

# Impact of Corporate Governance Characteristics on Banks Performance

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**Abstract:** *The concept of corporate governance comes in '19<sup>th</sup> century when the state of organization law boosted the rights of business boards. The notion of corporate supremacy is to enhance the performance of corporation with good board structure. Mostly firms moved on this supposition that sound corporate supremacy increase business performance. Yet, on that time no consensus has developed on the influence of 'corporate supremacy on performance'. It has been seen this concept applied on financial sector to boost economic development and poverty improvement. In any economy banking system plays a very important role. Corporate governance (CG) is an effective tool to manage organizations performance. The purpose of this study is to analyze the impact of corporate governance on banks performance of Pakistan. Our research is based on secondary data and the data collected from annual Reports of Banks. The dependent variables are Return on asset (ROA), and Return on Equity (ROE). The independent variables are Board size, Board meeting, and non-executive directors. The overall result shows that corporate governance has significant relationship with bank performance of Pakistan.*

**Keywords:** Bank Performance, Corporate Governance, board Size, Performance', Board of director, commercial bank.

## Introduction

In order to avoid biasness in the way an organization operates, corporate governance obtains a high share in how an organization is guided, managed or simply controlled. Having a set of rules along with the code of practice which affects the decisions of those in control and contributes the way company is supposed among present and potential future the investors. The Corporate Supremacy designs the structure that clearly 'specifies the sharing of rights and duties in between various candidates in the organization'. For example; Members of the board, managers in the corporation, participants in authority of shares and provides a major role in decision-making processes by setting rules and processes and minor assistance in corporate activities. By establishing such an action, Corporate Governance provides a structure in which the organizations goals are defined, how the defined goals are obtained and what practices are put into progress to obtain the defined goal. It is fair to say that Corporate Supremacy may be the remedy of getting investor interest and the managers so it can be made sure that corporations are operated in the benefit of stockholders.

A Corporate Governance effectively put in motion spreads the capital seized in the raise of proper use the 'resources within the company and towards the economy as a whole'. Fung (2014) they play a role in inviting low cost investment capital by gaining confidence amongst the local and international investors. Proper corporate governance keeps track of the panel and the management. The directors are bound to work the in the frame of permissible compliance and to take neutral judgments for the betterments of the business'. It is proven that any unethical practices

developed or beginning to take root is eradicated by efficient corporate governance, though it may take a while to do so.

A. C. G. (2010).The CG rotates around a few essential characteristics in perspective of the role of directors. Hermanson, &Rittenberg, (2003). A basic structure for the BOD, its remuneration, ownership in directors, availability in freedom of an enterprise, the role of services in institutional directors, involvement of a member of BOD, financial reporting and public image. An institute of audit is functioning and connected with shareholders. Vitols, & Kluge (2011). Effective corporate governance enhances the value of developing comprehensive management and enriching outcomes of CG for the society at ordinary and the shareholders specifically made the beneficiaries.

Advance countries such as USA,UK, Hong Kong, Germany and many more have already established diverse different structures of CG which is now implemented with great motivation and organized action. Iqbal, & Shah, (2008) the interest of World Bank has also been highlighted through the development of World Governance Index. Gurtner, (2010) the objective seem in 'this index is to assess the performance of the corporate in developed and developing countries on the basis of basic regulations, rule of law and corruption'. The consequences of the index indicated the best performer was Germany with a score of 90.8 % whereas Bangladesh proved to be the worst performer with a score of 24.3 %.

Pakistan's money market of bookkeeping profession is operated under the name of ICAP and the corporate sector is examined by SECP. Other requirements due for the financial

reporting tend to be approved by the compliance of the pronouncements of IFRS foundation. Afterward some accounting mishaps of 'ENRON & WorldCom, and the issuance of Sarbanes-Oxley act in 2002, SECP in Pakistan issued the code of CG in the same year and stated its application a prerequisite. This code was studied and revised in 2012'.

