

CORPORATE GOVERNANCE AND FIRM VALUE OF KAZAKHSTANI COMPANIES IN THE CONDITIONS OF ECONOMIC INSTABILITY

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Abstract: The main goal of this paper is to evaluate the effects of corporate governance system on Kazakhstani companies' economic and financial performances following the ongoing economic sanctions against the Russian Federation. With the empirical study of the Corporate Governance disclosures of large Kazakhstani listed firms, we tested the hypothesized causal relationship between management ownership and other corporate governance variables and corporate financial performance indicators, such as ROA, ROE, ROS, and others. Based on correlation and regression analysis, we found that there is no reason to presume the strong relations between the analyzed variables. Moreover, we come to a conclusion that the sanctions only have an indirect influence at the Kazakhstani companies. Our findings indicate that the firms' financial conditions might be mostly affected by other factors, such as the low oil and gas prices in world market.

Key words: Corporate governance, company, ROA, ROE, ROS, economic and financial performance, Kazakhstan

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Introduction

Few decades ago, the term "corporate governance" was not so familiar to large audiences. Nowadays, most would acknowledge its importance it is for business enterprises as well as the entire economy. The German corporate governance code, for example, defines the aims of corporate governance as follows: "The purpose of corporate governance is to achieve a responsible, value oriented management and control of companies. Corporate governance rules promote and reinforce the confidence of current and future shareholders, lenders, employees, business partners and the general public in national and international markets."

Kazakhstan companies also realize the importance of corporate governance, and how it can affect economic and financial performance of firms. That is the reason why, today many of them gradually instill the principles and norms of corporate governance into their business practices. Therefore, the significance and relevance of this topic cannot be underestimated.

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Literature Review

Voluminous research has been conducted with a focus on the study of problems faced by Boards of Directors such as: the optimal size of the board, its composition, the number of insiders and outsiders (independent directors) in the board, the precise relationship between CEO and the chairman of the board of directors, and etc. Such research involved several industries in several countries (Bushman et al., 2004; Drobetz, 2012).

In 2007 in their Annual Board of Directors Survey by Korn and Ferry Institute it was reported that the average board size in the United States companies is 10 members, with 7 independent directors. Nevertheless larger boards exist, including 12-15 people, in banks and in companies from the entertainment industry. In other countries, such as Germany, France or Japan, the number of board directors can reach even 16 members, but the ratio of insiders and outsiders is varied. For example, French corporations have a majority of independent directors, while Japanese and other East Asia companies have a majority of insider directors. German boards consist only of insiders (Annual Board of Directors Survey, 2007). Kim, Nofsinger and Mohr (Kim et al., 2010) came to the conclusion that if the board has a higher proportion of independent directors, then it can, more objectively, monitor management and, consequently, be more effective. The level of the efficiency of a board is, additionally, affected by its size. Smaller board can more effectively fulfill its functions than larger boards primarily because of low level of social loafing and absence of "free-riders". Nevertheless, researchers did not find a clear positive correlation between board quality and firm performance (Joh, 2003; Gul and Leung, 2004; Morck et al., 2005).

Leung and Horwitz (2004), in their analysis of the financial performance of main Hong Kong corporations during the period of the Asian Financial Crisis (1997-1998), found that the degree of equity ownership by executive directors and board none-executives affects company's economic and financial results (Williamson, 2004). They examined 463 of the largest Hong Kong's legal entities and concluded that the firms with more equity ownership by non-executive directors, and in which the position of Board chairman and Chief Executive Officer were occupied by the same person demonstrated smaller decline in stock prices (Leung and Horwitz, 2004).

As for family owned companies, there are two points of view. One is, the more concentrated the management ownership, the less the conflict of interests between managers and shareholders (Ali et al., 2007; Brown and Caylor, 2005). The second point of view asserts that the more concentrated management ownership leads to the conflicts of interests between majority and minority shareholders because family (as major shareholder) can gain private benefits at the expense of minority (Anderson and Reeb, 2003; Fan and Wong, 2002).

These studies indicate that there is a disagreement over the impact of ownership structure on the value of the firm. We conducted our own research in this field, and

focused only on large Kazakhstan companies in the current economic situation during the period of 2012-2016.

