DOES REVISED GOVERNANCE CODES EFFECTS STOCK INFORMATIVENESS: EVIDENCE FROM PAKISTAN STOCK EXCHANGE

Afkar Majeed, Universiti Teknologi Malaysia
Rohaida Basiruddin, Universiti Teknologi Malaysia
Iram Naz, Riphah International University

ABSTRACT

The main objective of this study is how revised corporate governance codes (CGC) affects stock informativeness at the Pakistan stock exchange. The period that is selected for this study is from 2009 to 2019. The final sample comprises a total of 726 firms' years. The data is analyzed by using the generalized method of moment (GMM). This method is considered most efficient because it reduces the endogeneity concerns. The study's findings indicate that board independence and gender diversity positively and significantly affect idiosyncratic volatility. In comparison, chairman CEO duality and audit committee independence have split results with both proxies. However, revised governance codes have a significant and positive effect on stock informativness. Therefore, the results of this study are beneficial for companies and regulators.

Keywords: Corporate Governance Codes, Stock Informativeness.

INTRODUCTION

The governance of the companies revolves around corporate policies—the corporate policies prepared under rules and regulations known as corporate governance codes (CGC). Therefore, the changes in CGC have multiple effects on various aspects of companies. For example, good governance practices provide clear, unbiased, transparent, and accurate information to all stakeholders, positively contributing to market efficiency and stock informativeness (Gul et al., 2011). On the other hand, poor governance practices will provide unclear, biased, and inaccurate information, negatively contributing to market efficiency (Huang & Ni 2017).

The Security and Exchange Commission of Pakistan (SCEP) introduced corporate governance codes (CGC) in 2002 and revised them in 2012, 2017, and 2019, respectively. The codes related to board independence (BI) in 2002 highlight that the inclusion of independent board members in the board is advisable, whereas, in 2012, at least one independent director is made mandatory. Moreover, in the years 2017 and 2019 inclusion of two independent directors is included mandatory. Additionally, the board cannot have more than 1/3 executive directors. Firth et al. (2007) state that board independence lowers information asymmetry and reduces agency issues, which positively contributes to stock informativeness. Therefore, this study investigates how the changes in CGC effects stock informativeness. This study is an effort to fulfill the contextual gap in the literature.

Pakistan male dominance society but know the visible shift is being observed. The initial codes that SECP launched in 2002 were utterly silent on the inclusion of female directors on the board. Even revised codes in the year 2012 follow the same pattern. SECP had made changes in 2017 and 2019 in CGC related to gender diversity, including at least one female director. Abad, Lucas-Pérez et al. (2017) explain that gender diversity enhances board independence, positively affecting firm disclosure practices and enhanced stock

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informativeness. However, a few studies have investigated have to impact of gender diversity on stock informativeness.

Another important governance code that is under the scope of this study is the chairman CEO duality. In the first launched codes, there is no legal compulsion on duality whereas, in 2012 code explains that both the positions must be separate with some exceptions. Currently, in the 2017 and 2019 codes, the role of CEO duality must be separated without exceptions. Prior literature is split in this context. One strand of literature links duality role with unity of command and effective implementation of strategies, whereas the other links duality with agency issues and fewer disclosure practices (Moumen et al., 2016; Liu et al., 2021). Therefore, this study will analyze how duality affects stock informativeness at the Pakistan Stock Exchange.

The study also analyzed another important code, i.e., it is related to the audit committee. Initial codes only suggested that the audit committee comprises at least three members. Whereas in 2012, the inclusion of on non-executive member is made mandatory. Moreover, SCEP revised this code in 2019, know at least one member must be independent. Indrawan et al. (2018) state that the independent audit committee reduces earning management practices, and more transparent information is being incorporated in prices. Likewise, Beasley et al. (2009) also highlight that the independent audit committee will increase financial reporting quality. Therefore, this study will provide empirical evidence on how changes in independence affect stock informativeness. In a nutshell, the main objective of this study is to investigate the impact of revised governance codes on stock Informativeness. The scope of this study is limited to four very important governance CGC, i.e., board independence, gender diversity, Chairman CEO Duality, and audit committee independence.

This study is significant in the context of Pakistan due to several reasons. As far as the author's knowledge, this is the first study investigating how revised CGC affects stock informativeness. Furthermore, the initial CGC was launched in 2002 and then revised in 2012, 2017, and 2019. Therefore, the period of study selected is from 2009 to 2019. Thus, the study provides recent evidence of how changes in CGC effects stock informativeness.

