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Evolution of Corporate Governance Practices and Conventional Banks Profitability

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Abstract

This study has been conducted to discover the good governance practices influence on profit of conventional banking system. Prime aim is to discover the application of these practices in the corporation for betterment. This research based on mixture of primary and secondary data. Sample for primary data collection for study is different conventional banks of Pakistan. Observation method and structured questionnaires is used to obtain the data from respondents (banks employees). Obtained data is analyzed through statistical software SPSS. Regression analysis is done to check out the effects of corporate governance and its determinants on profitability of conventional financial institution. So findings possess that banks profit tend to be enhance with the espousal of ethical practices in corporate culture. Study concluded that if financial institution behave ethical manner, socially obliged and invest for well being of society after that they will get and enhance profit from social capital in addition to be considered as socially responsible corporations by adopting regulatory system aptly.

Keywords: Corporate governance; Profitability; Ethical practices; Regulatory system; Performance measures

Introduction

Corporate administration is known as mix of parameters, standards, regulation and business rehearses that lead the relationship among administration and all partners. This business technique or practice includes reasonable, translucent and productivity in organization which make them ready to get the sought and arranged results. Corporate administration works and controls an organization in precise way despite the fact that organizations animate and draw in the money related and human capital. Corporate administration framework is grasped a wide exhibit of business practices and organization since book keeping laws and standard which concern the financial admission and revelation towards administrative remuneration and in addition piece of corporate board.

First time in Pakistan corporate administration code was dispersed in March 2002. Prior to this it was noticed that present business college was accentuating on the improvement of solid corporate administration. Pakistan establishment of corporate administration was produced to put consideration on preparing of personnel of SECP and stock trade. In corporate world, that establishment was formed to add to a bridge or association among company and its regulation framework. In broad mind and wide view corporate administration is the reciprocal and relating arrangement of legal , social and money related organization that shield the enthusiasm of all partners of company.

In Anglo American framework, real shareholders known as proprietors and corporate chief acts as specialists so corporate administration origination expect an essential anxiety among shareholders and corporate directors. The two put exertion for their own particular intrigue so as organization set administrative bodies as Directors who are the adherents of stewardship hypothesis. The foundation and establishing of SEC security and Exchange Commission of Pakistan is spoken to an indispensable highlight for the advancement of domineering structure of capital marketplace. SEC performs operational exercises and be fruitful for CLA Corporate Law Authority known as government office appended to Ministry of Finance. In the first place it was concerned with administrative of capital business and corporate division. Commission has been ordered into distinctive areas like as protection, securities, HR and Administration and organization Law division and the greater part of that work for powerful administration.

Good corporate governance proves more supportive for the development of economic sustainability through maximizing corporation's performance and productivity as well as access to outside or exterior capital. It reduces liability and exposure of financial crises, reinforcing property rights and contributes to development of capital market. Corporate governance concerns to the linkage between major and minority shareholders, BOD's, top management and all other stakeholders. East Asian Financial crises capture the serious consideration and notice to the vitality of corporate governance in developing countries.

In 1999, OECD (organization for Economic Co-operation and Development) has developed a series of principles for corporate governance that have been proved core pattern to assess the country CG pact and arrangements. It provides composition by which company goals are set, means of accomplishing all those objectives and monitoring performance and quality standards. General approaches to corporate governance to defend and protect rights of investors. Initially delegates power to investors and shareholders through legal way and focus for minorities shareholders' rights and legal prohibition beside administrative self decision and dealing. The next major approach relates to concentrated ownership by major investors by matching considerable and significant cash flows and control rights. Large investors mostly rely on legal system and minimize the agency cost and issues as they do not have require many rights as minor shareholders needs to protect own rights, So Corporate governance is commonly exercised via major investors or shareholders.

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Effective corporate governance leads to efficiency and high growth of companies, minimize risk and stabilized economic conditions by getting investors confidence in strategic way. Apart since all these financial development and modifications, corporate governance code has been executed to all listed firms of Pakistan in 2002, prime aim is to persuade good governance in whole dynamic business market.

The aim of this research paper is to find out the link among corporate governance and corporate performance for financial institutions. So in this study we try to recognize the relationship among corporate governance determinants and practices with conventional banking regulatory and profitability in dynamic competitive market.

Literature Review

This research paper is going to review the previous studies on corporate governance practices in various financial institutions of different developing and developed countries. Corporate governance makes sure that companies get the responsibility to manage, control and monitor all matters in systematic way by preserving the interest of stakeholders [1]. The facets of corporate governance deal with initiating the process by which core values are achieved and ethics known as behavioral guide [2-4].

According to Mallin [5] corporate governance is a mode through which companies administer and oversee their businesses by following its practices and reforms strategies and maximize profitability. Ineffective corporate governance mechanism in corporations proves as major factor to the current financial crises. Jamali, Safieddine, Rabbath [6] argued that ideas and suggestions for governance variables as corporate social responsibility is the advancement and evolution since benevolent activities toward applicable tactic for getting the trust of community and major clients at all. In accordance to Marcinkowska [7] corporate governance determines all factors that have significant influence on institutional procedures such as employing and appointing controllers and regulatory systems for organizing activities. The customers are the co-initiator of assessment and value thus corporate governance practices and social responsibility of corporations is incorporated similar to others firm capital and possessions that give strength to shareholders as well as all stakeholders. In accordance to Iqbal [8], study finding explored strong connectivity among fiscal performance of banking sectors of Pakistan and application of corporate governance. It covers up basically many gauges involving effectiveness and independence of board and audit committee for regulatory system. Khan et al. [9] explains that corporate governance practices and governance determinants and financial performance of Islamic financial institutions. Study revealed that significance link and connectivity among large board size and profitability because board protect the rights of major shareholders. They idealize the resource dependent theory which mainly emphasize on accountability, profitability and transparency for achieving corporate goals (Figure 1).