Corporate Governance Variables and Firm Performance in Modern Conditions in Kazakhstan

Significance and objective of the research

Quite a lot is known nowadays about corporate governance. Yet with nearly regular periodicity, the world is shaken by the scandals connected with large corporations and their management systems (Zhussupova et al., 2016). For Kazakhstan the corporate form of business is rather new, and, therefore, insufficiently studied. Indeed there is urgent need to carry out detailed analysis of the practices of corporate relations from the point of view of the realization of rights and protection of interests of shareholders. That is necessary if we are to gain a deeper understanding of the processes, currently being implemented, in corporate governance system and relations developing between stockholders (in fact the owners of company) and managers (technically, officers or executives who control the firm).

The main objective of the research is the development of a theoretical and methodical basis of corporate governance components (variables), such as size of board of directors or non-executive equity ownership, and firms' economic and financial performances in the conditions of economic instability and development of the directions of their effective functioning.

The following tasks have been identified:

- to study the main scientific findings of researchers in this field
- to analyze the structure and quality of the Board of directors of large companies in Kazakhstan
- to identify the correlation between corporate governance variables and firms performance
- to determine dynamics of the main economic and financial indicators of companies for 2012-2016

Analysis

For this research we analyzed the data of the 20 largest companies of Kazakhstan, operating in various industries of economy, except from the banking sphere. Objects of research were chosen from the list of the companies trading their stocks at the Kazakhstan stock exchange. The selection was made on the basis of firm's actual total assets which had not to be lower than 100 billion tenge.

Table 1. Industry distribution of sample

#	Industry	Number of firms
1	Production of electro energy	5
2	Production, processing and transportation of hydrocarbons	6
3	Agriculture	3
4	Communication	2

5	Industrial machinery & equipment	1
6	Investment	2
7	Railway transport	1
	Total	20

First, we analyzed the size and composition of the Board of directors of those companies, the number of insiders and outsiders (independent directors) in the boards, the proportion of executives and non-executives among insiders, the degree of ownership by board non-executives, the unity or duality of the CEO and board chairperson, the existence of independent audit agency, and the number of family owned firms.

The analysis of the size and composition of the boards of directors shows that the largest board consists of 9 members, the smallest – 3 members. The average number of directors in these companies is 6. The boards consists at least one independent director, in average the number of independent directors is 2.5. If we compare the quantity of executives and non-executives among insiders, the proportion of non-executives average 72.3 percent. The degree of ownership by board non-executives average 5.3 %. In all companies the roles of CEO and board chair are separated. All firms have their own independent audit agencies, which provide them high quality audit services. Finally, among the 20 largest Kazakhstan companies only two can be considered as family owned companies.

The second part of our research aimed to test the relationships between highlighted components of corporate governance system and firm's economic and financial performance indicators, such as ROA, ROE, and ROS.

The correlation and regression analysis of the relationships between these factors provided the following results:

Table 2. The results of correlation dependence calculations between the components of corporate governance and financial ratios, 2016

#	Correlation Dependence of Indicators	ROA results	ROE results	ROS results
1	Board size	0.087	0.128	0.077
2	Number of insiders in board	-0.043	0.062	0.162
3	Number of outsiders in board	0.204	0.133	-0.084
4	Number of executives directors	-0.307	-0.406	-0.196
5	Number of non-executive directors	0.038	0.172	0.217
6	The degree of ownership by board non-executives	-0.162	-0.117	-0.063
7	Family owned firms	-0.154	-0.160	-0.548

The correlation analysis does not show strong relations between the analyzed variables, except the relations between number of executive directors and the ROA, ROE and ROS ratios, and family owned firms and the ROS ratio. In this case we can definitely see the high level of negative correlations, which means that increase

in numbers of executives in firms or family owned companies leads to the significant decrease in these indicators.

The regression analysis results confirm the correlation findings. The Table 3 shows that if the number of executive directors is raised by 1, the ROA, ROE and ROS ratios drop down by 2.87 percent, 6.11 percent and 7.59 percent respectively.

