Role of Financial, Corporate Governance and Economic Variables on Banking Sector Performance of Pakistan

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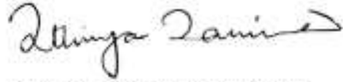

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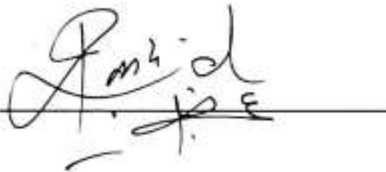
External Examiner: 

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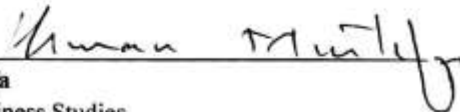
Head of Department: 
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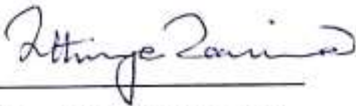

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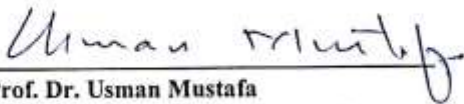

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DEDICATION

I would like to dedicate my work to my beloved parents and sister for their endless love and to my teacher Dr. Attiya Yasmin Javed for her support and encouragement.

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ABSTRACT

The present study is conducted to find the role of financial, corporate governance and macro-economic indicators on banking sector performance of Pakistan for the period of 2005 to 2015. Results show that these factors have a great role on performance of banking sector of Pakistan, where performance indicators are:(i) Return on Equity (ROE),(ii) Return on Assets (ROA) and (iii)Net Interest Margin (NIM). Corporate governance practice in banking sector plays a vital role in improvement of bank's performance. There is high involvement of government and other authorities like SECP in banking sector therefore banks corporate governance differs from corporate governance of other business. To eliminate unnecessary risks by management and financial soundness can be ensured by implementation of corporate governance practice. Concluded on the basis of observation that increase in earnings per share results increases in bank's performance. On the other hand, banks can gain the public confidence by maintaining the Minimum Paid-up Capital Requirement (MCR) which ultimately improves the bank's performance. Continuous improvement in mechanism of corporate governance structure of banks is needed moreover there is need that Non-Performing Loans to Total Loans Ratio (NPLTL) and Loan Loss Provisions to Non-Performing Loans Ratio (LLPNPL) values should be at lower side. Lower the ratio better its performance. Risky assets are managed by Pakistani banks so well that capital adequacy ratio is insignificance to bank's performance. Despite all this there is improvement is needed to compete with international level. The results show that internal mechanism such as board size, board independence, CEO duality and transparency; external mechanism (capital adequacy ratio, minimum paid up capital and macroeconomic variable (GDP growth) are important determinants of performance of banks in addition to financial determinants.

Keywords: Corporate governance, Return on Equity (ROE), Return on Assets (ROA), Net Interest Margin (NIM), Capital Adequacy Ratio (CAR), Minimum Paid-up Capital Requirement (MCR), OLS panel common effect technique.

CHAPTER 1

1.0 INTRODUCTION

Corporate governance plays a significant part in the banking sector performance by giving clearly instructions to the management and guides them to perform in such a way that rights of shareholders cannot be affected. This study explains the scope of governance practices in Pakistan and also its relationship with the performance. Such relationship were supported by many previous authors. Corporate governance is set of rules, regulations and provides the guidelines to manage and control the organization effectively. Moreover, it provides directions to senior and top managing executives, directors/Board of Directors to safe guard the interest of all stakeholders includes: its management, shareholders, customers, financiers, suppliers, community and the government as well etc. Cadbury Report, (1992) defines corporate governance as “the process to direct and control the companies”. La Porta *et al*., (1999) describe the corporate governance as a tool by which stakeholders are protected from effects caused by Insiders. Furthermore, Corporate Governance practice as the process which gives direction to the management for day to day operations of the organization and it also built long term values by protecting the interest and rights of all stakeholders. Moreover, Corporate Governance is a tool which describes the association between shareholder and its board of directors and it also define the power and right of directors and off course protects the right of creditors, stakeholders and employees as well (Kariuki, 2009). Corporate governance refers to internal system of an organization which set rules and regulations to monitor the activities of management and also give the directions, so, that everyone’s is satisfy and protect the right of all stakeholders (Mang’unyi, 2011). Corporate governance is a structure which supports all the stakeholders to influence on company’s top management to operate the activities in such a way that interests and rights of shareholders doesn’t affect (Rezaee, 2009).

Corporate governance practice have a great importance in the organizations because it helps to monitor the financial records as well as it gives timely feedback through which

organizations remain on right track (Kaja, 2010). Performance and efficiency of banking sector depends on different factors like Inflation, trade, interest rate, human capital, investments and outflows as well as inflow etc. So, if any country wants financial development then its banking sector should be efficient. Therefore, for the growth of the economy, banks needs to improve their performance and efficiency. It is observed that financial sector is directly associated to financial and economic development of the country.

If the bank is independent in its decisions and environment is transparent it is the proof of healthier corporate governance practice on the other side corruption and mismanagement shows weak corporate governance practice. Corporate governance also specifies the responsibilities of board of directors to run the day to day activities of the business moreover it also define the relationship between stakeholder and directors (Pass, 2004). Effective corporate governance also increases the bank's value and reducing the risk thus increase the investor's confidence which results increase in investment (Spanos,2005). Additional corporate governance also tells that how a company can manage and who the real owners of the company are. Furthermore it also describes the process of distribution of profit among the employees, shareholders, managers, and all stakeholders (Barle, 2010). Some researcher thinks that through corporate governance we can also protect outsider investors from loss.

Currently, corporate governance is a hot topic among the world's leading banks, because it has a significant role in economic growth. In every part of the World Bank's efficiency is one of main topic for the economists because it is directly related with economic growth of the country (Zaidi, 2005). Many of the leading companies failed due to poor management activities and many prior studies has supported that corporate governance has significant impact on the performance of the bank (OECD, 2009), (Gompers *et al.,* 2003). After the failure of big firms in 1990's corporate governance practices gain too much boost to run and manage the management affairs of the bank in better and effective way more over after the scandal of Enron's and WorldCom's Corporate governance gain more boost and attention. However, corporate governance depends on various factors like nature of the business, environment, rules and regulations.

Corporate governance structure is under a great consideration among the government, board of directors, banking industry, as well as investors. Today nearly every bank is focusing on effective corporate governance structure which may include proper financial disclosure, audit committee, transparency, board composition/size, independency, and various other factors which are highly focused in leading organizations like IMF (International Monetary Fund), World Bank and OECD (Organization of Economic Co-operation and Development) in their conferences (Inyanga, 2009). That is why different countries follow international practice of corporate governance structure to manage their banks and also guidance to managers to perform their duty in such a manner that the right and interests of shareholders cannot be effected. Each country has its own techniques and policies with accordance to its political, social culture and religious norms. Carter et al., (2003) mentioned in their study that company's rules and regulations shows the standards of the company and guarantees that allocation of the company's profit will also be done according to rules and regulation of the company. Thus every country has developed its own rules and regulation of corporate governance. Basic purpose of this is to give right direction to the firms regarding the management affairs of the firm as well as rights of the stakeholder. Likewise, SECP (Security and Exchange Commission of Pakistan) issued the code of the corporate governance in Pakistan in 2002. This code cover all the international code of governance points which are necessary for practice of corporate governance. Fundamental purpose of this code is to implementation of effective corporate governance practice in Pakistan and to bring improvement in selection of the board of directors as they are liable for the disclosure of financial statements of the company as well as liable to all the shareholders.

Adnan et al., (2011) examine that corporate governance practice in banking sector is more important than any other sector. Due to poor corporate governance in banking sector financial crisis may occur in a country and it may also losing confidence and ability of market which is called systemic risk. On the other hand, Claessens and Fan, (2002) mentions in his research that due to effective corporate governance property rights reinforces, cost of Transaction and cost of capital can be minimized which leads the development of capital market.

Effective corporate governance in banks not only increases the wealth of all its stake holders but also encourage to make investment and improve the business environment and it can boost through banking efficiency. Effective corporate governance is much needed in banking sector of developing counties like Pakistan because it is the most common source of deposits of savings and commonly accepted mode of payment. Through proper and effective corporate governance practice in banking sector of Pakistan it can play a vital role in the development of the Pakistan's economy as a whole.

It is supposed that macroeconomic conditions are reason behind financial crisis which occurred previously. Further some authors discusses in their study that World Bank also encourage the banking sector of developing countries to bring improvement in their banks to help them in eliminating macroeconomic effects of poor governance (Zaharia *et al.,* 2010). Prior empirical studies shows that interest rate has gone up due to effective corporate governance practices because it has positive effect on the commercial banks (Adams, 2012), (Adams *et al.,* 2008). Moreover, some researchers show in their research that commercial banks should have healthier corporate governance structure because it increases the performance of the banks (Franks & Mayer, 2001), (Santos & Rumble, 2006). Thus, empirical studies has proven that better corporate governance structure in the banking sector leads to improvement in the performance of the banks, this is why implementation of effective corporate governance is need to make banks transparent, trustworthy and accountable.

Furthermore, this study also focuses on the impact of various corporate governance variables on the performance of the banking sector of Pakistan. Due to poor governance system many developing countries is facing problems like in Pakistan collapse in Pakistan Telecom Communication Limited (PTCL), that is one of the major governance failure in the history of the Pakistan. Likewise, there are also big failures in banking sector due to poor governance which may include: Atlas bank, Mehran bank, KASB bank, Silk bank, and Crescent bank etc. Failure of these banks also impact on different economic sectors of economy also. Thus, this study inspect the implementation of the corporate governance act, 2002 moreover its practices in the banking sector of Pakistan. This is due to healthier corporate governance practices which solve the agency problems as well as it gives

protection to the shareholders and all stake holders of their interest and wealth and yes off course it also has an impact on the financial performance of the banks. This is the reason behind this research to observe the relationship between the corporate governance variables as well as macroeconomics variables and its impact on the performance of the banks in Pakistan.

