

THE ROLE OF CORPORATE GOVERNANCE ON THE PERFORMANCE OF PAKISTAN TEXTILE INDUSTRY

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ABSTRACT - *The performance of corporate sector is all important in the development of both developed and developing countries. The industries are considered as revenue generation resources of any country and all corporate activities clustered around the industries performance, specially the textile industry shares major portion of GDP of Pakistan. Pakistan is a leading exporter of goods produced by textile industry. The fabrics production by this vital important industry is widely appreciated by different countries of the world. The main objective of the current research study is to evaluate the meaning of corporate performance within the context of Government policies in wake and it is a dire need to present the corporate governance operations and firm performance accordingly. The problem in recent decades faced by economy of (Pakistan) is the core objective of the issue under investigation, the setback in the corporate sector due to performance of corporate governance resulted in reduction of investment either local or foreign. This study is designed to investigate co-relation between firm performances and corporate governance. Research results show that 85% separates the role of leadership during 2008 in Pakistan Textile industry, while this role has decreased to 80% in 2009.*

KEYWORDS: Corporate Governance, Pakistan Textile Industry, Firm Performance, Economy Sector.

1. INTRODUCTION

It is now obvious that the performance of the corporate sector is all important in the development of both developed and developing countries. The well known reality that the efficiency of the corporate sector is an important determinant to gauge out the firm performance also as a custodian of interests of stakeholders has enhanced the world point of view about this crucial topic. We all know the method of functioning of the corporate sector is altogether different in all along the globe; it totally depends upon the socio-political environment of the related country. The social laws have been made and being amended as per societal change taking place in the society. We have lots of examples regarding the nature of developed and developing countries and their way of treating to the corporate sector. One can easily predict about it, the developed countries would be friendly towards corporate sector and their policies would be attractive to attract the attention of investors and in developing countries due to the difficult environment because of unstable social and political situation are the key ingredients of underdeveloped countries. As a conclusion, we are in a position to predict about the operation of a firm which is a part of a developing country like Pakistan, would face more problems as compared to the firm working in developed countries. Another worthy determinant in the way of firm performance is the availability of power at all times and most importantly at cheaper rates. The current corporate sector performance is hampered by shortage of energy to run the economic wheel of industrial sector.

The industries are considered as revenue generation resources of any country and all corporate activities clustered around the industry's performance, specially, the textile industry shares a major portion of GDP of Pakistan. Pakistan is a leading exporter of goods produced by textile industry. The fabric production by this vital important industry is widely appreciated by different countries of the world. The main hurdle in the way of progress of textile industry, but also overall industrial sector of Pakistan is lawlessness and

lack of political will to give tax holidays to promote the working of this industry and consequently a healthy step for this important sector of the economy. According to various think tanks this century belongs to Asia also the focus of attention of world great powers is towards the Asian countries like China, India and Pakistan. It is a golden opportunity for Pakistan to cash it because of its geographical location on the map of the world to double the profit ratio. It is a great time for developing country like Pakistan to rehabilitate its area to avoid ruin [1]. In order to be successful, there is a dire need to reframe the economic policies to ensure the development at large scale; it would give a valuable place in shape open market for goods and will help out Pakistan in saving the capital which is crucial for the survival of any economy.

The administrative and institutional framework in Pakistan is not satisfactory the day to day unpredictable fluctuation in prices of oil, gas and other energy resources have declined the progress of this sector. The overwhelming increases in macroeconomic issues have encouraged the investors to flee out country to those economies which are friendly to them. The point to ponder is what is the reason behind the current position of textile industries of Pakistan in spite of all above mentioned problems, what is the stimuli behind the reasonably good performance of textile industry even the conditions seem not well.

The study will explore the efficiency of governance of corporate sector under the umbrella of textile industry of Pakistan. The objectives of the study are two prongs; first to judge the efficacy of governance of corporate sector and second will attempt to explore the structure of corporate board, corporate coverage and excellence of work. In the end study analyzes and find out the way to make the stakeholders accountable through proper coverage through reporting technique.

The concept of free market economy emerged vigorously in the wake of 1999, it was a good advancement to accept the new trends to get par with the rest not completely but enough

achieved good results for the world in the field of economy. Recent progress from the part of the Government is appreciated by declaring our beloved country liberal and democratic. Pakistan is now progressing good in the area of textile industry for eliminating poverty. Various organizations like Al-Karam mills; Mehmood Textile mills; Shabbir Fabrics; Chinab Mills; Five star Textile Mills; and many mills are where the recent Government has attracted the attraction of worthy investors.

