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Does Voluntary Disclosure improve Firm Performance: Evidence from Pakistan

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ABSTRACT

This study investigated the influence of voluntary disclosure (VD) and Corporate Governance (CG) on firm performance in the non-financial sector of Pakistan. The sample size consists of 300 firm-year observations of a non-financial sector of Pakistan for the year 2002 to 2016. The results indicate that several elements of VD and CG mechanisms are important for better firm performance. The Board of Independence and disclosure of product information show a positive and significant impact on Earning per share and Return on Asset (ROA). However, CEO duality has a significant but negative association with firm performance. While board size and disclosure of future strategy show no effect on firm performance.

Keywords: Voluntary disclosure, Corporate Governance, firm performance.

1. INTRODUCTION

Corporate disclosure aims to disclose definite information to the creditors and investors about the performance and value of the firm. In order to make appropriate financial decisions, this information is valued by investors and analysts as it helps to forecast the future performance of the company. The functioning of the capital market leads to breakdown due to information asymmetry and incentive conflicts between owners and managers of the firm (Li et al., 2013; Myers, 1984). However, the self-interest (agency problem) can be reduced by compensation plans for rewarding the managers for good financial performance (Guay and Verrecchia, 2018; Anson et al., 2004). While information asymmetry can be reduced by creating regulations for a

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corporation that requires management to release necessary information to shareholders (Goldstein and Leitner, 2018; Healy & Palepu, 2001).

An important aspect of an efficient capital market is an effective CG system that not only monitors managers but also provides corporate disclosure (Al-Bassam et al., 2015; Kanagaretnam et al., 2007). OECD (2006) reports that: “All material issues relating to Corporate Governance of the enterprise should be disclosed in a timely manner. The disclosure should be clear, concise, precise, and governed by the substance over form principle”. (p.29)

Good CG system helps to improve the firm performance and high performance of firms improve the economic stability of an economy and attracts capital from investors. Effective CG system helps to provide sustainable financial development by increasing the performance of companies and enhancing their access to attract outside capital for the company. CG describes a wide range of rules and practices that covers every aspect of financial policies and clearly defines the rights of stakeholders and composition structures of boards in good detail.

In Pakistan, the code of CG was presented in 2002, so that public trust shall be maintained in capital markets. The code is composed of different recommendations that are in line with international good practice. The most important areas that need alteration in Pakistan are the numbers of the board of directors and to make them responsible to all investors. There shall be better disclosures to the investors including improved internal and external audits for listed companies. However, the code does not provide any guidance on putting internal controls in firm, risk management, and board compensation policies. Firms provide mandatory disclosure to the outsiders through financial statements and footnotes (Kolotilin, 2018; Kothari et al., 2008). Besides mandatory disclosure of information, some firms provide VD such as conference calls, press release, websites, analysts’ presentations and other corporate reports in the financial reports (Platonova et al., 2018; Chen et al., 2018; Chen, 2015).

VD take place by the will of managers and can take place at the time of occurrence of mandatory disclosure (Akamah et al., 2018; Menon, 2015). The purpose of the research is to present the connection of the important VD and better CG system on the

performance of the firm in the non-financial sector of Pakistan. Though CG application varies from country to country and many studies reveal that informative VD increase the performance of the firm (Brown et al., 2018; Hamrouni et al., 2015; Menon, 2015) and help to reduce the cost of capital (CoC) (Botosan & Marlene, 2001; Dhaliwal et al., 2012; Lajili & Zeghal, 2006;). Further, Botosan and Marlene (2001) examine the VD timings and its effect on CoC and finds that it reduces only with annual reporting of VD while increases with frequent disclosures. However, Burks et al. (2018) and Basah (2015) report that informative VD have an impact on market capitalization. Since previous research reports about the different level of disclosures impact on firm performance during the year. This study enlarges and elaborates the earlier studies by adding the term of VD with CG to find the firm performance.

2. LITERATURE REVIEW

Prior literature investigates different variables of CG and VD effect on firm performance. Morris and Tronnes (2018) reveal that positive link between board composition and firm performance. In China, Huafang and Jianguo (2007) find the relation between two variables of CG (Ownership structure and board composition) on corporate VD. Allegrini and Greco (2013) and Par et al., (2019) report that CG and VD are complimentary as the presence of board provides a clear image to outsiders about firm performance. All CG mechanisms are not alike and thus each company defines and portrays a unique set of such mechanism for itself. (Park et al., 2019; Yasser, 2011). In comparison to literature, this study contains a different combination of CG mechanisms to find the firm value when firms provide VD in the non-financial sector of Pakistan.

