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Managerial Commitment towards Shareholder's Value: An Empirical Study on Listed Cement Firms of Pakistan

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Abstract
This research study establishes a relationship among shareholder's value, board size and board composition. This study is conducted on the cement sector of Pakistan. The balance sheet analysis is done and Market Value Added is used to measure the shareholders' value. The results show that the independent variables, board size and board composition (non-executive directors) have a negative relationship with the dependent variable, Shareholders' value. This shows that with the increase in the number of non-executive directors and the board size, the board does not remain efficient and well informed and hence the shareholders' value decreases. The regression analysis depicts that the impact on the shareholders' value caused due to the board composition (non-executive directors) and the board size is up to 10%.
Keywords: Shareholders' Value, Board Size, Board Composition, Market value added.

Introduction
Shareholders' value is the value delivered to shareholders because of management's ability to grow earnings, dividends and share price. In other words, shareholder value is the sum of all strategic decisions that affect the firm's ability to efficiently increase the amount of free cash flow over time. Shareholders are the real owners of the organization so every investment decision should be done while keeping in mind the shareholders' return maximization.
The purpose of this study is to find the impact of board size and board composition on the shareholders' value. Board size and board composition are the corporate governance measures whereas in order to measure the shareholder's value "market value added" is used. For board composition, the non-executive directors have been considered. This research is done on the cement industry of Pakistan. Renewed construction boom in Pakistan has helped the nation's cement producers significantly increase their sales and profits. Year-over-year, income at Lucky Cement, Pakistan's largest producer of building materials, is up to 33% while DG Khan Cement, second largest cement company, has quadrupled its profits.
The canonical view of the role of boards of directors is that boards monitor management and resolve agency problems between shareholders and management. Ensuring that the firm is run in the shareholders' interests is the board's fiduciary duty. A large literature that examines the role of the board assumes that all directors on the board have a single, identical objective to maximize shareholder value.
The objective of this study is to find the impact of board size of directors on shareholders value and assume that directors have potentially different objectives and that their board membership confers on them the right to contract with the firms' executives. This study also attempts to test the notion that whether large board sizes improve corporate performance and the shareholders' value as being proposed by Tchouassi and Nosseyamba, (2011). It is examined how the size of a firm's board of directors is associated with multiple firm objectives, and how it impacts managerial incentives to improve firm performance. Specifically, a question is addressed; does board size and board composition affect managerial incentives to increase shareholder value? In addition, it is not clear that whether firms need large boards or small ones or why there would be heterogeneity in boards.
While there is a presumption that board size and composition should have real effects on board monitoring, it is not obvious what this impact should be. A priori, small boards may be more or less effective monitors than larger boards. For example, smaller boards may be better able to monitor and concentrate because they would be more vigilant towards managerial actions. Further, the empirical literature examining whether board size and composition have real effects on firm performance and managerial incentives. There is also a view that the composition of the board is determined by top executives in order to allow those executives to extract rents from the firm. This "board capture" view suggests that contracting between the board and management is far from optimal from a shareholder value perspective.
A view is taken that the function of the board is to establish firm objectives and contract with top management (the agent) about these objectives. As noted above, the canonical view is that the only firm-level objective is shareholder value maximization. However, firms or board members may also care about employees, the local community, the environment, pensioners, diversity in the workplace, or other objectives. The significance of this study is that it would be helpful for the cement sector as well as for the other companies as it provides a view on how the board of the company should be composed and how their activities be managed in order to increase the shareholders' value.

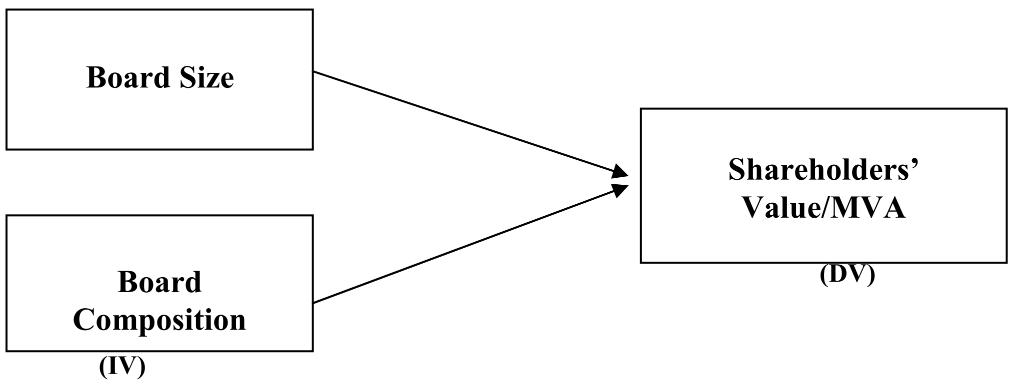
Literature review
Shareholder's value
Shareholders' value is a definitive measure of the company's success to the degree the shareholders' interests are served. It is actually a value that the managers create for the shareholders by increasing the profits, dividends and the price of their shares. Many ratios are being used to measure the shareholders' value. It is found that the ROI and ROE are the least effective measures for the shareholders' value. Shareholder wealth is maximized by maximizing the difference between the market value of firm's stock and the amount of equity capital that was supplied by shareholders (Petravicius et. al, 2008).
There is found to be a conflict between the interests of the shareholders and the management who run the organization. The shareholders want wealth maximization whereas the insiders (management) utilize the company's resources for their own wellbeing. A research states that in order to have a shield against the agency risk, the shareholders ask for a higher risk premium and they increase the cost of equity capital as they are aware of the conflicting interests of the managers and their own interests (Mazzotta & Veltri, 2012).
The directors are the stewards of the shareholders and are meant to represent and secure the interests of the latter. Yeh et al., (2011) in their research are of the view that the directors belonging to successful companies place a lot of attention towards fulfilling the needs of the stakeholders.

