Corporate Governance Practices and Firms Performance: A Case of Banking Sector of Pakistan

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***Abstract*– In this paper, we examine the relationship between corporate governance practices and firms performance banking sector of the Pakistan. In this paper, we apply the Mann-Whitney U-test for the comparison of the 3 commercial banks that practice good corporate governance and 3 commercial banks that did not practice good corporate governance. We use four financial ratios for measure the performance of the banks. The ratios which are used in paper are ROA (Return on asset), ROE (Return on equity), EPS (Earning per share) and PM (Profit margin). The time period for which financial performance is measured is from 2008-2012 at end it is concluded that there is no significant difference in the performance between commercial banks that practice good governance and commercial banks that practice weak governance.**

***Keywords*– Corporate Governance Practices, Banks and Mann U Whitney Test**

I. INTRODUCTION

In this paper, we study the relationship between the corporate governance practices and the firm's performance of the banking sector of the Pakistan. Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the boards, managers, shareholders and other stakeholders, and spells out the rules and procedures or making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance. A company committed to good corporate governance has well-defined and protected shareholder right, a solid control environment, high levels of transparency and disclosure, and an empowered board. The interest of the company and those of all shareholders are aligned.

The first code of corporate governance for Pakistan was finalized in March 2002 and issued by SECP. It was incorporated in the listing of the three stock exchanges and is now applicable to all public listed companies. The primary objective of this code is to establish a system where by a company is directed and controlled by these directors in compliance with the best practices, so as to safeguard the interests of diversified stakeholders. It proposes the restructuring of the board of director's to introduce board-based representation by minority shareholders and by executive and non-executive directors. The code is emphasizes openness and transparency in corporate affairs and the decision-making process and requires directors to discharge their fiduciary responsibilities in the larger interest of all stakeholders in a transparent, informed, diligent and timely manner.

SECP took initiative to establish the Pakistan Institute of Corporate Governance (PICG) in public private partnership in 2004. The main objective of PICG is to engender sound corporate governance practices and provide an enabling environment for the implementation of the Code of Corporate Governance issued by the SECP. Another purpose of this institute is to fulfils the need for an institutional arrangement where all major stakeholders jointly study governance practices and identify the problems, remain responsive to the external environment and initiate a combination of legislation, facilitation, cultural change, social values and changes in their respective roles, where necessary.

The mission of the international Finance Corporation (IFC), the private sector of the World Bank Group, is to promote sustainable private sector investment in developing and transaction countries in order to reduce poverty and improve people's lives. IFC finances private sector investments in the developing world, mobilizes capital in the international financial markets, helps clients improve social and environmental sustainability, and provides advisory services to governments and business. IFC launched the Pakistan Corporate Governance Project (PCGP) in 2006 to improve corporate governance practices in Pakistan.

Aims and Objective

The objective of this study is to check the impact of good CG practices on commercial bank performance in the comparisons of weak CG practices commercial bank in the economy of Pakistan.

II. LITERATURE REVIEW

In past many researchers have done their studies regarding this topic and their conclusion are under fallows:

Mobeen Ur Rehman & Aabid Husain (2013) in this research paper they focus on the relationship between corporate governance and overall firm performance. This study also focuses on the style of governance that is practices in the emerging market. They had constructed questionnaire measuring corporate governance in different aspects with a strong test of validity and reliability followed by a pilot testing so check the accuracy of the questionnaire. In this way they calculate mean and standard deviation of the responses on variables. At the end they find that all three variables included independent variables in this study had the strong impact on the overall firm performance.

Gibson Munisi & Trond Randoy (2013) this study focus on the impact of corporate governance Practices on the market evaluation and company performance. In this paper they study on sub Saharan African countries that adopted practices of corporate governance but finding indicates it implement corporate governance practices particle. At the end this paper was found a positive relationship between good corporate governance practices and accounting performance. And negative relationship between the corporate governance and the market valuation. When the sub-indices are considered, they found that only the board of directors and the audit committee sub-indices are associated positively and significantly with accounting performance. And they also found that only the audit committee sub-index is associated negatively and significantly with market valuation.

Achchuthan S & Kajananthan R (2013) was found in their study on two main objectives of corporate governance practices. First is significant difference between the practices of corporate governance practices on firm performance. Second is to suggest manufacturing firm in the Sri Lanka by adopting corporate governance practices improve the efficiency of the firm performance. They select 28 manufacturing listed companies as sample size from Colombo stock exchange during the period of 2007 to 2011. For findings they use independent t- test and ANOVA (F-test). Finding exposed that, there is no significant mean different between the firm performance between corporate governance practices as board leadership structure, board committees, board meetings and proportion of nonexecutive directors.