1.1 Overview of Banking Sector in Pakistan:

Despite suffering from different crises like political instability, poor economic conditions as well as lack of resources banking sector of Pakistan has done a tremendous progress since the independence in 1947. After independence, there were forty five banks in Pakistan which had branches in both west and GD East Pakistan. But the banks who had Indian owners moved their banks to India moreover customers who had their capital in the Pakistani banks moved their capital to Indian banks. Another big issue suffer the banking sector performance is the lack of professional and skill human resources due to which they were unable to offer services and products to their customers. Reserve Bank of India (RBI) was the common central bank of both India and Pakistan till September, 1948. RBI ran its operations against the interests of Pakistan which ultimately effect the Pakistan's economic growth. Unfair and biased polices of RBI against Pakistan's interest leads to end of an agreement between Pakistan and RBI, Pakistan established their own central bank named State Bank of Pakistan (SBP) .State Bank of Pakistan (SBP) was established on, 1 July, 1948 to supervise and monitor financial sector. Many changes has been done in SBP Act, 1956 in order to support the financial sector of Pakistan. Different measures have been taken by State Bank of Pakistan (SBP) for the set-up of financial sector in country and they also supported the private sector for their part in the banking sector. This is how it was all created but due to unethical activities and competition among banks, rule of corruption and bribe was started in 1950s and 1960s as well (Balboa and Medalla, 2006). In 1974, Government of Pakistan take the measures in a great interest of the development of banking sector of Pakistan and nationalized all the private bank which were operating at that time. However, this policy did not work for a long time because despite the performance of employees government try to protect the jobs of employees which results poor quality of services and products were offered to their customers. Loss of confidence of the foreign

investors is another cost had to bear by the government of Pakistan. Continuous decline in performance of banking sector in 1980's. To improve the performance of banking sector, in 1990's, government of Pakistan has decided to start the privatization process in the banking sector. Its aftermaths is that in June 2010, there were thirty six commercial banks were operating throughout the country which includes only four were public commercial banks whereas twenty five were local private commercial and seven were foreign commercial banks. All of these banks have 9,187 branches operating throughout the country. Today banking sector of Pakistan plays a key role in the development of country. Banking sector of Pakistan is contributing high percentage to economy and also empowering the country's economy day by day. Even that financial crisis in 2008-2009, Pakistani banks attracted FDI as well as gave tough competition.

1.2 Corporate Governance of Banks in Pakistan

Corporate governance practice in banking sector is quite different as compared to the other sectors of the economy. Reason behind this is because of high involvement of government, depositors well as shareholders. The government involvement and its supervision protect the interest of public and depositors. In banking sector external corporate governance plays a key role in performance and also minimizes the risk of banks by implementation of CAR (capital adequacy requirement) (Fanta *et al.,* 2013).

Corporate governance structure in Pakistan is very new in banking sector. Code of Corporate governance was issued by SECP (Securities and Exchange Commission of Pakistan) in March 2012 for improved governance, transparency, and also safeguard investor's interest through proper financial reporting of the organization. This code of corporate governance was formed with the combine efforts of Chartered institute of Pakistan, Securities and Exchange Commission of Pakistan , institute of cost and management accountants of Pakistan and 3 stock exchanges of Pakistan (at that time Karachi stock exchange, Lahore stock exchange and Islamabad Stock exchange) (Javed & Iqbal, 2010).

Code of governance gives a right directions to the organization. The main part of this reform is that even a director of the board is liable to answer to all stakeholders' and for listed organization proper internal and external audit should be performed every year.

However, still in this code there is no proper guidance regarding internal control, risk management, provisions on director's independence, compensation polices (Javed & Iqbal, 2010). Lower level of production and mismanagement Practices cannot be disclose in the company's disclosures moreover transparency is also needed for better corporate governance policies as well as a strict regulatory process is also need. In 2006 a survey was conducted by SECP, IFC (International Financial Corporation) and institute of corporate governance Karachi for the understanding of corporate governance structure.

Rehman and Mangla, (2010) finds in their study regarding the control and right direction of the company through corporate governance practice. They further mentioned in their study about the structure of the corporate governance as well as the duties and rights of; executives, boards, all stakeholders as well as shareholders. Thus, corporate governance defines the responsibilities of top executives as well as the Board. Unwanted risk in banking sector effect the whole cycle which may include taxpayers, creditors and investors. Haan and Vlahu, (2015) have observes in their study that improved in the performance of those institutes which having incline towards risk taking attitude and their risk committee is independent.

1.3 Macro-Economic Variable Impact on Bank's Performance

There are several techniques to measure the performance and efficiency of the banks. There results may vary due to different external and internal factors. These factors has a major impact on the bank's performance which include regulatory factors, bank specific factors, governance practices adopted by banks and especially the economic factors that can change business conditions.

It has been observed that ROA and ROE of the bank is highly depends on the size of the bank, thus, increase bank size leads to increase in the bank's performance. Increase in non-performing loans to total loans ratio has adverse effect on the bank's performance. Increase in Earnings per share (EPS) shows that there is improvement in performance of bank. Minimum paid-up capital of the banks arises the confidence of general public so it has a positive relationship with bank's performance. MCR also raise up confidence level of banks because it provide cushion so higher the MCR higher its effectiveness level to satisfy its the depositors ,customers and the shareholders. Capital Adequacy Ratio has a negative

significant impact on Return on equity (ROE) as well as Return on Assets (ROA). Increase in capital adequacy ratio results increase in risky assets of the banks which means banks are involved in uncertain lending.

Increase in Gross Domestic Product (GDP) is positively significant to return on assets (ROA) but insignificant to return on equity (ROE) of the banks. Moreover, Net Interest Margin (NIM) is also used as a performance indicator besides ROA and ROE. However we observed that nearly all variables to be insignificant with it except for CAR, LLPNPL, corporate governance which are observed positively significant to Net Interest Margin (NIM). Bank size is negatively significant, higher the bank size will leads to difficult to maintain the standards of the bank which ultimately result to decline in bank's performance. Deposits and advances are positively significant to the bank's performance where it indicates that the more the deposits & advances the better its performance. It has been observed that Non-Performing Loans (NPLs) are negatively significant to bank's performance which means higher the NPLs less its performance. Similarly, Corporate Governance is also negatively insignificant to performance of banking sector. Both CAR and MCR also insignificant to Bank's performance which shows that all the regulatory variables are indicating to safeguard the rights of: the shareholders, depositors, other stakeholders and owners.

The reason behind this research to examine the corporate governance practice and its impact on Bank's efficiency and on its performance. But questions is that what kind of corporate governance effects the performance and efficiency of the banks. This is the key reason why this issue is focus to research. Our empirical research emphases on the corporate governance which includes board of directors /board size, Chairman/Chief Executive Officer (CEO) Duality, managerial ownership for internal control, board independence and transparency (which refers to bank's financial statement publishes quarterly, semi-annually and annually) and its impact on bank's performance. Bank's Performance, management efficiency and profit efficiency and through ROA, EPS, ROE, Operation efficiency and Cost efficiency.

1.4 Banks Performance

Getting best results from the given resources in a productive and improved way is called performance (Hayat, 2011). Now question is how much an organization is efficient with an effective use of its limited resources? Here is its answer that efficient organizations display high performance within its lowest inputs usage. Financial progress of the financial institutes are highly depends on its efficiency. Banking sector efficiency depends on market efficiency which is highly influenced by brokerage efficiency and off-course the financial policy.

Improved performance of banking sector is beneficial for all, it is beneficial for depositors, routine people as well as for bear debt burden and it also leads towards the progress of the country's economy. Even though a question arises in a banking sector that why should a taxpayer bear the cost of poor corporate governance. As credit market variations may influence the essential and lending costs of borrowing.

Shaari *et al.,* (2010) have mention in their study that the macroeconomic variables effectiveness in an economy where the state bank responds to fluctuations in forward-looking inflation information controlled in asset price inflation. In the growth of any economy, banking system plays key role, competitive and established role unlike the whole economy of a country will threaten if there is an incompetent and weak banking system (Shaari *et al.,* 2010). The efficiency of banking sector became a hot topic in developing states after 1995s research includes, Korea (Gilbert & Wilson, 1998); for Thailand (Leightner & Lovell, 1998); For Singapore (Rezvanian & Mehdian, 2002); and for Pakistan (Burki & Niazi, 2010), (Burki & Ahmad, 2010), (Patti & Hardy, 2005); all of them have focused on efficiency, financial liberalization and ownership structure.

Still there is a gap to explore of banking sector performance with corporate governance and corporate governance sub parts which includes: board size, intellectual capital, risk management, transparency, CEO Duality/Chairman, managerial ownership for internal control and Ownership structure and its influence on the efficiency sub parts which includes: profit efficiency, economics efficiency (Technical and Allocative efficiency), cost efficiency value added intellectual capital efficiency and intellectual capital efficiency through diverse risks.

1.5 Banking Sector Performance in Pakistan

Pakistan financial sector is divided in to two main groups;

- Non-securitized institutes.
- Securities markets.

Further non-securitized institutes divided into 3 groups:

- ➢ Conventional banks.
- ➢ Modarba's, Leasing firms, and investment banks.
- ➢ Financial development institutes.

In Pakistan major supplier of financing are lease funding and financial development institutes. Second group of financial sector is securities market.

Motive behind the nationalization process in 1975 was that to merge the banks into fewer and larger institute (Khan, 1998). But later in 1990's Government of Pakistan has decided to sell partial share of MCB as well as ABL to promote the private sector involvement in banking sector of Pakistan. However during the period of 1993 to 1995 the performance of overall banking sector was declined in Pakistan. But picture of partial private banks, private domestic banks and foreign banks was quite different with respect to performance. Growth of private domestic banks was remarkable during the period of 1992 to 1997 and their market share was increased from 5.7 percent to 14 percent.

Great change has occurred in performance and environment of the banks after the reform in 1997-1998. Improvement in better governance, banks regulator's, bank owners, banks management was part of reform (Khan, 1998).

