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Multinational Firm, Firm Value and Corporate Governance Quality: Evidence from Pakistan

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ABSTRACT

This study explores the effects of corporate governance quality, multinational firm and non-multinational firm on firm value. Further, this study explores the moderating effects of corporate governance quality with multinational firm and non-multinational firm on firm value. For this purpose, OLS regression is applied. Data related to Pakistan Stock Exchange (PSX) from 2012 to 2021 is used for empirical analysis. Based on data cleaning 173 non-financial firms used for analysis. Results suggest that corporate governance index and non-multinational have positive & significant impact on firm value, while multinational firms have negative & significant effect on firm value. This is because of exchange rate risk related with multinational firm. Both domestic and international businesses experience in quite different ways. This study results support transactional cost and institutional theory. Further multinational firms have positive & insignificant effect on firm value with the moderating effect of corporate governance quality. This suggest that corporate governance quality improve the performance of the multinational firm but not to the complete extend this is may be due to exchange rate risk or other governance and international market related issues. Lastly, non-multinational firms have positive & significant effect on firm value the with moderating effect of corporate governance quality. This study has lessons for investors, managers, and policymakers.

Introduction

Approximately 25% of the world's GDP, 75–80% of worldwide research and development, and at least 33% of global trade through intra-firm trade are all attributed to multinational corporations (Sturgess, 2008). One Therefore, it would seem that comprehending capital allocation choices and the influence of multinational corporations on valuation should be of considerable relevance. This is particularly important in areas where global integration is lacking and multinational corporations are able to bridge markets in corporate governance, finance, and expertise. Nevertheless, there hasn't been any solid proof connecting investing choices to value up to this point.

While multinational valuation has been examined using the same methods as industrial corporate diversification, the majority of the literature now in publication has examined multinational investment decisions separately, frequently as a natural experiment. According to the theory of industrial organization, businesses are drawn to financing outside because they have unique advantages that allow them to outperform their domestic rivals. Market imperfection determines whether global corporations are more successful than domestic companies. Multinational corporations would gain market share from domestic companies if the market is flawed and they have advantages over domestic companies in terms of capital, technology, and entrepreneurial abilities. However, if the market is proper, local businesses can purchase the technology and other expertise that global corporations possess. In this instance, domestic businesses are not at a disadvantage when compared to other domestic businesses. According to Choi et al. (2014), as compared to native Japanese companies, global corporations offer a statistically significant value premium. A multinational company's general objective is to increase shareholder wealth. The multinational company's management decides on a course of action that will raise the company's share price. A multinational company's management and its stockholders may have an agency issue. The multinational company's managers make decisions to further their own agendas rather than to maximize shareholder profit. According to international theory, if a global company has intangible assets like increased capacity for research and development, production expertise, management expertise, marketing, and customer loyalty, foreign direct investment will result in a better stock price.

Multinational corporations are associated with high-tech and high-growth industries in Pakistan, including engineering, construction and cement, automotive, and chemical industries. These sectors demand significant investments in R&D and technology (Khan et al., 2022). Panel data from 189 companies registered on the Pakistan Stock Exchange between 2010 and 2019 was used by Khan et al. (2022). They discovered that although non-multinational firms have a negative relationship with company value, multinational firms have a positive relationship. Only the size of the board significantly affects the firm value of both multinational and non-multinational companies, out of all the board features (i.e., CEO duality, board size, and board independence). Board size has a negative correlation with a non-multinational company's value and a positive correlation with a multinational company's firm value. To confirm the finding of khan et al., (2022) this study, firstly investigate the effect of multinational and non-multinational firm effect on firm value by using the fresh data from 2012 to 2021 non-financial firms listed on Pakistan Stock Exchange. Secondly, this study key motive is to explore the effects of corporate governance quality on frim value in multinational and non-multinational firms.

The remaining work is arranged as follows: The literature review is covered in Section 2; the technique is covered in Section 3; the findings are elaborated in Chapter 4; the discussion is concluded in Section 5; and finally, sources are cited.

