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Impact of Corporate Governance on Firm Financial Performance in Financial Sector

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Abstract
The study of Insurance has proved that there is positive relationship between the corporate governance and financial performance. However this study has focused on only three determinants of corporate governance (CEO Duality, board independent and audit committee independence).

1. Introduction

Corporate Governance (CG) is a way of being directed, organized, managed and controlled. It comprises on set of rules and regulations for all stakeholders as well as for shareholders. It defines the responsibilities and duties of the managers, board of directors, labor and shareholders. It provides proper guide to the management how to attain goals and monitor performance. A bundle of predefined standards, rules & regulations and properly stated division of labor for determining job duties and responsibilities explicitly and its implantation should be effective (Mcconomy at el. 2002). Implementation ensures the proper division of power among shareholders, management and board of directors through corporate Governance).

Corporate governance encompasses various strategies, plans and policies in order to maintain as well as improve the financial position of the firms. Corporate governance includes corporate social responsibility, social welfare, employees career plans performance appraisal, attractive dividend policies and different strategic plans and actions but all are in accordance with business goals and objectives. Good corporate governance means directing, controlling and planning should be transparent, goal oriented and address all stakeholders stakes. Corporate governance includes CEO, Board of Directors, Chief executive officers and executive manager. Effective corporate governance always works as a Bridge between the shareholders/ stakeholders and management. That's the reasons behind this fact that they serve as Watch Dogs over each and every action or activity of management in order to secure the motives & interest of the shareholders.Hence, these shareholders are considered prime concern of corporate governance because plethora of corporate shares market value is associated with their consentand it also strengthens importance of effective governance

Therefore, the importance of effective corporate governance is going to be increasing with the passage of time because investors consider it before going to invest in a specific industry or even in an organization. Recent financial scandals like Enron, Cirio and world com where investors were more conscious about CG in order to get an insight about its business, to tap favorable impacts of CG on financial position and fore most important concern was to invest with greater awareness with minimum risk. Several studies (Recent & Past) have proved the positive link between the corporate governance and firm's value and its financial position (Drobetz et al., 2006; Beiner et al., 2006 & Brown et al., 2006).

The peculiar of firm value is massively affected by financial crises. And after the Asian financial crisis of the '90s' and late global financial crisis of the last two decades, clearly state the emergence of Governance in banking sector as well as insurance companies. Especially banks are important factor in the elaboration of the systematic risk and other risk where they tried their level best to reduce or control the risk at optimal level in order to get maximum return with minimum risk. Basel committee of banks explicitly states the relevancy of effective CG with its financial position and as this authority body issue a written document in 1990, to urge all banks to adopt the modern CG structures in order to have an effective management and satisfied customers.

Moreover, during the financial crisis of 2007-2008 many financial institutions broke down and were near to collapsed due poor governance which leads to the inactive global credit markets and financial markets. Taylor (2009) studied that the cause of their financial crisis on national economic level was due to bad government governance and ineffective monetary policies. Some recent studies found that firm's risk management & financing policies along with effective CG has a greater impact on firm's sustainability (Brunnermier, 2009). Risk management and financing policies linked with cost benefit trade off designed by board of governance (Kashyap e al., 2008).

Therefore, as aconcern with financial institutions they are obliged to follow the rules and regulations in order in order to compliance with predefined standards and to satisfy their shareholders as well as their policy holders(customer). For all these, they required effective CG to meet standards and to get clean reports from the auditors. On the basis of its importance a verdict can be extract from it that good CG plays a vital role in each organization as well as industry either it may be financial or non financial.

Financial institutions are pillar of economy. This paper evaluates the impact of corporate governance on profitability of financial institutions in Pakistan. Good corporate governance force and attract different investors and corporate clients to invest in financial institutions with full confidence as due to this organizations compete and survive in dynamic and competitive environment. Corporate governance lead to meaningful and effectual command that facilitate to collaborative working environment in the organizations. For financial institutions, corporate governance becomes critical and essential for the stability of economy of some country.

2. Literature Review

Corporate Governance having all the standards of enterprise to support the economic agents to participate in the productive procedures, to produce excess beyond what is needed within the organization and maintain a good contribution among the partners, capturing into attention what they bring for organization. There were many researches about the link between Corporate Governance and firm performance in financial sector. Different studies concluded that corporate governance and finanicial performance of the company positively correlated with each other (Shleifer et al. 1997),Davis et el. 2002), Cheema, et al. 2005),Khan et al. 2011),Kumar 2012. It is also investigated that shareholders, posses condensation in firms , having a vital role to restrain and guide the management to show interest in favor of the condensation group.While corporate governance having authority to give permission to shareholders for the guidance of management for achieving better desirable position of their investment. Many studies investigated the link among four corporate governance processes (board size, board composition ,CEO/chairman duality and audit committee independence) and firm financial position measures (return on equity and profit margin) . The result have the positive interlink among the Corporate Governance procedures (board composition , board size and audit committee and performance measures , return on equity and profit margin) . The impact of study is that , the size of the board should be small within measurable limit and executive and non-executive directors must be present in the board. The research did not find out the affectionate link among the firm financial standards and CEO duality (Yasser et al. 2011).

