AN EXPLORATION OF CORPORATE GOVERNANCE AND ITS RELATION WITH FINANCIAL PERFORMANCE: A CASE STUDY FROM BANKING INSTITUTIONS OF PAKISTAN

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ABSTRACT
This study shows the link between corporate governance and firm’s financial performance. Board size and Board composition are studied under CG head and we checked its impact on Financial Performance. These relationships are studied in the context of banking sector of Pakistan. The convenience sampling technique is used for the selection of sample of our study which consists of six Banks. Data was collected through questionnaire distributed among employees of these six Banks in DG Khan. The different descriptive statistics, correlation coefficient and regression of all variables are computed to confirm our hypothesis through IBM SPSS Software. From data analysis we have concluded that Board Size and Board Composition have positive impact on financial performance.

KEY WORDS: Corporate Governance, Financial Performance, Board Composition, Board Size

INTRODUCTION
This research study attempts to explore how corporate governance affects performance of an organization. Pay for performance have been central elements for providing benefits for top management (Jensen and Murphy,1990; Firth,et al.,2006; Kato and long,2006). Previous research studies have also identified that corporate governance also effects the level of executive return. (Boyd,1994; Ryan and Wiggins ,2004). Corporate governance is gaining worldwide importance in recent years.

The development of corporate governance practices is extensively documented as one of the crucial elements in consolidation the foundation for the long term economic performance of corporation and countries (Ibrahim et al.,2010). Due to global financial crises and major corporate failures it has got more importance (Imam and Malik,2007).Good corporate governance is an important necessity to keep on running a firm successfully (Abu.Tapanjeh,2006).It has long been played an important role for increasing the long term
value of stake holders in the business World. Corporate governance offers a structure that works for the overall good of the firm and can help in enhancing firm’s financial performance. Corporate governance deals with the methods in which suppliers of finances to corporation assure them of receiving a reward on their investment (shliefer and vishney, 1997). Banking institutions play an important role for economic health of a country by providing finances to commercial enterprises and basic financial services to community. Some banks do provide credit and liquidity options in market crises. Banking institutions do have an easy hand to government safety nets and due to this prominence of banking institutions is very important for a nation’s economy. Corporate governance may be taken as the way in which business and individual affairs are framed by board of directors (BOD). Affecting how bank set corporate objectives? How they run the day to day operations of the business. How they consider the interest of renowned stakeholder? and how they protect the interests of depositors.

Many developing countries (including Pakistan) have practiced financial sector liberalization during 1990s and early 2000s. Policy makers of these nations were of the opinion that financial liberalization will bring a change in corporate governance which will be better for efficiency of banking institutions. Some countries made a mixture of privatization, merger and acquisitions and restructuring of state owned and foreign banks. Due to these reforms there was a change in governance structure. How do corporate governance changes affect performance of these banks. This articles provide an overview of some research we have done on different characteristics of corporate governance influencing bank performance to provide a comprehensive detailed of governance issues, we use a sample of community banks where large number of management, ownership and board structures are present. Another source from which we have gather much of our data are bank examination reports to gain a complete look at different parts of bank governance structure and financial inducements that influence key players in this governance process like bank stock ownership and importance of this ownership to their overall financial wealth.

LITERATURE REVIEW:
Governance as designated by president of the world bank Mr. J Gulfansohn “is about promoting corporate fairness ,transparency and accountability “(Financial times, June 21,1999). Renato Geovannini (2009) states that corporate governance and board ownership as mechanism to manage and control the firm without missing chances that have stem in share holder base expansion, rather than following exploitation of outsider director skills .potential clashes of interest among stakeholders creates the need for corporate governance (Mehmood Usman Imam and Mehfoja Malik ,2007).These conflicts of interest originates due to two main reasons. First, different participant have different goals and preferences .Second the participants have incomplete information of each others actions, knowledge and preferences. Tosi and Gomes-Mejia (1989) depicts that challenge of corporate governance is to set up guiding and incentive placement devices that change the risk and effort orientation of agents to line up with the interests of principals.

A large amount of supervisory changes have focused on board of directors .For defining board of directors or a system of governance Casellli,S & Gatti ,S(2007) say that elements must be taken in to account with respect to board of director : Actors and contest by actors they meant the entire range of stakeholders showing interest and power with in the firm .This presence assure on one hand the creation of value and its distribution . On the other it governs contextual factors starting with governance devices. Now by context meant geographical, cultural, sectoral, and firm specific differences and changes. Differences in size, life cycle variations crises and
configurations of firm resources and CEO tenure have degree of dispersion in all of them. Existing literature finds out a significant relation between ownership structure and performance and different styles were investigated for changing efficiency levels in banking sector and one of the leading approach is principal agent framework and public choice theory. Departure of ownership from management control can create principal agent problems when there is shortage of capital market discipline. In such situations there is every possibility that managers would work for their own interest and not for the interests of stakeholders (owners) (stiggler(1976),Fama and jenson(1983),Shliefor and Vishney(1997),Altonbus(2001).

In recent years a lot of privatization activity has occurred in state owned banks of developing countries La Porta et al.(2002), Clarke et al.(2005), Meggenson(2005)]. Some empirical researches also analyze the relationship between commercial banks performance and privatization in developing countries including those by Boubakri et al .(2005), Otchere(2005), Beck(2005), Omran(2003), Chen et al (2005) Patti and Hardy (2005). Only after painful trial and error privatization improves bank performance this is suggested by empirical evidences gain from these studies [Megginson (2005)].