Nadeem Ahmed, sheikh Zongjun & Shoaib Khan (2011) were found in their study on internal attributes of corporate governance such as CEO duality, ownership concentration, Outside directors, managerial ownership and board size affect the Pakistani firm performance. Results of their study firm size are positively related to all measures of performance. In sum, empirical results indicate that internal governance mechanisms had material effects on firm performance. Panel econometric technique namely pooled ordinary least squares is used to estimate the relationship between internal governance mechanisms and performance measures (i.e. ROA, ROE, EPS and market-to-book ratio) using the data of non-financial firms listed on the Karachi stock exchange Pakistan during 2004-2008.

Mostafa Kamal Hassan and Sawsan Saddi Halbouni (2013) this paper focus on effect of C.G mechanism on the financial performance of UAE listed firms. Scholars were take 95 UAE listed firm as sample in which some firm affiliated to financial and non financial sector. The result shows that CEO duality voluntary disclosure and board size significantly affect the accounting based performance measure of UAE but none of the variable affects the market performance measure of the firm's. The results also reveal that firm size is the only control variable that significantly influences firm's performance. For calculate the results they were used a cross-section regression analysis to test the significance relationship between governance mechanisms and firm performance.

Zhao yang Guo and Udaya Kumara KGA (2012) another study was done on the relationship between firm performance of the listed companies on Colombo stock exchange in Sri Lanka and corporate governance. They collect data from 174 firms and used multiple regression analysis. This study shows that there is negative relationship between board size and firm value. The shareholder directors and firm size have a significant impact on firm performance in Sri Lanka.

Krishna Reddy, Stuart Locke and Frank Scrimgeous (2010) the paper focus on the effect of principal base corporate Governance practices on the financial performance of large publically listed company. Panel data of top 50 firm's over the period 1999 to 2007 of NZX are analyzed by using ordinary least square and two stage least square regression techniques to evaluate whether, those firm's that were continuously compliant with the NZSC requirements perform better; and the firm performance post-NZSC recommendations are better than pre-NZSC recommendations. In this study there is support for the view that the NZSC recommendations had positive influence on firm performance measured by Tobin's Q, MB and ROA. The results show that the presence of a remuneration committee has had a positive influence on firm performance.

Maria Aluchna (2009). He was study on the relationship between corporate performance and corporate governance best practices. The investigation is based on the regression of corporate performance on a sample polished listed company and corporate governance compliance rating for the year of 2004 to 2006. He was concluded that corporate governance best practices are associated with lower rate of return on investment in Poland. The tendency changes into negative but statistically insignificant for the second and third years, and positive but statistically insignificant when only rated companies are included in the research sample. The relationship between proxy of Tobin's q and corporate governance rating remains statistically insignificant and is negative for the whole sample and positive for first and third year as well as for rating companies. The tendency changes into positive but stability insignificant and negative but statistically insignificant for second and third year when in research paper only related companies are included.

Bita Mashayekhi and Mohammad s Bazaz (2008) concluded from their study the role of corporate governance indices on the firm performance and the data of listed companies in Tehran stock exchange use for the year of 2005 and 2006. For corporate governance indices they used board independent institutional investor board size and board leadership and for firm performance EPS, ROE and EPS are used. There is a Positive and significant relationship between board size and financial performance Dalton at all 1998. They take samples of 240 firms and multiple regression analysis is used.

III. METHODOLOGY

In this paper we examine the relationship between the good corporate governance practices and Banks performance. We conduct this study on the banking sector of Pakistan. We divided these banks into two clusters namely good corporate governance practices and weak corporate governances. Then we computed four financial ratios namely (ROA, ROE, EPS and Profit Margin) the information is extracted from the respective annual report of the concerned banks. The time period is for which financial ratios are check from 2008-2012 of the banking sector of the Pakistan. These financial ratios are the performance indicator of the banks. After calculation of the ratios than we compared these ratios using a Mann-Whitney U test to determine whether there is any significant difference between the performances of the good corporate governance practices banks and weak corporate governance banks. In Appendix 1 we define the criteria on which we select the good corporate governance of the banks. In Appendix 2 we enlist the two groups of Banks which are used for comparison. In Appendix 3 we enlist the list of all other banks which corporate governance practices are not good.

The financial ratios can be calculated as of the respective banks:

(1) Return on asset (ROA): Net income/ Average asset
(2) Return on equity (ROE): Net income / Average common stock holder's equity
(3) Earnings per share (EPS): Net income / Weighted average of Common Shares Outstanding.
(4) Profit Margin (PM) : Net income / Total income

This study involves a small sample size (3 Commercial Banks in the both group), the Mann-Whitney U test is performed to test the following hypothesis.

H_0 = There is no significant difference in the performance between Commercial banks that practice good governance and Commercial banks that practice weak governance.