The rest of the paper is divided into the following sections. Section 2 comprises of theoretical framework, literature review, and hypothesis development. Section 3 explains the methodological proportion of the study. Whereas, section 4 discusses the result of the study. Finally, section 5 includes the conclusion, limitations, practical implications, and future directions.

LITERATURE REVIEW

Agency theory is being used in the majority of studies that are related to corporate governance. Jensen & Meckling (1976) coined this theory, which mainly debates our agent and principal relationship. Literature highlights that agent and principle conflict occurs because of poor alignment of interests. The role of corporate governance codes is significant because, through CGC, all the governance practices are being derived (Chaudhary, 2021). Good governance practices lower agency conflicts; therefore, more information is being incorporated in prices, whereas weak governance practices increase the agency problems; hence, significantly less information is being incorporated in prices (Gul et al., 2011; Huang, & Ni, 2017). The board structure is a critical component for lowering agency conflict (Petra, 2007). Including independent directors on board helps to reduce agency problems (Chaudhary, 2021) and thus enhances stock Informativeness. Likewise, (Ahmed 2015; Raimo et al., 2021) highlights that an independent audit committee lowers information asymmetries' and enhances oversight function and informativeness, which also lessens agency issues.

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Furthermore, making the board more diverse can improve decision-making and protect the rights of monitory shareholders (Reddy & Jadhav, 2019). Literature also highlights that chairman CEO duality enhances agency issues, whereas separate positions improve disclosure practices (Liu et al., 2021), positively affecting stock informativeness. Therefore, it can be summarized that corporate governance practices can have positive and negative effects on stock informativeness, but these practices are dependent upon CGC.

HYPOTHESIS DEVELOPMENT

Board Independence and Stock Informativeness

Dimitropoulos & Asteriou (2010) states that stock informativeness is directly affected by the presence of the independent board of directors. Moreover, the study also identified that companies with a majority of independent directors on board have conservative approaches while announcing negative news. Ferreira & Raposo (2011) point out that board monitoring will be improve by better governance mechanisms. The study suggested that one mechanism used by companies is the inclusion of independent directors on board that will positively impact the quality of earnings, which also enhance stock informativeness (Firth et al., 2007; Petra, 2007). Further literature highlights that independence on the corporate board improves the firm transparency that will enhance trust and confidence of investors, which will reduce earning management practices as well as lowers the agency conflict, particularly in high ownership concentrated firms (Chi, Hung et al., 2015; Luan, & Tang, 2007). Chen & Wang (2015) explained that increased independence would positively affect reporting quality, which will enhance stock informativeness.

H1: *There is a positive relationship between board independence and stock informativeness.*

Gender Diversity and Stock Informativeness

Previous literature highlights that gender diversity on corporate boards will bring more independence that improves financial information quality. Therefore, more firm-specific information is being incorporated prices, enhancing stock informativeness (Gul, Srinidhi, & Ng, 2011). Likewise, McInerney-Lacombe et al. (2008) also elaborated that gender diverse boards boost board monitoring and oversight function; therefore, the board has a productive discussion that enhances firm disclosure practices. Additionally, Loukil et al. (2019) states that gender diversity is an alternative for independence, specifically in high ownership concentrated companies. Moreover, gender diversity reduces firm opacity by providing quality information. Abad et al. (2017) also highlight that in gender-diverse boards, more information is disclosed, which reduces informational gaps between all stakeholders. Hence stock informativness gets enhanced. Moreover, Loukil et al. (2019) provided evidence that gender diversity is positively associated with firm trading at the stock exchange because more information is being reflected in prices

H2: *There is a positive relationship between board gender and stock informativeness*.

Chairman CEO Duality and Stock Informativeness

Literature highlights that the most strategic and influential positions in the board are chairman and CEO; therefore, if the is hold by a single person, then according to agency theory, agency problems are challenging to solve (Moumen et al., 2016). Moreover, (Kaymak,

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& Bektas, 2008; Ho & Wong, 2001) state that duality creates information biasness; very selective information is being disclosed to stakeholders, affecting stock informativeness. Likewise, Anderson et al. (2003) explained that information related to earnings would be better dissimilated in the absence of duality. Whereas Fu et al, (2021) described that a similar dialect of chairman-CEO improves communication. Therefore mutual trust and understanding get increased, which will enhance stock informativness. Goergen et al. (2020) point out that duality improves controls mechanisms that positively affect stock informativeness. However, Liu et al. (2021) find out that separate positions, particularly in high ownership concentrated firms, would resolve agency conflicts and also protects the rights of minority shareholders.