1.6 Issues of the Banking Sector of Pakistan

Despite reforms in banking sector of Pakistan there is still a gap for improvement and need amendments in the Pakistan Banking Ordinance, 1962. There is a huge difference between the lending and deposit rates of banks in Pakistan. Banks are considered to most safe investment because they avoid risky lending. KIBOR rate update on regularly basis but on the other side PLS accounts rates update on semi-annually or annually basis. High rates are

exploitation for customer. Most of the banks in Pakistan are owned by private sector only few owned by government. As a result, primary reason behind the private owner banks is to gain abnormal profit not to protect the rights of their customers. So it's the responsibility of the State Bank of Pakistan to monitor this kind of unethical profit seeking activities at cost of general public money. Similarly, banks should also care while granting to small and medium enterprises, risky loans and advances to agriculture sector.

Above mentioned are the few issues which banking sector is facing now a days that because banks are established for the benefits of general public not to earn abnormal profits from public money.

1.7 The Role of the Corporate Governance in Banks Efficiency

Effective corporate governance in banking sector leads to better financial efficiency which ultimately leads to growth of the economy. Better the corporate governance better the performance which motivate the savers to pay large payments for organization. It has been observed that firm value and efficiency of the organization is highly depends on the good corporate governance. So, to achieve the economies of scale, private banks should increase their number of branches. Proper capital market is needed like stock market to improve the competition and corporate decisions (Fanta et al., 2013).

Gonzalez & Andr'e (2014) observes in their study that age of organization is directly link to the ability of corporate decision making. Organizations that are in the beginning will have less independent boards, less experienced boards, and sample design.

Ahmed (2006) finds the speculation in the performance and the efficiency in the banking sector because of corporate governance moreover he mentioned that reforms in banking sector has a positive impact on the performance of the banks and further added that privatized banks performance is remarkable. Akhter (2002) has shown that efficiency level of foreign banks is on a higher side as compare to domestic commercial banks.

Nilsson *et al.,* (2014) shows the capital structure in banks are effected through financial crises, and also indicated the impact on backing sector after the changes in financial strategy. Fundamental purpose of making the board is to make principles to manage the bank effectively and efficiently. Bank should hold at least 8 percent capital of its asset is

proposed in Basel I in 1988.Then in 1999 Basel II was introduced but it was implement in 2004 after being revised. Nilsson et al., (2014) liquidity was the main component of Basel III regulation which is LCR (Liquidity Coverage Ratio). Corporate governance structure and the efficiency of bank was measured by Return on Assets (ROA) and Return on equity (ROE) by (Fanta *et al.,* 2013).

1.8 Problem Statement

A country's economy is highly depends on its banking sector, stronger the banking sector the stronger its economy many failures in banking sector has happened in recent past due bad practices of corporate governance like bank of New Frontier, Bank New England, Southeast Bank of Miami, The Bank of Credit and Commerce International, and also failures in Pakistani banks which includes KASB bank, Mehran bank and Atlas bank etc.

CEO (Chief executive officer) shareholding and incentive plans of acquiring company has a positive relationship with CAR (capital adequacy ratio). Equity based return and Shareholding of the managers motivate them for acquisition and merger and leads to high CARs. Since 2009, KASB bank was suffering from low level of CAR in Pakistan. Merger of Bank-e-Islami Pakistan ltd (BIPL) and KASB bank Pakistan was announced by State bank of Pakistan (SBP) approved from Federal government. SBP further added that active depositors of KASB bank will now maintain their account in the branches of Bank-e-Islami Pakistan ltd (BIPL). But later this case became more complicated when a Chinese company show the interest to acquire it but couldn't do so because of minimum required capital condition from the SBP. Governance of banks and policies of SBP became question mark due to failure of KASB bank. Experts has observed that one of the common reason behind all these failures was poor governance system.

Failure of Crescent bank is another example of poor corporate governance. Management of this bank did unethical activities which includes concealment of bank assets, unlawful maintenance of parallel accounts and illegal investments in stock market. Governance system in Pakistan is not as strong as in other countries of the world. For the survival of banks in banking sector it is requirement for the banks to implement effective corporate governance practice. Effective corporate practice has directly related to the performance of a banks.

Business environment of banking sector has changed dramatically after the increase in number of banks and also increase in number of people using the banking services. The financial crises and instability in financial sector may arise due to unwanted excessive risk taken by the manager on cost of tax payer's money.

Policies regarding improvement in performance of banks are made in the developed countries where as in many developing countries and also in Pakistan they are far behind in this mission. Therefore, policies regarding bank's performance should focus. So, the main focused in this research is to investigate the impact of corporate governance on banking sector performance of Pakistan. .

Research on performance of the banks in Pakistan is very less. Researchers observed in their study that in recent past SBP has improved their work as a supervisor and regulator (Kalid and Hanif, 2005); (Akhter, 2002); (Burki and Niazi, 2003) and (Qayyum and Ahmed, 2006) have focus on governance sub parts like: ownership structure, board size, CRO, Risk management, Intellectual capital and internal control its impact on bank's performance like economies efficiency (technical and allocative), Cost efficiency, and Intellectual capital efficiency. (Qayyum & khan, 2010) observes that performance of domestic bank is quite low if we compared them with foreign domestic banks in period of 2000 to 2005.

1.9 Research Questions

- **I.** What is to inspect the financial variables on the bank's performance?
- **II.** What is the role of corporate governance on the performance of bank's ROE, ROA, NIM?
- **III.** What is the impact of macroeconomic variables (GDP) on the bank's performance of Pakistan?

To answer the above question following objectives are formed

1.10 Objective of the Study

- **a)** The main objective of the study is to investigate the factors that affects a bank's performance in Pakistan.

b) More specifically objectives are

i. To investigate the impact of financial variables on a bank's performance

ii. To investigate the effect of corporate governance on a bank's performance

iii. To investigate the impact of macroeconomic variable on a bank's performance.

1.11 Significance of the Study

Many studies have found the relationship of corporate governance with financial sector. Despite prior study there is sufficient literature gap exist to examine the impact of corporate governance on banking sector performance of Pakistan. Continuous improvement in bank's performance leads to attract domestic as well as foreign investment which results positive impact on the banking sector as well as economy of the country. Poor management is one of the reasons behind the poor performance of the banks. In the history of Pakistan there are some big failures of corporate governance in major sectors of Pakistan, one of them was failure of PTCL's corporate governance failure.

A lot of research has already done on impact of corporate governance on various sectors of the economy but little research has conducted on role of corporate governance on Pakistani Bank's performance. results of these empirical studies shows that corporate governance system plays a vital role in improving the financial performance on the other hand these prior studies does not provides a clear picture of corporate governance practices and to identify one of its main factor that is impact on its performance. The effect of financial variables and corporate governance is investigated earlier but the effect of macro-economic variables are not examined. This study includes NIM to measure performance.

The topic corporate governance is always under the consideration for researchers for banking sector because it is associated with rules and regulation for banks. It includes standards and moralities and standards that banks have to maintain for survival in the market. But one thing is noticeable weather it has impact on the performance of the bank or it has no impact on bank's performance. CAR and MCR is need for protecting the right of investors, customers and for itself bank because to know the impact on its objectives. In

1974 the main reason behind the nationalization of banking sector was increase the performance of banks through competition and off course profitability. Therefore, we have combined the state bank's regulatory variables with internal regulatory variable of corporate governance to observe what impact they cause on the primary goal on bank's performance.

Internal variables are under the control of the management of the bank by increase or decrease they can achieve the desired level of performance but the external variables are not under the control of bank's management if they collapse in any organization it leads towards failure of the organization like KASB bank and PTCL in Pakistan.

Traditional approach is used in the start to calculate the bank's performance, where ROA, ROE, interest rate, coverage ratio, ROI and administrative expense as well as operating income are adjusted in financial statement for several accounting measures (Nazir & Alam, 2010); (Qayyum & Khan, 2007). Financial ratio approach is used to find the present position of the firm. Performance of the firm can be assess through this method by comparing the benchmark moreover financial risk ,forecast future performance, and liquidity position of the firm (Qayyum & Khan, 2007).

There are several techniques available to observe the bank's performance, its results may vary because system also have some impact, various factors includes corporate governance (Board independence, transparency, board of directors, CEO/ Chairman Duality and managerial ownership for internal control) MCR, leverage, CAR and financial stability loan loss provisions. These factors may influence the industry as well as banks performance. This study aims to know performance of banking sector of Pakistan by including corporate governance (board of directors ,Board independence, CEO/ Chairman duality , transparency and managerial ownership for internal control,) as well as CAR (Capital Advocacy ratio) and MCR (minimum paid up capital ratio) used as a risk management(regulatory), loan loss provision to total assets and leverage variables. Financial ratios are used to find the bank's performance in traditional approach later the relationship is verified through OLS panel data common effect estimation technique.

The effect of financial variables and corporate governance is investigated earlier but the effect of macro-economic variables are not examined. This study includes NIM to measure performance.

Macro-economic variables are also essential to determine the bank's performance. Later, we observed that macroeconomic variables are essential for our study for better understanding the behavior of different factors targeting the banking sector of Pakistan.

Therefore both qualitative and quantitative technique are used in this study to examine how corporate governance variables effect the performance of banks. This research also helpful for other sectors to re-access corporate governance system in order to improve the performance. This study is significance to the banking industry, investors, policy makers and authorities like SECP etc. To the best of our knowledge, none of the previous study has included all these factors to study the impact of bank's performance in Pakistan.

Nowadays, corporate governance is an emerging concept in Pakistan. In developing countries it is considered as a key to develop market economy and civil society. Unfortunately there is there is lack of research culture in institutional areas as well as in academic sector in Pakistan that's why there is not so much research on corporate governance field as it required . Generally the research conducted in East Asian countries like: Korea, China, Japan Malaysia, and Thailand.

CHAPTER 2

2.0 LITERATURE REVIEW

This chapter explains the prior empirical studies that were presented by various authors about the performance of banks and the role of financial variables, Corporate Governance regulatory variables and macro-economic variables on banking sector performance of Pakistan.

