Impact of Corporate Governance on Financial Performance

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Abstract:
The purpose of the study is to determine the structural relationship between corporate governance and financial performance. The study develops a model linking corporate governance and financial performance then verifies it through structural equation modeling based on partial least square. The study is based on random sample of all Karachi Stock Exchange listed companies. Data related to corporate governance and financial performance was collected through annual reports of listed companies. The study reveals and determines the existence of critical structural relationship between corporate governance and financial performance through data analysis using PLS Graph software. The study concludes that corporate governance does not improve financial performance consistently. Rather it proposes that corporate governors can enhance it significantly through exploiting intangible resources. The study can be considered as one of the most comprehensive studies in Pakistan measuring the impact of corporate governance on financial performance using structural equation modeling and covering all Karachi Stock Exchange companies.

Keywords: Corporate governance; Financial performance; Structural equation modeling; Partial least square; Karachi Stock Exchange.

I. Introduction
Objective of corporate governors is to gain competitive advantage in a free market knowledge economy. This competitive edge is possible if CG enhances value through exploiting all available resources. Good CG practices ensure better decision making, operational efficiency, and reduction in wastes. It further balances the interests of all stake holders including executives and non-executive (Shleifer and Vishney, 1997). Shareholders can believe that companies with good CG practices make sure that free cash flow should be returned to shareholders as dividend rather than being expropriated by the insiders (La Porta et al., 2002).

Big corporate scandals in USA during the years 2000 and 2001 (Enron, WorldCom and Tyco etc.) and rest of the world left deep scars on the corporate world. These scandals pushed regulatory authorities to bring laws against complains of corruption, frauds, deception and insider trading such as Sarbanes-Oxley Act (2002). It was proved that traditional governance structure could not stop expropriation of insiders and was a
source of inefficiency. Due to these scandals faith of the investors on capital market was shaken. As a result, regulatory authorities around the world made it compulsory for corporate sector to comply with the code of best CG practices to promote the transparency, accountability and fairness for all stakeholders. This in turn can mitigate the agency cost as predicted by Jensen and Meckling (1976). These corporate scandals and agency theory were the major reason behind the promulgation of codes and standards of CG around the world. As a result the market regulatory agency, Securities and Exchange Commission of Pakistan (SECP) introduced the code of corporate governance for the first time in 2002. Thus after using the effective governance system corporations can improve their managerial efficiency and maximize the value for its stakeholders. Now once again SECP improved CG codes further in 2012.

Because previous studies show that poorly governed firms have lower operating performance while good governed firms demonstrate higher financial performance and market valuation (Shleifer and Vishny, 1997; Bebchuk et al., 2004). Firms with good CG practices not only grant more cash dividend but also more rights to its shareholders. Arnott and Asness (2003) suggest that better governed firms pay more cash dividend to its shareholders. Javed and Iqbal (2006), while analyzing the effect of CG on firm’s performance in Pakistan conclude that good CG measures uncover low production and bad management practices through transparent disclosure and transparency standards. Reporting on the causes of failure of rural community banks in Ghana, Bank of Ghana (2001) identifies that ineffective board of directors has been one of the causes of failure of those banks. In this way good CG practices help to help to promote general welfare of the society.

Pakistan is an interesting case to analyze the CG – financial performance link due to number of reasons. Since 2002 after the promulgation of the code of corporate governance by SECP, State Bank of Pakistan and stock exchanges, reasonable time period has passed until 2005 to streamline the CG adoption and reporting. Now it is possible to study whether good CG measures proposed by regulatory authorities of Pakistan have any impact on financial performance of listed companies of the country.