H3: *There is a negative relationship between chairman-CEO duality and stock informativeness.*

Audit Committee Independence and Stock Informativeness

The composition of the audit committee plays a very central role in providing reliable and accurate information to all the stakeholders (Li & Li, 2020). Black & Kim (2012) report an exciting fact that independent audit committee members are the indicators of good governance. Furthermore, Putra, & Ratnadi (2018) state that independent directors in audit committees help in reducing information asymmetries, which also lowers agency conflicts. Woidtke & Yeh (2013) explains that an increase in independence in the audit committee leads to an increase in oversight function that also reduces the informational gap among stakeholders; as a result, more information is being incorporated in prices. Additionally, Bryan et al. (2004) state that audit committee independence enhances the informativeness of the earnings. Likewise, Beasley et al.(2009) point out that audit committee independence improves the quality of financial information that is presented in annual reports. Indrawan, et al. (2018) highlights that earning management practices will be reduced by adding an independent director to the audit committee. Furthermore, the study finds that independence increases monitoring will enhance the flow of quality information. Hence stock informativeness gets increased.

H4: *There is a positive relationship between audit committee independence and stock informativeness.*

METHODOLOGY

Data and Study Sample

Data is obtained from multiple sources, i.e., annual reports, companies' web and Eikon, etc. This study has selected time from 2009 to 2019 because the study focuses on how revisd governance codes affect stock informativeness. SECP has revised governance codes in years 2012, 2017, and 2019 respectively. Moreover, in this study, we have selected one of the most efficient index of the Pakistan stock exchange, i.e., the Pakistan stock exchange 100 index (PSX-100). This index captures 85% of total market capitalization. The study's final sample comprises 66 companies, excluding 22 financial and 12 companies that were dropped because of incomplete data non-availability. Data will be analyzed by the generalized method of moment (GMM). This method is efficient compared to Panel data and ordinary least squares because it eliminates endogeneity concerns.

Model specification and measurement of the study variables

The following econometric model is used for the analysis of the study.

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$IDV_{i,t} = \beta_0 + \beta_1 BI_{i,t} + \beta_2 GD_{i,t} + \beta_3 CCD_{i,t} + \beta_4 ACI_{i,t} + \beta 5D2012 + \beta 6D2013 + \beta 7D2017 + \beta 8D2018_{i,t} + \beta_9 D2019_{i,t} + \beta_{10} FS_{i,t} + \beta_{11} FA_{i,t} + \beta_{12} LEV_{i,t} + \beta_{13} ROA_{i,t} + \beta_{14} MTB_{i,t} + \varepsilon_{i,}$

Table 1
PROXIES OF VARIABLES

Variable Name	Type	Formula	Source
Stock informativeness	Dependent variable (DV)	IDV= Ln $(1-R^2_{i,t}/R^2_{i,t})$	Ferreira & Laux (2007)
Board independence	Independent variable (IV)	BI = number of independent directors on the board	Linck et al. (2008)
Gender Diversity		GD = coded as 1 if there is at least one woman on the board; 0 otherwise	Bravo & Alcaide-Ruiz (2019)
Chairman CEO Duality		CCD = coded as 1 if the CEO and chairman are the same person; 0 otherwise	McIntyre et al. (2007)
Audit committee independence		ACI= number of independent members in the audit committee	Al-Matari et al. (2013)
Year Dummy		Dummy variable	Hiraki, Inoue, Ito, Kuroki & Masuda (2003)
Leverage ratio	Control variable (CV)	LEV= long term debt to total assets	Kusnadi & Srinidhi (2018)
Firm size		FS = natural log of total assets	Hasan et al. (2014)
Firm age		FA= number of years since company is incorporated	Hasan et al. (2014)
Return of assets		ROA= net Income / total assets	Khatri, et al. (2002)
Market to book ratio		MTB = market value of equity per share/ book value of equity per share	Hasan et al. (2014)

The choice of control variables is in line with the prior studies that examine the relationship between corporate governance variables and information informativeness. These control variables include LEV, FS, FA, ROA, and MTB in Table 1.

RESULTS AND DISCUSSION

Table 2 provides the descriptive statistics of the entire sample from the year 2009-2019. The mean value of IDV is 0.003, whereas the mean value of turnover is 0.454. The average number of independent board of directors is 6.565, whereas the average number of independent audit committee members is 3.479. Furthermore, the maximum value of independent members on board is 15, and the minimum value is 2. Likewise, the maximum value of audit committee independence is eight (8), and the minimum is one (1). Furthermore,

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the minimum value of gender diversity and CEO duality is 0, and the maximum value is 1.

