The Influence of Corporate Governance to the Firm Performance in Logistics Industry

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Abstract

The transportation and logistics industry believe to be one of important sector that may influence the economy in United Kingdom. Due to the question for the growth in the industry, the paper was conducted to study the internal/external factors that influence the performance of the company. The paper would answer the objective question i.) To identify the variable that influence the performance; ii.) To analyze the performance which influenced by the risk. The quantitative method of research would analyze the 5 years annual report from 2013-2017 for Easy Jet plc. The stock price changes within the 5 years would be collected as well. The analysis would be carry out by using SPSS Stepwise regression method. The correlation results showed the credit risk had the negative relationship with the company performance while the coefficient showed the operating margin give the impact to the profitability ratio.

Keywords: *Profitability, Credit Risk, Liquidity, Macroeconomic, Corporate Governance*

CHAPTER 1

INTRDUCTION

1.1 Overview of The Topic

The logistics and transportation industry perform a significant part for the economy growth in a country. This connect to the export and import for the countries as well as the daily used for people like bus, train and so on. Without the industry the market could not be delivered physically, especially for the e-commerce activity. E-commerce become trend recently, people tend to shop online because the convenient they just click what they want, making payment online as well then just wait the parcel reached to house. Therefore, the demand for shipping service are increased as a complete of supply chain.

It could be said that the industry is important to the economy in United Kingdom because it make up the 5 percentage of the UK Gross Domestic Product (GDP). The business contributed about £55 billion to the economy of the country. The labor force for the transportation sector was about 1,721,000 in year 2017, 1,669,000 & 1,546,000 in year 2016 and 2015 respectively. It is within Top 10 among the jobs in UK for these 3 years. It showed that the number of workforce was increased with years.

1.2 Problem Statement

According to British International Freight Association (BIFA), the customers converted from other service providers account for more than half of the major sources of new services for logistics operators. 73% of respondents expect the industry's outlook to improve or remain the same, but nearly a quarter of respondents believe that the situation is more difficult. Therefore, there was a need to investigate whether the company is performing well and what are the conditions or factors that could affect it.

1.3 Aim, Objective and Scope

1.3.1 Aim

To analyze the corporate governance and the performance of logistics industry.

1.3.2 Objective

i. To identify the variable that influence the performance
ii. To analyze the performance which influenced by the risk

1.3.3 Scope

One company from logistics industry in United Kingdom which is Easy Jet plc. The evaluation and analysis through the 5 years annual report which within 2013-2017.

1.4 Outline of Report

The first chapter showed the concept of the whole paper. The problem statement expresses the main idea of the study and the objectives would be answer in the subsequent chapters.

Chapter 2 is the literature review which review on past study about the internal and external factors as well as the performance of company.

Chapter 3 would discuss about the framework of the study to derive the results and findings which could answer the objectives of the paper. The finding results would analyze in the next chapter.

Lastly, chapter 5 which discuss and conclude the results that I work for. Thus, answer the objectives.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

In the paper, the variables divided into two major elements which are the internal factors and external factors. It believes that the performance of a company could be impacted by the conditions. It would be elaborated in the following section.

2.2 Background

2.2.1 Internal factors

Internal factors refer to the elements within a company such as liquidity risk, operational risk, credit risk and corporate governance.

a. Liquidity Risk

Liquidity risk imply the ability of a company to convert the assets into cash at the appropriate value and the time. The liquidation would be costly if the company unable to covert the asset into a reasonable price at the favorable period. In other words, the liquidation activities could impact the cash flow in a company. In paper of Collis and Jarvis (2000), discussed that the operating and planning of day-to-day cash flow could be considered as the liquidity management.

The liquidity management could not only have an effect on performance for the company but also the reputation (Maaka,2013). It’s meant that the capability of the firm to meet their business commitment, if the company always meet the daily commitments obviously the reputation would be high or vice versa.

b. Operational Risk

Operational risk indicated the probability of the failure in process, human error, system and external events. It is the uncertainty of loss exposure from the operational error (Samad-Khan, A., 2008). The example proposed by Panjer (2006) consist of human error (fraudulent, fail to follow the rules &regulations), natural disaster and system error (IT support).