H_1 = There is significant difference in the performance between Commercial banks that practice good governance and Commercial banks that practice weak governance.

IV. FINDINGS

A. Descriptive Statistics

As discussed in the methodology, the performance of banks with good governance practices is compared with the performance of companies with weak governance practices. The banks return on asset, return on equity, earnings per share and profit margin from the year 2008 until 2012 have been calculated from the related company's annual report. Then descriptive statistics were calculated under fallows see in Appendix 4:

ROA for Good CG group is much better than weak CG in 2009 as compare to 2008. We see Good CG group perform much better in next two years then CG weak governance practices banks. In 2012 both groups seen declined trend but Good CG group is better perform compare to weak CG group. The higher ROA indicate that the good governance practices banks were able to relatively better exploit their assets to generate higher return.

As for the ROE, the weak governance practices banks seem to have better perform then good CG Practices banks in 2009. We see Good CG group perform much better in next three years then CG weak governance practices banks.

As for the EPS, We see Good CG group perform much better in next four years from 2009-2012 then CG weak governance practices banks.

As for PM the good governance practices banks is slightly better than the weak corporate governance, but both in negative. In next year's PM ratio of the both groups are same -0.08 in 2010. In 2011 the PM ratio of good CG practices banks much better then weak CG practices, but in 2012 we see the negative trend in PM ratio of good CG practices and very highly positive trend in PM ratio of weak CG practices banks approximately 34%.

B. Hypothesis Testing

To test the hypothesis stated in section 4.0 above, we employed the Mann-Whitney U test to determine whether any significant difference exist between the performance of the two groups. The Mann- Whitney U test is a non-parametric test equivalent to an independent t-test. This test would compare the mean from two independent samples to identify whether the samples have significant difference. The Mann-Whitney test was more appropriate for this study considering small sample size used.

Table 1: Result from Mann Whitney test

Ratio's	Bank	N	Mean Rank	Sum of Rank
ROA	G	5	6.6	33
	NG	5	4.4	22
	Total	10		
ROE	G	5	6.4	32
	NG	5	4.6	23
	Total	10		
EPS	G	5	7.8	39
	NG	5	3.2	16
	Total	10		
PM	G	5	5.3	26.5
	NG	5	5.7	28.5
	Total	10		

C. Test Statistics

	ROA	ROE	EPS	PM
Mann-Whitney U Test	7	8	1	11.5
Wilcoxon W	22	23	16	26.5

Results from table 4 generally suggest that the null hypothesis could not be rejected. Our result show that we accept the null hypothesis in (ROA,ROE and PM) that means there is no significant difference between bank which have CG good practices and banks which have CG weak practices. In EPS we reject the null hypothesis and accept the alternative hypothesis due to significant change in the results. For rejection and acceptance we match the Mann-Whitney U test values with critical values that are mentioned Table 3 in Appendix 5.

V. CONCLUSION

This study examines the relationship between good corporate governance practices and company performance. Utilizing governance score form a study by S&P, we grouped companies into two clusters namely good governance practices and weak governance practices. Selected financial ratios namely return on asset, return on equity, earnings per share and profit margin were used to compare the performance of the two groups of banks.

The study predicts that if banks practice good corporate governance, the banks will be able to perform better than banks that did not practice good corporate governance because a banks practicing good governance would have an effective and efficient board of directors that could play the role of monitoring and thus reduce the agency problem in banks. However the results indicate that banks' performance based on financial ratios did not reveal any difference in performance between the two groups of banks.

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Appendix 1:

Criteria on which Top 3 Bank's vs. Below 3 Bank's are selected

	Item	% of Top 3 Bank	% of Below 3 Bank
a)	Board met more than Six Time's in year	100%	83%
b)	HR & RC met more than 5 Time's in years	100%	30%
c)	Disclosure of individual attendance of HR & RC directors above	100%	N/A
d)	Above 80% attendance HR & RC meeting	100%	N/A
e)	Chaired by Independent directors HR & RC committee.	100%	N/A

Appendix 2:

Groups of Top 3 Bank's vs. Below 3 Bank's

S.No	Good Corporate Governance Bank	Weak Corporate Governance Bank
1	Allied Bank limited.	Faysal Bank limited.
2	Askari Commercial Bank limited.	Habib Metro-Politian Bank limited.
3	Silk bank limited.	Summit Bank limited.