An effective implementation of rules of corporate governance yields to the great benefit not only to the banking sector but also to the all country's economic sectors as well as to the all stakeholders. Corporate Governance gives solutions to solve the issue of interest and conflicts. Moreover, it leads to accountability among banks also tells the sense of ethics and efficient control organization (Rosado, 2005). Effective corporate governance is the result of strong inner and outer Corporate Governance tools that helps to reduce the agency problem of the banks. It also leads an efficient and effective usage of given resources in the banks/firms (Roche, 2009). Deb, (2013) explains the corporate governance "the tool through which firms are directed and controlled". Corporate Governance in banking sector give assistance to risk protection, initial threatening process and improved risk valuation. Inner (Internal) Corporate governance is broader which includes the board of directors as well as management of the bank. On the other side, outer (external) corporate governance comprises directions and principles, set of government rules, and control over the corporate market (Fanta et al., 2013). Through proper use/operation of corporate governance provide an efficient and effective controlling system which helps in fair allocation of the resources between the various departments of the company which brings the rise in price of share of the firm/organization resultantly increase in the shareholder wealth also (Keong, 2002). Javid and Iqbal, (2010) mentions that there is a great support on financial institution large inside investors to obtain effectiveness in the corporate sector but less support in recognized market of corporate governance in Pakistan on capital market and investor. Risk is face by the minor shareholders when the capital is transfer to the majority. An effective corporate governance show the betterment in the cash flows as well as high return on investment which supports in day to day operations of the firm. It also provides an easy

access to strong internal control system, low cost capital, and supports in getting desired credit ratings in market also decreases the deficiency of funds (Caprio, 2003). One more study mentioned that the companies who have efficient corporate governance ultimately supported by financial markets which results that they have proper disclosure of financial information and have strong internal governor structures, which ultimately results to lead towards stability in terms of economic as well as financial. The companies which have strong corporate governance also increases the growth rates at national as well as international level then those who has weak corporate governance system (Banks, 2004).

Basharat *et al.,* (2014) added that today the banks (Financial institutions) can boost its profitability, have an option to increase their activities, this improvement increases the competition between the financial institution and the efficiency of banking sector also improves, which ultimately helps the banking sector efficiency and can improve its liquidity. Improvements in financial sector have changed a lot of things regarding ownership in banking sectors in these two eras.

In the South Asian countries, there is much more research regarding the corporate governance sector conducted in India as compare to any other Asian country (Khanna *et al*., 1996, 1997, 1998, 1999); (Pankaj, 1996); (Goswami *et al*., 1996); (Singh *et al*., 2000, 2002, 2003). There are many factors of corporate governance, which, have been designed in Pakistan in the same pattern of corporate governance studies which have been already conducted in other countries of the world (Cheema *et al.,* 2003). There are many past studies that highlighted the application of control and ownership to control the ownership structure and capital market structure of Pakistan (Claessens *et al.,* 1999), SECP has taken the responsibility to take strict actions so that prevent from unethical activities. This act also helps to raise investor's confidence as well as it boost effective corporate governance practices in the companies. It also assists accountability and transparency in the firms and protects the right and interest of stakeholders (Akram, 2006).

Now a days cooperate governance practice is doing in banking sector in almost all emerging economies and it shows a great result in form of growth in the economy. That is why central bank (SBP) reorganized its entire regulatory framework regarding the control of activities of commercial banks and also giving instructions regarding corporate

governance practice (Zahra & Hubaib, 2007). Another researcher in his study mentioned that in recent years SBP has improve so much as a supervisor and regulator that helps SBP a strong control over commercial banks (Haris, 2007). But corporate governance practice in the banks of Pakistan are not too old so still there is gap of information which is needed to determine the effectives and performance of corporate governance in banking sector of Pakistan (Kalid & Hanif, 2005).

2.1 Concept of the Corporate Governance of Banks

From banking sector point of view, the process of corporate governance in which relationships of business and individual institutions are decided by senior management and its board directors by manipulating how banks put corporate goals (includes generation of economic returns to shareholder), operations day-to-day running process and business affairs and identified place corporate activities, stakeholders interests, and behavior's by expecting sound and safe manner functions of banks and applied in accordance to law and regulations, as well as save the depositors interest (Basel, 1999). There is more risk if there is larger share of ownership (among few) is present in the institution in time of financial crises because larger share holder will face high losses if this crises happens. Additionally, corporate governance in banks encourages the banks' accessibility towards the requirements of the society which ultimately affects the long-term performance of the banks (Gregory & Simms, 1999). In the implementation of effective corporate governance there may be various types of ownership which may have different objectives, authorities and capabilities. To execute corporate governance in the banks then foreign banks are far better than by others (Tandelilin *et al.,* 2007). Some authors further indicated that the institutions which having a strong corporate governance practices have easy availability of capital and they can perform efficiently for a longer period of time as compared to those firms who having weak corporate governance practice (Calabrese *et al.,* (2013).

2.1.1 Board Independence

The code of 2010 suggested that there should be about at least fifty percent independent management ratio (Vafeas, 2005). Bebchuk and Weisbach, (2010) mentions that many studies suggested that effective decisions are directly related to independent directors. Further, in another study there is a strong link between board independence and managing

incomes (Klein, 2002). In board structure part the most commonly discussed issue is the board independence. To accepting, rejecting or auditing the business recommendations from managing team the board directors are responsible. Moreover, when the majority of directors have a right to decision in a company then they hardly reject the proposed proposal of other director. By increasing the proportion of independent directors a company can monitor its affair more efficiently (Thomsen & Conyon, 2012).

Level of Bank performance is clearly moves upward when the company has more non-executive and independent board directors. He further added that non-executive and independent board directors can do reasonable decisions and required level of risk management (Eilon, 1980).

2.1.2 Board of Directors/ Board Size

The board size shows how many directors in a company. Governing body of the banks are highly depends on board of directors because they oversee risk management as well as set the whole plan and objective of working for the bank. It is assumed that is the duty of the senior management to conduct the business of bank through operational polices. Company ordinance 1984 has given the right to Shareholders to appoint the directors of the boards. Independent, motivated, skillful, confident, Strong, experienced and well-informed board need to perform their duties efficiently and effectively in time. Board of directors has an active role in operations of the bank. Active and involve board knows the foreseeable problems and do suitable measures in time to run the smooth operations of the bank.

Board size should be small. Big board size are less effective and there is also issue of supervision and management (Jegede *et al.,* 2013). Another study states that larger boards are less effective and difficult to control, manage and coordinates also strategic issues (Lipton & Lorsch, 1992). Hermalin & Weisbach, (2003) suggests in their study that the larger board is not as effective as compare to smaller board because when board size is big then it may contains agency problems and also conflicts among the board members. But on the other side Dalton, (2005) in his study mentioned that the companies having smaller boards cannot bring broad knowledge and also variety in expertise and skills which is supposed to be present in larger board. But the authors like, Mak & Yuanto, (2003) in their study says that the performance of listed organizations in Malaysia and Singapore is better

due to small board size which contains 5 board members only. Some researchers find that there is a positive relationship between performance of the organization and large board size, further added that relationship between firm performance and board size highly depends on the type of industry or sectors (Adams & Mehran, 2005).

Andres & Vallelado, (2008) suggests that the inclusion of outside directors in the board will improves monitoring of administration as well as reduces the issues between the investors as forecast by the theory. But on the other hand Mac, (1998) suggests outside directors have a very slight effect on the value of the firm. Many authors have argues on the consequence of board composition i.e. non-independent and independent executive directors on the performance of the organization. In agency theory, it has been define that a board perform efficiently when it having a more number of non-executive directors, so that they can give better results because of their independency from the bosses of the organization (Dalton *et al.,* 1998). On the other side the answer was given by the stewardship theory, that an organization wants to achieve the high profit margins along with higher shareholders return for that purpose bosses (stewards) are considered as the best source of achieving these goals of the organization (Donaldson & Davis, 1994). They suggested that the large board size may be good for the organization because they also raise the pool of skill and resources in organizations remarkably within a multifarious business model.

2.1.3 Transparency

The Companies which highly perform well have strong and better corporate governance system which forbids unethical activities and happening of events in the firm (Thomsen, 2012). When the banks issue its financial reports that may be annually, semi-annually or quarterly for shareholder or may be for stakeholder or for any other concerns persons, true and fair disclosure to stakeholders and solid corporate governance structure will improve the financial position of company (Qi *et al.,* 2000). Confidential nature of information can make difficulty for presentation of true and fair arguments. Effective corporate governance can give advantage the firm through the process of transparency.

2.1.4 Audit Committee

The main purpose of the audit committee is to monitor each and every financial activity of the organization every year. Audit committee includes at least 3 members and also 1 form the board of directors (Erickson, 2001) .Audit committee plays a vital role between external and internal auditors by making a link of communication among them (Dalton, 2005). Their key responsibilities include to monitor performance of the nominated auditors, progress of audit as well as reviewing annual audit reports and also monitoring the internal financial control system of the firm and purpose of performing all these duties is to provide accurate financial information to the public (FCCG, 1999). Audit committees are considered as important tool for the protection of shareholders' interests and rights because they independently monitoring the activities of an organization (Harrison, 1987). That's why separation of the monitoring and execution function is developed by agency theory in order to monitor the activities and functions of audit, remuneration and nomination (Roche, 2005). As the basic role of audit committee is the safeguard of shareholders wealth and also monitoring the annual financial reports of the firm in order to make sure that these reports are quite accurately prepared by the managers of an organization (Lee & Frank, 2001). In order to fulfill these objectives audit committee must be developed from skillful and knowledgeable person's so that they can control and monitor the financial activities of an organization.

So according to the Cadbury committee and OECD principles suggestions it is the basic reason that audit committees must contains independent non-executive directors who have ability to monitor efficiently and make internal control systems of an organization strong and effective (Davis, 2002) and (Laing & Weir, 1999). Another authors finds in their studies that such Audit committees declared less chances of failure in their roles and responsibilities which are comprised from large number of non-independent directors (Carcelle & Neal, 2000). Similarly another author further comments in his study that audit committees which are independent in their job perform much better and also bring improvement in the quality of financial statements (Petra, 2007).

On the other hand audit committee meetings has also very importance among many firms because in order to make quite accurate financial statements of the firm. Another author

indicated in his study that audit committees helps in improving the financial statements of an organization that's why such committees have great importance among so many firms as well as shareholders and they mentioned in their study about 40 percent firms conduct three times meeting in a year for the purpose of discussing problems of a firm which are other than the issue of financial statement and at least 23 percent firms conduct four time audit committees meeting in a year for the purpose of solving financial statement issues which become detected (Raghunandan & McMullen, 1996).