Basel Committee on Banking Supervision (BCBS) suggest a few methods to compute the operational risk which are Basic Indicator Approach (BIA), Standardised Approach (SA), Alternative Standardised Approach (ASA). The BIA is calculated using the average positive gross annual income of the previous three year with a certain percentage (15%). SA used the gross income times with its eight business lines, each of the line had the given percentage. While in ASA, the expected loss and unexpected loss would be computed, and the method could determine the potential damage from extreme cases.

c. Credit Risk

Known as default risk or counterparty risk, the company may default to honor the obligation which agreed between each other. The eventuality of the counterparty would not perform the contractual commitment to meet the obligation that has been stated (Bielecki & Rutkowski, 2013).

In the results of the paper of Atiya (2001) showed that the creditworthy would interrelated with performance of a company. If the creditworthy of a company is low meanwhile the capacity of a company is low as well. Thus, it indicated the performance of it which the profitability is low. It is positive relationship between creditworthy and the firm’s performance, the higher the creditworthy the higher the performance of the company. In other words, the higher the creditworthy, the less chances of counterparty or default risk.

The credit risk and the liquidity risk are interrelated because if the company does not have the appropriate liquidation activities, it may unable to make or honor the obligation like repayment on due.

d. Corporate Governance

Corporate governance demonstrated the system or guideline which directed the internal control in an organization. There is a direct relationship between the internal control and the profitability of corporation (Harford, Mansi & Maxwell, 2008; Gompers, Ishii, & Metrick, 2003). A good or strong governance formation will lead a better performance for a company.

The good governance structure could avoid most of the unfavorable events like fraudulent, conflicts of interest and so on thus reduce the unnecessary cost. As a result, the profitability of firm could be increased because the debt cut down.

In the study of Gompers et. al. (2003) the fulfillment of corporate governance was computed through the governance index, it would be applied and used in this paper as well.

2.2.2 External Factors

The market economy indicator considered as the external factors which included inflation rate, unemployment rate, interest rate, gross domestic product (GDP) and beta of the company. These could be referred to market risk as well, the systematic risk which could not be controlled or non-diversifiable risk.

Hendricks and Hirtle (1997) stated that market risk implies the volatility movement of the price of assets, liabilities or imbalance sheet position. Therefore, the performance of a company must affect since the entire market or economy would be affected as well.

In Dowd (2007) also stated that the factor of market risk is the volatile environment, the unreliability in economy conditions. And those volatility generally based on the stock price, exchange rate, interest rate and the commodity price.

2.2.3 Performance

The return on asset (ROA) nominal the performance of a firm. It can be known as profitability which evidence the company either making the profits. Therefore, the higher the ratio, the greater the performance of company. Meanwhile, the company wish to generate more income could reduce their expenses, cost or the debt to increase the rate of profitability (Waemustafa, W., and Sukri, S. ,2016). The ROA formula could be displayed as:

$$ROA = \frac{net\ income}{total\ assets}$$

The formula of ROA has been used in the Elyasiani, E., & Zhang, L. (2015) and Daft, R. L., Sormunen, J., & Parks, D. (1988) to carry out the study in their paper.

CHAPTER 3

METHODOLOGY

3.1 Introduction

This chapter was performing to make up the framework of study and deliver the response to the objectives question. The research design and the analysis method would describe and elaborate in detail for the following section.

