Impact of corporate governance on firm performance : (A case study of family-owned financial sector in Pakistan)

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ABSTRACT

The main purpose of this study is to examine the impact of the corporate governance on firm performance. The variables, employed in this study to measure firm performance, return on assets. And Board Size, Board Composition, CEO/Chairman Duality as indicator of corporate governance. For this purpose sample data collected for listed banks in Pakistan from 2005 to 2010. The empirical results indicate that firm performance have a significant relation to board Size, board composition. On the other hand, firm performance has insignificant impact on CEO/Chairman Duality.

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statements of different banks.  
Model:  
\[ \text{ROA} = a + b_1(\text{BS}) + b_2(\text{BC}) + b_3(\text{Duality}) + e \]  
Where:  
\[ \text{ROA} = \text{Return on Asset} \]  
\[ \text{BS} = \text{Board Size} \]  
\[ \text{BC} = \text{Board Composition} \]  
\[ \text{Duality} = \text{CEO and Chairman Duality} \]  

### Explanation of Variables

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent variable</td>
<td></td>
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<tr>
<td>Board Size</td>
<td>Number of directors on the board.</td>
</tr>
<tr>
<td>Board Composition</td>
<td>% of independent non-executive director/total directors.</td>
</tr>
<tr>
<td>Duality</td>
<td>CEO duality refers to the situation when the CEO also holds the position of the chairman of the board.</td>
</tr>
<tr>
<td>Dependent Variable</td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>Net income divided by book value of total assets.</td>
</tr>
</tbody>
</table>

### Board Size:

The board shall have a reasonable number of members. The number of directors should be fixed according to the company’s size, age, nature of business operations, and future plans, ensuring effective and efficient governance. The optimal number of board members should be seven. A causal vacancy on the BOD’s shall be filled by the remaining directors expeditiously. The company should set a certain percentage of board members to be designed as non-executive. Numbers will vary with the size of board, but at least one director should be non-executive.

\[ H_0: b_1 = 0 \]  
\[ H_a: b_1 \neq 0 \]  
**Board size has no effect on ROA**

\[ H_0: b_2 = 0 \]  
\[ H_a: b_2 \neq 0 \]  
**Board size has some effect on ROA**

### Board Composition:

Non-executive directors act as the checks and balances in achieving boards effectiveness and they are considered to be “decision expertise” (Fama and Jensen, 1983). They reduce managerial consumption of perquisites and they act as a positive influence over director’s decision (Brickley and James, 1987). They also act as middleman between companies and the external environment due to their expertise, prestige and contacts (Lricke, 1984). Family companies prefer to have non-executive directors in their boards because they enhance companies performance. There is a significant association between proposition of independent non-executive directors and financial performance.

\[ H_0: b_3 = 0 \]  
\[ H_a: b_3 \neq 0 \]  
**Board composition does not affect ROA**

\[ H_0: b_4 = 0 \]  
\[ H_a: b_4 \neq 0 \]  
**Board size may be taken as causal factor of ROA**

### CEO/Chairman Duality:

The board of directors can lose its independence and monitoring power when the chairman is working as a decision-maker as well as also as a supervisor and consequently performance is being affected in a negative way. It is attested by the Bally and Dalton (1993), Bahya (1996) that CEO duality deteriorates firm performance. Following the above stated attestation we proposed the hypotheses as under:

\[ H_0: b_5 = 0 \]  
**CEO/CHAIRMAN Duality have no impact on ROA**

\[ H_a: b_5 \neq 0 \]  
**CEO/CHAIRMAN Duality have impact on ROA**

### Results

Table 1 shows that total number of observations are 72, mean of board size is 26.25, mean of board composition is 20.83, mean of director’s duality is .42, mean of return on asset is 6.25. The standard deviation of board size is 13.960, SD of board composition is 8.681, SD of DD is .496 and SD of ROA is 14.274.

Table 2 shows that all the independent variables have collective impact on return on asset as it is significant at .000. Total independent variables change the dependent variables with 27.9 %. R is greater than 50 % so it has collective impact on ROA.

Table 3 shows that the board size has some significant impact on dependent variable, the unitary increase in the board size will decrease the return on asset by 1.29, board composition has a significant impact on return on asset, unitary increase in the board size will also increase return on asset by .481, CEO chairman duality has no significant impact on ROA.

### Conclusion

With all facts and indications from the empirical analysis, it is concluded that there is a significant relationship between Corporate Governance practices and Organizational Performance. Furthermore, the result of the research findings showed the relative contribution of each of the independent variables on the dependent variables. The first code of Corporate Governance in Pakistan was issued in March 2002 by Security and Exchange Commission Pakistan (SECP). SECP established an institution for corporate governance in 2004. Research conducted shows that there is a significant relationship between board size and firm performance and there is also a significant relationship between board composition and firm performance which is being measured by ROA. CEO/Chairman Duality has non-significant impact on firm performance. And as whole all the independent variables: board size, board composition, CEO/Chairman Duality as whole has significant impact on firm performance.

### References


Table 1
Descriptive Statistics

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<tr>
<th></th>
<th>N</th>
<th>Mean</th>
<th>Std. Deviation</th>
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</thead>
<tbody>
<tr>
<td>Size</td>
<td>72</td>
<td>26.25</td>
<td>13.96</td>
</tr>
<tr>
<td>Bcom</td>
<td>72</td>
<td>20.83</td>
<td>8.681</td>
</tr>
<tr>
<td>Duality</td>
<td>72</td>
<td>42</td>
<td>.496</td>
</tr>
<tr>
<td>ROA</td>
<td>72</td>
<td>6.25</td>
<td>14.274</td>
</tr>
</tbody>
</table>

Table 2
ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
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<tbody>
<tr>
<td>Regression</td>
<td>1923.273</td>
<td>3</td>
<td>641.091</td>
<td>37.370</td>
<td>.000</td>
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<tr>
<td>Residual</td>
<td>3808.444</td>
<td>222</td>
<td>17.155</td>
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<tr>
<td>Total</td>
<td>5731.717</td>
<td>225</td>
<td></td>
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</tr>
</tbody>
</table>

R = .541 R² = .279

Table 3.
Coefficients

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized Coefficients</th>
<th>Standardized Coefficients</th>
<th>T</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>13.151</td>
<td>2.559</td>
<td>5.140</td>
<td>.09</td>
</tr>
<tr>
<td>Size</td>
<td>-1.29</td>
<td>.062</td>
<td>-.002</td>
<td>.021</td>
</tr>
<tr>
<td>BCom</td>
<td>.283</td>
<td>.044</td>
<td>.481</td>
<td>6.431</td>
</tr>
<tr>
<td>Duality</td>
<td>.132</td>
<td>.073</td>
<td>.122</td>
<td>1.808</td>
</tr>
<tr>
<td>ROA</td>
<td>a. Dependent Variable:</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>