#### The Code of Corporate Governance

Javid, & Iqbal. (2010), to enhancing the corporate supremacy many new financial instruments presented by (SECP) 'Security and Exchange Commission of Pakistan'. The code of corporate supremacy was presented by (SECP) in March 2002. 'The purpose of this issuance is to improve transparency related to company's data, governance and to protect the investor's interest by improving financial reporting issued by banks. Through the joint effort of these three stock exchanges are the results of code of corporate governance such as Securities and SECP and chartered of Pakistan and Pakistan in collusion with Institute of Cost and Management Accountants of Pakistan (ICMAP)'. Good international practices & many recommendations are included in this code.

'In Pakistan all listed banks and companies registered in Pakistan stock exchange are bound to issue circulate a statement with their annual report'. The purpose of this is to convey the message to their shareholders that they are compliance with the good practices of corporate governance issued by SECP. The first aim of code of corporate governance is to create a system where the interest of diversified stakeholders is safe and company is controlled and directed by its directors. It also states how to rearrange the composition of board of directors. For securing the rights of minority shareholders, it introduced board based representation by the executive and non-executive directors. Related to corporate affairs the code emphasize decision making process must be fair, crystal as clear and openness. It also requires the actions and responsibilities of directors towards all stakeholders must be diligent, crystal clear and timely manner. Internal audit functions and audit committees are the silent feature of (code of corporate governance 2002). Security and the exchange commission of Pakistan (SECP) in collaboration with Economic Affairs Division of Government of Pakistan (UNDP) launch a project on corporate governance in august 2002. The main purpose for launching this project in Pakistan is to implement the code and tough monitoring work structure. SECP with coordination of Financial Corporation (IFC) and (PINCG) in 2007, conducted a survey on (CCG of Pakistan). Local registered and large local un-registered companies and financial institution like banks and etc. are targeted in this survey. One major thing was observed in this research, this is necessity to create the awareness among the directors of company about the benefits of code. So they can understand

and implement the benefits of code. Board Development series (BDS) has been developed by the SECP with the help of IFC. Many workshops had been conducted by ICS for understanding the responsibilities of board of directors and corporate governance.

#### Literature review

Performance of the firm & its board structures are the current discussable issues across the globe. Larcker, Richardson and Tuna (2007) presented the link between the corporate governance and firm's performance. However, they were not successful in concluding the consistent deductions from their study.

Tariq et al (2014) mentioned that practices of corporate governance have an affirmative impact on the bank's performance. They further mentioned that arrangement of board meetings on the regular basis also has a similar positive effect on the bank's progress.

Inam and Aqeel (2014) pointed out the impact of board structure on various banking parameters e.g. net income, bank interest and return on equity. They additionally highlighted the role of an efficient board structure in the advancement of banking sector across the Pakistan. Malik et al (2014) deduced from their research that large size of bank board can increase the performance of banks and also has the potential to enhance the bank profitability. Stepanovo and Ibantsova (2012) stated that directors who are not dependent have significant impact on performance on bank as they possess much knowledge and experience.

Lorsh & Lipton (1992) drew the attention towards the inverse relationship between board size and company value. He further mentioned that conflicts within the large board size can be processed easily as compared to smaller ones and he further advised to have board size of ten instead of eight or nine.

Weisbach & Hermalin (1992) concluded from their study that bank performance is independent of bank directors composition. They further specified that even there is not any relationship between outside directors and bank performance.

Yermak (1996), like Weisbach & Hermalin (1992), also emphasized that the relationship between the bank performance and firm's values do not exist. He supported his study from the questioning of 452 large manufactures in USA. The firm's value was represented through Return on sales, Return on asset, and Tobin's Q. The study confirms the results presented by Lipton & Irosh (1992) and Jensen (1993).

In (2002) Peck and Conyon presented the negative relation between the board size and organizations performance. They came to this conclusion as they determine the performance of the company through the evaluation of ROE. They further recommended the role of company's board as the matter for resolution for agency problem.