As per the report of India Today (2006) Pakistan is positioned at a worthy place with respect to the stock market. The stock sale in the market of Pakistan is far better than the previous year, which was fifteen times improved one. It is also obvious that the law and order situation was also unfavorable to the investment [2]. When we compare it with the statistics of companies in the capital of MORGAN, not including Japan (Asia Pacifica) sold indices were seventeen times less than to average of the last 5 years as compared to current year. Even at the end of sectarian conflict happened in 2009 the average stock market ratio, reported as far better than the previous record of the stock market performances in the world context Daily News (2009).

The international monetary organizations are consistently engaged in for the promotion of better performance of overseas investment and also like to attract the local investors to bring them in investment, net the organizations like IMF, World Bank are important in this regard. New industrial codes were introduced during 1990s to tackle the financial matters related to the operations of the industrial sector to impart the effective performance.

1.1 Corporate Governance Practices and Firm Performance

The main objective of the current research study is to evaluate the meaning of corporate performance within the context of Government policies in wake and it is a dire need to present the corporate governance operations and firm performance accordingly. Cadbury [3] described corporate governance in the following words, a method to organize and control the affairs of the organizations and also directed by Government authorities to operate. It is to hand over the set of responsibilities to and related duties to Board of directors of the companies to regulate the affairs of the firms efficiently; also to entertain the stakeholders with best promises to share their assets to widen the value to assets of the organization. Another definition is given [4] procedure by which stakeholders stimulate managerial staff to perform in the best interest of investor, invoking the confidence of persons going to invest in the firm providing the place to market the goods to earn revenue [5].

Normally Governance issues of corporations are considered prominent as they manifest revenue for the country and share significantly in the enhancement of Gross National Product. The good but friendly environment e.g. special concessions in Tariffs, Tax holidays is kick on this sector minimizes the risk of under capital threats in the economy, consequently encouragement for investors from the world [6]. In contrast favorable co- relation between the domestic investors and revival of foreign investors, he predicted that local investors are source of induction for the overseas investors to invest in the local market.

1.2 Research Model

After conducting the rigorous literature review the study is intended to find out the relationship between the performance of firm with respect to corporate Governance strategies and policies in the best interest of the shareholders. This portion of the study emphasized on the theoretical framework, providing the theoretical base to the research study. The study is composed of stakeholder theories, agencies and stewardship to evaluate co- relational between firm performance and corporate governance in the Textile Industries of Pakistan. In this framework, corporate governance variables are Employees satisfaction and market value, customer satisfaction and profitability would be dependent variables while social and environmental performance would be Profitability, Customer Satisfaction, Employee Satisfaction and market value) appear as dependent variables whereas environment performance and social performance are intervening variables. The performance of the organization will be gauged with respect to market and accounting based measures.

The importance of corporate governance is escalating day by day in the recent years; especially in form of control by the directors employed by the board. Consequently, the research work done in the line of agency theory is responsible for the work done by the different researcher is the outcome of this particular theory. Initial work of [7] on this topic concentrates on the main issues arises from varied partnership in the recent ownership patterns. According their perception the governance is a matter of discussion where the placement and designation of directors of the prescribed board is a tool to mitigate the core issues if arises between agent and the owners. Meanwhile, agents are those persons who manage the overall process of the firms. The management and ownership are like the wheels of the car which cannot be separated at all, if deficiency is occurring in one part the part cannot move on single handedly. Similarly is the case with the stakeholders and management. It is assumed that if the management and shareholders are on the same page, then the probability of success and profitability is maximum otherwise, the firm has to wait for some good luck to continue with the positive results.

Steward theory is altogether different to that of agency theory in its practical application also the way out presented by both directs opposite ways [8]. The building of steward theory is based on the executives and psychology of the society. The theory which advocates the inclusion of the manager's interest is directly linked to the success of their respective firms. So the concept presented by the steward theory is in the best interest of the shareholders. Fundamentals of stewardship theory are based on social psychology. The steward is always looking for to satisfy the stakeholder's interest in the firm which is the part of the organization. In the view of steward model of corporate organization the success of the firm lies in the best interest of the stakeholder satisfactions and this is the reason behind the inclination of steward towards the stakeholders as well. Steward model organizes the wealth of firm by maintaining the relationships between stakeholders [9]. So; corporate governance has to make the firm under control and accountability.