Determinants of governance and profitability and development of hypotheses

Corporate governance is used as independent variable measured through its component which is Ethical practices applicable in corporation. Banks profitability is measured through two determinants that is Return on equity and Return on Assets. Research Hypotheses is developed after review previous studies regarding corporate governance and financial performance of financial institutions and test by descriptive research device.

H1: There is a positive link among corporate governance Practices and conventional banks profit.

H2: There is a positive link among Ethical practices (business ethics and social obligations) and firm financial performance.

Research Methodology

For this study, descriptive research design is adopted that include questionnaires, observation method, individual interviews and case study but convenience method is structured questionnaires by using lickert scale method. Primary data is obtained by distributing questionnaires among bank's employees by hand and some through mails in different branches of conventional banks in Punjab. Response from electronic mode is less significance rather than by own visits and individual interviews from employees.

Data Analysis and Results

Statistical analysis is conducted by the help of statistical instruments SPSS. Various tools and techniques are availed for testing research hypothesis. Regression analysis is done to interpret the obtained data. To get confirmation the significance of governance variables and profitability measures through firm performance, ROA and ROE (Tables 1-4).

Results

In this study analysis shows that the goodness of research model, in accordance to ANOVA test results significance value is .000<. .005 and R SQUARE results = .992 which implies 99% variation come into dependent variable measures ROA is due to applying ethical practices in the financial institution R-SQUARE value for ROE .87 which explains by CG determinants. Social obligation of corporate Coefficient value is 2% and 8% which possess that if firms invest 1% for social work then it will become cause increase near about 8% increment

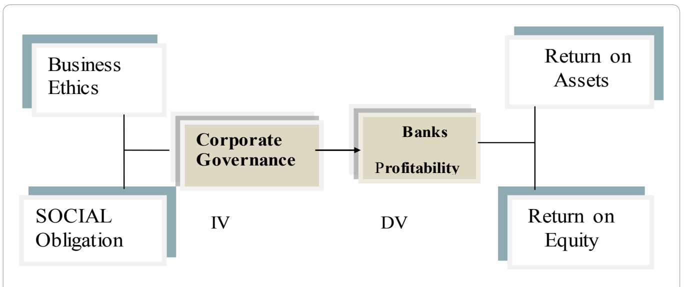

Figure 1: Conceptual framework.

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	220.324	4	55.081	2922.064	.000[a]
	Residual	1.791	95	.019		
	Total	222.115	99			

a. Predictors: (Constant), ethics, CSR
b. Dependent Variable: ROA

Table 1: ANOVA[b].

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	32013.365	4	8003.341	169.526	.000[a]
	Residual	4484.956	95	47.210		
	Total	36498.321	99			

a.Predictors: (Constant), business ethics, social obligations
b.Dependent Variable: ROE

Table 2: ANOVA[b].

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.996[a]	.992	.992	.13730

a. Predictors: (Constant), Business ethics, Social obligation.

Table 3: Model summary.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.937[a]	.877	.872	6.87096

a. Predictors: (Constant), Business Ethics, Social Obligation

Table 4: Model summary.

IV	DV		p-value
Business Ethics	ROA	0.008	0.046
Business Ethics	ROE	0.039	0.038

Table 5: Regression results.

IV	DV		p-value
Social Obligations	ROA	0.020	0.043
Social Obligations	ROE	0.086	0.045

Table 6: Regression results.

in profitability. Regression results shows p value is significant at .04 for ROA and .03 for ROE for both predictors as social obligation and ethics. Business ethics coefficient results reveals no more change in profitability measures as in results of investing in ethical practices. So statistical results are quite different from previous study and discussed data in this research (Tables 4-6).

Conclusion and Discussion

By applying different statistical tool to interpret the obtained data and to test the research hypothesis, it is identified positive influence of governance practices on banks profitability. First hypothesis states positive relationship among governance practices and conventional banks profitability so statistically proved the significance of link among both variables. Profitability ratio is enhanced little bit way when banking system behave themselves as ethical manners. By performing these codes of conduct and principles, performance and profitability of financial institutions will lead to the development of corporations. Second hypothesis is analyzed statistically, all components of ethical practices like as business ethics and social obligations are positively associated with firm financial performance. If corporations behave ethically and maintain business decorum and socially obliged to perform for well being of society thus they will not consider as materialistic entity that only work for profit maximization. Since corporations act as socially responsible and enhance their social contacts with clients and customers subsequently they achieve their goals ultimately.

Direction for future research

Current study has revealed the significance influence and relationship among corporate governance and profitability of banks. Thus here researcher emphasize on governance variables or determinants like as business ethics and social obligations of the corporations so others ethical practices must have to be discussed and evaluated in terms of financial performance indicators. Corporate governance code should be essential for adoption for every firm because adequate application of this code will prove more opportunistic ways for getting maximum profitability.

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