Firm performance is measured by three profitability ratios i.e. ROA (Core et al., 1999; Georgiou, 2010; Uyar, 2011; Yermack, 1996), Return on equity (ROE) (Brown & Caylor, 2004; Dar et al., 2011; Georgiou, 2010; Marston & Polei, 2004; Shaheen & Nishat, 2005) and earnings per share (EPS) (Aboody & Kasznik, 2000L; Lang & Lundholm, 1993). The independent variable is CG that is proxied by Board Size (Allegrini & Greco, 2011; Gao & Kling, 2012; Hajji & Ghazalli, 2013; Kent & Stewart, 2008), Board Independence (Chau & Gray, 2010; Gracia & Ballesta, 2010; Matocsy et

al., 2012), CEO duality (Collett & Dedman, 2010; Felton & Watson, 2002; Gao & Kling, 2012) and VD that is proxies by disclosure of future strategy and product information (Li et al., 2018; Brown et al., 2018; Albawwat & Baseh, 2015; Chau & Gray, 2002; Himrouni, Miloudi, & Benkraiem, 2015). The control variable is total Asset (Iqbal & Javed, 2006; Shaheen & Nishat, 2005; Yasser, 2011).

2.1. Parties Involved in Corporate Governance

A CG system defines who owns the firm, and dictates the rules by which economic returns are distributed among shareholders, employees, managers, and other stakeholders. The important personalities involved in CG such as Board of Directors, Shareholders/Stakeholder of the firm, Audit Committee, Chief Executive Officer and Management.

▪ The Role of the Board of Directors

The board of director of the company is responsible to ensure that company practice in line with rules of CG. For this purpose, directors need to remain well informed and good in decision-making. He must exhibit effective monitoring and control over management. Board of directors is responsible for good judgment and better decision making. He should act as a guide to business strategy for the company. He must be able to determine an appropriate corporate appetite for risk. He should be able to select a chief executive from a pool of candidates involves decision-making that cannot be reduced to a mechanical series of steps. His monitoring and supervisory functions may comprise a range of reasonable approaches. He must ensure the integrity of accounting and financial reporting systems and oversee the process of disclosure and communications.

▪ The Role of the Audit Committee

The audit committee role is to ensure the company's compliance with legal and regulatory requirements. Audit committee monitors the integrity of the company's financial statements and announcements with the actual position of the firm. Auditors review internal financial controls and the internal audit function. The committee recommends the appointment or replacement of external auditors and to review the effectiveness of their work. The audit committee is responsible to develop and implement policy on the use of the auditors for no audit services. The main duties and

responsibilities of the Committee include; highly responsible for the analysis of the audit plan of external auditors, the internal auditing process, accounting standards, and practices. Financial information, the system of accounting, internal controls and the reliability of information, financial risk management, any certifications required by regulatory authorities. Moreover, analyze or evaluate financial statements. Ensure the external auditors are working independently or not and should keep a direct link with the board of directors, CEOs, Chairman and as well as with the investors of firms.

- **The Role of CEO and Management**

They are responsible for operating the firm in the best interest of shareholders., prepare future strategies and budgets, ensure the accuracy of the financial reports, maintain the financial reporting standard, the management shall review the submitted internal audit reports and can request for audits any time in the discharge of their responsibilities.

2.2. Corporate Governance Mechanisms

- **Board Size**

Board size is one of the most important variables of CG which greatly impact the level of corporate VD to the outsiders. Director's function is to direct the CEO of the firm and monitor overall activities of the firm (Raheja, 2005). It is found in many studies that board size should be limited in order to improve firm performance this is because monitoring of large numbers of directors on board is outweighed by the poorer communication and time challenging decision making by a large group (Lipton & Lorsch, 1992). However, Yermack (1996) adds to this literature that if board size is between 6 and 15 show high firm performance than companies with other board sizes. Moreover, the agency problem is high with a large board of directors (Eisenberg et al., 1998). Numerous studies report a negative association of board size with firm performance (Haniffa & Hudaib, 2006; Hermalin & Weisbach, 2003; Yermack, 1996). However, other reports that a firm having a large number of board of directors can provide a range of expertise and experience to the firm. The expert directors can help to improve firm performance (Dalton, 1999).