3. Methodology

The research engaged mixture of primary and secondary facts and figures to find out the results. These facts gathered by the use of financial statements of the companies for the period 2009-2012. In this study various corporate governance factors have an impact on the linkage among corporate governance and firm’s financial position. While in our research we just have following variables that are stated below.

3.1 Independentble Variable

•CEO Duality: It prefers toward the two officers as one person was like CEO and other was Chairman.
•Board Independent: If board of the company depends one third or more upon the non executives’ directors so we can say that board is independent , in case of less than one third , it is not independent.
•Audit Committee Independence: It included non-executives in the audit committee.

3.2 Dependent Variable

•ROA: We calculate this by dividing, net income divided by total assets of the company.
•ROE: We calculate this by Net Income divided by shareholders equity of the company.

3.3 Hypothesis

It depends on the previous literature review.
H1 = There is no relationship between the corporate governance and firm’s financial performance.
H2 = There is positive and significant relationship between the corporate governance and firm’s financial performance.

3.4 Sample and Data Collection

For exploring the facts we have taken a listed company of insurance sector named as Pak – Qatar Family Takaful. Annual reports from 2009-2011 of this company studied for the collection of data.

Table 1: Analysis of Insurance Company

Company Name	Year	CEO Duality	Audit Committee	Board Independent	ROA %	ROE %
Meezan Bank Ltd	2009	Yes	Yes	Yes	13.9	16
	2010	Yes	Yes	Yes	9	11
	2011	Yes	Yes	Yes	14	12
	2012	Yes	Yes	Yes	13	11.567
Bank Islami	2009	No	Yes	Yes	14.57	13.69
	2010	No	Yes	Yes	12.5	13.01
	2011	No	Yes	Yes	11.278	14
	2012	No	Yes	Yes	13.32	14.567
State Life Insurance Pakistan	2009	No	Yes	No	9.89	9.46
	2010	No	Yes	No	9.09	9
	2011	No	Yes	No	8.67	9.78
	2012	No	Yes	No	8.82	9.97
New Jubliee Life Insurance	2009	No	Yes	Yes	0	0
	2010	No	Yes	Yes	2.3	4.5
	2011	No	Yes	Yes	5.2	5.98
	2012	No	Yes	Yes	5.8	6.2

Table 2

Company	Year	CEO Duality	Board Independence	Audit Committee
Pak Qatar	2009	No	Yes	Yes
Family Takaful	2010	No	Yes	Yes
	2011	No	Yes	Yes
	2012	No	Yes	Yes

Table 3: Performance Measures

Years	ROA	ROE
2009	(14.39%)	(15.45%)
2010	(18.02%)	(19.88%)
2011	(1.96 %)	(2.16%)
2012	5.22%	6.00%

4. Discussion

The analysis tells that financial performance of the Pak-Qatar Family Takaful is on rise due to good corporate governance as proofed by No CEO Duality, but board independence and audit committee independence have positive impact.

After analysing the Pak-Qatar Family Takaful insurance company, we find out that there is no CEO Duality , Board is independent and audit committee is also independent but the performance of the company has decreased in the last years but now is positive . Performance was decreasing due to government regulations , high taxes and energy crisis. Performance increased when number of non-executive directors decreased (from 6 in 2009 to 4 in 2012).

On the base of above discussion, the study results that corporate governance is positively associated with the firm financial performance. So it is provedthat there is a positive relationship between the corporate governance and firm's financial performance. After analysing the data we find that the ROA of Pak-Qatar Family Takaful has increased from (14.39%) in 2009 to 5.22% in 2012. Similarly the ROE was (15.45%) in 2009 and increased to 6.00% in 2012. The equity has been improved.

5. Directions for Future Research

There exist other internal and external factors and determinants of corporate governance that need to be investigated. Further investigation also can be carried assuming other factors to examine the relationship between the corporate governance and firm financial performance. It can also be extended by considering other measures of performance. CG and financial position of the firm in terms of ROA & ROE. They also studied the comparative impact of board structure and corporate structure on firm's performance. From the results they extract that the impact of corporate structure is much more higher than the board structure.

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