3.2 Proposed Methodology/ Approach/ Design

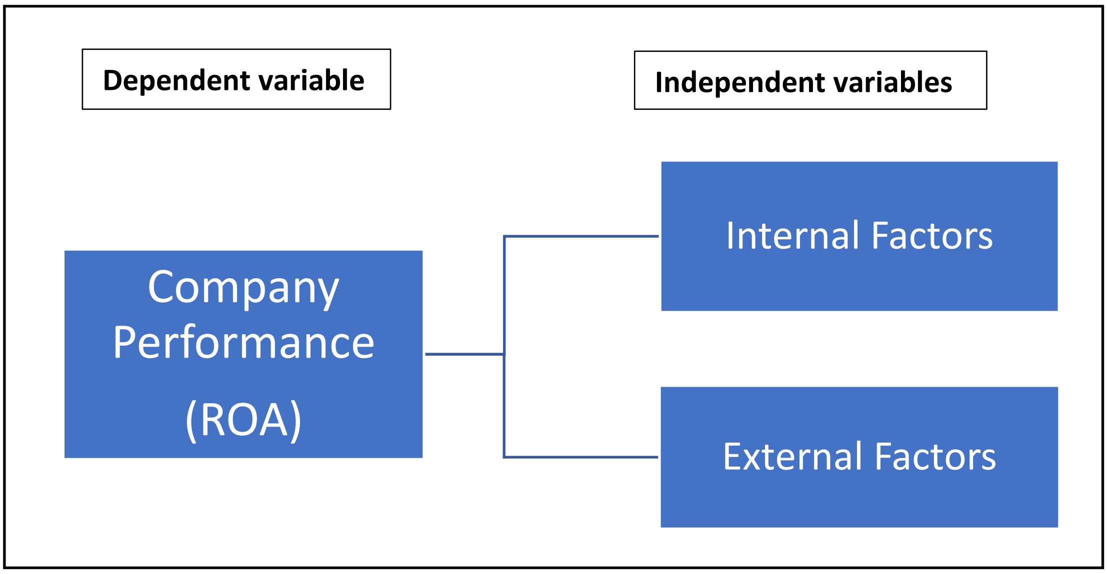


Figure 3.1 Research Framework

The figure above showed the framework that going to study about the paper. Which was the connection between the manifestation of the corporation and the internal as well external elements.

The independent variables would be construe in the following table:

Table 3.1 Independent Variables

Factors		Indicators
Internal factors	Company Performance	ROE
	Liquidity Risk	Current ratio, quick ratio
	Credit Risk	Average collection period, debt-income ratio
	Operational Risk	Operational ratio, Operating margin
	Corporate Governance	Index Score
External factor	Systematic Risk	Inflation rate, Interest rate, Unemployment rate, GDP, Beta

The quantitative method was used in the paper to compute the ratios, beta and collect other data such as the market indicators to carry out the analysis. The data collected from the 5 years annual report of the Easy Jet and the 5years economy indicators of the United Kingdom's market.

The data calculated by using Microsoft Excel and the analysis run through SPSS. The SPSS used to carry out the regression analysis using Stepwise method which the system helps to decide which variable to be included or removed and get the best results. Since the sample size is too small which only 5 less than 30, the Enter method cannot analyze the data very well.

The results presented into three tables included descriptive statistics, correlation and coefficient. The first table explain each variable through average and standard deviation show the variation among five years. Correlation showed the relevance between the independent and dependent variables either significantly positive relationship or vice versa. While the coefficient indicated the element, which give the impact to the dependent variable.

3.3 Summary

The chapter intended the flow of the paper which could figure out the respond to the objective question stated in chapter 1. It set the range for the research that help to easier the work of researcher.