- **Board Independence**

Board independence refers to a number of independent directors on board. Independence means that the director has no blood, social or economic relation to the firm stakeholders. It is the most research focused variable of CG. CEO earns high compensation due to the existence of outside directors (Boyd, 1994; Finkelstein & Hambrick, 1989). Brown and Caylor (2004) suggest that researchers using financial statement data find no relation between firm performance and board independence. However, Lin et al. (2009) report that firm performance is significantly and positively related to the board independence and with the frequent board meeting. Another study by Gracia and Ballesta (2010) suggests that VD and board independence are positively linked but in the higher investor protection companies. Huafang and Jianguo (2007) investigate that VD is greater with more independent directors but less with CEOs duality.

- **CEO Status**

One the most important mechanism of CG that is widely argued across the world that whether better financial performance can be obtained by employing two important positions i.e of CEO and chairman by one person or two persons at the same time. CEO duality means when the firm CEO holds a dual position at a time i.e. of CEO and board chair. Studies suggest that firm value increases with CEO duality (Bhagat & Black, 2002; Brown & Caylor, 2004; Yermack, 1996). Allegrini and Greco (2011) report a negative relation with CEO duality and corporate VD. Latif et al. (2013) investigate the impact of different CG variables on firm performance and reports that there is a significant and positive relation of CEO duality on ROA. However, Yermack (1996) suggests that firms prove to be more profitable when govern by CEO duality mechanism of the company. The study by Dar et al. (2011) reports a positive association of ROE with board size and negative link with CEO duality. Core et al. (1999) report that agency conflict is high with weak governance system and firm performance is badly affected as CEOs earn more compensation. Later, they further find that when the CEO and board chair are separated than compensation of CEOs decreases. Thus, large board size and CEO duality decrease firm performance. Thus there are more chances of expropriation of shareholders by management when CEO and Chairman is the same person. However, Georgiou (2010)

study shows a positive association between the size of the board, audit team, CEO duality, and firm value.

2.3. Voluntary Disclosure

Voluntary Disclosure (VD) is a way by which managers convince shareholders that they are working in an efficient manner by providing additional financial and non-financial information (Cade, 2018; Baldini et al., 2018; Watson et al., 2002). Some firms are busy in providing VD such as conference calls, press release, websites, analysts' presentations and other corporate reports in the financial reports (Chen, 2015).

VD has been more studied in developed countries but little researched in developing countries. The results are mixed about the link of VD with firm performance. Such as Lang and Landholm (1993) find that association between VD and firm performance is weak while Baldini et al., (2018) and Albitar (2015) report that VD and CG have a positive relationship with profitability. Grewal et al., (2018) Core et al., (1998) suggest that agency problem is high with weak governance system and Firm performance is badly affected as CEOs earn more compensation.

Prior literature reports a positive relation of VD on Firm performance. For example, Allegrini and Greco (2011) report that frequent meeting of the audit committee, the size of the board is positively linked with corporate VD but reports negative relation with CEO duality and corporate VD.

VD take place by the will of managers. These can take place at the time of occurrence of mandatory disclosure (Brwon et al., 2018; Menon, 2015). Studies suggest the importance of correct time to disclose information voluntarily by the managers to the outsiders to enhance firm performance such as Yermack (1996) finds the difference in news declaration of CEO's before and after the date of awards. Further, Aboody and Kaznik (2000) investigate the CEOs timing of disclosing voluntary information and finds that CEOs discloses good news near to the date of getting stock option awards. Roy chowdhury and Sletten (2012) suggest that management disclose bad news in advance to the outsider to avoid negative stock price shocks. Platonova et al., (2018) and Gracia and Ballesta (2010) find that VD and board independence are positively linked but in the higher investor protection companies. Huafang and Jianguo (2007) report that VD is

greater with more independent directors but less with CEOs duality. Rouf and Harun (2011) report that VD is positively associated with institutional ownership however, has a negative link with the managerial ownership. Akhtarudin and Haron (2010) suggest that putting more independent directors in audit helps to enhance the VD. Chau and Gray (2010) report that CEO duality is positively related to VD. Guay and Verrecchia (2018) and Allegrini and Greco (2011) report that an increase in board size results in high level of VD. However, inconsistent with previous studies CEO duality is significant but negatively linked with VD. Wang, and Claiborne (2008) find that Firm performance is positively related to the extent of VD.