Appendix 3:

Bank's that did not practice good corporate governance

Serial No	Ticker Symbols	Commercial Bank's
1	AMBL	Apna Micro finance Bank limited.
2	BAFL	Bank AL-Falah limited.
3	BAHL	Bank AL-Habib limited.
4	BIPL	Bank Islami Pakistan
5	BOK	Bank of Khyber XB limited.
6	BOP	Bank of Punjab limited.
7	FABL	Faysal Bank limited.
8	HBL	Habib Bank limited.
9	HMB	Habib Metropolitan Bank.
10	JSBL	JS Bank limited.
11	KASBB	KASB Bank limited.
12	MCB	MCB Bank Limited.
13	MEBL	Meezan Bank Limited.
14	NBP	National Bank of Pakistan.
15	NIB	NIB Bank limited.
16	SBL	Samba Bank limited.
17	SCBPL	St. chart Bank.
18	SMBL	Summit Bank.
19	SNBL	Soneri Bank Limited.
20	UBL	United Bank limited.

Appendix 4:

Years	Minimum		Maximum		Mean		Std. Deviation	
	Good CG	Weak CG	Good CG	Weak CG	Good CG	Weak CG	Good CG	Weak CG
ROA -2008	-3.62	-0.77	1.21	1.8	-0.74	0.61	2.54	1.30
2009	-4.01	-5.99	1.81	1.14	-0.57	-1.37	3.05	4.01
2010	-1.51	-4.03	1.89	1.1	0.24	-0.80	1.70	2.81
2011	0.49	-1.22	2.1	1.13	1.11	0.12	0.87	1.21
2012	-0.37	-2.03	2	1.12	0.66	-0.15	1.21	1.66
ROE -2008	-45.87	-3.29	21	21.71	-7.30	9.59	34.60	12.52
2009	-164.65	-44.58	30.5	14.62	-42.07	-10.19	106.76	40.03
2010	-23.4	-89.45	28.83	13.88	3.84	-22.35	26.19	58.17
2011	9.64	-24.67	29.5	13.35	17.16	-1.30	10.77	20.46
2012	-6.43	-89.27	29	12.04	9.76	-23.15	17.91	57.30
EPS - 2008	-2.24	-0.38	6.43	5.44	1.71	2.39	4.39	2.92
2009	-3.22	-4.57	10.02	3.14	2.99	0.18	6.66	4.16
2010	-0.42	-4.16	10.52	2.69	3.86	0.05	5.85	3.69
2011	0.26	-1.43	11.79	3.13	4.78	1.08	6.15	2.32
2012	-0.13	-2.54	12.34	3.25	4.58	0.75	6.77	2.97
PM - 2008	-0.44	-0.07	0.13	0.21	-0.10	0.07	0.30	0.14
2009	-0.49	-0.58	0.17	0.13	-0.09	-0.13	0.35	0.39
2010	-0.45	-0.42	0.18	0.12	-0.08	-0.08	0.33	0.30
2011	0.05	-0.15	0.19	0.12	0.11	0.00	0.07	0.14
2012	-0.04	-0.26	0.24	1.25	0.08	0.35	0.14	0.80

Appendix 5:

Table 3 Critical values of U (5% significance).

n_1 \ n_2	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
1																				
2								0	0	0	0	1	1	1	1	1	2	2	2	2
3					0	1	1	2	2	3	3	4	4	5	5	6	6	7	7	8
4				0	1	2	3	4	4	5	6	7	8	9	10	11	11	12	13	13
5			0	1	2	3	5	6	7	8	9	11	12	13	14	15	17	18	19	20
6			1	2	3	5	6	8	10	11	13	14	16	17	19	21	22	24	25	27
7			1	3	5	6	8	10	12	14	16	18	20	22	24	26	28	30	32	34
8		0	2	4	6	8	10	13	15	17	19	22	24	26	29	31	34	36	38	41
9		0	2	4	7	10	12	15	17	20	23	26	28	31	34	37	39	42	45	48
10		0	3	5	8	11	14	17	20	23	26	29	33	36	39	42	45	48	52	55
11		0	3	6	9	13	16	19	23	26	30	33	37	40	44	47	51	55	58	62
12		1	4	7	11	14	18	22	26	29	33	37	41	45	49	53	57	61	65	69
13		1	4	8	12	16	20	24	28	33	37	41	45	50	54	59	63	67	72	76
14		1	5	9	13	17	22	26	31	36	40	45	50	55	59	64	67	74	78	83
15		1	5	10	14	19	24	29	34	39	44	49	54	59	64	70	75	80	85	90
16		1	6	11	15	21	26	31	37	42	47	53	59	64	70	75	81	86	92	98
17		2	6	11	17	22	28	34	39	45	51	57	63	67	75	81	87	93	99	105
18		2	7	12	18	24	30	36	42	48	55	61	67	74	80	86	93	99	106	112
19		2	7	13	19	25	32	38	45	52	58	65	72	78	85	92	99	106	113	119
20		2	8	13	20	27	34	41	48	55	62	69	76	83	90	98	105	112	119	127