Board composition
By board composition is meant the percentage of the executive and non executive directors against the total number of directors. Among non executive directors how many are depended or how many are independent. Outside director are vital for the board independence whereas the inside directors are needed for the direct monitoring and control over the firm.
For measuring the performance of any company the size of its board and the number of its executive directors play a very important role as they are termed to be the substitute for the board of directors (Shakir, 2008).
A great emphasis is established now in the Asian countries for following the corporate governance principles, including the compulsory training and development of the board members of the organization about the rules and regulations, the workplace environment and the code of conduct that are provided by the corporate control authorities (Chong-En et al., 2006). A study conducted in the Chinese companies showed that board composition has a large impact on the company's effort in creating shareholder's value. The companies having a CEO Chairman leader and a larger representation by the affiliated directors are the high performers (Tian & Lau, 2001).
In recent years an increase has been found in the board activities, by activities is meant the range of activities and their involvement in the decision making process (Jonnergard & Karreman, 2004). If the board directly monitors the managerial actions and attract them to do so by offering valent rewards, the protection of shareholder's interests can be ensured (Hoskisson et al., 1994). The quality of the board of directors can improve when shareholders actively participate in the company's decision making process; this is so because independent directors better perform managerial activities. The board can be of high-type independent directors and low type non-independent directors. The cost is relatively low when there is a single board and shareholders have right to participate in the company's decision making process (Loureiro, 2009).
It has been found that the more independent the supervisory board the greater is the performance of the organization (Velte, 2010). The board of directors should be independent for having a better control over the management. The agency theory also says that whether the board is independent or not is dependent on its composition (John and Senbet, 1998). The independent directors are incentivized to build high image in controlling actions and this actually encourages them to control the management better (Fama and Jensen, 1983).
A large impact of board composition, board activity and ownership has been found on company's performance. Researcher found that independent directors performed better than other board factors and shareholder meetings are positively correlated with firm performance rather than board meetings. Researcher argues that those firms are at top which have total and trade able shares rather than the firms which have only single concentration (Ma, & Tian, 2009). Those firms having a higher percentage of independent directors having an audit committee on board and generates quality accounts information about the firm, ratio of the shares owned by the company, board meetings and the number of the in depended directors are not correlated to the financial reporting of the firm. And board meetings are abnormally negatively correlated to the quality of financial reporting (Qinghua, et al., 2007).
It has been found that the gender composition of the board has no significant effect on the success of the company. It does not matter whether the board comprises of male or female members. The females are just appointed to the board in order to encourage their participation (Luisa, & Salvandor, 2011).

Board size
Board size is the total number of directors of the board of a company and includes executive directors, non

executive directors and outside directors. Research has found the presence of a significant negative correlation between the board size and the shareholder value for the firms (Eisenberg et. al, 1998).It has been argued in a research that there is a strong positive relationship between board size and efficiency. In future this issue will highlight with new interest in academic and policy circle taking to the consideration of recommended policies about the role and function of the directors (Tanna, et al., 2011). It has been proved through the previous researches that the board size and the remuneration of the CEO have a strong positive relationship, also a strong relationship has been found between foreign board of directors and the remuneration of CEO (Randoy & Nielsen, 2002).

Theoretical Framework



Hypotheses
H1: There is a negative relationship between board size and shareholders' value.
H2: There is a negative relationship between the number of non-executive directors and shareholders' value.