The measures used for VD in this study are given below in form of future strategy and product information. As we know that company discloses different necessary information at different times so when company disclose information about its strategic plans and provide information about its product line or any new launching product than it's counted as VD. Such information takes place by the will of management irrespective of any regulations (Li et al., 2013; Kolotilin, 2018; Morris and Tronnes, 2018; Park et al., 2019).

Albawwat & Baseh (2015) used checklist index for Amman Stock Exchange of Jordanian listed corporations for the data from 2009 to 2013 and find that VD occurs due to the best implementation of CG in Jordan. Their results report that VD has a potential impact on market capitalization and Akhtarudin and Haron (2010) also used the same variables for VD measurement. The above two variables are chosen from their index for measuring the impact of VD on firm performance of Karachi Stock Exchange listed firms.

3. RESEARCH METHODOLOGY

3.1. Sample Size

In this study, the sample consists of 300 observation covering 20 firms from eleven different industries listed on Pakistan Stock Exchange (PSX) representing the non-financial sector of Pakistan for the years 2002 to 2016. This period is selected since institutional and regulatory changes occurred after the introduction of the code of CG in

Pakistan. Since the performance of the firm does not change overnight due to changes in institutional and regulatory environment rather takes place over a long period of time (Shleifer & Vishney, 1997). In literature CG impact on firm performance is examined by many authors. For example, Nishat and Shaheen (2005) examine the impact of the year 2004. Similarly, Iqbal and Javed (2006) covered only 3 years (2003, 2004 and 2005). Also, Yasser (2011) selected the data for 2003 to 2008. While a recent study by Dar et al. (2011) is for the year 2004 to 2010. In considerations of the above studies in Pakistan, the author selects the most recent 16 years' data from 2002 to 2016 for presenting the impact of VD on firm performance that is not studied before. The variables values are obtained from financial statements and annual reports of the companies taken from the companies' websites, PSX and State bank of Pakistan. The random sampling method is used for the selection of the sample from the population based on the availability of data from sources.

3.2. Model Specification

Panel data methodology is used as it combines time series and cross-sectional data. The data is analyzed using fixed regression model to investigate the relationship between independent variables VD and CG with the dependent variable firm performance. Model is given as under:

$$FP_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 BL_{it} + \beta_3 CD_{it} + \beta_4 FS_{it} + \beta_5 PI_{it} + \beta_6 TA_{it} + \epsilon_{it} \quad (1)$$

where FP is the firm performance and is a dependent variable for firms i at times t . The independent variables are VD that is VD and CG as CG for firms i at times t and ϵ_{it} shows the error between the entity and ϵ_{it} shows the error within the entity.

3.3. Variables Descriptions

▪ Firm Performance Variables

Firm performance is measured by three profitability ratios i.e. Return on Asset (Core et al., 1999; Georgiou, 2010; Uyar, 2011; Yermack, 1996). Return on Equity (Brown & Caylor, 2004; Dar et al., 2011; Georgiou, 2010; Marston & Polei, 2004; Shaheen & Nishat, 2005) and earnings per share (Aboody & Kasznik, 2000L; Lang & Lundholm, 1993).

▪ Corporate Governance Variables

The independent variable is CG that is proxied by board size (total number of directors on the board) (Haniffa & Hudaib, 2006; Hermalin & Weisbach, 2003; Yermack, 1996). Board Independence (Number of independent directors on board divided by total number of board of directors) (Brown & Caylor, 2004; Gracia & Ballesta, 2010) and CEO duality (when board chair and Chief executive are the same people than 0 otherwise 1) (Bhagat & Black, 2002; Brown & Caylor, 2004; Yermack, 1996).

▪ Voluntary Disclosure

VD is an independent variable and is proxies by disclosure of future strategy and product information in the annual reports of the company (Albawwat & Baseh, 2015; Chau & Gray, 2002; Himrouni, Miloudi & Benkraiem, 2015).

