in the quantity of independent directors on audit committees

Data Collection and Analysis

The required secondary source data was collected from manufacturing companies registered in the Pakistan Stock Exchange for the period from 2010-2019. To elaborate the result in these studies advanced Second generation statistical estimation techniques are used. Statistical estimation techniques are Descriptive statistics, Pearson correlation matrix, and Regression analysis (GMM model). The Generalized method of moments (GMM model) has the capabilities to normalize the data, remove the autocorrelation, heteroscadicity, and endogeneity problems from the data, and robust the result efficiently (Roodman, 2009).

Descriptive Analysis

In Table 1: descriptive statistics provide us with a summary of the basic information about the variables. The basic components of Descriptive statistics include observation, mean, standard deviation, minimum and maximum values. The average value of investment efficiency is 0.17 with a standard deviation is 1.004. Board Independence means value is 0.582 with a standard deviation is 0.143, the average value of Board dependent meeting is 8.223 with a standard deviation is 1.948, the average value of board size is 5.466 with a standard deviation is 2.233, the average value of Audit committee Independent variable is 0.664 with a standard deviation is 0.148, the average audit committee meeting is 4.274 with 1.879, and average audit quality is 0.766 with standard deviation is 0.424.

Table: 1 Descriptive Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Investment efficiency	530	0.170	1.004	-2.276	2.634
Board Independence	530	0.582	0.143	0.056	01.75
Board Meeting	530	8.223	1.948	0.000	0014
Board Size	530	5.466	2.233	3.000	0035
Audit Committee Independence	530	0.664	0.148	0.067	0001
Audit committee meeting	530	4.274	1.879	0001	0044
Audit Quality	530	0.766	0.424	0000	0001

Correlation Analysis

In Table 2, shows the correlation between dependent and the independent variables. The dependent variable is Investment efficiency while independent variable is Board Independence, Board Director Meeting, Board size, Audit committee Independence, Audit committee meeting and Audit quality. In the below table, there is a weak negative relationship is found between Investment efficiency and Board Independence, Board director meetings, and audit quality while Board size, Audit committee Independence and Audit committee meeting is found weak positive relationship with investment efficiency. Furthermore, the value of the Variance Inflation Factor is less than 5 means that there is no issue of multicollinearity problems (Gujarati, 2004).

Table: 2 Pearson Correlation Matrixes

Variables	Investment Efficiency	Board Independence	Board Meeting	Board Size	Audit Committee Independence	Audit Committee meeting	Audit Quality	VIF
Investment efficiency	1.000							
Board Independence	-0.062	1.000						1.044
Board Meeting	-0.183***	0.132***	1.000					1.049
Board Size	0.149***	-0.0500	-0.068	1.000				1.045
Audit Committee Independence	0.029	0.103***	0.104***	0.062**	1.000			1.027
Audit committee meeting	0.114**	-0.004	0.047	0.007	0.043	1.000		1.005
Audit Quality	-0.102**	-0.114***	0.090***	0.175***	-0.009	-0.024	1.000	1.060

******, ** and * represents values statistically significant at 1%, 5% and 10% respectively.***

Regression Model

The Regression model shows the effect of the independent variable on the dependent variable. In this model, the independent variable is Board Independent, Board dependent meeting, the Board size, Audit committee independence, Audit Committee meeting, and Audit quality whereas, the dependent variable is Investment efficiency.

The positive and significant coefficient 0.1890 (p=0.000) effect of Board Independence prevails that adding some independent directors to the board may increase the investment efficiency of firms. The same result is found in (Khanchel 2007).

The Negative and significant coefficient – 0.0035 (p=0.014) of board meetings with investment efficiency prevails that arranging quarterly, and yearly does not impact investment efficiency in developing countries. The same result is found with (Wu et al., 2007, Sanchez. I.M 2010; Zattoniet et al., 2015).

The negative and significant coefficient -0.0129 (p=0.000) of Board Size prevails that a lesser board size would be more effective in reducing problems with free riders, communication breakdowns, monitoring issues, and shortcomings. To put it briefly, managing a firm effectively requires a focus on quality above quantity may increase investment efficiency. The same result is found with (Yermarck, 1996; Eisenberg et al., 2003; and Hermalin and Weighbach, 2003).