Literature review

Multinational Firms

The findings on business worldwide diversification are generally at odds with the economic literature that examines the operations and choices made by multinational corporations. For the most part, this area of research has come to the conclusion that multinational corporations function effectively on a worldwide scale. Desai et al. (2004) demonstrate in a series of papers using US foreign direct investment (FDI) data that multinational corporations use internal capital markets to mitigate the effects of local capital controls by lowering subsidiary profitability and that they optimally alter the capital structure of both the parent company and foreign subsidiaries in response to tax, local risk, financial development, and expensive external financing. Desai et al. (2007) demonstrate how multinational corporations use their internal capital market to profit from local currency crises by investing in local assets and seizing sales growth using a comparable dataset. In terms of productivity, the examination of firm-level data for the US, Italy, and the UK reveals that the average labor productivity of multinational corporations' overseas subsidiaries is between 30% and 70% higher than that of their domestic operations, while it is roughly 30% higher Griffth et al., (2004), Benfratello and Sembenelli (2006) and Castellani & Navaretti (2004). Additionally, multinational corporations typically employ more highly skilled workers than local companies (Almeida, 2003) and pay higher compensation for identical individuals (Feliciano and Lipsey (2006).

According to Doukas and Travlous (1988), investors in multinational corporations (MNCs) place a higher value on MNC investments in less developed nations since MNCs have greater access to technologies and knowledge than domestic firms. Grant (1987) discovered that company-related abilities, as opposed to country and industry-related characteristics, determine a multinational firm's performance. Multinational firms have a positive relationship with company value, while non-multinational firms have a negative relationship. Khan et al. (2022) discovered that although non-multinational firms have a negative relationship with company value, multinational firms have a positive relationship.

Corporate governance quality

Good investor protection and firm value have been shown to be strongly correlated by academic research, beginning with the groundbreaking work of La Porta et al., (1998), whose variables have recently been updated and enhanced by Djankov et al., (2008). Legal regulations, for instance, dictate corporate valuation in La Porta et al. (2002). Firm valuations are lower in nations with insufficient legal shareholder protection, according to Durnev and Kim (2005) and Dahya et al., (2006). However, corporations can counterbalance this by adopting greater internal governance, such as having a dominant shareholder. Institutional Shareholder Services (ISS) data, which records internal corporate governance at the business level across nations, has been used more recently by Agrawal et al. (2007). According to both studies, there is a negative correlation between the value of international companies and the difference between their governance index and the index of comparable US companies. Additionally, the two studies look at the complementarity between investor protection at the national level and internal corporate governance and come to different conclusions: While Bruno and Claessens (2010) identify replacement effects. Only board size significantly affects the firm value of both multinational and non-multinational enterprises, according to Khan et al., (2022) analysis of board qualities, including CEO duality, board size, and board independence. Board size has a negative correlation with a non-multinational company's value and a positive correlation with a multinational company's firm value.

Methodology

Sample selection

The purpose of this study is to look into how corporate governance quality affects both multinational and non-multinational firms' firm values. The annual reports of non-financial corporations listed on the Pakistan Stock Exchange (PSX) provided the data. Information on the stock price was gathered from PSX publications. Data from 2012 to 2021 were used in this investigation. Additionally, firms with missing data were not included in this analysis. The study's final data set included 173 firms across a ten-year period and 1730 firm year-wise observations.

Variables

The factors that are examined in this study are listed in Table 1 along with their definitions. Firm value is the dependent variable. Multinational firms and non-multinational firms are explanatory factors, while Corporate governance quality is a moderating variable. Dividend payments, interest payments, return on assets, and the ratio of total debt are control variables. Variables are adopted from Nazeer et al. (2023), Khan & Kouser (2023), Khan et al. (2022) and Khan & Kouser (2019).

Table 1: Measurement of variables

Variable	Definition
Dependent variable	
Firm Value (FV)	The sum of the average market value of equity, short-term debt, and long term debt scaled by total assets.
Explanatory variables	
Multinational firm(MUL)	The dummy variable is 1 if the company is a part of a multinational corporation and 0 otherwise.
Non-multinational firm(NMUL)	If the company is a part of a non-multinational group, the dummy variable is 1 and 0 otherwise.
Moderating variable	
Corporate governance quality(GOV)	Ratio of the scores from 70 Pakistani corporate governance regulations from 2002 and 2012.
Control variables	
Dividend payment (DIV)	The ratio of dividend payment to total assets.
Interest payment(INT)	The ratio of interest payment to total assets.
Profitability(ROA)	The ratio of earnings before tax to total assets.
Debt ratio(DR)	Total debt (short + long) to total assets.