II. Literature Review

In the early literature, relationship between CG and corporate performance has been widely studied but reached no consensus. There is a widely held view that good corporate governance practices are associated with better firm performance. Prior research has linked corporate governance to firm valuation using Tobin’s Q. There are also some studies in which CG indexes and financial performance have been correlated. Some studies have found this important relationship significant (see Ehikioya, 2009; Gruszczynski, 2006; Alves and Mendes, 2002; Drobetz et al., 2003 and Gemmill and Thomas, 2004) and some found it as insignificant (Abdullah and Page, 2009; Sueyoshi et al., 2010). Couple of CG measures have also been proved as having inverse relation (Yermack, 1996). Although, many studies prove that CG is a performance driver and adds value to a firm (Ehikioya, 2009; Gemmill and Thomas, 2004 and Drobetz et al., 2003). Even those studies which provide inconclusive results related to CG and performance argue that CG has, at least, indirect effect on company performance (Maassen, 1999).
Poor corporate performance has also been treated as a byproduct of poor corporate governance. For example Gompers et al. (2003) examine the relationship between CG index and long term equity returns, firm value and accounting measures of performance. Their results reveal that well governed firms show higher equity returns, higher value and better accounting results as compared to their poorly governed counterparts. In the same way Drobetz et al. (2004) find positive relationship between CG practices and expected stock return in German public firms. Brown and Caylor (2005) find that better governed firms are more profitable, enjoy high market value and pay more cash dividends to their shareholders. Shaheen and Nishtar (2005) explore relationship between CG and firm performance. They find association between CG and firm performance but not causality. Black et al. (2006) while exploring the effect of CG on firm value find positive relationship between CG index and Tobin’s Q in a sample of Korean public firms. Gruszczynski (2006) while advocating panel data and using Logit model to study the firms listed on Warsaw Stock Exchange concludes that there is significant association between CG rating and operating profit. Che-Haat, et al. (2008) while studying the CG, transparency and performance of Malaysian firms use hierarchical regression technique on 73 good performing companies and 73 bad performing companies and find that CG factors have strong predicting power on company performance in Malaysia mainly due to debt monitoring and foreign ownership.

On the other side, Sunday-O (2008) conducted a study on CG and firm performance using twenty Nigerian listed firms between 2000 and 2006. Using panel methodology and OLS as a method of estimation, the results were mixed; CEO duality and board size were significant while board composition and audit committee were insignificant. Javed and Iqbal (2006), while analyzing the effect of CG on firm’s performance in Pakistan conclude that not all elements of CG enhance firm’s performance. They further conclude that good CG measures uncover low production and bad management practices through transparent disclosure and transparency standards.

In the recent studies related to CG and firm performance, Ehikioya (2009) conducted study on CG structure and firm performance based on listed companies of Nigerian Stock Exchange and concluded that ownership concentration has positive impact on performance and greater than one family members on the board showed adverse effect on firm performance. Abdullah and Page (2009) conduct study on CG and corporate performance, using data of FTSE 350 companies of UK find little support of association between CG and corporate performance. They further that CG factors explain very little variation in risk variables. While Sueyoshi et al. (2010) bring new empirical evidence that corporate governance reforms by the Japanese government have influence on the performance of Japanese firms. They further prove that foreign shareholders bring managerial discipline and experiences which ultimately enhance the operational performance of Japanese firms.

Bauer et al. (2010) while studying the impact of corporate governance of Real Estate Investment Trusts (REIT) and their performance find that Corporate Governance Quotient Index (CGQ index) is neither related to REIT value measured through Tobin’s Q nor to any of the three operating measures of performance, while REITs with greater property, plant and equipment show relationship between CGQ index and performance. In the same direction is the study done by Aboagy and Otieku (2010), who examine the association between CG of microfinance institutions and performance. The authors find
no association between categories based on CG and categories based on financial performance. Renders et al. (2010) find significant positive relationship between CG ratings and performance in a Cross-European study covering fourteen countries after controlling sample selection bias and endogeneity. It is further added that strength of this relationship seems to depend on the quality of institutional environment. In the same direction is the study done by Reddy et al. (2010), who apply ordinary least squares and two stage least squares regression techniques to analyze the impact of New Zealand Securities Commission’s principles of CG on firm performance. It is concluded in their study that these CG principles have positive influence on firm performance measures.

A comprehensive review of literature shows that the researchers have not reached any consensus and document that some studies find significant impact of CG on financial performance (Ehikioya, 2009; Gruszczynski, 2006; Gemmill and Thomas, 2004; Droebetz et al., 2003; Alves and Mendes, 2002 and Yermack, 1996) while others demonstrate no association (Aboagye and Oteiku, 2010; Sueyoshi et al., 2010; Bauer et al., 2010; Abdullah and Page, 2009). These mixed results prompt the researchers to investigate the role of CG and financial performance further. Even those studies which provide inconclusive results argue that CG has at least indirect effect on performance (Maassen, 1999). Further studies are needed to determine interplay of CG and financial performance. In this way, our study attempts to test the previously undecided link between CG and financial performance.

III. Developing the Model

The research focuses on good CG measures and their connection with financial performance. Further, it develops a structural model to prove these connections based on the premise that board of directors is responsible to gain higher financial performance. That’s why board composition, ownership structure, board meetings, CEO duality and managerial remuneration have been taken as firm level CG measures. The financial performance of a firm is measured by return on investment (ROI), return on equity (ROE) and net profit after tax (NPAT) following the studies conducted by Mavridis (2005) and Tan et al. (2007).