Methodology
Population
The population taken is cement sector of Pakistan. The reason for opting for this sector is the current profitability of its firms. There are 20 Cement Companies working in Pakistan.
Sample
In this study 50% of the total population is taken as the sample on the basis of their profitability. The financial statements of the sample companies are taken from the state bank of Pakistan. Five years data from year 2007 to 2011 is taken from the balance sheets to calculate the ratio of MVA which is the difference between the market value of the firm and the shareholders' equity.

$$\text{MVA} = \text{market value of stock} - \text{total common equity}$$

Where,

$$\text{Market value of stock} = \text{shares} \times \text{stock price}$$

And,

$$\text{Number of shares} = \text{total shareholders' equity} \div \text{breakup value of shares}$$

Also,

$$\text{Price per share} = \text{net income} - \text{preferred dividend} \div \text{number of shares}$$

A larger and positive MVA value would tell that the company is creating shareholders' value and then that company would be analyzed that whether it has a larger or a smaller board and what is its composition. The regression and correlation are used to analyze the relationship among the variables taken. These tests are applied on the MVA calculated through above formulas and the board size and board composition (non-executive directors) taken from the companies' financial statements.

Data Analysis
Correlation Analysis
Correlation analysis is used to determine the strength of the relationships among different variables. The results of this study show that board size and board composition have a strong negative correlation with the shareholders' value. A correlation value of -0.32 between board size and shareholders' value shows a strong

negative relationship. This means that with the increase in the board size the shareholders' value decreases. The correlation value between board composition and shareholders' value is found to be -0.19 which also shows significantly negative association between these two variables. This shows that with the increase in the number of non-executive directors, the board does not remain efficient and well informed and hence the shareholders' value decreases. Also, there is strong positive correlation between the board size and the board composition. This tells that with the increase in the non executive directors the board size also increases and vice versa.

Table 1

	Shareholders value/MVA	*Non ex.*	*Board size*
Shareholders value/MVA	1		
Non ex.	-0.195339203	1	
Board size	-0.329241337	0.642788091	1

Regression analysis

In this study the regression analysis is used to determine the dependence of shareholder value upon the independent variables i.e. board size and board composition. The results have shown that up to 10% change in the dependent variable (shareholder value) is explained by the two independent variables considered i.e. board size and board composition. The results showed that values of coefficients are 1.240 and 1.006 for board size and board composition respectively. The t- values here show the size of effect of this relationship or in other words the difference between the means of two groups. The larger its value the greater would be the difference. The results show smaller values showing a lesser difference. The t statistics for coefficients are found to be statistically significant. The p – values for both board size and board composition are significant.

Table 2

Dependent variable	**Independent variable**	**R square**	**β**	**t stat**	**P- value**
Shareholders value	**Board size**	0.10	1.240	2.137	0.005
	Board composition		1.006	2.713	0.009

Discussion

This study attempts to establish a relationship between the shareholder's value and the board size and board composition. The market value added is used to measure the shareholders' value. For the board composition, only the non executive directors are considered. This is done so because there is a common notion that non executive directors play a very important role in creating shareholders' value due to their unbiased attitude in decision making. For the board size total number of executives and non executives was added. The market value added was found for all the sample companies.

The results however revealed very different findings. It was found that for the textile companies where the board comprised of all or majority of non executive directors, the market value added came out to be negative in most cases or having a very small value in a few cases. So this shows that as the number of non executive directors increases, the market value added decreases. This means that by employing a larger number of non executives the close monitoring and control loosens because the non executives do not have all the necessary information and hence are not motivated to create the shareholders' value.

The board size of the sample companies ranged from 7 to 12 board members. The results also showed that as the board size increased from 7 to 12 the market value added started getting lower and negative showing that when the companies employ more directors it loses strong and direct control. These results also negate the argument given by Tchouassi and Nosseyamba, (2011) by proving that large board sizes do not create shareholders' value and show the opposite of it. Different directors have different views and it slows down the decision making process. These arguments are further supported by the correlation and regression analysis. The correlation value of -0.32 between board size and shareholders' value and -0.19 between board composition and shareholders' value shows significantly negative association between the dependent variable and the independent variables. This shows that with the increase in the number of non-executive directors and the board size, the board does not remain efficient and well informed and hence the shareholders' value decreases. The regression analysis depicts that the impact on the shareholders' value caused due to the board composition (non-executive directors) and the board size is up to 10%.

Conclusion

Shareholders' value is created when the board acts as a steward by safeguarding the shareholders' interests and by minimizing the agency relationship. This study highlighted two important factors regarding the company's board which are found to be very important for creation of shareholders' value and these are the board size and board composition (non-executive directors). The study used the Market Value Added to measure the shareholders' value. The results showed that the Market value added (shareholders' value) decreased with the increase in the number of non- executive directors (board composition) and board size. So, the companies should maintain a balance between the executive and non-executive directors and should keep the board size normal to make the decision making of the board efficient.

Limitation

The limitation of this study is that although the textile sector was found to be undergoing prosperous conditions due to the construction boom but still many companies were not going profitable which also affected the results.

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