2.1.5 Chairman Duality /Chief Executive Officer (CEO)

CEO duality is when the chief executive officer is also the head of the board. Pi and Timme, (1993) indicates that the main role of the bank's board head to establish results for banks, that have the alike person giving services as head of the board and chief executive officer than for banks without such contrast. The result shows lower cost efficiency return on assets.

Haan and Vlahu, (2015) suggests that there are few drawbacks having a double role i.e. CEO duality. Firstly, there is a negative impact on board monitoring body. Secondly, there is marginal benefits to that person because of marginal increase in powers which might change the decisions of the board.

Adams and Mehran, (2003) mentions that it is observed that Chief Executive Officers of financial institutions have a low share of ownership as compared to non-financial organizations Chief Executive Officer. He further added that if they have large share of ownership then they behave more likely as principal than as agents.

Commonly in Asia it has been observed that there is badly need of an effective solution to overcome the agency problems because agency problem in the organizations may create a hurdle in the way of maximizing of the firms value. By takeover the board of directors (CEO Duality) they cannot overcome the agency problems and on the other side cross holding structure and business groups. All of these are the reasons behind poor performance of the organizations which ultimately moves towards the macroeconomic crises and financial risk (Claessens *et al.,* 2002).

2.1.6 Managerial Ownership for Internal Control

Managerial ownership actually means that the ratio of the shares processed by the directors by the total number of shares per bank. Internal control includes operational and managerial rules of the banks and also includes the main control such as: risk controlling functions, process of reporting and internal inspection of the structure. Shareholders who have larger shares can elect their directors in the board meeting moreover corporate governance gives opportunity to its members to give them directions for the benefit of their investments (Shleifer *et al.,* 1997). It has been observe that shareholders who have larger share in organization will play a key role to direct and control the administration and they also take deep interest in betterment of organization (Friend & Lang, 1998).

It has been examined in prior studies that the members having large shareholdings can check the management activities in better way. This check and balance reduces the agency cost and also eliminates the issues between management and owners'. Corporate governance also impact on value of the firm as well as on capital structure, indirectly or sometimes directly (Jensen, 1986). Westman, (2011) suggests in his study that it is difficult for the outsiders to monitor each and every activity. Due to safety net ownership in a board is a plus point to monitor banks. A firm can achieve its long term goals if they have strong internal control as well as managerial and reliable financial reporting.

In another research it is examined that if owner and controller are separated then there may be chances of conflict of interest (Iannotta *et al.,* 2007). According to another research it is examined that the issue of interest arises due to their attitude towards risk or maybe in difference in the level of management effort, which causes disagreement between the goals of shareholders managers (Robbert, 2002). All of its objectives like control environment, monitoring the actions of board of directors, management techniques, patterns of shareholding, awareness and approach will be met according to goals (Njanike *et al.,* 2011). Basically Internal control system is the complete control which includes managerial working process, financial reporting and many more. Internal control systems known by management team to fulfill them firm business in an organized way. Healthier internal control leads to good performance of banks (Nazir & Alam, 2010).

2.2 Review of Concept of Banks Performance

Many studies has been already discussed the relationship between firm performance and the corporate governance with diversified results (Yermack, 1996); (Claessens *et al.,* 2000); (Klapper & Love, 2002); (Gompers *et al.,* 2003) and (Black *et al.,* 2003). Some studies shows that the corporate governance has positive relationship with firm's performance (Bhagat *et al.,* 2000) and (Weir *et al.,* 1999). Similarly some others observes in their research that the corporate governance has relative association with the firm's performance (Albeit *et al.,* 1998). Akhtar, (2002) examines data from 1996 to 1999 in Pakistan and measures the efficiency, technique efficiency and allocation efficiency of the forty commercial banks. Mir & Nishat, (2004) conducted a research on the corporate governance sector. They both collected data from the survey for the year 2004 and annual reports, then they compared the effectiveness of the corporate governance practices with firm's value. Similarly, Javid & Iqbal, (2007) also conducted a research in which they used a panel data from the annual reports for the year 2003 – 2006 to observe the various impact of corporate governance practice on firm's value. Result of these studies shows that good corporate governance practices helps in maximizing the firm's value.

Good corporate governance practices help an efficient and effective management system. It also helps in fair distribution of resources among departments of the firm which results raise in share price of the firm which maximize shareholder wealth (Keong, 2002). Good corporate governance develops a strong relationship with stakeholders (Enobakhane, 2010).

Khalid, (2006) shows in his research the aftermaths of privatization of commercial banks in Pakistan during the period of 1990 to 2002. He observes that this all privatization process has major support for improving the efficiency of banking sector of Pakistan. Continues privatization process in Pakistan is the proof of this study's result. Attaullah *et al.,* (2004) observes in his study that there is a clear difference in technical efficiency and total efficiency after the privatization of commercial banks in Pakistan. He further adds that there is improvement the efficiency of the commercial banks of India and Pakistan after the privatization.

Technology has played a major role in the cost reduction of the banking sector. But unfortunately some banks doing its operations with diseconomies of scale. If banks play efficiently then they can do a significant role in financial development. Qayyum and khan, (2007) observes that performance of domestic banks in Pakistan is quite low if we compare them with foreign banks which are working in Pakistan during the period of 2000 to 2005. Similarly, development in domestic banks is also on lower side if compare with foreign banks. CMPD (Capital Development Program) a program started by Government of Pakistan with the help of ADB (Asian Development Bank) in 1997 to 1998 to diversify capital market. This program helps in better allocation of resources and also to increase the utilization of the long term resources effectiveness and it also encourage the involvement of investors in issues and matters.

Muhammad and Ismail, (2009) mentions in his study that relational capital which refers to the resources that is directly linked with customer's relationship as well as supplier relationship, external stakeholders and also with brand image. Structural capital is built on the modest rules and regulations, intellect, information, process, procedure and formulation etc. In short, when an individual leaves, the structural capital of the intellectual value would stay with the organization. Company's earning price per share, expense to assets ratio and assets growth shows the management performance (Kujansivu & Lonnqvist, 2006). Another author states in his study that Earnings per share (EPS) are highly positively significant which shows directly association with profitability (Pulic, 2000).

It is observed that private banks and foreign banks were doing far well as compared to other banks. Earnings per share is used as a medium to measure the management efficiency of banks. EPS is use as bank variable in this research which shows that how much efficient the bank management more over it also shows the market share of bank. Higher the EPS represents rise in the profitability of banks.

Burki and Niazi (2010) observes in the study that cost efficiency is relatively more in private and foreign banks as compared to state-owned banks. Another study shows that cost efficiency can be improve by using technology like telephone banking and other online facilities (Khan, 1998)

Banking sector performance and profitability depends upon the work level, later noticed unsystematic sequence, which clearly indicates that reform might reduce the banking performance. On the other hand it is observed that financial reforms always lead to improvement in banking sector. Patti and Hardy, (2005) states in his study that there is a clear difference in performance between foreign owned banks and domestic owned banks which includes both private and public owned banks. Hayat, (2011) mentions in his study that researcher always emphasis on efficiency of the banks they should also emphases on technical efficiency. Efficiency analysis shows the picture of profits of organization in available resources. Also mentions that cost efficiency and profits hampered due to main usage of funds and government interference. However, it has been observed that every time effectiveness of corporate governance practice shows different results due to change in cultures and environments of organization and also every country has its own norms and traditions and off course it varies from sector to sector (Anthony *et al.,* 2007)

2.3 Review of Implementation of Code in Pakistan

During 1997 to 1998 when economic crisis affected the stock markets of south east Asia then after the occurrence of such disturbance in stock market these economic crisis influenced governments of developing countries to bring reforms in corporate governance sector of their counties in order to improve the governance system (Mobius, 2002). Now as a result it brings some changes in governance system that ensures the safeguard of investor and also helps in encouraging investor confidence (Monks & Minow, 2004). That's the reason many south east Asian countries developed codes of corporate governance for their own countries in order to encourage a continuous flow of capitals and also to increase the investor confidence in their capital markets (Haniffa & Hudaib, 2006). But however these developing countries even have awareness about the importance of corporate governance were not better in effective implementation of corporate governance system in their firms (Mobius, 2002). Another author further added that it is not necessary that corporate codes which are successful in developed countries are also successful in underdeveloped countries because of their national character, and economic as well as social priorities differences of an organizations therefore while establishing the corporate governance code all these factors must be taken in mind (Hanif & Rauf, 2007).

Security and Exchange Commission of Pakistan (SECP) issued the first code of corporate governance for Pakistan in March 2002. It was incorporated in three stock exchanges i.e. Karachi, Lahore and Islamabad; currently it is applicable to all public listed companies. Making improvements in corporate governance sector of Pakistan this code play very important role. This code contains many sanctions regarding the good corporate governance practices at international level. Basic purpose of this code is to bring changes in board of directors in order to make them accountable to all shareholders and also better disclosure of information including internal and external audits for listed companies but this code lacks in giving guidance regarding internal controls, risk management and board compensation policies and also limits the provisions on director's independence (Huzaffah & Hudaib, 2007). In order to launch an effective regulatory structure for the corporate governance sector in the Pakistan the UNDP provide technical and financial support to the SECP for developing and implementing good corporate governance practices in Pakistan (Naseem *et al.,* 2011). According to (Westhead & Howorth, 2006) the corporate governance code act like a procedure which explains who are owners and managers of the firm, it gives regulations and rules regarding the better allocation of managerial resources. Similarly, Dittmar & Mahrt, (2007) further comments on that it describe the responsibility of managers which are accountable for managing organizational resources in order to gain huge amount of profit both for society and corporate.