**Corporate governance and financial performance**

The origin for the argument that corporate governance results in superior financial performance was based on the notion that better corporate governance led to improved financing decisions and investment decisions Vermaelen, 2010). Primarily financing options were only limited to debt and equity. The company can better raise the capital if both of these resources were less expensive. In a study conducted in Pakistan on the impact of Corporate governance on cost of equity (Shah and But,2009) It was found that good corporate governance meaningfully reduce the cost of equity , so helping better access to capital at a lower cost .

Association between corporate governance and financial distress is an argument in favor of good corporate governance. In a study on corporate governance features of companies in financial distress (Chang, 2009), it was summarized that facets of good corporate governance decreased the probability of financial distress for companies. Board composition and Board size were two aspects of governance in particular cited in this study and concluded that companies with boards consisting of more none executive directors had a smaller chance of financial distress. The study also explained that a company with large size board had a higher chance of being in financial distress. Fama and French (1992) resolved that size was a significant factor relating financial performance. Companies with small market capitalization tended to do better than the rest of the market concluded by the study.

**RESEARCH MODEL**
METHODOLOGY
Sample size:
The convenience sampling technique is used for the selection of sample of our study which consists of six Banks. Data was collected through questionnaire distributed among employees of these three Banks in DG Khan. We distributed 100 questionnaires from which 77 showed response with the help of which we were able to complete this study.

- The dependent variable of our research is firm’s performance
- Independent variable that is corporate governance is separated in to Board size (BS) and Board composition (BC)

Hypothesis:
H1: Board size is positively related to firm’s performance
H2: A good Board Composition is likely to insert positive influence on firm’s performance

Data Analysis
Descriptive statistic:
In this section, we have calculated minimum, maximum, mean and standard deviation of all variables in our research. The table 1 shows the descriptive statistics of our variables. The minimum value of BS of all firms is 1.20 and maximum value is 2.60 while the mean is 1.77 and SD is .3179. The minimum value of BC is 1.40 while the maximum value of BC is 2.40 and mean is 1.76 and standard deviation of BC is .23805. The minimum value of FP is 1.25 and maximum value is 2.50 and the mean is 1.77 and SD is .2692.

Table: 1 Descriptive Statistic

<table>
<thead>
<tr>
<th></th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std: Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>BS</td>
<td>1.20</td>
<td>2.60</td>
<td>1.7760</td>
<td>.31791</td>
</tr>
<tr>
<td>BC</td>
<td>1.40</td>
<td>2.40</td>
<td>1.7600</td>
<td>.23805</td>
</tr>
<tr>
<td>FP</td>
<td>1.25</td>
<td>2.50</td>
<td>1.7700</td>
<td>.26926</td>
</tr>
</tbody>
</table>

Correlation Analysis:
The Pearson correlation is used to find the relationship among all variables of our research. The Table 2 shows Pearson Correlation Matrix among the concerned variable (independent variables and dependent variables). Result shows that there was positive relationship between BS and FP because (r = .152,). Result shows there was positive correlation between BC and FP because (r = .187,). Value of “r” is positive and showing positive relationship between variables under study.

Table: 2 Correlations Analysis:

<table>
<thead>
<tr>
<th></th>
<th>BS</th>
<th>BC</th>
<th>FP</th>
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<tbody>
<tr>
<td>BS</td>
<td>1</td>
<td>.035</td>
<td>.125</td>
</tr>
<tr>
<td>BC</td>
<td>.035</td>
<td>1</td>
<td>.273</td>
</tr>
<tr>
<td>FP</td>
<td>.152</td>
<td>.273</td>
<td>1</td>
</tr>
</tbody>
</table>

Regression Analysis:
The results of regression are presented in table 3. The beta value of BS and FP is (.152), significance of “F” is (.543), adjusted R square is (-.019) and value of “T” is (.737) and P value is <.05 that is significant to accept the results. All the results show the positive relationship
between the variables because of the positive beta value in the results. It shows that our null Hypothesis one is rejected and alternate hypothesis of H1 is accepted.

The beta value of BC and FP is (.273), significance of “F” is (1.853), adjusted R square is (.034) and value of “T” is (.1.361) and the value of P<.05 that is showing significant result. All the results show the positive relationship between the variables because of the positive value of beta. It shows that our Hypothesis one is accepted because result shows the positive relation between BC and FP.

<table>
<thead>
<tr>
<th>No</th>
<th>DV</th>
<th>IV</th>
<th>Beta</th>
<th>T</th>
<th>P-Value</th>
<th>F</th>
<th>Adjusted R Square</th>
</tr>
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<tbody>
<tr>
<td>1</td>
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<td>BS</td>
<td>-.697</td>
<td>1.469</td>
<td>.000</td>
<td>3.774</td>
<td>.357</td>
</tr>
<tr>
<td>2</td>
<td>FP</td>
<td>BC</td>
<td>.218</td>
<td>.447</td>
<td>.003</td>
<td>.199</td>
<td>.191</td>
</tr>
</tbody>
</table>

CONCLUSION:
The existing literature suggests that there is a positive relationship between the components of corporate governance and firm performance. This study has been conducted in the context of Pakistan banking sector, for which data is collected through questionnaire and results shows the positive relationship and proving hypothesis. From data analysis of our study, it is concluded that components of corporate governance like Board Size and Board Composition have positive effect on the firms’ financial performance. With the effective Board size and Board composition, the firms are able to improve its performance.

LIMITATIONS AND FUTURE DIRECTIONS:
Pakistan’s banking sector is the large sector due to shortage of time and resources the study is limited to six banks and to one district DG Khan. Secondly, only two determinants of independent variable are discussed that surely not enough so more of the determinants can be tested to have a better picture of the phenomena.

REFERENCES:


Mahmood Osman Imam and Mahfuja Malik (2007), Firm Performance and Corporate Governance through Ownership Structure