Using structural equation modeling based on partial least square, first latent exogenous construct (corporate governance) can be measured in mathematical terms as:

\[ \xi = \gamma_1 X_1 + \gamma_2 X_2 + \gamma_3 X_3 + \gamma_4 X_4 + \gamma_5 X_5 + \gamma_6 X_6 + \zeta \]

Second latent endogenous construct (financial performance) is measured as:

\[ \eta_1 = \gamma_7 Y_6 + \gamma_8 Y_7 + \gamma_9 X_8 + \zeta \]

In this way, the hypothesis \((H_1)\), impact of latent exogenous variables, corporate governance measures (\(\xi\)) on latent endogenous variables, financial performance (\(\eta_1\)) would be measured as:

\[ \eta_1 = \beta_1 \xi + \zeta \quad (H_1) \]

Table 1 gives a summary of exogenous and endogenous variables.
IV. Developing Hypothesis

a) Percentage Share of Directors

Board of directors play important role in implementing good CG measures. They are usually expert in specific industries and monitor the top managers, take corrective actions, replace poorly performing managers and determine managers’ compensation. There are various studies which show percentage share of directors plays significant role towards overall performance of an organization while others find it insignificant.

Morck et al. (1988) conducts empirical study on managerial ownership and firm valuation and find a positive relationship when the ownership is below 5%, and negative relationship when the ownership is between 5% - 25%. They estimate piecewise linear relation between board ownership and Tobin’s Q concluding that Tobin’s Q increases with board ownership. Hiraki et al. (2003) also find evidence in the same direction while studying the CG and firm value in Japan covering the period from 1985 to 1998. Khanna (2005) conduct study on managerial ownership and firm value in the light of agency theory and conclude that this relationship is not spurious and there is a strong evidence that insider ownership significantly impact firm value.

On the other side, there are Himmelberg et al. (1999), who calculate determinants of managerial ownership and their link with performance. They find no meaningful correlation between managerial ownership and performance. Based on the above literature it is assumed that high percentage of ownership by the board of directors in a firm would lead to improve financial performance.

b) Percentage of NED directors on the board

Board of directors is recognized as important mechanism for protecting the interest of different stakeholders (Fama and Jensen, 1983). Agency theorists argue that if executive directors and managers are well supervised by the board, it reduces the agency cost. This supervision can be achieved through a balancing the board of directors having majority independent NEDs to control the opportunistic behavior of executive directors. They further argue that the larger the number of NEDs on the board the better they can play their role in monitoring and controlling the activities of insiders (Jensen and Meckling, 1976).

Literature shows mixed relation of independent NEDs on the board and corporate value. John and Senbet (1998) find better performance of firms with board of directors dominated by outsiders. Liang and Li (1999) after using data of 228 small private firms in China conclude that the presence of outside directors has significant positive correlation with return on investment. Daily and Dalton (1994) while examining CG in bankrupt firms find that having more independent NEDs on the board improves performance. Abdullah and Page (2009) after using two stage least squares methodology on field data from UK between 1999-2004 conclude that return on assets and sales to total assets ratios have significant regression coefficients with board independence.

However, Pinteris (2002) finds no such relation of the presence of NEDs on board and accounting profit of the firms. Bhagat and Black (2002) find no correlation between degree of board independence and measures of performance. They also find that poorly performing firms are more likely to increase the independent NEDs on their board. Sunday-O (2008) in his study of twenty Nigerian listed firms for the period 2000-06
conclude that outside directors sitting on the board and two performance measures; return on equity and profit margin have no statistically significant correlation. The above literature portrays mixed relation between proportion of outside directors and firm performance, it is thought appropriate to examine and conclude its impact on performance.

c) CEO duality

This measure of CG has become a point of concern for corporate community. Proponents of agency theory argue for separation of CEO’s role from chair on the grounds of providing enough check and balance over CEO’s and other executives’ performance (Blackburn, 1994).

Abdul-Rahman and Haniffa (2005) while analyzing the effective mechanism of governance document that Malaysian companies with role duality do not perform equal to their counterpart with separate leadership and the effect of separate leadership on performance is worth testing. Carter et al. (2003) use two stages least square to estimate the relationship between CG, board diversity and firm value and conclude that CEO duality has negative significant impact on Tobin’s Q suggesting that firm value declines when CEOs are also board chairs. Brown and Caylor (2004) conclude that firms show more value when CEO and Chair positions are occupied by separate person.