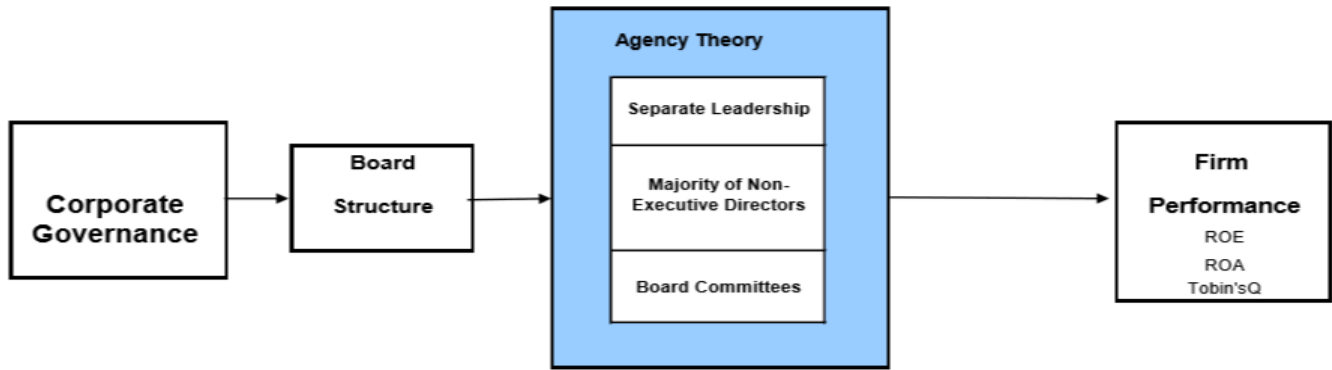


Figure 1: Corporate Governance and Firm Performance

1.3 Problem statement

The problem in recent decades faced by the economy of (Pakistan) is the core objective of the issue under investigation, the setback in the corporate sector due to performance of corporate governance resulted in reduction of investment either local or foreign. This study will try to explore that how the corporate governance affects the efficiency of the Industrial sector specially Textile industry of Pakistan? However the efficiency of the corporate governance structure and practice of a corporation working in the highly unstable environment of Pakistan has not been empirically inv tested. For that reason, to know the governance practices which contribute to boost up the significance of given textile industry in Pakistan, the study designed to:

Investigate the usefulness of corporate governance practice; which induces firm act last impact in process of answerability to stakeholders and with the help of feasible reports produced to multiply the worth of textile industries of Pakistan given the list above.

1.4 Research Question

What is the correlation between the firm performance and governance of the corporate sector?

What is the significance of textile industry in term of its impact on the whole of performance of the corporate sector?

1.5 Hypothesis

RH1: It is more likely that divided leadership pattern in the firms is strongly associated with the firm performance.

RH2: It is more likely the board having non-executive in majority would be negatively linked with performance of the firm.

1.6 Significance of the Study

The research work would manifest and coordinate the already literature available on corporate governance and its impact on performance of the firm. The study is significant in term of its impact the corporate sector specially the textile industry of Pakistan is a key determinant to measure the GDP of the country so, any study related to it will be regarded a special position in the area of research. We all are very well known that corporate governance is a factor which govern and regulates the affairs of the industries and conversely it is run by government machinery, the good relationship between

them will enhance the efficiency this sector and consequently will put the country on the way of economic progress. In the light of above given advantages of study one cannot ignore the importance of the importance this study. The study will make efforts to explore the theoretical work and will present the key notes for both sectors to do its best performance.

- The study is designed to investigate co-relation between firm performances and corporate governance.
- To find out impression of Pakistan’s’ textile industry on the whole performance of corporate sector.

1.7 Delimitation

This will be the earliest study which considers the sound effects of governance of corporate sector of Pakistan under the light of Textile industry coverage on the worth of firm in a underdeveloped marketplace in which the basic object is unstable environment of politics conversely prospects of high level growth ratio.

2. LITERATURE REVIEW

With the emergence of globalization in the wake of 1970s the concept of capitalism got pace which was not evident in the past decades. Along with the globalization capitalism is attached firmly because in order to invest in the firm’s they need the investors and capitalist the best investor in the word [10].