CHAPTER 4

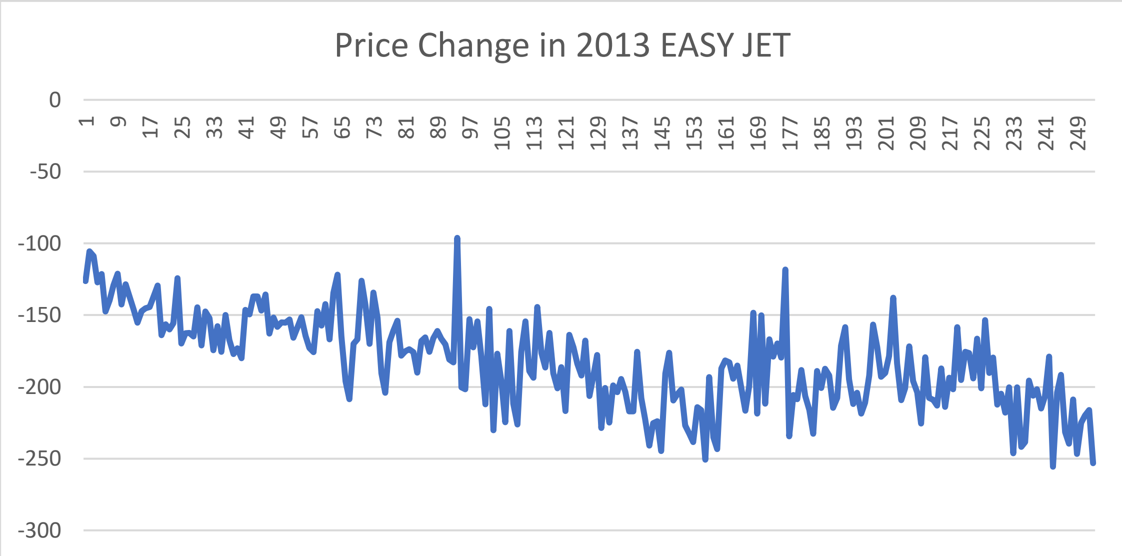
DESCRIPTIVE ANALYSIS AND FINDINGS

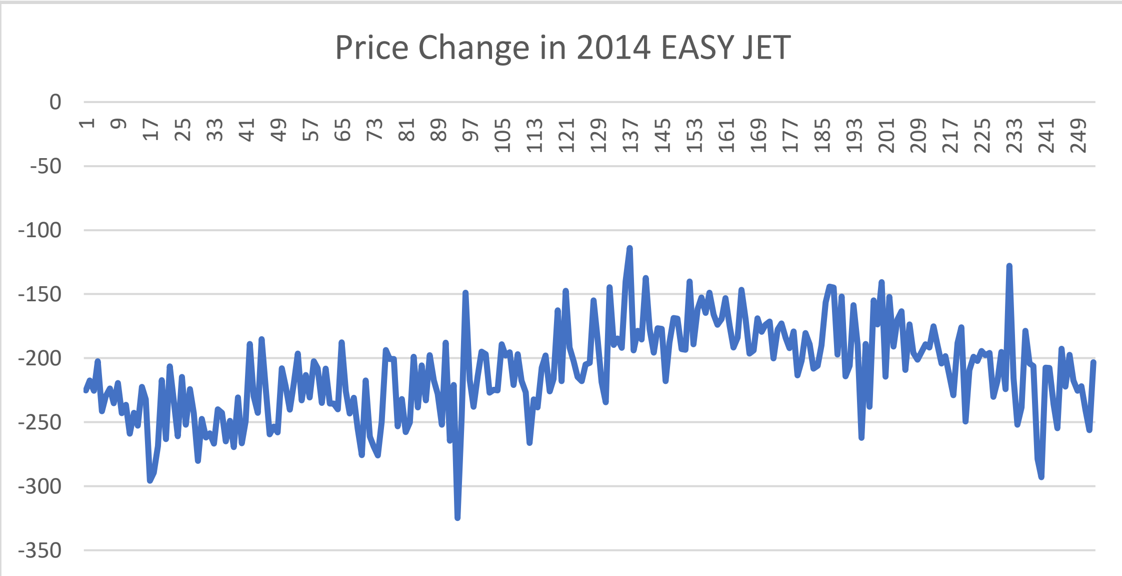
4.1 Introduction

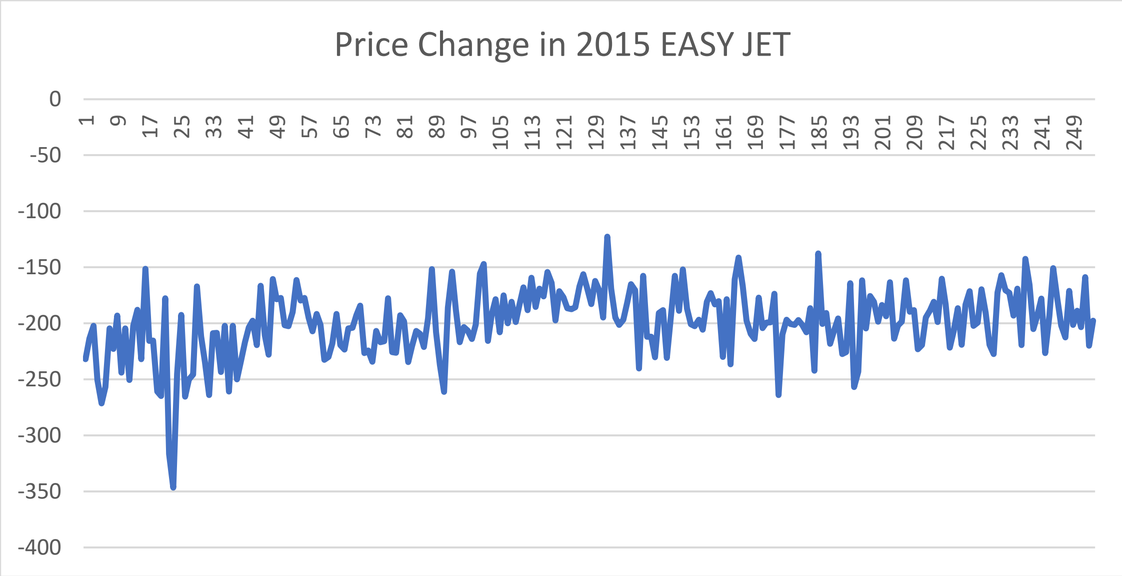
Since the sample size is only 5, the SPSS could not carry out the result by using Enter regression method. Therefore, the Stepwise regression analysis was used in the paper to get best results. The R square is about 98.8% that the dependent variable could be explained by the independent variable.