Table 2
DESCRIPTIVE STATISTICS

	Mean	Median	Maximum	Minimum	Std. Dev.	Skewness	Kurtosis
IDV	0.003	0.002	0.08	-0.001	0.004	11.308	189.52
TO	0.454	0.145	6.518	0	0.79	3.292	17.253
BI	6.565	6	15	2	2.526	0.869	3.641
GD	0.355	0	1	0	0.479	0.606	1.367
CCD	0.086	0	1	0	0.28	2.962	9.771
ACI	3.479	3	8	1	1.158	0.945	4.269
FA	36.645	32	74	2	18.125	0.275	1.752
LEV	1.311	0.45	54.91	0	3.258	9.615	130.333
ROA	0.103	0.082	12.164	-0.414	0.462	24.668	644.657
MTB	4.833	1.52	83.58	-9.66	31.892	21.001	97.985
FS	4.509	4.442	8.885	2.904	0.77	2.183	13.539

Table 3 provides the correlation matrix, which shows the direction and magnitude of variables. The results indicate that board independence has a positive and significant (0.121***) relationship with IDV. An increase in board independence will have a positive effect on IDV. Whereas, results further show that gender diversity has a negative but insignificant (-0.031) relationship with IDV. Chairman CEO duality and IDV have a positive but insignificant (0.025) relationship. In this study, the turnover ratio is used as a measure of robustness. Table 3 further shows that this proxy also has a positive and significant effect on board independence (0.090**). The association between gender diversity and turnover ratio is positive and insignificant (0.032). However, audit committee independence has a positive and significant (0.066*) relationship with the turnover ratio. An increase in ACI will enhance the turnover ratio as well. If the audit committee possesses more independence, the quality of information will be reflected in the prices. As a result, turnover will increase.

Table 3
PAIRWISE CORRELATIONS

Variables	(IDV)	(TO)	(BI)	(GD)	(CCD)	(ACI)	(FS)	(FA)	(ROA)	(MTB)	(LEV)
IDV	1										
TO	-0.032	1									
BI	0.121***	0.090**	1								
GD	-0.031	0.032	-0.039	1							
CCD	0.025	0.063*	-0.180***	-0.103***	1						
ACI	-0.160***	0.066*	0.597***	-0.098***	-0.118***	1					
FS	-0.270***	0.036	0.421***	-0.036	-0.063*	0.436***	1				
FA	0.001	-0.063*	-0.064*	0.024	0.003	0.114***	0.021	1			
ROA	-0.038	-0.055	-0.044	-0.019	-0.025	-0.003	-0.03	0.081**	1		
MTB	0.022	-0.055	-0.052	0.065*	-0.022	-0.028	-0.021	0.024	-0.006	1	
LEV	0.158***	0.063*	-0.062*	0.014	-0.049	-0.114***	-0.03	-0.120***	-0.085**	0.094**	1
*** p<0.01, ** p<0.05, * p<0.1											

Table 4 presents the results of the dynamic panel data estimation, two-step system GMM. The results indicate that board independence has a positive and significant relationship with IDV. One percent increase in BI will lead to a 0.01% increase in IDV. Therefore, we accept hypothesis 1. Furthermore, the results are also in line with previous literature and theory. An increase in BI improves the flow of quality information, which reduces agency problems and earning

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management practices. Hence, stock informativeness gets enhanced (Chi et al. 2015; Dimitropoulos & Asteriou, 2010).

Table 4 shows that gender diversity has a positive and significant relationship with IDV ($p<0.05$). This result is also in line with hypothesis 2. Gul et al. (2011) explained that the inclusion of different genders on corporate boards increases the quality of information; therefore, more firm-specific information is being incorporated in prices. Model 1 further shows the results of chairman CEO duality on IDV. Again, the study finds a positive and significant relationship with IDV. Therefore, the study hypothesis does not support the results. However, the results are supported by one strand of the literature, e.g., Goergen et al. (2020) describe that duality enhances the control on the corporate board, which positively affects IDV.