However, there are studies who conclude different results on this relationship. For example, Liang and Li (1999) do not find any positive link between separation of the position of CEO and board chairman. The above discussion provides basis to support the assertion that there is a positive link between this important measure of CG and firm performance.

d) Remuneration of Directors and Other Executives

Agency theory explains that executive management will act opportunistically to increase their personal outcome after using their privileged position at the cost of other stakeholders. Evans and Stromback (1994) conduct study on structure and accounting determinants of Australian executive remuneration. They find statistically significant relation between executive pay and accounting rate of return. Mehran (1995) concludes positive relationship of percentage of compensation earned by managers and firm performance measured through Tobin’s Q and return on assets. Therefore, it can be argued that increase in executives’ compensation is likely to have positive impact on financial performance of a firm. Brown and Caylor (2005) find that two governance factors; executive and director compensation are significantly correlated with firm valuation measured in terms of Tobin’s Q.

However, Evans et al. (2002) conduct study on sample of Australian listed firms covering the period 1996-1999. They find no significant relationship between executive compensation and firm performance. Considering the above arguments of agency theory and literature support, it is hypothesized that managerial remuneration is likely to have positive impact on financial performance.

e) Percentage Share of Executive Directors

This study uses the ratio of executive directors’ shareholding to total shareholding of the firm in order to capture the incentive level of executive directors. As the proportion
of managers’ share increases, their interests match more closely with outside shareholders thus reduces the agency problem and improves the financial performance. There are many studies that focused on examining this relationship. Mehran (1995) finds the positive relationship of percentage of equity held by managers and firm performance measured through Tobin’s Q and return on assets.

Therefore, debate in CG literature is conflicting as to whether share of executives leads to higher financial performance. In this way, this study attempts to test this relationship empirically.

f) Number of shareholders
Role of large number of shareholders in an organization can be positive as they can attend annual general meetings regularly and exert their pressure to protect the rights of outside shareholders, reduce the expropriation of insiders, manipulation of accounts thus strengthening the external control system (Aguilera and Jackson, 2003). If executive directors do not take care of the interest of majority of shareholders, it leads to reduction in market price of shares. Good CG measures ensure the alignment of the interest of shareholders and managers. That’s why German and Japanese CG models give authority to shareholders to appoint supervisory board on the top of primary board of directors/management boards. In the literature impact of large number of shareholders on financial performance has not been explored earlier.

In this situation of conflicting arguments and evidences from the literature regarding the relationship between different CG measures and financial performance, it seems appropriate to revisit this link. Thus study proposes its testable hypothesis as follows:

\( H_1: \) All else being equal, companies with good corporate governance measures tend to have higher financial performance.
Fig 1: Structural Connections between CG and Financial Performance

V. Data Analysis and Results

a) Partial Least Squares Approach To Structural Equation Modeling

PLS is a powerful statistical tool of second generation allows to model and examine series of relationships simultaneously thus suitable for theory construction in explanatory sense and can be used for causal predictive analysis. Wolds (1985) explains that PLS is primarily intended for causal predictive analysis where complex models and multiple sets of endogenous and exogenous indicators are involved and is useful for theory development, such as this study which focuses on measuring the impact of CG on financial performance. It is regression based prediction oriented approach focusing on explanation of variance for predicting the dependent constructs rather than covariance between items. It focuses on minimizing the variance of dependent variables explained by independent variables instead of reproducing the covariance matrix (Chin, 1998). It calculates all path coefficients and individual item loading simultaneously thus allowing researchers to avoid biased and inconsistent parameter estimates (Cabrita and Bontis, 2008). Yu and Main (2010) suggest that SEM to be used in dealing concepts difficult to capture, such as governance and board monitoring. Thus PLS based SEM is common research methodology in management research (O’Regan et al., 2001; Bontis et al., 2002). Although it is possible to handle formative indicators with covariance based SEM rather than PLS, it can lead to problems such as identification of the model or the existence of equivalent models (Chin, 1998). Considering the features of PLS such as smaller sample requirement, no assumption about multivariate normality, ability to handle both reflective and formative indicators, capacity to handle different measurement scales and its robustness with fewer identification problems, it has been selected for this research study.