The negative and significant coefficient -0.4136 (p=0.029) of Audit committee Independence and Investment efficiency prevails that audit committee independence closely monitors the financial reports and detects management misappropriations. The lessor in size may easily and quickly monitor the financial reports with suggestions for the betterment of investors and other stakeholders. The same result is found in (Xie et al., 2003; Choi et al., 2004).

The positive and significant coefficient 0.0069 (p=0.000) of Audit Committee Meeting and Investment Efficiency prevails that meeting of the audit committee may enhance the investment efficiency. It may be quarterly, or twice a year reduces problems in financial reporting. The same result is found in (Anggarini 2010).

The positive and coefficient 0.0680 (p=0.000) of Audit quality and Investment Efficiency prevail that 4 big firms when audited a company, and then they may enhance the quality of investment efficiency. A good audit quality offers opportunities for the investor to invest in these projects. The same result is found in (Cahen et al., (2006; Sahafi & Motamadi 2011).

Table 3: Two Step System (GMM) Estimation Result

Regressor	predicted sign	Model:	Prob: value
(1) Investment effi~y	**ive (+)**	**1.0548*** **	**0.000**
Board Independence	**ive (+)**	**0.1890*** **	**0.000**
Board Meeting	**Neg (-)**	**-0.0035*** **	**0.014**
Board Size	**Neg (-)**	**-0.0129*** **	**0.000**
Audit Committee Independence	**Neg (-)**	**-0.4136*** **	**0.029**
Audit Committee meeting	**ive (+)**	**0.0069*** **	**0.000**
Audit Quality	**ive (+)**	**0.0680*** **	**0.000**
Constant		**0.2122*** **	**0.000**
Year Dummies		**NO**	
Observation		**530**	
AR(1)		**0.029**	
AR(2)		**0.695**	
Hansen		0.04	

In Table 3, there is no autocorrelation or serial correlation is found in AR (1) and second-order AR (2). The null hypothesis of AR (1) and AR (2) represent no serial or auto-correlations. The Hansen test value 0.04 which is distributed as a chi-square represents the null hypothesis of instrument validity. Statistical significance of 10%, 5%, and 1% is indicated by ***, **, and *, respectively.

CONCLUSION AND RECOMMENDATION

Conclusion

The purpose of this study is to find out the impact of guidelines for good corporate governance with investment efficiency. The guidelines of good corporate governance include Board Independent, Board dependent meeting, Board size, Audit committee independence, Audit Committee meeting, and Audit quality, The finding of the result in board independence and investment efficiency prevails that increasing the size of independent director in board may increase the investment efficiency. The positive impact of Audit Committee Meetings and Investment Efficiency prevails that meeting of the audit committee may enhance investment efficiency. It may be quarterly, or twice a year reduces problems in financial reporting. The positive Audit quality and Investment Efficiency prevails that 4 big firms when audited a company, and then they may enhance the quality of investment efficiency. A good audit quality offers opportunities for the investor to invest in these projects. The Negative of board meetings with investment efficiency prevail that arranging quarterly and yearly does not impact investment efficiency in developing countries. The negative of Board Size prevails that a lesser board size would be more effective in reducing problems with free riders, communication breakdowns, monitoring issues, and shortcomings. To put it briefly, managing a firm effectively requires a focus on quality above quantity may increase investment efficiency. The negative of Audit committee Independence and Investment efficiency prevails that audit committee independence closely monitors the financial reports and detects management misappropriations. The lessor in size may easily and quickly monitor the financial reports with suggestions for the betterment of investors and other stakeholders.

Recommendation

We recommend of this paper is discussed below:

1) We have to robust the result more clearly using the Two-Step System GMM estimation model some other model may be applied for further research.
2) In this study we have taken six independent variables, Board Independent, Board dependent meeting, the Board size, Audit committee independence, Audit Committee meeting, and Audit quality. Some other variables like Interest rate, Corporate social responsibility, Envirmental Social and Corporate Governance (ESG model) Cash holding, Ownership structure may applied with investment efficiency.
3) In this study covered the period from 2010-2020. So, further periods may be extending for research.
4) In this study, the researcher has covered the manufacturing sector of Pakistan. It may be extending to Non-manufacturing sector in Pakistan.

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