2.4 Review of Impact of Corporate Governance Subparts on the Banks Performance

Corporate performance and corporate governance structures are consistent with each other (Black *et al.,* 2006). Corporate governance subparts are: board size, Chairman/Chief Executive Officer (CEO) duality, risk management, senior management, managerial ownership for internal control, board independence, board of directors etc. its effect indirectly as well as directly on the banks performance like technical, cost efficiency, profit, and banks operations. Increase in performance of banking sector also has an impact on financial conditions of the country. Main objective of an effective corporate governance structure is to increase the shareholder's wealth, if corporate governance structure is working properly in organization then it helps in fair distribution of power among board of

directors, shareholders and also in management (Mcconomy *et al.,* 2000). Effective and proper cooperate governance practice leads to attract investment capital, reduction of risk for investors, and also helps in increase the company performance (Spanos, 2005). Prior research shows different outcomes about corporate performance and also on corporate governance structure. Many other researchers observed positive relationship between the corporate performance and ownership structure (Haniffa & Hudaib, 2006); (Leech & Leahy, 1991); (McConnell & Servaes, 1990); (Xu & Wang, 1999). Demsetz & Lehn, (1985) and Murali & Welch, (1989) shows that there is no link between the corporate performance and ownership structure of organization.

2.4.1 Board of Directors/ Board Size Impact on Banks Efficiency

Now a days there is a great debate that weather the board size has negative or positive effect on the performance of the firm. This is the reason behind many research conducted on this issue and which shows different results. Lorsh & Lipton, (1992) and Jensen, (1993) observes that there is a strong connection between the value of the firm and board size. Yermak, (1996) observes in his research he took sample of 452 large manufactures firms of United states of America (USA) and collect the data of 1984-1991, return on asset (ROA) is used to measure the value of the firms, return on sales and Tobin's Q, the results shows that there is a negative relationship between the value of an organization and the board size. Some studies also shows that if board size having 60% of foreign members then it also has a negative effect on the performance of the organization as well as on wealth of the shareholders (Breyd & Hickman, 1992). Board structure contains large variety of responsibilities and duties that is why board members should be selected carefully and must have pool of knowledgeable and talented members to run the operations of organization successfully.

Andres & Vallelado, (2008) states in a study that the board size have impact on the bank value is trade-off profits like advising process, monitoring and drawbacks which may be like, control coordination and decision-making problems in bank. Bank board size do a vital role which is proactive than responsive. Haan and Vlahu, (2015) mentions that a free riding can be disturbed by director's presence. Minton *et al.,* (2010) it is observes that the size of board may affect the director attendance.

Effective board comprises of majority of non-executive director on board (Dalton *et al.,* 1998). Besides monitoring the day to day operations of the organization like marketing and finance, it is responsibility of the non-executive director's that they should bring required level of knowledge and expertise for the firm. And also they are the subordinates of Chief executive officer (CEO) so their duty is not only to monitoring that is why it is essential for an organization that it must have a proper channel which monitor the performance of both Directors as well as CEO (Weir *et al.,* 2001).

Cadbury, (1992) states in his study that key responsibility of the non-executive directors to monitor the activities of the organization. But if the service period of non-executive directors increase then it is also harmful for the organization interest because then they can built links with the executive director which results that they are unable to monitors functions efficiently (O'Sullivan & Wong, 1999). Fama, (1980) and Jensen, (1983) argues that non-executive directors has a very important role because non-executive director gives extra devotion for the security of the shareholders and interests and rights for the goodwill of the firm. However, Mak & Kusnadi, (2005) finds in his work that board which consist of large number of independent directors is always better for organization performance. On the other hand, other researchers argue that there is no relationship between performance of the organization and the board composition and also on organization's value (Weir & Laing, 2001) and (Pinteris, 2002). Forsberg, (1989) mentions in his research that there is no link between outside director and performance of the bank. On the other hand a research conducted in China, in which took two hundred and twenty eight sample size of private firms and check the relationship between firm performance and outside director. In this research it has been clearly observed that outside directors show high return of investment (Liang & Li, 1999). Similarly it has been observed in prior studies that there is a positive relationship between the board composition and the firm value (Lee *et al.,* 1992). Additionally, Baysinger & Butler, (1985) in their research mentions that board composition has effect on financial position of the firm and further added that the board having majority of non-executive director's gives high performance as compared to board a less number of non-executive directors showed low performance. However, it is still uncertain among many researchers that either the non-executive director plays an effective part of monitoring or their presence have any effect on performance of the firm (Yammeesri &

Herath, 2010). Some researchers also criticize in their research that the non-executive directors do not have any interest in the performance and value of the firm because they are selected from the outside (Lodh & Rudkin, 2010). Other researchers further argued in favor of inside directors that inside director perform much better as compared to outside directors because they know the cultures, traditions and norms of the firms. So inside director perform their duty more effectively then outside directors (Nicholson & Kiel, 2007). Another researcher further criticized on outside director that outside directors have not sufficient internal information of firm which results they lose their control and he further added that outside directors may also not get any support from internal directors of the organization which may cause the failure in the performance (Rashid *et al.,* 2010). Some authors also mentioned in their research that outside independent directors are hired for part time job that is why their attention may turn away in other task and additionally they also have not sufficient inside information to perform their duty efficiently and effectively (Cho & Kim, 2007) and (Brennan & Solomon 2008). On the other side Bonn *et al.,* (2004) argues in their study that if want to increase the performance of the firm most important thing is board structure of the organization. Board structure is more essential then board size because in board structure director bring their expertise and knowledge to organization which improves the value of the firm.

On the contrary Bhagwat & Black, (2002) mentions in his study that there is no link between performance of the firm and the board size and there is no link between board size and performance of the firm. However, prior research shows diverse results. Some researchers indicated that large size board has positive connection with firm performance (Chan & Li, 2008); (De Andres *et al.,* 2005) and (Mustafa, 2006). But, some researchers establish no association between organization performance and board size (Bhagat & Black, 2002); (Limpaphayom & Connelly, 2006).

2.4.2 Review of Managerial Ownership for Internal Control Impact on Banks Efficiency

Control measures are always special techniques as a guide to deliver 100 percent. However, it has been noticed that it not always happened that the managers do perform their duties in the best interest, to overcome this problem corporate governance process is needed

which motivate mangers and also gives control, order and directions the affairs of the firm so that protect shareholder's interest (Henderson, 1986). Research conducted in Canada which shows that one of the main reason of decreasing in organization performance is that difference between the manager and interest of shareholders (André & Schiehll, 2004).

Haan and Vlahu, (2015) argues that manager who has more equity stakes than stakeholder then they might behave like principal, less like agent. In this manner it is mandatory to answer the agency issue, several empirical research shows that debt holder or Indebtedness is key tool which plays significant role in solving agency issues. Aim behind this is that debt-holders assist in reducing the issue between the managers and the shareholders via monitoring because debt-holders have great power to control organization by support of observing managers activities. As a result, it brings improvement in the corporate governance Furth more it maximize in the performance of firm (Jensen & Meckling, 1976). Contrary, La Bruslerie, (2003) suggests in his research that indebtedness rise the power of shareholder additionally it is link with polices of the investment which may be considered profitable.

2.4.3 Board Independence Impact on Banks Performance

Pathan (2009) observed in his studies on the board independence of financial firms and their performance which indicates various two hundred and twelve big United States banks holding firms (BHCs) 1997 to 2004 use to measure the percentage of non-executives director and used assets return risk, systematic risk, idiosyncratic risk and total risk as dependent variable which shows inverse relation.

2.4.4 Chairman/Chief Executive Officer (CEO) Duality

Adams and Ferreira (2009) observes in his research that mostly CEOs are liable for the poor stock price (Pathan, 2009). Another researcher mentioned that the CEO Duality power is undesirable through all bank techniques for hazard utilized and factually critical as a part of generally relapses. 212 substantial U.S. (BHCs) 1997–2004 used measure CEO ownership extent dependent variable result was positive and dependent variable result was not significant.

This research is designed to observe corporate governance part on performance in the developing states like: Pakistan. It also inspects the effect of the corporate governance which independent variables includes: managerial executive's ownership for internal control, board size/director, board dependence, transparency and CEO/Chairman Duality. Dependent variables of performance are ROE, ROA, operational efficiency and cost efficiency from, leverage and financial reliability of the banks.

2.5 Macro-Economic and External Regulatory of Corporate Governance Variables on the Performance of Banks

Main objective of banking sector around the world is profitability and to improve the performance. So, all the strategies, policies, strategies, schemes and approaches that the banks accept are to attain these goals. All the banks, exclusive of profitability objective, have other social and economic aims too.

Banking sector has been globalized tremendously after 1980's, it extends around the world, and many of the banks have opened its offices in other countries. Number of researches already conducted on banks performance which includes both macro as well as micro variables, industry specific variables and bank specific variables. Banking sector researches have been supported with different numbers of variable.

Micro economic variables have direct influence on the performance and profitability of the banks however there are also some external variables which have influence on bank's performance as well as on profitability.

Number of research already done on interest rate and the profitability of the banks. Thornton (1992) mentions in his research the association between profitability, performance and liquidity of bank, additionally significant and negative and among them. On the other hand Noulas, (1997) finds negative correlation between profitability, performance and credit risk.

Banking performance and profitability depends on various factors like bank diversification, response of owners, size, and the managers relating to bank ownership, risk and the bank competition (McKillop & Ferguson, 1993); (Rhoades, 1997); (Goddard *et al.,* 2001). ROE

(Return on Equity), ROA (Return on Assets) and NIM (Net Interest Margin) are the most commonly used as indicators of profitability and performance for the banking sector.

NPL Ratio (Non-Performing Loan ratio), ROA (Return on Assets), and CAR (Capital Adequacy Ratio) were used by Indian researchers to measure reliability of India's banks with the rest of the world (Gupta and Jain, 2010) and (Satoshi Shimizu, 2007). Phil *et al.,* (2004) observes in his study in which he took European bank and observed a positive relationship of capital assets to profitability.

Return on Equity (ROE) and the Return on Assets (ROA) are commonly used variables (Sufian & Habibullah, 2009); (Sayilgan & Yildirim, 2009). Berger, (1995) observes a positive association between ROE and CAR. Epure and Lafuente, (2012) conducts a research and observed that NPL are positively affected by ROA on the other side CAR (Capital Adequacy Ratio) shows positive impact on NIM.