Nineteen century brought the pool of investors in merged form, among the one thousand investors The east India company (Dutch) was the eminent on for the number of investors in it. Due to inventions and advancement in the line of technology the new market paces became prominent all along the globe. No doubt it brought capital in the markets and investment as well. The corporate governance has to go through from different forms of changes during the last few decades.

Now a day’s management of the corporate is not simple to be handled easily but it is complex one. It encompasses the rules and regulations, codes, professionalism, institutionalization, politicization etc. Although these characteristics are still not found in the developing or progressing countries. The structure of governance in under developed countries is ambiguous, the political inclusion politicization of institute is a common practice so, and it is a one obstacle in the way of

smooth and proper administration of developing countries. The system of judiciary is bleak to safeguard the rights of business community. This is the reason that most of the potential investors are leaving the Pakistan economy. Pakistan in recent years is facing so immense wave of terrorism and extremism which is directly responsible for the flight of capital. Low level of structure of judiciary and more importantly the process of investigation is very weak here in developing countries like, Pakistan.

Governance of corporations includes many levels of structures of the system of the firms. Government machinery contains land, labor capital and investment also the place to display the goods for sale called market. The regulating authorities have to make the plan and procedure also have to devise the mechanism which ensures the management process and makes the accountability possible. The norms and codes are set by the authorities to move the management system efficiently and effectively [11]

A conception about the concerned topic, the researcher called the governance as a set of rules and regulations and ways to attract the attention of the potential investors in the country also the ownership is the part of procedure of the firm and its success is dependent on them.

Corporate sector area is recognized as a matter influenced inward as well as outward. The outward system is eminent in the countries which already have got the success and are considered in the list of developed countries like China, Canada, and Australia etc. The ownership pattern in these countries is varied one means is not static, where liquid asset are available in the market place. The inward process is the example of the relations centered economy like European Union and Asian markets where the shareholders are controlled by the economic laws introduced in the system of Government. The levels of transparency in markets where liquid securities are available and where economy depends upon the financial institutions help are called controlled markets.

Union of a provincial governance system among frequent generalized rules have made major differences which show that with what principles used and interpreted the value of stakeholders in the attraction of the shareholders and local as well as the international investment towards the economy. It encourages the positive but constructive environment suitable for the overall performance of the economy [12].

Rezaee [13] called the corporate sector governance a course the regulatory authorities bound the management through legal cover to act in the best line of judicial system; any violation thereof is given punishment through a legal process. It is devised to move the economy smoothly because without it the monopolist's organization can damage the interests of financially weaker organizations.

The governance structures referred to in the previous section are based on corporate governance principles. There is no globally accepted set of principles that can be applied to board structures. The principles of corporate governance have been developed as guidelines rather than rules which could be used across different countries and markets [14].

During the 1990s codes introduced due to consequences of

failure of corporate sector. Suggestions were made to amend the system and structure of the board to ensure the accountability process within the organizations. The whole struggle clustered around to satisfy the stakeholder's intent [15].

The revision was made in the codes of OECD of corporations in 2004. It was an attempt to help out the authorities engaged in management process of firms under their control. Legal representation through legal advisors was the objective of the amendments [16].

3. METHODOLOGY

There are several studies have been done in this line of direction in order to investigate the governance practices and their impact on the overall performance of the firm (Textile industry of Pakistan). The present study has adopted the method of investigation as that of the methods used in the past, which were to investigate the impact of corporate governance on firm performance. The conceptual framework of this stands on the deduction procedure and quantitative data gathering technique was used to analyze the data that is collected from secondary sources.

The co-relation among the variables and performance of the firms under study is the basic objective of the study. Five textile industries of Pakistan were chosen as a sample of the study. SPSS software package is a tool of data measurement.

For the fulfillment of the objective of the study, which is to investigate the how the corporate governance can last impression on the best or bad performance of the firms (textile industries of Pakistan), especially in the years 2008 and 2009. Descriptive data was utilized to measure up mean value and statistical tool (T test) was used to sum up the degree of difference between the means collected in these two years.