Estimation method

OLS was employed as an estimating method in this investigation. The relative benefits of fixed and random effects models are assessed using the Hausman test. The following formulas are used for estimation.

To check the impact of corporate governance quality(GOV), multinational(MUL) and Non-multinational (NMUL) of the firm on firm value, equation 1 is applied.

$$FV_{it}= \alpha_{it}+\beta_1 GOV_{it} + \beta_2 MUL_{it} + \beta_3 NMUL_{it} + \beta_4 DIV_{it} + \beta_5 INT_{it} + \beta_6 ROA_{it}+ \beta_7 DR_{it} \mu_{it}\text{……..1}$$

To check the moderating effect of corporate governance quality (GOV) with multinational(MUL) and Non-multinational (NMUL) on firm value equation 2 is used.

$FV_{it}= \alpha_{it}+\beta_1 GOV_{it}\times MUL_{it} + \beta_2\ GOV_{it}\times NMUL_{it} + \beta_3 DIV_{it} + \beta_4 INT_{it} + \beta_5 ROA_{it}+ \beta_6 DR_{it}\ \mu_{it}$……..2

Results

Table 2: Descriptive statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
FV	1,730	1.19	0.71	0.54	3.40
GOV	1,730	0.82	0.05	0.76	0.91
MUL	1,730	0.16	0.37	0.00	1.00
NMUL	1,730	0.84	0.37	0.00	1.00
DIV	1,730	0.02	0.03	0.00	0.13
INT	1,730	0.03	0.03	0.00	0.09
ROA	1,730	0.06	0.08	-0.08	0.22
DR	1,730	0.53	0.19	0.18	0.85

Table 2 shows the descriptive statistics of the study. Mean value of firm value is 1.19. Average value of corporate governance quality is 0.82, this is an indication that Pakistan firms are reporting code of corporate governance compliance. Average of multination firms is 0.19 which show 16 % of firms are multinational. Average no multinational firms are 84%. Mean of dividend paying ratio is 2% compared with total assets. Interest payment average of sample is 3 % compared with total assets. Average of return of assets is 0.06. Average debt ratio is 0.53 of sample firms.

Table 3: Correlation matrix

	FV	GOV	MUL	NMUL	DIV	INT	ROA	DR
FV	1							
GOV	0.307***	1						
MUL	0.411***	0.199***	1					
NMUL	-0.411***	-0.199***	-1	1				
DIV	0.634***	0.261***	0.347***	-0.347***	1			
INT	-0.357***	-0.317***	-0.259***	0.259***	-0.363***	1		
ROA	0.510***	0.127***	0.239***	-0.239***	0.641***	-0.334***	1	
DR	-0.105***	-0.0858***	-0.0196	0.0196	-0.317***	0.532***	-0.471***	1

* $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

The correlation analysis from this empirical study is shown in Table 3. To ascertain the probability of multicollinearity among variables, correlation is necessary. The literature states that the likelihood of multicollinearity between variables is assessed using a threshold value of +/-0.70. Because the correlation value is so low, correlation analysis shows that multicollinearity across variables is unlikely.

Table 4 shows the results of regression analysis of impact of multinational and non-multinational firms on firm value. Hausman test shows the result suggest fixed effect model is preferable over random effects. First panel shows the results of multinational firms on firm value. Corporate governance index has positive & significant impact on firm value. Dummy of multinational firms has negative & significant effect on firm value.

Table 4: Regression results (Multinational, Non-multinational)

	OLS	Fixed	Random	OLS	Fixed	Random
	FV	FV	FV	FV	FV	FV
GOV	5.772***	6.553***	5.772***	5.772***	6.553***	5.772***
	(0.534)	(0.553)	(0.534)	(0.534)	(0.553)	(0.534)
MUL	0.854***	-1.242**	0.854***			
	(0.156)	(0.452)	(0.156)			
DIV	1.469***	1.097***	1.469***	1.469***	1.097***	1.469***
	(0.247)	(0.241)	(0.247)	(0.247)	(0.241)	(0.247)
INT	-1.354*	-0.629	-1.354*	-1.354*	-0.629	-1.354*
	(0.669)	(0.655)	(0.669)	(0.669)	(0.655)	(0.669)
ROA	2.961***	2.340***	2.961***	2.961***	2.340***	2.961***
	(0.296)	(0.295)	(0.296)	(0.296)	(0.295)	(0.296)
DR	1.377***	1.394***	1.377***	1.377***	1.394***	1.377***
	(0.168)	(0.181)	(0.168)	(0.168)	(0.181)	(0.168)
NMUL				-0.854***	1.242**	-0.854***
				(0.156)	(0.452)	(0.156)
_cons	-4.474***	-4.760***	-4.474***	-3.620***	-6.002***	-3.620***
	(0.474)	(0.504)	(0.474)	(0.501)	(0.614)	(0.501)
Hausaman			0.00			0.00
N	1730	1730	1730	1730	1730	1730