Table 3. The results of regression analysis calculations between the components of corporate governance and financial ratios, 2016

#	Regression Dependence of Indicators	ROA, %	ROE, %	ROS, %
1	Board size	0.170	0.411	0.671
2	Number of insiders in board	-0.119	0.240	1.801
3	Number of outsiders in board	0.672	0.708	-1.286
4	Number of executives directors	-2.873	-6.107	-7.591
5	Number of non-executive directors	0.045	0.602	2.290
6	The degree of ownership by board non-executives	-0.027	-0.032	-0.046
7	Family owned firms	-2.911	-4.983	-46.131

It is well known that the return on asset ratio indicates how much net income each tenge of assets produce on average. It shows whether the business is investing in its assets effectively. If a company has many assets that do not help generate profit, then the ROA ratio will be relatively low. The assets that do not help generate profit can be fancy offices or luxury automobiles of firm's executives. That is why, in our opinions, companies have to very carefully monitor the ROA degree.

The return on equity ratio measures the average return on the firm's capital contributions from its owners-stockholders. It indicates how many tenge of net income were generated for each tenge invested by the common stockholders. Consequently, we see that the ROE of Kazakhstan companies twice more sensitive on occurrence of one more executive director.

One more figure in the Table 3, which derives our attention is the ROS ratio and the factor of family owned firms. If the number of family owned firms raise, the return on sales will drop down almost by 46 percent. The ROS ratio shows the relations between operating income and sales revenue, and the higher the result, the better the company's economic performance. We believe that family owned firms have such significant ROS's decline rate because their activity is less transparent than public corporations' business.

The final part of our research is to (1) investigate the economic and financial conditions of the large Kazakhstani firms (as the indicators of conditions of the whole the Republic economy and its business sector) over the last five years starting 2012; (2) identify the main factors affecting the possible changes, and (3) try to make future forecasts.

Figure 1 represents the amount of return of assets of the 20 largest local companies in percentage from 2012 to 2016 in Kazakhstan. There are eight graphs, which respectively relate to return of assets in the following sectors: electro energy,

production, processing and transportations of hydrocarbons, agriculture, communication, investment, railway transportations.

In this graph representing the return of assets between 2012 and 2016, we can see a large contrast between the dynamics of changes in return of assets between such sectors as agriculture, railway transportation, machine building, investment and such sector as communication. That tendency is caused by the increase of net income of telecommunication companies. In 2012, the return of assets of communication went down significantly by the year of 2013 and then continued to fell steadily until 2015 and it is expected to plummet by 2016. Contrary to such fluctuations in communicational field the return of assets in such fields as investment, and production, processing and transportation of hydrocarbons remains almost the same throughout three years period.

In some cases, however, it is predicted that the return of assets of railway transportations and machine building sectors will hit the bottom or even go below 0 percent return. Concerning the return of assets of agricultural sector there was a positive tendency of grow and this sector continued to slightly increase till 2014, but nevertheless this upward trend was followed with a gradual decrease by the year of 2015.

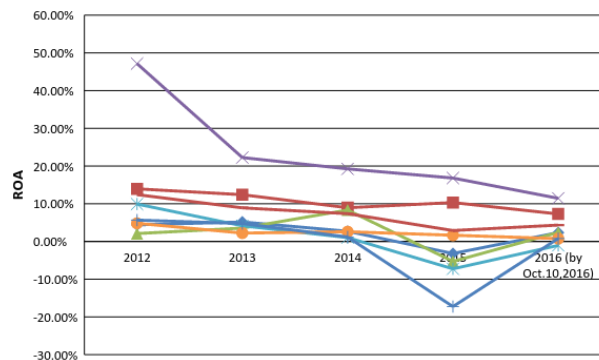


Figure 1. Dynamics of ROA ratio by industries in the Republic of Kazakhstan, 2012-2016

The return of assets of all industries average had a moderate decline from 2012 till 2014 which was continued by steady decrease by the year 2015. According to the data of 2016 we can see the positive changes in this financial indicator.

Figure 2 shows the dynamics of ROE ratio of large Kazakhstan companies grouped in seven industries.