Bourke, (1989) observes positive association among the profitability, performance and inflation. Delis *et al.,* (2006) also mentions direct influence of inflation on the performance and the profitability. Alexiou & Sofoklis, (2009) finds in his research that inflation has positive impact on bank's profitability. Felix and Claudine, (2008) study's result showed that ROE (Return on Equity) and ROA (Return on Assets) both variables use as the measure of performance and profitability and were inversely related to NPL advances to total advances of financial organizations hence ,moving declining the profitability and performance as well.

Market specific variables like market share and concentration ratio has positive impact but minor impact on the profitability of the organization (Gibson, 2001). Delis *et al.,* (2006) shows that concentration ratio has negative influence on bank's performance.

At International level corporate governance takes the attention significantly and then corporate governance in Pakistan start taking attention in late 2000's. First code of corporate governance was issued in 2002 and then finally the Pakistan Institute of Corporate Governance was established in 2004. Different research shows different outcomes, some of them shows positive relationship of corporate governance with banks performance (Bhagat, *et al*., 2000). On the contrary some shows negative relationship with

bank's performance. Eisenberg *et al.,* (1998) and some studies shows that corporate governance has no relationship with bank's performance (Beth, 2003).

Interest rates and gross domestic product (GDP) are insignificant to corporate governance but ROE and ROA are highly significant to Corporate Governance (Ramiz and Mangla, 2010)

2.6 Hypothesis

The ongoing research generates the following hypothesis to experiment what impact different variables have on performance:

- **H_0** The financial variables have no significant impact on banking sector performance of Pakistan

  H_1 The firm specific variables have significant impact on banking sector performance of Pakistan

- **H_0** The corporate governance variables have no significant impact on banking sector performance of Pakistan

  H_1 The corporate governance variables have significant impact on banking sector performance of Pakistan

- **H_0** The macroeconomic variables have no significant impact on banking sector performance of Pakistan

  H_1 The macroeconomic variables have significant impact on banking sector performance of Pakistan

2.7 Framework

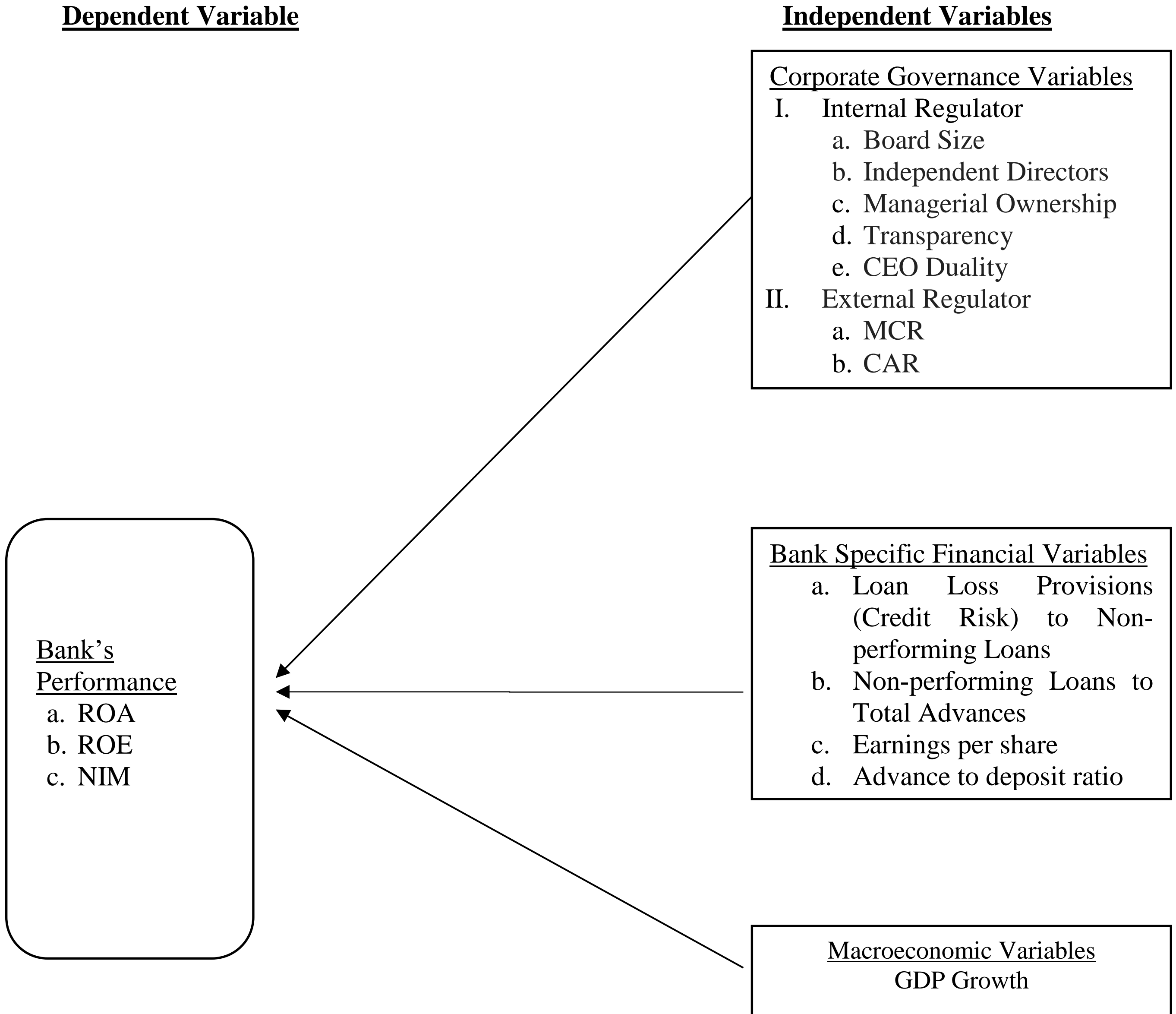

Figure 2.1: Frame Work

CHAPTER 3

3.0 METHODOLOGY AND DATA

This chapter presents the methodology used for analysis and data used for analysis.

3.1 Research Design

The research design is important part of study. Kumar, (2005) mentions in his study that research design provides a clear picture of research work to the researcher in process of collection of data as well as in utilization of data, in order to acquire reliable and accurate information. After acquiring required data and information testing of hypothesis can be done easily and properly.

Key objective behind this study is to examine role of internal regulatory and external regulatory of corporate governance, bank specific variables and also economic conditions on performance of banking sector of Pakistan. In this study is to focus on the corporate governance on performance of banks in Pakistan to rise up the ROA, NIM, ROE as well as role of macro-economic variables and also MCR and CAR on bank's performance. Secondary objective of this empirical study is to is analyze the results of variables i.e.: i) corporate governance which includes: managerial executive's ownership for internal control, Board size /directors, board dependence, transparency and chief executive officer (CEO). ii) bank specific variables includes: non-performing loans to total loans, advances to deposits, earnings per share and Loan loss provision to total asset. iii) MCR and CAR included in regulatory variables IV) and lastly GDP growth is used as macroeconomic variable. Banks performance variables are: NIM ROE, ROA.

3.2 Estimation Technique

We have used panel data technique to estimate the relationship between performance of bank specific variables, both internal and external regulatory variables and macroeconomic variables. Since we have data for twenty one banks for the period of 2005 to 2015, so panel data analysis is more useful for this analysis. Quantitative approach is used in this research

for analyzing the results. Mugenda, (2003) mentioned in his research that hypothesis can be test properly if data is collected and quantitative approach and also support in required answer to those questions which are necessary for the study.

This study is basically design to eliminate the existing gap in the literature by including factors associated with bank specific, corporate governance, regulatory and macroeconomics which are impacting on bank's performance of Pakistan. Secondary data is used from 2005 to 2015 to verify overall study of the Pakistani banks.

3.3 Source of data

This heading provide the details about the sample collected for the study as well as the source of data collection. This section also includes the details and description of variables that we collected for this study.

There are number of studies which emphasis on bank's performance, main aim of this study is purely on corporate governance, its subparts, bank specific as well as macro-economic factors that how to relate these variables with bank's performance. Ultimate objective of this study is to find the relationship between corporate governance variables (both internal and external regulatory), bank specific and macro-economic variables with bank's performance of Twenty one banks of Pakistan form the period of 2005 to 2015. Secondary data is collected from Pakistan Stock Exchange (PSX), annual reports and balance sheets of commercial banks as well as from State Bank of Pakistan website and data for GDP growth is taken from WDI for this research. To observe the impact of bank specific variables, macro-economic variable and regulatory variables on bank's performance panel data for twenty one bank is used from 2005 to 2015. These all are Pakistani banks

3.4 Variables of the Study and Measurement Indicators

3.4.1 Particulars of the variables (Performance)

Dependent variables are NIM, ROA, and ROE which are used for performance measure. Independent variables include financial variables, corporate governance (internal regulatory variables and external regulatory variables) as well as macroeconomic variable.

a) Financial variables includes: Loan loss provisions to non-performing loans, earnings per share (EPS), non-performing loans to total advances**,** advance to deposit ratio.

b) Banks internal regulatory variable of corporate governance includes; board size/ board of directors: the total number of executive directors per bank, board independence: is the ratio of the number of independent directors to the total number of directors, per bank, transparency: when the bank publishes its financial statements annually, semi-annually and quarterly, managerial ownership for Internal Control: is the ratio of the shares held by the directors by the total number of shares, per bank, , chief executive officer (CEO)/ chair duality: when the chief executive officer is also the chairperson of the board, it is known as CEO duality.

c) External regulatory variable of corporate governance which are: minimum paid-up capital requirement (MCR): compulsory condition for the minimum capital to be held by each bank as per the rules of State Bank of Pakistan and the other ratio is capital adequacy Ratio (CAR): it is the condition of State Bank of Pakistan for all bank to maintain a capital to protect themselves from the loss of risky investments made by the banks.

Macroeconomic variables are the external factors which can effect on the performance of the banks. Variables of macroeconomics includes GDP Growth

3.5 Bank Performance indicators

To measure the performance of banks there are numerous ratios. Return on Equity (ROE), Return on Asset (ROA), Net Interest Margin (NIM) are the most important variables to measure performance (Murthy and Sree, 2003).To measure bank’s performance of Pakistan there are a lot of ratios but for this study three financial ratios are used which are ROA, ROE and NIM.