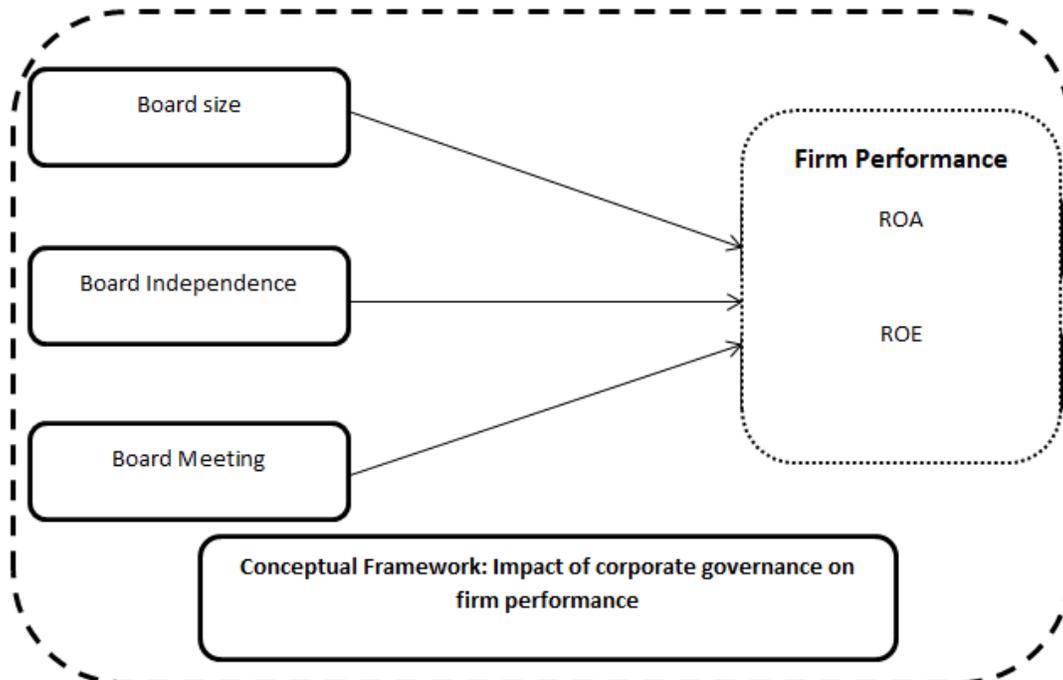
Tomar and Bino (2012) stated the positive influence of the Jordanian's executives and it's layout on the performance of bank. Mohammed (2011) concluded in his research that level of corporate governance is low in Nigeria that is the reason behind poor banking performance in Nigeria. He also added that if corporate governance performances are good it helps to increase the bank performance and ultimately increase the probability of success.

The studied was conducted by Ahmed et al (2014) which mentioned a favorable influence of board structure and board size on the bank performance in Pakistan. Professional board structure and board size can enhance the performance of the banking sector of Pakistan. He also concluded that the large board size may some negative impact on the bank performance.

**Research Methodology**

For this study the secondary source of data is used. Secondary data has been taken from the financial reports of all listed banks in Karachi Stock Exchange (KSE) and State

**Conceptual frame work**



**Econometric Model**

'For the analyses of the data we used a multiple linear regression model'. Return on assets & return on equity is

Bank of Pakistan (SBP) and sample is comprised of all listed banks in Karachi stock exchange for the period from 2010 to 2015.

S.No	Name of Banks	S.No	Name of Banks
1	UBL	6	Samba Bank
2	MCB	7	Silk Bank
3	Askaribnk	8	Allied bank
4	Summit Bank	9	Bank Alfalah
5	Bank Al Islami	10	Mezan Bank

**Type of Research**

The research on Effect of corporate governance on the organization performance, to analysis ten registers commercial banks of Pakistan. Our research is on numerical bases. The data we are collecting from others sources like annual reports of the various banks from the entire industries.

**Target Population**

Our target population is the entire banking industries of Pakistan for our study.