The graph compares the dynamics of fluctuations of the return of equity of 20 large local companies in percentage from 2012 to 2016 in Kazakhstan. It can be clearly seen, that the sharp upward trend of agricultural sphere, which took place in 2014, was followed by considerable downward trend, which continued throughout the period of 1 year. That significant contrast is caused by the large volume of harvest collected in 2013 and moderate volume in 2014. It is at once visible that in

comparison with the return of equity of industries that are engaged in production of electro energy, investment and the production, processing and transportation of hydro carbonates, the return of equity of communication, machine building, railway transportation and agricultural sectors is represented by sharp fluctuations. In 2015, we can see the similarity between the agricultural, machine building, and railway transportation industries - there was a decline, which is caused by such external factors as sanctions against the Russian Federation, the global oil market's prices and the fluctuations of national currency. However, there is also difference between them, if for the machine building, and railway transportation sectors there was a gradual decrease in the level of return of equity; we can see that significant decline in agricultural sphere.

In case of industry that is engaged in the production, processing and transportation of hydrocarbons there is a static trend, which took place from 2012 to 2013 and was followed by gradual decline until the 2016. The same dynamics is illustrated in investment sector, but with a slight difference, in comparison with the dynamics of production and transportation of hydrocarbons there was a moderate growth in the investment sphere by the year 2014.

In conclusion, we can see the tendency of decline in communication, hydrocarbons production and processing, and investment. Nevertheless, we see that possibility of future growth in the return of equity of railway transportation, agriculture, and production of electro energy spheres.

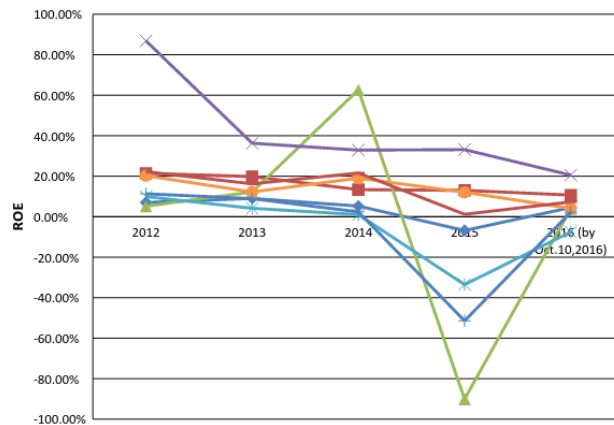


Figure 2. Dynamics of ROE ratio by industries in the Republic of Kazakhstan, 2012-2016

Figure 3 shows the dynamics of ROS ratio of large Kazakhstan companies grouped in seven industries. This line graph illustrates the amount of return of sales of 20 large local companies in percentage from 2012 to 2016 in Kazakhstan. Contrary to previously mentioned two graphs, there are sharp and dynamic tendencies of the return of sales in the following sectors: electro energy, production, processing and transportations of hydrocarbons, agriculture, communication, investment, railway

transportations. It is clearly visible that there is a positive dynamics of growth in the return of sales of such industries as investment, and the production, processing and transportation of hydrocarbons.

Contrary to these sectors, there is downward tendency of the amount of the return of sales of agricultural sector. However, there was a peak approximately 25 percent that was reached in 2014, that is caused by the quantity of harvest collected in these years, and the tremendous fall down by 2015. One more industry that was unsuccessful in 2015 was the railway transportation which faced more than 65 percent loss. Unlikely other graphs there was a peak of 60 percent of return of sales in the investment sector, which sooner was followed by dramatical and sharp decline by 2013. This downward tendency kept till 2014, but raised slightly in 2015, and it is forecasted to rise considerably by the 2016. That situation depends on external and internal factors. External factors are the attraction and the increase of interest of foreign investors for instance, Chinese, Arabian and British investors. Internal factor is that internal deposits were mobilized during the period between 2014 and 2015. It is necessary to mention that the amount of return of sales remains almost the same in the sphere of communication throughout the 2012 and 2016 period. In general, it is forecasted that there will be an upward tendency of the return of sales of all given sectors of economy.



Figure 3. Dynamics of ROS ratio by industries in the Republic of Kazakhstan, 2012-2016

Discussion

Undoubtedly, the obtained results do not give a full answer to all questions related to the corporate governance and firm value of Kazakhstani companies in the conditions of economic instability (Alijani and Karyotis, 2016). In particular, the issues of practical application require deeper study as they cannot be completely solved within a single work.