▪ Control Variable

Control Variable is the natural log of total Asset (Iqbal & Javed, 2006; Shaheen & Nishat, 2005; Yasser, 2011).

4. ANALYSIS AND RESULTS

Table 1 shows the descriptive statistics of all the variables used in this study.

Table: 1 Descriptive analysis of dependent and independent variables.							
Variable	Mean	Median	StDev	Min	Max	Skewness	Kurtosis
Board Size	7.962	7.100	2.044	4	15	0.98	1.51
Board independence	0.406	0.412	0.248	0.34	0.96	-0.06	-0.99
CEO Duality	0.232	0.017	0.420	0	1	1.27	-0.36
Future Strategy	0.569	0.561	0.495	0	0.5	-0.28	-1.93
Product Information	0.438	0.023	0.496	0	1	0.25	-1.95

In the above table, board size indicates that it is almost 8 in size that is perfect for the great performance of the company. The CEO status result shows that about 23% of firms have the persons who occupy two positions at one time like the CEO and Chairman as well in the firm. Mean of Future strategy indicates that almost 57% of firms disclose the future strategic plans of the corporation voluntarily and 43% of firms provide products information of the company. Boards that are composed of at least 40% of

independent directors are more profitable for the firm.

4.1. Hausman Test

The Hausman specification test compares fixed and random effect models under the null hypothesis that individual effects are uncorrelated with any regressor in the model (Hausman, 1978). In this study by applying the Hausman test for the variables, we get the following results.

Table 2 Hausman Test			
	Test Summary		
Cross-section random	Chi-Square Statistic	Chi-Sq. d.f	Probability
Result for EPS	12.269	6	0.056
Results for ROA	12.408	6	0.053
Results for ROE	11.334	6	0.078

As the above Table 4.3 shows above chi-square statistic for EPS, ROA, and ROE as 12.269, 12.408 and 11.334, respectively. The first two results of the Hausman test concludes that Fixed effect is a suitable model based on the respective p-values while the third test for RoE indicate that random effect model is the suitable model for analysis on the basis of its p-value (0.078).

4.2. Regression Analysis

Regression analysis is considered as the most important statistical mechanism, which determines the impact of all independent variable on the dependent variable. It is composed of different techniques for modeling and analyzing the relationship between a dependent variable and one or more independent variables. The important table of regression analysis model for EPS, ROA and ROE through fixed and random effect models, respectively.

4.3. Fixed Effect Model

The following table presents the results of the fixed effect model. EPS is the dependent variable while board size, board independence, CEO duality, future strategy, and product information are independent variables. We control for the size of the firm based on the log of total assets.

Table 3. Fixed Effect Model for Earning Per Share

Variables	Coefficient	Std. Error	t-Statistic	Probability
Constant	3.662	0.527	6.955	0.000
Board size	-0.015	0.014	-0.345	0.785
Board Independence	0.353	0.123	2.960	0.003
CEO duality	-0.338	0.080	6.247	0.000
Future Strategy	0.031	0.057	0.639	0.601
Product information	0.114	0.055	2.100	0.036
Size	0.020	0.023	0.920	0.410
Adjusted R-squared= 28.1 % F-statistic = 11.061				

The results of model 1 show that there is a positive impact of board independence. The association is statistically significant. The coefficient of board independence indicates that with the increase of one independent director on board can increase 35 % earnings per share of the firm. Since the independent directors of the board are representatives of shareholders; therefore, they will go for decisions that are in the best interest of shareholders. The results are highly consistent with earlier studies (Bhagat & Black, 2002; Brickley, Coles, & Terry, 1994; Brown & Caylor, 2004). Moreover, independent directors tend to be more active in the management of the company, therefore management normally takes a decision in the best interest of shareholders that ultimately improves Firm performance.

CEO duality and Firm performance association are negatively and statistically significant. The coefficient of CEO duality indicates that one-unit increase in CEO duality enhances 33% performance of the firm. The separation of board chairman and CEO reduce the power of judgment of the CEO and increases the chance for the board to dig out wrong decisions if taken place. Prior literature also indicates the significance of CEO duality with Firm performance (Brown & Caylor, 2004; Goyal& Park, 2002; Iqbal & Javed, 2006; Latif et al., 2013 Yermack, 1996). The future strategy has no effect on the earning per share of these companies. The adjusted R^2 is 28.1% and F-statistic is 11.061 that shows that the model estimated is accurate.