**Sample Size& Sampling Design**

The data our study has been selected for ten registered banks from 2010 to 2015 of Pakistan.

occupied as 'dependent variables although Board size, Board meeting, and Bank size board independence are taken as independent variables'.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \epsilon \quad (1)$$

$$ROA_{it} = \alpha + \beta_1 BORDZ_{it} + \beta_2 BORDM_{it} + \beta_3 NEXED_{it} + \beta_4 BNKZ_{it} + \epsilon \quad (2)$$

$$ROE = \alpha + \beta_1 BORDZ_{it} + \beta_2 BORDM_{it} + \beta_3 NEXED_{it} + \beta_4 BNKZ_{it} + \epsilon \quad (3)$$

**Where**

i = 1 to 10 Banks

t = 2010-2015

‘Y= Bank Performance’

‘α= Constant’

BODSZ = Board size

BODM= Board meeting (total meetings in a year)

BODIN= Non-Executive Director (total members in board)

BNKSZ= ‘Bank size’

‘β1, β2, β3, β4, β5 are the coefficients of independent variables’.

‘ε= error term’

**Research Procedures**

This research answers will be carried-out by setting numerical model for hypothesis testing as well as by identify association between the targeted variables.

**Instrument Selection**

The data is available in the form of “Financial Statements” ‘issued by State Bank of Pakistan for all registered banks at Karachi Stock Exchange’.

**Hypotheses**

The hypotheses for this research are as follows:

**‘H1:** Board size has significant relationship with bank performance.

H1a: Board size has significant relationship with ROA.

H1b: Board size has significant relationship with ROE’

**‘H2:** Board meeting has significant relationship with bank performance.

H2a: Board meeting has significant relationship with ROA.

H2b: Board meeting has significant relationship with ROE’.

**‘H3:** Non-executive directors have significant relationship with bank performance’

H3a: Non-executive directors, has significant relationship with ROA.

H3b: Non-executive directors, has significant relationship with ROE.

**DATA ANALYSIS AND FINDINGS**

This portion deals with the expressive statistics, the data we collected from annual reports, that data is used for the analysis of this research. The main structure of the data will be expressed quantitatively (e.g. central tendency of the statistics such as mean, max and min, observation). The tables contain the descriptive statistics this will show the descriptive statistics separately, with the appropriate table extracted from the original table.

	ROA	ROE	BODSIZE	BODIND	BODM	BNKSIZE
Mean	0.009	0.087	9.100	0.748	6.033	12399
Median	0.009	0.184	9.000	0.800	6.000	34840
Max	0.031	0.299	13.000	0.923	12.00	32936
Min	-0.041	-0.943	7.000	0.333	4.000	30511
Obs	60	60	60	60	60	60

**Correlation 1 Dependent variable (ROA with all independent variables)**

	ROA	BODSIZE	BODIND	BODMEET	BNKSIZE
ROA	1.000000	0.644056	0.484662	0.390998	0.411773
BODSIZE	0.644056	1.000000	0.184297	0.189089	0.013532
BODIND	0.484662	0.184297	1.000000	0.084182	0.141354
BODM	0.390998	0.189089	0.084182	1.000000	0.081152
BNKSIZE	0.411773	0.013532	0.141354	0.081152	1.000000

**Correlation 2 Dependent variable (ROE with all independent variables)**

	ROE	BODSIZE	BODIND	BODMEET	BNKSIZE
ROE	1.000000	0.460498	0.347677	0.482123	0.453699
BODSIZE	0.460498	1.000000	0.184297	0.189089	0.013532
BODIND	0.347677	0.184297	1.000000	0.084182	0.141354
BODM	0.482123	0.189089	0.084182	1.000000	0.081152
BNKSIZE	0.453699	0.013532	0.141354	0.081152	1.000000