b) Analysis of the Measurement Model

Analysis of the measurement model attempts to confirm the validity and reliability of all latent variables that are included in the structural model. Weights calculated
through bootstrapping technique through PLS Graph Version 3.0 demonstrate that how each individual indicator contributes towards its respective emergent construct. As far as the CG construct is concerned, managerial remuneration has greater contribution towards capturing the CG rather than any other individual indicator in all five years period 2009-05. Further this contribution (0.900, p < 0.01; 0.828, p < 0.01; 0.973, p < 0.01; 0.982, p < 0.01; 0.971, p < 0.01) remains significant in all five years period. While ratio of non executive directors on the board shows significant contribution towards measuring the CG in the year 2007 and 2009 only. Rest of the indicators in CG construct remains insignificant in all years, but keeping in view the theoretical perspectives, legislative support, literature support to CG and IC indicators and to maintain the content validity they were not dropped from the construct.

In can be observed that financial performance construct is best captured through net profit after tax. Its contribution (0.998, p < 0.01; 1.007, p < 0.01; 0.996, p < 0.01; 0.545, p < 0.05; 0.636, p < 0.01) towards capturing the overall financial performance remains significant in all five years period. While return on investment shows significant contribution towards capturing the financial performance in the year 2006 only. Rest of the indicators in financial performance construct remains insignificant in all years, but keeping in view the legislative support, theoretical perspectives, literature support and to maintain the content validity they were not dropped from the construct. If all these weights had been significant and very high, doubts would have arisen regarding the formative nature of indicators (Aldas-Manzano et al. 2009).

Andreev et al. (2009) conclude that construct reliability of formative indicators should be performed through multicollinearity test. Considering the arguments of Andreev et al. (2009) and Thongrattana, (2010) it is thought appropriate to test construct reliability of formative indicators through test of multicollinearity. The variance inflationary factor (VIF) is a common way of detecting multicollinearity. Because high collinearity among indicators can produce unstable estimates and makes it difficult to judge individual indicators’ role towards formation of their relevant construct. For this purpose, collinearity test was performed through using SPSS to calculate VIF after taking each indicator of financial performance construct one by one. Results show that VIF remains below 10 in all five years 2005-2009 indicating that none of the independent indicator is substantially explained by other independent indicator. Indicators have greater than 10 VIF and greater than 0.90 correlations were dropped from the measurement model. According to Kleinbaum et al. (1988) and Mayer (1990) VIF value lesser than 10 does not pose problem of multicollinearity.

c) Analysis of the Structural Model

Once the quality of measurement model is confirmed through appropriate tests, the quality of structural model is assessed on the basis of significance of relations between latent constructs (\( \beta \)), overall goodness of fit (R\(^2\)) and predictive power of the model (Q\(^2\)). To understand the dynamics of CG and its impact on financial performance, it seems advantageous to apply structural equation modeling based on partial least square to measure the impact of a set of independent variables on another set of dependent variables. PLS is a non parametric technique which combines principal component analysis and regression and does not require normality of data.
Using PLS based SEM, strength of hypothesis formulated in the research is generally measured through analyzing path coefficients ($\beta$). Standardized path coefficients permit the fulfillment of the proposed hypotheses (Saenz et al. 2007; Serrano-Cinca et al. 2009). In order to have the statistical significance of path coefficients ($\beta$) a bootstrapping technique through 500 resamples with replacement was applied.

**TABLE 1: Path Coefficients (2005-09)**

<table>
<thead>
<tr>
<th>Path</th>
<th>Beta Coefficient</th>
<th>t-value</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corp_Gov and Fin_Perf. (2009)</td>
<td>-0.0210</td>
<td>0.0137</td>
<td>p&gt;0.10</td>
</tr>
<tr>
<td>Corp_Gov and Fin_Perf. (2008)</td>
<td>-0.1070</td>
<td>0.1788</td>
<td>p&gt;0.10</td>
</tr>
<tr>
<td>Corp_Gov and Fin_Perf. (2007)</td>
<td>0.5280*</td>
<td>1.7376</td>
<td>p&lt;0.10</td>
</tr>
<tr>
<td>Corp_Gov and Fin_Perf. (2006)</td>
<td>-0.0340</td>
<td>0.063</td>
<td>p&gt;0.10</td>
</tr>
<tr>
<td>Corp_Gov and Fin_Perf. (2005)</td>
<td>0.1390</td>
<td>0.2131</td>
<td>p&gt;0.10</td>
</tr>
</tbody>
</table>

* Significance at 10% (1.645), ** Significance at 5% (1.96), *** Significance at 1% (2.576)

Table 3 list the beta coefficients and t values including their level of significance from the year 2005 to 2009. Link between CG and financial performance has been seen very weak in the year 2009 ($\beta = -0.021$, t-value = 0.0137, p> 0.10). This weak relationship between CG measures and financial performance is consistent with Abdullah and Page (2009) and Sueyoshi et al. (2010) who find insignificant link between CG and FP. The year 2007 is the only year when CG impacts positively financial performance ($\beta = 0.528$, t-value = 1.7376, p< 0.10). Overall 2005-09 results support the basic premise of the study that CG does not influence financial performance directly rather it may exert its influence on financial performance through some hidden variables.

