

A Spill over Relationship - Corporate Governance and Investor Reaction: A Case of Karachi Stock Exchange

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Abstract

The current study aims to investigate the relation of corporate governance with reaction of investor towards investment. The sample of the study contains on 114 companies of manufacturing sectors specifically and sample is acquired from (2004-2013). Thus, single and composite correlation is applied to check relationship of variables. Moreover, univariate and multivariate both regression methods are applied and study concluded negative insignificant relationship of variables of study.

Keywords: Corporate Governance, Investor Reaction, Univariate, Multivariate, Composite

1. INTRODUCTION

A corporate firm works out on the bases of pre-defined financial objectives i-e profit maximization and shareholders wealth maximization. It is the corporate governance that helps to achieve targeted goals through efficient allocation of funds, proper management, and allocation of capital by deciding on cost of capital and also pooling of resources in investment pursuits. Thus, all these activities are taken to increase the stakeholder benefits and their sentiment of trust on corporation. Hence, such all activities represent corporate governance mechanism and it allows international investor's to invest in local market (Okpara, 2010).

Schwert, (1981) & Binder, (1985) investigated investor reaction response with respect to corporate governance and have found the firms who are more prone to use corporate governance mechanism have greater response by investors and vice versa. Moreover, Foerster & Huen, (2004) has supported the study and have argued that companies working with corporate governance have higher stock returns in stock market because of their governance efficient management. Chavez & Silva, (2006) argued that governance system has spillover effect and relationship on firm's profitability and share prices movements. Though, it helps to execute better investment decision that boosts investors trust on corporation. However, past studied have clarified a significant relationship among corporate governance and investors reaction in financial perspective.

So objective of the study is to investigate the relationship among corporate governance and investor's behavior and to analyses the significance of such relationship among cross culture economies.

According to Aycan et al., (2000) Pakistan is underdeveloped country in research or scientific investigations. Corporate governance is rich field in recent time regarding scientific investigations but such mechanism of governance with respect to reaction of investor is less investigated in Pakistani context. Hence, hypothesis of the study is as follows,

H1: *There is significant relationship of corporate governance with investor's reaction*

The scheme of the study contains on four parts i-e first part elaborates introduction and literature of the study, second part edicts methodology, third part explains the results of the study and findings and fourth part concludes entire study and elaborated the recommendations.

2. RESEARCH METHODOLOGY

The objective of the study is to investigate the relationship among corporate governance structure and responsiveness of investor's under umbrella of Karachi stock exchange. The population of the study is listed companies under Karachi stock exchange. The sample of the study contains on 114 listed companies of manufacturing sector of Pakistan for the period of 2004 – 2013. Entire data is acquired from financial statements of the companies by taking annual reports.

Therefore, www.sbp.com , www.brecorder.com & www.opendoors.com database are followed to extract data for current study. Moreover, univariate regression analyses and correlation techniques are applied for test after analyzing the data reliability and its normal distribution. Hence, following model is developed for test,

$$IR = C + \beta_1 CG + e \dots\dots\dots Eq. (01)$$

By combining equation (01) in to equation (02),

$$IR = C + \beta_1 BI + \beta_2 BS + \beta_3 OS + \beta_4 ACI + e \dots\dots\dots \text{Eq. (02)}$$

Where, C is constant, CG – corporate governance, BI – board independence, BS – board size, OS – ownership structure and ACI is pronounced as audit committee independence. Thus such study by following instrumentation and first four proxies measure corporate governance and investor reaction is measured by incorporating stock returns,

- 1) Board Independence = (Number of Nonexecutive directors/ Total Directors)
- 2) Board Size = Natural Log (Total Directors)
- 3) Ownership Structure = (Shares Held by directors/ Total Shares)
- 4) Audit Committee Independence = (Number of Nonexecutive directors/ Total Number of Directors)
- 5) Investor Reaction = Natural Log (Pn/Po)

3. RESULTS & ANALYSES

Table 01 Representation of Sector

Sector Name	Percentage Representation
Chemical Sector	33.7%
Cement Sector	32.0%
Food Sector	15.3%
Automobiles Sector	06.0%
Pharmacy Sector	13.0%

Table 02 Reliability Statistics

Variables	Cronbach's Alpha
BI	0.79
BS	0.71
OS	0.69
ACI	0.84
IR	0.77

As mentioned in prior studies reliability analyses shows percentage of error's associated with variables. Thus, in current study data has shown standard percentages of reliability. Thus, Board independence has 0.79, board size 0.71, ownership structure, 0.69, audit committee independence 0.84 and investor reaction has 0.77 percentage reliability.

Table 03 Individual Correlation Analysis

	1	2	3	4	5
BI	1				
BS	-0.079	1			
OS	0.084	0.743	1		
ACI	-0.231	-0.324	-0.127	1	
IR	-0.00071	-0.0267	-0.01077	-0.038	1

Table 04 Combined Correlation Analysis

	1	2
CG	1	
IR	-0.04105	1

In table 03 correlation analyses explain negative relationship between board independence and board size, board size has positive correlation with ownership structure, ownership structure is negatively correlated with audit committee independence and audit committee independence is also negatively correlated with investor's reaction respectively. And in table 04 there is negative relationship among corporate governance and investor's reaction. Hence, corporate governance is negatively correlated with investor's reaction.

Table 05 Multivariate Regression Analysis

Variable	Beta	t. Statistics	Probability
C	0.355	1.29	0.3423
BI	-0.3783	-1.18974	0.3462
BS	-0.05371	-0.6491	0.6927
OS	-0.3217	-1.8439	0.2401
ACI	0.01874	0.07099	0.7934
R- Square	0.0056	Mean Dependent Variation	-0.09753
Adj. R Square	-0.00249	S.D Dependent Variation	0.90187
S.S.R	621.6280	F - Stat	0.9297
Durbin Watson	2.059	Probability (F – Stat)	0.47562

Table 06 Univariate Regression Analysis

Variable	Beta	t. Statistics	Probability
C	-0.18372	-1.123968	0.34728
CG	0.13574	1.08142	0.2629
R – Square	0.0018117	Mean Dependent Variance	-0.005419
Adjusted R - Square	0.002475	S.D Dependent Variation	0.785693
Sum Suq. Residual	786.4591	F - Statistics	1.2739
Durbin Watson	2.05789	Probability (F – Statistics)	2.568739

Under OLS when individual regression analyses shown no relationship and correlation among corporate governance and investor's reaction. The value of R – Square is 56% that represents that model explain few phenomena are that represents investor's reaction and much more are still unexplored. Thus, F – stat is 92% shown in table 05 and is in significant. And in table 06 when investor reaction is regressed with corporate governance shown 18% r – square value and 1.27% f – statistics that has proved negative spillover of investor's reaction and corporate governance.

4. CONCLUSION

Past studies contributed vitally and have concluded that corporations with corporate mechanism provide more safety to an investor in financial perspective. But in current study it proved vice versa and study found insignificant negative relationship of investor reaction with corporate governance. Thus, hypothesis of the study are rejected and because of inefficient market investors not have full information regarding corporations and their governance mechanism. However, past justification are not justified in current study and as implications managers should focus on other factors like information, investor trust, efficiency of markets and investor's life time value.

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