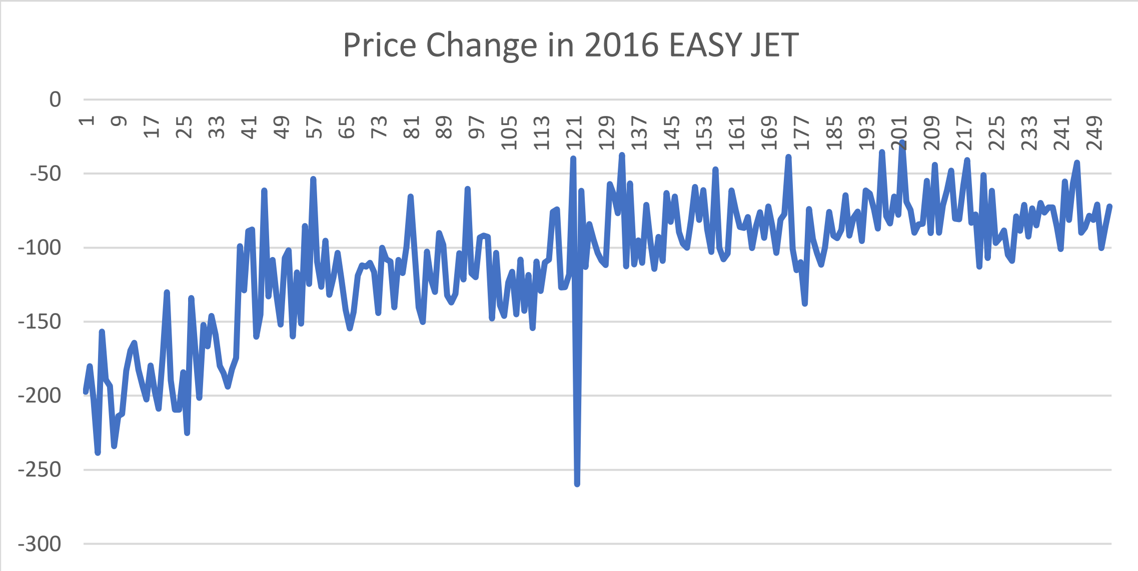
4.2 Findings

4.2.1 Price Change









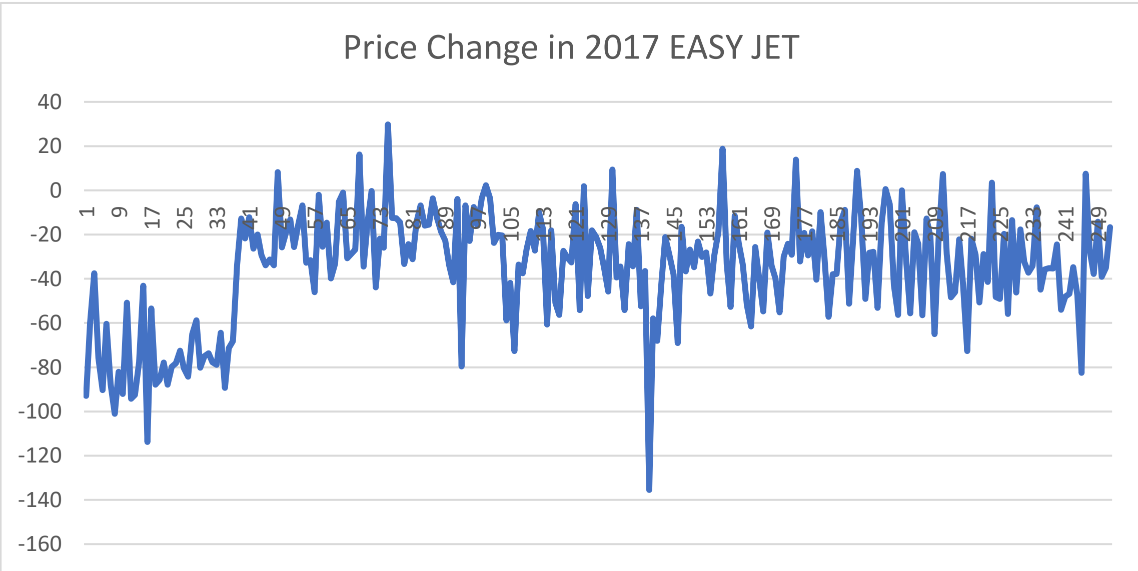


Figure 4.1 Price Change for EASY JET

- On 15 May 2014, minimum price change happened in Easy Jet because of the unexpectedly slow growth in the Eurozone and it makes more significant a new analysis by the Bank of England of the UK’s poor trade and terrible current account deficit. The recent account shows the difference between money received from the rest of the world and money paid to the rest of the world by UK residents.
- On 9 July 2015, maximum price change happened in Easy Jet because government of UK published the country’s first Road Investment Strategy. UK government will make a greatest investment on new surfaces for 80% of existing roads and better roads to airports and sea ports. UK expected to have strongest economic growth of any major advanced economy in the world. Thus, government could have the perfect excuse to cut capital spending on roads and other infrastructure. After all, road investment costs money we could use to reduce the deficit.
- On 18 October 2016, maximum price change happened in Easy Jet because of the return of higher levels of inflation. Once the figure for inflation rises above the figure for wage growth, at just over 2%, then incomes start falling in real terms. These also will pressures the UK on course to exceed the Bank of England’s target of a 2% inflation rate.
- On 27 June 2016, minimum price change happened in Easy Jet because UK economy in a position of strength. George Osborne has said the UK is ready to face the future “from a position of strength” and indicate there will be no immediate emergency budget. Despite the comments, the FTSE 100 extended losses with bank, airlines and property shares tumbling.
- On 20 July 2017, maximum price change happened in Easy Jet because the council discuss the importance of steps that can be taken to boost productivity, investment and keep the economy of UK strong. They also discussed ways to build business and consumer confidence within society.