**d) Results of Hypotheses Testing**

The study tests the hypothesis formulated in the beginning on the bases of strength of path coefficients by calculating multiple path values through PLS Graph Version 3.0. The standardized path coefficient ($\beta$) shows the significance of relations between latent constructs and permit the fulfillment of the proposed hypotheses to be analyzed. Chin (1998) suggests value of path coefficient should be at least 0.20 and may ideally exceed 0.30 to analyze the hypothesis meaningfully. Link between CG and financial performance shows very weaker $\beta$ values and remains lesser than 0.14 in all years except in 2007 when it is insignificant but up to 0.528. In this way it can be concluded that CG exerts insignificant, inconsistent and weaker impact on financial performance. Forthcoming table shows hypothesis testing for the period 2005-09.
Table 2: Hypothesis Testing (2005-09)

<table>
<thead>
<tr>
<th>Year</th>
<th>Hypothesis</th>
<th>Suggested effect</th>
<th>Path coefficient</th>
<th>Sig.</th>
<th>Confirmed</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>All else being equal, companies with good corporate governance measures tend to have higher financial performance.</td>
<td>+</td>
<td>-0.0210</td>
<td>p&gt;0.10</td>
<td>no</td>
</tr>
<tr>
<td>2008</td>
<td>All else being equal, companies with good corporate governance measures tend to have higher financial performance.</td>
<td>+</td>
<td>-0.1070</td>
<td>p&gt;0.10</td>
<td>no</td>
</tr>
<tr>
<td>2007</td>
<td>All else being equal, companies with good corporate governance measures tend to have higher financial performance.</td>
<td>+</td>
<td>0.5280*</td>
<td>p&lt;0.10</td>
<td>yes</td>
</tr>
<tr>
<td>2006</td>
<td>All else being equal, companies with good corporate governance measures tend to have higher financial performance.</td>
<td>+</td>
<td>-0.0340</td>
<td>p&gt;0.10</td>
<td>no</td>
</tr>
<tr>
<td>2005</td>
<td>All else being equal, companies with good corporate governance measures tend to have higher financial performance.</td>
<td>+</td>
<td>0.1390</td>
<td>p&gt;0.10</td>
<td>no</td>
</tr>
</tbody>
</table>

* Significance at 10% (1.645), ** Significance at 5% (1.96), *** Significance at 1% (2.576)

In hypothesis it is suggested that CG would have positive impact on financial performance. Table 4 shows values for the parameter of this relationship (-0.0210, -0.1070, 0.5280, -0.0340, 0.1390) for the period 2009-05. All of these path coefficients are statistically insignificant except in the year 2007, thus it proves that CG does not exert significant impact on financial performance directly. In this way H1 related to the impact of CG on financial performance is not supported.

VI. Conclusion

The main research issue of this study was to determine the structural links and resulting impacts of CG measures on firm’s financial performance. The study was positioned to conclude CG – Financial Performance relationship through empirical research. The path coefficient values (β) reject the premise that there is a high positive correlation between CG measures and financial performance, thus H1 is not supported. It should be noted that the rejection of H1 is not surprising and consistent with the results of previous studies, such as Abdullah and Page, (2009) and Sueyoshi et al. (2010).
After considering the reliability and validity of measurement model and path coefficients, coefficient of determination of structural model, it can be concluded that there is no direct impact of company’s corporate governance measures on financial performance.

Using a stratified random sample of KSE listed companies; impact of good CG practices on financial performance has been studied. The research reveals that good CG has mixed impact on financial performance over the period 2005-09. The study uses second generation multivariate technique; PLS based structural equation modeling particularly appropriate in causal-predictive analysis in complex situation which has not been applied before in the area of CG. The contribution of this research is important for both academic researchers and business managers. This study enhances the validity of previous studies on relationship between CG and financial performance and makes several significant contributions to the literature.

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