Panel 2 of table 4 fixed effects results shows that non-multinational has positive & significant effect on firm value. Corporate governance index has positive & significant impact on firm value.

From control variables, dividend payout, return on assets and debt ratio have positive & significant effect on firm value. Interest ratio has negative & insignificant effect on firm value.

Table 5: Regression results (moderating effect of corporate governance quality)

	OLS	Fixed	Random	OLS	Fixed	Random
	FV	FV	FV	FV	FV	FV
GMUL	1.312***	0.470	1.312***			
	(0.182)	(0.495)	(0.182)			
DIV	1.701***	1.322***	1.701***	1.771***	1.268***	1.771***
	(0.255)	(0.252)	(0.255)	(0.257)	(0.248)	(0.257)
INT	-3.114***	-2.661***	-3.114***	-3.496***	-1.827**	-3.496***
	(0.669)	(0.662)	(0.669)	(0.674)	(0.662)	(0.674)
ROA	2.818***	2.078***	2.818***	2.889***	2.209***	2.889***

	(0.305)	(0.308)	(0.305)	(0.308)	(0.304)	(0.308)
DR	1.062***	0.900***	1.062***	1.051***	1.079***	1.051***
	(0.170)	(0.184)	(0.170)	(0.173)	(0.182)	(0.173)
GNMUL				-0.631***	2.864***	-0.631***
				(0.182)	(0.395)	(0.182)
_cons	0.467***	0.709***	0.467***	1.095***	-1.315***	1.095***
	(0.117)	(0.129)	(0.117)	(0.179)	(0.307)	(0.179)
Hausman			0.00			0.00
N	1730	1730	1730	1730	1730	1730

Standard errors in parentheses * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 5 shows the results of moderating effect of corporate governance quality with multinational and non-multinational firms. Fixed effects regression results shows that multinational firms have positive & insignificant effect on firm value with the moderating effect of corporate governance quality. Non-multinational firms have positive & significant effect on firm value the with moderating effect of corporate governance quality.

From control variables, dividend payout, return on assets and debt ratio have positive & significant effect on firm value while interest ratio has negative & significant effect on firm value.

Discussion and Conclusion

This study explores the effects of corporate governance quality, multinational firm and non-multinational firm on firm value. Further, this study explores the moderating effects of corporate governance quality with multinational firm and non-multinational firm on firm value. For this purpose, OLS regression is applied. Data related to Pakistan Stock Exchange (PSX) from 2012 to 2021 is used for empirical analysis. Based on data cleaning 173 non-financial firms used for analysis.

Results suggest that corporate governance index and non-multinational have positive & significant impact on firm value, while multinational firms have negative & significant effect on firm value. Possible explanation of negative effect on firm value is align with the finding of Ihsan & Naz (2018) they checked how changes in exchange rates affected the stock returns of 232 nonfinancial companies that were listed on the Pakistan Stock Exchange. According to their findings, firms' stock returns seem to be significantly impacted negatively by increasing exchange rate volatility in addition to exchange rate dynamics. Moreover, Multinational corporations are more exposed to currency rates than domestic businesses. Lastly, they demonstrate that firms' stock returns are significantly impacted differently by exchange rate appreciation and depreciation. Both domestic and international businesses experience these repercussions in quite different ways. This study results support transactional cost and institutional theory.

Further multinational firms have positive & insignificant effect on firm value with the moderating effect of corporate governance quality. This suggest that corporate governance quality improve the performance of the multinational firm but not to the complete extend this is may be due to exchange rate risk or other governance and international market related issues. Lastly, non-multinational firms have positive & significant effect on firm value the with moderating effect of corporate governance quality.

This study has lessons for investors, managers, and policymakers in Pakistan's chemical sector. This study's data and time frame about Pakistan's multinational firm are also constrained.

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