4.2.2 Index Score

Table 4.1 Index Score

	easy jet	*2013*	*2014*	*2015*	*2016*	*2017*
Nationality	Foreign	1	1	1	1	1
	Local	1	1	1	1	1
Qualification		1	1	1	1	1
Gender Diversity		1	1	1	1	1
Female		2	2	2	2	3
Shariah Supervisory Board		0	0	0	0	0
Risk management Committee		1	1	1	1	1
Audit Committee		1	1	1	1	1
Remuneration Committee		1	1	1	1	1
Size		1	1	1	1	1
Actual size		10	12	10	9	9
Meeting		1	1	1	1	1
Actual meeting		9	8	9	9	10
experience		1	1	1	1	1
Total score		9	9	9	9	9
Index score		0.9	0.9	0.9	0.9	0.9
Remuneration (BOD) £'000		10,907	12,570	7,410	3,522	2,592

The table above showed the governance index of Easy Jet which indicated it had a good corporate governance which meet the principles of corporate governance.

The independency, the experience which refers to the number of board of director (BOD). If there is more than 3 independence director, it will score 1. It illustrated that the company could reduced or avoid the conflicts of interest based on the two-tier board. Moreover, the separate committee which could provide a clear duty to each director.

The committee distribution could be explained the accountability as well, because the actions or any decisions must be accountable to the board by the management and the board should be accountable to the shareholders who are the owners of the corporation. And the number of board meeting, that indicated the boards would deliberate to get best decision to ensure the shareholders' benefit.

Fairness, it refers to the diversity of board rather than the shareholders' right in the paper. The female director is about 20% of the number of director for the previous few years and in year 2017 it increases to 30 %. It showed the fairness in gender as a corporation.

For the transparency, it could refer to the annual report announcement. The financial position, cash inflow/outflow, the decision making and so on must be clearly disclose in the annual report of the company. It may increase the reputation of firm as well, due to the confidence of the company.

The remuneration of board is fluctuated due to the shift in human affairs, the old directors resigned, and the new directors be appointed. It deems that the amount of remuneration could affect the company performance. Because the humanity, the people typically work for their self- interest. So, the higher the remuneration could push the directors to work hard for the company hence to ensure the interest of the shareholders.

The overall index score for the company is high which closest to 1 and it is believed that the good corporate governance could lead a good performance for the firm.

4.2.3 Descriptive Statistics

Table 4.2 Descriptive Statistics

Descriptive Statistics

	Mean	Std. Deviation	N
ROA	.087222055700000	.022594067000000	5
CURRENT RATIO	.881716717000000	.121165517000000	5
QUICK RATIO	.877798548000000	.122261418000000	5
AVERAGE-COLLECTION PERIOD	16.895950190000000	1.564880282000000	5
DEBT TO INCOME	.569840758000000	.045158320500000	5
OPERATIONAL RATIO	.828094448000000	.020648949700000	5
OPERATING MARGIN	.116669331000000	.023243031000000	5
INDEX SCORE	.900	.0000	5
REMUNEARATION	7400200.00	4392715.470	5
BETA	33.153929120000000	6.539727573000000	5
GDP	.022400	.0051769	5
INFLATION	.01484940	.011560571	5
UNEMPLOYMENT RATE	.057000	.0125300	5
INTEREST RATE	.0042500	.00111803	5

The table describe the variables through the average value among 5 years and the volatility between each other. The ROA is 8.72% in average which it could make around 9% profit from its assets and the variation among the is low.

The liquidity ratio is about 0.9 times and there was a narrow change within the five years. It showed the ability of company in managing the asset and liabilities. It is quite insufficient because there is around 0.88 of asset could cover the 1.0 liabilities. The company still need to improve the asset-liability management.

The credit risk ratio which was the average collection period showed an efficient in collecting debt. It was only take about half month to receive back the due. The debt to income ratio showed a good condition in Easy Jet because the debt of the company was probably half from the income, means that the company had the ability to make the repayment on debts.

The operating ratio indicated the effectiveness of the company operational environment. The higher the ratio, the inefficient operation in a company. The average of this company is quite high but still acceptable because is it not about 1.0. While the operating margin demonstrated the scale of income that cover the non-operating expenses such as the interest payment. Hence, it could reveal the riskiness of the company as well. The mean of operating margin was only 0.12 it showed that company had the ability to meet the obligation.