3.1 Data Analysis and Interpretations

The major variables of Pakistan textile industry for the year of 2008 and 2009 are described below:

Table 1: Major variables of a Pakistani Firm.

| Variables | 2008 | | 2009 | |
|---------------------|--------------------|------|--------------------|------|
| | Minimum Minimum | Mean | Minimum Minimum | Mean |
| Separate leadership | 0.001 .83 | 1.00 | 0.00 .810 | 1.0 |
| Board composition | .28 .60 | .92 | .21 .68 | .91 |
| Board committee | 0.02 .58 | 1.00 | 0.01 .78 | 1.01 |
| Return on Equity | -13 14.43 | 45 | 3 21.73 | 97 |
| Return on Assets | -39 43 | 24 | 1.01 7.38 | 37 |
| Tobin's Q | 062 0.99 | 2.08 | 0.58 1.26 | 4.39 |

Table 2: Comparison of Mean (Board characteristics) Values for 2008 and 2009

| Variables | 2008 | 2009 | Value(Z) | Sig. | Mean sig. |
|--------------------------|-------|-------|----------|-------|----------------|
| Leadership structure | 0.83 | 0.80 | 0.738 | 0.704 | No significant |
| Composition of the board | 0.62 | 0.66 | -3.066 | 0.003 | .05 |
| Committees | .58 | .77 | -4.334 | .002 | .05 |
| Return On Equity | 12.42 | 20.75 | -5.122 | .0021 | .05 |
| Assets Return value | 2.60 | 9.36 | -3.540 | .010 | .05 |

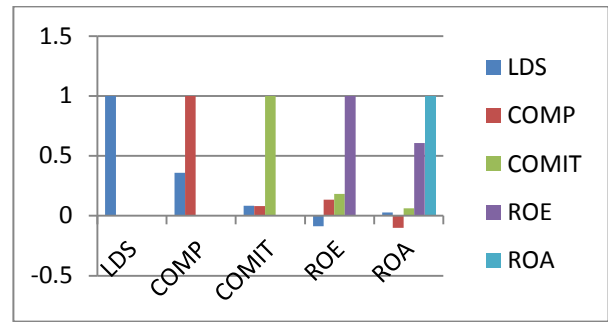


Figure 4: Correlation for the year 2009

3.1.2 Analysis of variance and firm performance.

Table 5: Corporate Governance and Firm Variables for the year 2008.

| Corporate Governance Variable | Firm Variable | 2008 F | sig |
|-------------------------------|---------------|--------|-------|
| Leadership structure | ROE | 0.398 | 0.551 |
| Leadership structure | ROA | 2.788 | 0.146 |
| Leadership structure | ROE | 0.723 | 0.728 |
| Board composition | ROA | 1.135 | 0.473 |
| Board composition | ROE | 0.199 | 0.672 |
| Board committee | ROA | 1.674 | 0.243 |
| Board committee | ROE | 1.498 | 0.267 |
| Board committee | ROA | 4.932 | 0.068 |
| Leadership composition | ROE | 0.036 | 0.856 |
| Leadership composition | ROA | 0.229 | 0.963 |
| Leadership composition | ROE | 1.220 | 0.412 |
| Leadership composition | ROA | 0.346 | 0.905 |

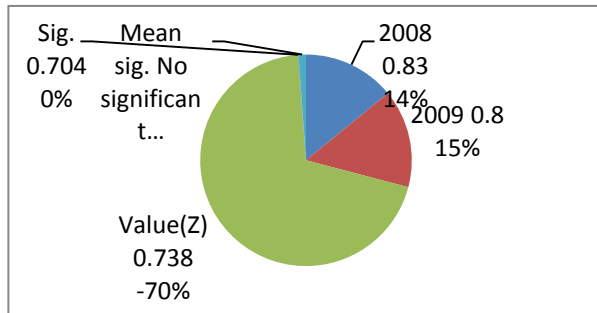


Figure 2: Comparison of Means

3.1.1 Correlation (Spearman)

Table 3: For the year 2008.

| | LDS | COMP | COMIT | ROE | ROA |
|-------|------|-------|-------|------|-----|
| LDS | 1 | | | | |
| COMP | .059 | 1 | | | |
| COMIT | .085 | .292 | 1 | | |
| ROE | .096 | .118 | .349 | 1 | |
| ROA | .028 | -.249 | .044 | .585 | 1 |