The study found that audit committee independence has a negative and significant relationship with IDV; therefore, we reject hypothesis 4. One possible reason can be that majority of listed companies in PSX are highly ownership concentrated. Consequently, it is challenging for the independent members to play an effective role. However, SECP is playing an influential role in introducing the best corporate governance practices. Dummy variables measure the impact of revised governance practices. SECP has revised codes in the years 2012, 2017, and 2019, respectively. The 2012 and 2013 are significantly different from previous years, which shows that changes are being incorporated, and their reflection is being observed in prices. The reporting results of 2013 are that due to lack of market efficiency in developing countries, changes take time incorporation. Likewise, Table 4 shows that the year 2017 is not different from previous years, whereas 2018 and 2019 are significantly different. In conclusion, it is established that changes in CGC have a positive and significant effect on IDV:

Table 4
DYNAMIC PANEL-DATA ESTIMATION, TWO-STEP SYSTEM GMM

	(1)
VARIABLES	IDV
L.IDV	.09627*** (0.003)
BI	.00012*** (0.000)
GD	.00021** (0.000)
CCD	.00136*** (0.000)
ACI	-.00026*** (0.000)
D2012	.00035*** (0.000)
D2013	.00043*** (0.000)
D2017	3.51e-06 (0.000)
D2018	.00033*** (0.000)
D2019	.00093*** (0.000)
FA	6.56e-06* (0.000)

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FS	-.00106*** (0.000)
ROA	-.00531*** (0.001)
LEV	-.00015*** (0.000)
MTB	2.71e-06*** (0.000)
Constant	0.007*** (0.001)
GMM udv	YES
Hansen Test (stat.)	48.15
Test AR(1) (z-stat.)	-3.65
Test AR(2) (z-stat.)	-1.47

Standard errors in parentheses
*** p<0.01, ** p<0.05, *p<0.1

Table 5 reports the sensitivity analysis. The results are sensitive with this proxy. The difference from the few results is in line with the previous proxy, i.e., IDV. Likewise, BI has a positive and significant relationship with turnover ratio (TO). Whereas, few results are sensitive with this proxy like gender diversity has a negative but insignificant relationship with TO whereas, with IDV relationship is positive.

Similarly, chairman CEO duality has a negative and significant relationship with TO, which accepts the study hypothesis, but results are opposite with the previous measure. The results are in line with literature and agency theory as explained by (Liu et al., 2021) that separate positions of chairman of board and CEO help resolve agency problems and enhance information transparency. Likewise, ACI has a positive impact on TO. An increase in ACI reduces earing management practices and enhances stock informativeness (Indrawan et al., 2018). The results of the year dummies are similar to this proxy as well.

Table 5
SENSITIVITY ANALYSIS

VARIABLES	(1) TO
L.TO	0.654*** (0.005)
BI	0.013*** (0.005)
GD	-0.011 (0.009)
CCD	-0.119*** (0.015)
ACI	0.022** (0.009)
D2012	0.075*** (0.013)
D2013	0.178*** (0.019)
D2017	0.004 (0.006)
D2018	-0.029*** (0.006)
D2019	0.036*** (0.008)

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FA	-0.001 (0.000)
FS	-0.046*** (0.012)
ROA	-0.291*** (0.047)
LEV	0.005 (0.004)
MTB	-0.000*** (0.000)
Constant	0.189*** (0.030)
GMM IDV	YES
Hansen Test (stat.)	46.27
Test AR(1) (z-stat.)	-2.24
Test AR(2) (z-stat.)	-2.36

Standard errors in parentheses
*** $p<0.01$, ** $p<0.05$, * $p<0.1$

CONCLUSION

The current study has analyzed the impact of revised governance codes on stock informativeness. The study has selected four corporate governance codes, i.e., board independence, gender diversity, chairman CEO duality, and audit committee independence. The idiosyncratic volatility is used as a proxy of stock Informativeness. Furthermore, the turnover ratio is used instead of IDV as a robust proxy. Finally, the study has used a generalized method of moment (GMM) for the analysis because this method gets rid of endogeneity concerns. Results show that revised governance codes positively and significantly affect stock informativeness in all three years 2012, 2017, and 2019. In addition, results show that an increase in board independence brings quality information disclosure to all stakeholders, increasing stock informativeness.

Moreover, results are split concerning gender diversity, audit committee independence, and duality of the corporate board. Additionally, the impact of revised governance codes is clearly observed. Therefore, it is inferred that SECP must introduce best governance practices to enhance market efficiency and protect the rights of minority shareholders. It will also lower's the agency conflict. The study is limited to only one market, i.e., Pakistan Stock Exchange. The study only covers the time frame from 2009 to 2019. Future studies can compare developed and developing markets with how the change in governance codes will affect those markets. Future studies can also be conducted on a larger sample size to capture the effect of different time frames. Companies can take benefit from the results of the study while defining various governance policies. Moreover, regulators can also take advantage of the study while setting multiple standards.

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