We have examined such features as the number of members of board of directors, CEO, non-CEO, external audits, independent directors and we can conclude that it does not contradict to the world standards accepted in modern business (Boyd et al., 2017; Ushakov et al., 2017).

We analyzed the 20 biggest companies of the Republic of Kazakhstan which provided us with a better understanding of the main development trends, reasons of factor fluctuations and key interdependencies. In particular, we have deeply reviewed the impact of the corporate government factors to ROA, ROE, and ROS. However, the considered topic requires deeper research where more companies should be taken into consideration. Especially, it concerns the ratio of considered firms within each branch (field).

Further expectations are going to involve the research of more Kazakhstani firms for the next years concerning studying the sanctions against the Russian Federation and their influence at the Kazakhstani companies.

Conclusion

To summarize, corporate governance is a complex system including not only board of directors, executive managers, and shareholders, but also investment banks, auditors, consultants, credit rating agencies, and regulators. Corporate governance has its own rules, norms, and regulations. Corporate governance affects firm's economic and financial performance, and finally shareholders' wealth. Nowadays, company's efficiency mostly depends on how well the corporate governance principles are instilling into overall management process.

In this research were identified the main components of corporate governance system and how they used in Kazakhstan companies. Using the correlation and regression methods, we determined what factors and to what extent they affect firm's economic and financial performances. For this study, we analyzed the data of the twenty largest Kazakhstani companies during 2012 - 2016. The main factor, which affect negatively firm's ROA and ROE, is the number of executive directors. Moreover, on the basis of firm's data during 2012-2016, we analyzed the trends of the ROA, ROE, and ROS indicators, which showed, in our opinion, only a slight and indirect influence of the sanctions against Russia on our studied companies. Our findings indicate that the firms' financial conditions might be more affected by other factors, such as the negative market conjuncture in the oil and gas world market and the fluctuations, as a result, of the rate of local currency.

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LAD KORPORACYJNY I WARTOŚĆ FIRMOWA SPÓŁEK KAZACHSKICH W WARUNKACH BRAKU STABILNOŚCI GOSPODARCZEJ

Streszczenie: Głównym celem tego artykułu jest ocena wpływu systemu ładu korporacyjnego na gospodarcze i finansowe wyniki kazachskich firm w następstwie trwających sankcji gospodarczych wobec Federacji Rosyjskiej. Dzięki empirycznemu badaniu ujawnień dotyczących ładu korporacyjnego dużych kazachskich spółek giełdowych przetestowano hipotetyczny związek przyczynowy między własnością zarządu a innymi zmiennymi ładu korporacyjnego oraz wskaźnikami wyników finansowych przedsiębiorstw, takimi jak ROA, ROE, ROS i inne. Na podstawie analizy korelacji i regresji ustalono, że nie ma powodu zakładać silnych relacji między analizowanymi zmiennymi. Ponadto wywnioskowano, że sankcje mają jedynie pośredni wpływ na firmy kazachskie. Nasze wyniki wskazują, że na sytuację finansową firm największy wpływ mogą mieć inne czynniki, takie jak niskie ceny ropy i gazu na rynku światowym.

Słowa kluczowe: Ład korporacyjny, firma, ROA, ROE, ROS, wyniki gospodarcze i finansowe, Kazachstan.

哈萨克斯坦公司在经济不稳定的条件下的公司治理和公司价值

摘要：本文的主要目的是评估公司治理体系对俄罗斯联邦持续经济制裁后对哈萨克斯坦公司经济和金融表现的影响。通过对大型哈萨克斯坦上市公司公司治理披露的实证研究，我们测试了管理层所有权与其他公司治理变量之间的假设因果关系以及公司财务业绩指标（如ROA，ROE，ROS等）之间的假设因果关系。基于相关性和回归分析，我们发现没有理由推断分析变量之间的强关系。此外，我们得出的结论是制裁只对哈萨克斯坦公司有间接影响。我们的研究表明，公司的财务状况可能主要受其他因素影响，例如世界市场的低油价和天然气价格。

关键词：公司治理，公司，ROA，ROE，ROS，经济和财务表现，哈萨克斯坦。