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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.

Introduction

Corporate governance, on the one hand, is about to setting up a system of entrusting the directors and managers with responsibilities in relation to running corporate affairs and, on the other hand, it is concerned with the accountability of those directors and managers.

In Pakistan, the code of corporate governance was formulated in the year of 2002 and since then it's working as watch dog over the legitimate functioning of the corporate sector. It also ensures that the sector is complying with its social responsibilities towards all its stakeholders.

All over the world and especially in Pakistan the corporate sector is divided in to public (listed/unlisted) and private companies. Usually the majority of PVT Ltd companies are owned by the members of a single family. These are established by the forefathers and governed by the coming cohorts. In such way the ultimate powers are entrusted in few hands. The situation become harsher as the code of corporate governance is not applicable on these companies with its true spirit and the companies truly may call as family-owned companies. These family-owned companies no doubt have the better performance but they never consider the social responsibility of the corporate sector.

The financial services sector in Pakistan is not beyond the scope of above-stated scenario. However it's important to point out that the increasing number of financial service providers are belong to non-family owned companies that are public listed/unlisted companies and they are also the primary subject of the code of corporate governance.

All other countries in the world especially Europe and Scandinavian countries are developing harmonized code of conduct for corporate sector. In spite of hopeful situation described in above paragraph it's quite important to bring the entire corporate sector under the roof of code of corporate governance for better prosperity of the corporate sector and integrity of our homeland.

Problem Statement

I have done this study to check the relationship between corporate governance and firm performance of family owned and non-family owned in banking sector. I focused on weather corporate governance effects firm performance or not?

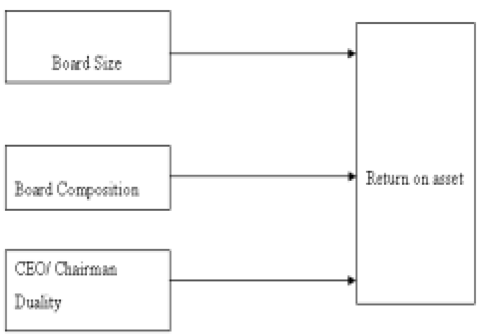
Research Objective

- To develop the understanding of corporate governance and its affect on firm performance.
- To enhance the firm financial performance
- To check the financial performance of family and non-family owned firms.
- To help the decision maker for starting family owned business either non-family owned business.

Return on equity taken as a dependent variable and family controlled firm, board composition, board size and CEO/chairman duality are independent variables.

Theoretical framework

Independent Variables Dependent Variable



Methodology

Sample size for this paper has been taken from the total banks operating in Pakistan. Total number of population is 42 and we take sample of 12 banks. Data for this study has be collected from basic balance sheet analysis and financial

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statements of different banks.

Model:

ROA = a + b_1(BS) + b_2(BC) + b_3(Duality) + e

Where:

ROA = Return on Asset

BS = Board Size

BC = Board Composition

Duality = CEO and Chairman Duality

Explanation of Variables

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

Board Size:

The board shall have a reasonable number if 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.

$H_o : b_1=0$

Board size has no effect on ROA

$H_a: b_1 \neq 0$

Board size has some effect on ROA

Board composition:

Non-executive directors acts as the checks and balances in achieving boards effectiveness and they are considered to be "decision expertise"(Fama and Jenson, 1983). They reduce managerial consumption of perquisites and they act as a positive influence over directorsdecision (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.

$H_o : b_2=0$

Board composition does not affect ROA

$H_a: b_2 \neq 0$

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. So following the above stated attestation we proposed the hypotheses as under:

$H_o : b_3=0$

CEO/CHAIRMAN Duality have no impact on ROA

$H_a: b_3 \neq 0$

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 in2004. 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.

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Table 1
Descriptive Statistics

	N	Mean	Std. Deviation
Size	72	26.25	13.960
Bcom	72	20.83	8.681
Duality	72	.42	.496
ROA	72	6.25	14.274
Valid N (listwise)	72		

Table 2

ANOVA[b]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1923.273	3	641.091	37.370	.000
	Residual	3808.444	222	17.155		
	Total	5731.717	225			
$R = .541$ $R^2 = .279$						

Table 3.

Coefficients[a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	13.151	2.559		5.140	.09
	Size	-1.29	.062	-.002	-.021	.098
	BCom	.283	.044	.481	6.431	.000
	Duality	.132	.073	.122	1.8082	.219
a. Dependent Variable: ROA						