The average beta was quite high it indicated the higher volatility in the stock price. The GDP, inflation, unemployment and interest rate were 2.24%, 1.48%, 5.7% and 0.425% respectively. Because it was the economy indicators, therefore there was not much different among the years.

4.2.4 Correlation

Table 4.3 Correlation of ROA

Correlation

		ROA
Pearson Correlation	ROA	1.000
	CURRENT RATIO	-.187
	QUICK RATIO	-.213
	AVERAGE-COLLECTION PERIOD	-.921
	DEBT TO INCOME	-.857
	OPERATIONAL RATIO	-.971
	OPERATING MARGIN	.994
	INDEX SCORE	.
	REMUNEARATION	.690
	BETA	.122
	GDP	.646
	INFLATION	-.637
	UNEMPLOYMENT RATE	.483
	INTEREST RATE	.645
Sig. (1-tailed)	ROA	.
	CURRENT RATIO	.381
	QUICK RATIO	.365
	AVERAGE-COLLECTION PERIOD	.013
	DEBT TO INCOME	.032
	OPERATIONAL RATIO	.003
	OPERATING MARGIN	.000
	INDEX SCORE	.000
	REMUNEARATION	.099

BETA	.422
GDP	.120
INFLATION	.124
UNEMPLOYMENT RATE	.205
INTEREST RATE	.120

The correlation showed the relationship between the ROA, internal factors and external factors. The results illustrated the average collection period, DTI, and operational ratio which had the p-value less than 0.05, had the significant negative relation with ROA. Meanwhile, the increased in collection period/ DTI/ operational ratio, would caused the ROA decreased.

While the operating margin and index score expressed the significant positive relation with ROA. The increased in operating margin and index score, the ROA would be increased as well.

4.2.5 Coefficients

Table 4.4 Coefficient of ROA

Model		Standardized Coefficients Beta	Sig.
1	(Constant)		.039
	OPERATING MARGIN	.994	.001

Based on the Stepwise method result, the operating margin give the impact to ROA. It revealed that the company wish to increase the ROA or profit, they need to increase the operating margin. Meanwhile the company need to increase the operating profits,

4.3 Summary

Since the sample size in the study is small the analysis could not explain the results as a whole idea, but the R square showed that the variables be could explained with 98% in this model. The findings not only regard to the SPSS results but also the price change and index score based on the stock market and the proxy report of the company.

CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

In the paper, its aim to investigate the relationship between corporate governance and the company performance. The findings result in the previous chapter would be discussed in the subsequent section. the limitation and recommendation would be pointed out as well as suggested in this chapter.

5.2 Conclusion

As stated in the first chapter, the paper aspires to study about the relevance within the variables. The coefficient result showed the operating margin had the impact on ROA significantly, it had answer the objective question i.) To identify the variable that influence the performance.

For the second objective question ii.) To analyze the performance which influenced by the risk. It showed in the price change (section 4.2.1) the changes in economy which could be consider as the market risk would affect the stock price directly. The correlation results also expressed that the credit risk increased, the ROA or the performance of company would be decreased.

In a nutshell which based on the results, the mostly influence to the company performance was the day-to-day operation. The well operation management could reduce or avoid the unfavorable happened, and quickly detect the problem before it occurs or become worst. The cost of maintenance could be reduced or avoided. Hence, the income of the corporation would be increased.

5.3 Limitation and Recommendation

The limitation in this study probably to be the sample size, as the recommendation for the future researchers, the observation should take more year's annual report to increase the sample size to at least 30 or select more than one company in the same industry.

The research could only based on the historical data like annual report, stock price, economic indicators and so on, it could not 100% ensure the results would be explained the future performance of company. The future researchers could find the alternative way to get the most appropriate results of study. It could take more time for doing the investigation. Since, this paper was only take about 2 months to complete. So, there would be some variables or conditions have been overlooked.

The future researchers should comprehend and familiar with the application software development in order to get clear idea on data and avoid the human error when using software application.

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