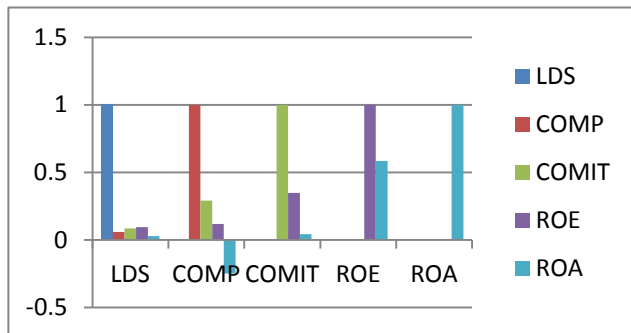


Figure 3: Correlation for the Year 2008

Table 4: For the year 2009.

| | LDS | COMP | COMIT | ROE | ROA |
|-------|-------|-------|-------|------|-----|
| LDS | 1 | | | | |
| COMP | .360 | 1 | | | |
| COMIT | .085 | .080 | 1 | | |
| ROE | -.086 | .134 | .182 | 1 | |
| ROA | .029 | -.101 | .062 | .608 | 1 |

Table 6: Corporate Governance and Firm Variables for the year 2009.

| Corporate Governance | Firm | 2009 |
|------------------------|------|-------------|
| Leadership structure | ROE | 10.78 0.011 |
| Leadership structure | ROA | 0.134 0.724 |
| Leadership structure | ROE | 14.08 0.000 |
| Board composition | ROA | 2.458 0.096 |
| Board composition | ROE | 2.332 0.002 |
| Board committee | ROA | 3.055 0.119 |
| Board committee | ROE | 3.290 0.079 |
| Board committee | ROA | 1.276 0.346 |
| Leadership composition | ROE | 3.450 0.072 |
| Leadership composition | ROA | 4.157 0.076 |
| Leadership composition | ROE | 0.026 0.876 |
| Leadership composition | ROA | 7.287 0.027 |

4. RESULTS OF INTERPRETATION

RH1: It is more likely that Separate leadership structure is strongly associated with the firm performance.

Results are described in the table no.1 explains that 85% separates the role of leadership during 2008 in Pakistan Textile industry, while this role has decreased to 80% in 2009. About 81% of the firms have given separate but important position by separating the scale and position chief executive officer of the firm. The results of table no.2 were not significant to the hypothesis. Spearman correlation analysis was shown in the table 3. Table no.4 includes the level of significance at 5% in 2008, so results are significant with the first hypothesis.

RH2: It is most likely a majority of non executive directors on the board are negatively linked with performance of the firm.

The results of second hypothesis are distributed in the tables; the major textile industries of Pakistan have increased the number of non-executives in Boards during the study period. The results of t(test) represented by table 2 while table no.3 the results of variance are shown by table 3 and table 4 described the level of significance at 5% for non executive representation in the board of directors. The results are non concurrent with the second hypothesis as second hypothesis was a prediction that non executive directors in the board are negatively linked with the firm performance.

5. CONCLUSION

From the study it is concluded that the corporate governance has a direct impact on the firm performance. The results of the study are concurrent with the predictions posed by the researcher earlier that the firm management is very much responsible about the overall performance of the firms especially the selected sample of the study, textile industries of Pakistan. It is evident from the available literature on the topic under consideration that board performance is effective tool to boost up the financial performance of the firms. The structure of the board as well as the major decisions made by the executive authorities is regarded by the employees over there and if they did any mistake in decision making can be detrimental for the financial success or failures of the companies.

It is evident from the work done by the researcher that there is magnificent alignment between the overall performances of the firm when compared with the cooperation level of the corporate sector. The person either directly or indirectly employed by firms is likely to influence the performance. Especially executive and non executive directors. The board committees are also the major role in the complete process of the organizations. There is need to completely overhaul the condition of the textile industry of Pakistan with respect to corporate performance due to corporate governance. Good but quality governance can enhance the economic condition of the industry, conversely which has the ability to put the economy of Pakistan on the right direction.

Mostly the companies having high value of return on assets and better equity statistics have turned itself into partnerships where they can make its business inventories fluent across the borders. The suitable and friendly environment towards the business activities produces the probability of good performance and bad performance lies on the side of bad governance. In addition to this, in Pakistan the stock market values are varied by the external investors and local investors are being deprived of local business profits. This why, the

conclusion is obvious that flight of capital or capital attraction by the economy depends upon the good governance in the direction of providing friendly and positive business environment in the country like Pakistan.

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