**Correlation 3 (All independent variables)**

	BODSIZE	BODIND	BODMEET	BNKSIZE
BODSIZE	1.000000	0.184297	0.189089	0.013532
BODIND	0.184297	1.000000	0.084182	0.141354
BODMEET	0.189089	0.084182	1.000000	0.081152
BNKSIZE	0.013532	0.141354	0.081152	1.000000

**Regression Analysis Model 1 Dependent variable (ROA with all independent variables)**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.038873	0.009226	-4.213608	0.0001
BODSIZE	0.024724	0.000766	6.163398	0.0000
BODIND	0.155525	0.008164	-3.676674	0.0014
BODMEET	0.061468	0.000889	2.152265	0.0442
BNKSIZE	0.049610	2.90E-10	1.712276	0.0925
cR-squared'	0.474413	c Mean dependent var'		0.009453
cAdjusted R-squared'	0.436188	cS.D. dependent var'		0.014077
cS.E. of regression'	0.010570	cAkaike info criterion'		-6.181963
cSum squared resid'	0.006145	cSchwarz criterion'		-6.007435
cLog likelihood'	190.4589	cF-statistic'		12.41122
cDurbin-Watson stat'	0.839032	cProb(F-statistic)'		0.000000

**Interpretation:**

The above result of regression shows the p values of coefficients ('board size, board independence and board meeting are < 0.05', which indicates that 'all our null hypothesis have been rejected' which can be interpreted as

the positive and significant impact of all above mentioned independent variables on the dependent variable ROA. So that we can say that firm 'performance is affected by the corporate governance'. The overall explanatory power of the model can be restrained by R-square which in the case of the above model is 0.4744 indicating that the overall model is

explaining 47% dissimilarity in the dependent variable (ROA).

**Regression Analysis Model 2** Dependent variable (ROE with all independent variables)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.058573	0.019226	-3.113608	0.0001
BODSIZE	0.022986	0.000736	4.055350	0.0002
BODIND	0.152787	0.008049	-2.830910	0.0064
BODMEET	0.230005	0.000921	-3.099209	0.0213
BNKSIZE	0.00510	0.000329	1.787010	0.0793
'R-squared'	0.404749	'Mean dependent var'		0.009453
'Adjusted R-squared'	0.367503	'S.D. dependent var'		0.014077
'S.E. of regression'	0.012048	'Akaike info criterion'		-5.935539
'Sum squared resid'	0.008128	'Schwarz criterion'		-5.795916
'Log likelihood'	182.0662	'F-statistic'		8.182137
'Durbin-Watson stat'	0.674347	'Prob(F-statistic)'		0.000132

### Interpretation:

The above result of regression shows the p values of coefficients ('board size, board independence and board meeting are  $< 0.05$ '), 'which indicates that all our null hypothesis have been rejected which can be interpreted as the positive and significant impact of all above mentioned independent variables on the dependent variable ROA'. So that we can say that firm enactment is affected by the corporate supremacy. The overall explanatory power of the model can be restrained by R-square which in the case of the above model is 0.404749 indicating that the overall model is explaining 40% dissimilarity in the dependent variable (ROA).

### Conclusion

In the economic development of any country financial sector 'plays a vital role in the world. Banking sector is one of the main and essential elements of financial sector'. For the progress of any country's economy, strong banking sector is necessary. In the present open economic environment and immediate integration and interaction with other countries, the banking sector in Pakistan cannot ignore the importance of Corporate Governance practices. Many financial modifications change the country's monetary position and played an significant part for the advancement of banking industries.

### Recommendations for Future Research

The notion of the research is to know, how the impact of corporate governance will come on the performance of the banks. So the doors are open for further studies because it will change time to time. The researcher would investigate that; the relationship we found in this study is exist over time. We conduct this study in Pakistan. If it is done in another country then our findings will be supported.

This research can be conducted through different banks performance and measure different set of groups. This type of study will be conducted for service sector traded in Pakistan stock exchange by using return on assets and return on equity.

Lastly, we believe that information technology is expanding day by day and the transparency relationship should needs to be considered in more detail for those companies which are in specific sector, and in another country.

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