Product information is positively associated with Firm performance. This study

indicates that with disclosing information about one product enhance the earning per share of the company by 11 %. The relationship is statistically significant as corporate VD help to improve Firm performance (Chau & Gray, 2010; Menon, 2015). However, board size and future strategy do not show any impact on earnings per share.

Table 4. Fixed Effect Model for Return on Asset				
Variables	Coefficient	Std. Error	t-Statistic	Probability
Constant	3.097	0.480	6.454	0.000
board size	0.023	0.015	1.510	0.127
Board Independence	-0.017	0.112	-0.215	0.780
CEO duality	0.104	0.073	1.431	0.153
Future Strategy	0.032	0.052	0.619	0.549
Product information	0.117	0.050	3.351	0.009
Size	0.005	0.021	0.330	0.719
Adjusted R-squared= 31%			F-statistic = 13.11	

The results of the fixed effect are shown for the return on the asset in the above table. The table shows product information is positively related to the return on asset. Their relation is significant. The indication of the coefficient is the same as for earnings per share that are with disclosing information about one product increases returns on an asset by 11% of the company. The relationship is statistically significant as corporate VD help to improve Firm performance (Chau & Gray, 2010; Menon, 2015).

Table 5. Random Effect Model for Return on Equity				
Variables	Coefficient	Std. Error	t-Statistic	Probability
Constant	5.345	0.721	7.412	0.000
board size	-0.028	0.023	-1.199	0.231
Board Independence	-0.008	0.154	-0.050	0.960
CEO duality	0.073	0.110	0.674	0.501
Future Strategy	-0.011	0.065	-0.162	0.871
Product information	0.102	0.065	1.562	0.119
Size	-0.042	0.031	-1.369	0.172
Adjusted R-squared= 26%			F-statistic = 11.19	

5. CONCLUSION

We came across the point that why do investors put their investment in firms and give it to managers when agency theory and other evidence suggests that managers have different intentions to expropriate much of it. An agency problem occurs in almost every market even in the developed ones. This is because investors have no skill and experience in running a business in comparison to highly skilled employees and management of the company. This is because of CG and SEC rules that affirms different responsibilities towards different parties involved in company operations and provides different important rights to the shareholders. Such regulations not only controlled the conflict but impact the firm's value as found in this study that Corporate VD plays a very important role in improving the Firm performance. It is concluded that in Pakistan VD and CG plays a dynamic role to increase Firm performance. VD is the additional information from the management to the outsiders that help them in their investment decisions. The key function of CG is to monitor and prevent the managers from expropriating the rights of shareholders. The study is based on the presumption that VD and CG affect firm performance. VD and CG impact on Firm performance in Pakistan. The outcome of the study shows that VD is very important in improving the Firm performance and CG is very important for VD. The variables used to explore the relation between VD and Firm performance is future strategy and product information.

The variables taken to explore CG with Firm performance are board size, board independence, and CEO duality. The outcome reveals those CG variables are significantly related to Firm performance. Board independence shows a positive link with firm performance. However, CEO duality is negatively linked with Firm performance. The result is consistent with developing countries. In Pakistan, the possible reason of high independence of board leads to excessive discussions and lack of real independence. Another reason can be that most firms are family and institutional owned therefore, mostly family members are appointed as directors. The study by Nishat and Shaheen (2005) also reports that for better performance of the firm there should be one independent director on board membership. The VD variables show a significant and

positive relationship with Firm performance. This is true in comparison with an earlier study (e.g. Chau & Gray, 2010; Menon, 2015).

Research Limitation

The results reveal that corporate VD are affected by board independence, product information, and CEO duality and governance quality. Since the change in the competitive business environment has highlighted and shed limelight on a number of important aspects of VD and CG which need to be integrated into the organization for better performance.

Future Research

This research provides the basis for the future research studies, however, due to small time span and budget, a number of important components and aspects of VD and CG are not analyzed. More future researches should be carried out integrating with other variables of CG and corporate VD so that they can overall bring improvement in the business environment of Pakistan.

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