3.5.1 Return on Equity (ROE)

Return on equity can be shortened as ROE.ROE shows the performance of the management of the bank that how good shareholder’s fund is utilized. ROE ratio tells that how much a company earned profit in respect of investment made in each shareholders' equity. More

the ratio value the greater the profit earned by the company and vice versa. ROE is the proportion of Net Income after taxes divided by total equity (Khrawish, 2011).

$$\textbf{Return on Equity (ROE)} = \frac{\textbf{Net Income}}{\textbf{Shareholder's Equity}}$$

3.5.2 Return on Asset (ROA)

Return on Assets can be say as ROA .ROA is an indicator which how much a company can earn against its assets and it further indicates that how well a company using its assets to generate the income .ROA is very important for every bank because ROA directly influence by the policy of the bank, government regulatory requirements as well as macro-economic factors. ROA is “Net income to total assets” (Khrawish, 2011). If ROA value is high then performance of the bank will be high and vice versa (Wen, 2010).

$$\textbf{Return on Asset (ROA)} = \frac{\textbf{Net Income}}{\textbf{Total Assets}}$$

3.5.3 Net Interest Margin (NIM)

Abbreviation of net interest margin is NIM. “Net revenue earns from non-interest performance and divided by total assets of the banks” is called NIM. Gul *et al.,* (2011) defines NIM as ratio between net interest income and total earnings assets. Revell, (1980) defines that difference between interest income and expense divided by total assets. Brock and Suarez (2000) mentions that it is unfavorable for the bank if value of ratio is high. This ratio also serves as performance indicator. If value is too low it indicates that bank’s performance is low and vice versa.

Basically primary function of NIM is to calculate the gap between interest incomes which a bank received from different sources like: securities and loans and interest cost of the funds that bank has borrowed. Greater value of NIM shows that bank is progressing and vice versa. So we can measure the performance of the bank through NIM. Interest margin is a very important factor in the performance of the banks because it shows how efficiently bank collect saving and allocate allocating the loans.

3.6 Bank Specific Financial Indicators

3.6.1 Non-Performing Loans to Total Loans

Non-performing loans to total loan is used to measure asset quality of financial firms. Competitive World like today quality of assets has a key importance in bank's operation because if asset quality is not maintained then here is a chance that bank can go in process of insolvency. It has been observed that "Loans are considered to proxy the assets of the banks and loan quality to proxy asset quality". Non-Performing Loans ratio are the perfect ratio to measure the quality of assets therefore practice of this ratio is currently doing in banks of Pakistan to measure the quality of assets**.** Greater the value of Non-Performing Loans ratio in TL bank's portfolio lower the performance of bank. Greater part of revenue earned by the banks form loan's portfolio, therefore, non-performing loan is directly associated with the performance of the banks. Dang, (2011) Observes in his study that bank's major risk is in giving wrong lending but this risk can be eliminate by proper monitoring of customer before credit and also by collateral lending against credit.

3.6.2 Loan Loss Provisions to Non-Performing Loans

Basically, Loan loss provisions to non-performing loans ratio is used as provision for the non-performing loans which is used as a buffer. NPL's to total loans represents that how strong the portfolio of the bank is. NPL to total advances has inversely relationship. Higher the value of ratio lower the Bank's performance (Sangmi and Nazir, 2010). It was observed that connection between loan loss provisions and earnings is insignificant (Collins *et al.,* 1995).

3.6.3 Earnings per Share

Earnings per share (EPS) is used as bank specific variable to measure the performance of the bank. It also represents the market share and earnings of the banks. Higher the value of EPS higher the bank's performance. Formula of EPS is

$$\text{Earnings per share} = \frac{\text{net income} - \text{preferred dividends}}{\text{Average common share outstanding}}$$

3.7 Macroeconomic Factors (Profitability)

All the banking sector faces the risk of interest rate. Rise and fall of interest rate has highly influence on the performance of banks, particularly on the bank's fixed deposits. Macro-economic variables effects the performance of the banks which includes: Inflation, Gross Domestic Product Growth, unemployment and real interest rates etc. Decrease in GDP has negative impact on bank's performance because decrease in GDP causes decrease in credit which ultimately effect on bank's performance. On the other side, when the economy is growing its mean there is increase in GDP growth which means increase in credit due to boom of business cycle, because in boom phase of business cycle demand for credit is high (Athanasoglou *et al.,* 2005). In this study we have taken only GDP as macroeconomic variable to observe the impact on bank's performance.

3.8 Regulatory Variables

3.8.1 Minimum Paid-up Capital Requirement

Basel Committee on Banking Supervision observed that there is a chance that bank may take massive kind of risks but they do not have enough capital to cover up those risks, which ultimately result that they default. According to option pricing model, to increase the share in the market bank involves them in risky lending, if they are not monitor properly by any authority. Bank management takes risk on the cost of depositors and other stakeholders (Keely and Furlong, 1990). It is assumed in buffer theory that banks can minimize the level of risk by increasing the capital through MCR requirement. MCR also safeguard the commercial bank from central bank's penalties if MCR is not satisfied. The banks could earn profit on the capital which is set aside but MCR is maintained for the safeguard of the depositor, investors and any uncertainty (Rochet 1992). Another researcher found in his observation that proper monitor by authorities makes pressure on the banks which ultimately increase its capital and think before taking risk, so that level of risk can be minimized (Bertrand rime, 2000).

There is lot of mergers and acquisitions take place in 2005 because State bank of Pakistan made a policy that all banks should maintain 2 billion rupees as minimum capital requirement and in 2013 it was 10 billion and 16 Billion in 2016.

3.8.2 Capital Adequacy Ratio

"The ratio of capital to risk weighted assets (credit, operational, market)" is called capital adequacy ratio. Concern authorities can safeguard the bank form uncertainties through maintaining the CAR level .this protection is basically to save banks from insolvency as well as to save the deposits of the depositors. Basically, this amount protects the commercial banks against their lending. State bank of Pakistan has increased the CAR form 10% to 10.65 in December 2016 furthermore, it is BASEL committee requirement.

3.9 Corporate Governance

Corporate governance is a tool used to measures behavior and ethics of banks. We have taken proxy and Dummy Variable technique (Table 3.1) to measure corporate governance variables (Mande et al, 2012).

Table 3.1: Indicators of Corporate Governance

No	Indicators	Measurement	Dummy Variable
1	Board of Directors /Board size	The total number of executive directors per bank	1 if less than median of sample and, 0 if greater than median of the sample.
2	Board independence	% of outside directors on the board per bank	1 if 60% or more directors are independent and, 0 if less than 60% of directors are independent.
3	Managerial ownership for internal control	Shares held by directors to total number of shares of the company.	1 if %age is less than sample median 0 if %age is greater than sample median
4	CEO is chairman/ Duality	When CEO is also the chairperson	1 if CEO is not chairperson of the board 0 if CEO is chairperson of the board.
5	Transparency	Publishing of financial reports on quarterly, semiannually and annually basis.	1 if the financial statements is published 0 if financial statements is not published

3.10 Methodology

Twelve models are used in this study .Following are the equations:

3.10.1 Models of performance

In this study three tool are used to measure the performance of banks which are ROA, ROE and NIM.

General Specification of model is:

<u>Model: 1</u>

$Perf_{it}$= f (financial variables, internal regulatory variables of corporate governance, external regulatory variables of corporate governance, macroeconomic variable)

OR

$$Perf_{it} = \alpha_1 + \alpha_2 FV_{it} + \alpha_3 IRCG_{it} + \alpha_4 ECG_{it} + \alpha_5 M.E_{it} + \in_{it}$$

OR

$$Perf_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 BS_{it} + \alpha_7 CG_{it} + \alpha_8 MCR_{it} + \alpha_9 CAR_{it} + \alpha_{10} GDPG_{it} + \in_{it}$$

3.10.2 Specific Model:

<u>Model: 2</u>

$$ROA_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \in_{it}$$

<u>Model: 3</u>

$$ROE_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \in_{it}$$

<u>Model: 4</u>

$$NIM_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \in_{it}$$

<u>Model: 5</u>

$$ROA_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \in_{it}$$

<u>Model: 6</u>

$$ROE_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \in_{it}$$

Model: 7

$$\text{NIM}_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \in_{it}$$

Model: 8

$$ROA_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \alpha_7 MCR_{it} + \alpha_8 CAR_{it} + \in_{it}$$

Model: 9

$$ROE_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \alpha_7 MCR_{it} + \alpha_8 CAR_{it} + \in_{it}$$

Model: 10

$$NIM_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \alpha_7 MCR_{it} + \alpha_8 CAR_{it} + \in_{it}$$

Model: 11

$$ROA_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \alpha_7 MCR_{it} + \alpha_8 CAR_{it} + \alpha_9 GDPG_{it} + \in_{it}$$

Model: 12

$$ROE_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \alpha_7 MCR_{it} + \alpha_8 CAR_{it} + \alpha_9 GDPG_{it} + \in_{it}$$

Model: 13

$$NIM_{it} = \alpha_1 + \alpha_2 NPLTA_{it} + \alpha_3 LLPNPL_{it} + \alpha_4 EPS_{it} + \alpha_5 ADVDEP_{it} + \alpha_6 IRCG_{it} + \alpha_7 MCR_{it} + \alpha_8 CAR_{it} + \alpha_9 GDPG_{it} + \in_{it}$$

$Perf_{it}$ = is set of performance variables which are ROA, ROE and NIM

i= represents the number of banks which is 21

t= represent the time which is from 2005 to 2015.

$IRCG_{it}$ = Internal Regulatory of corporate governance variables which includes board size, board independency, Transparency, CEO duality and Managerial Ownership for Internal control.

$NPLTA_{it}$ = Non-Performing loans to Total loan

$LLPNPL_{it}$ = Loan Loss Provisions to Non-Performing Loans

EPS_{it} = Earnings per Share

$ADVDEP_{it}$ = Advance to total Deposits

MCR_{it} = minimum capital requirement

CAR_{it} = capital adequacy ratio

$GDPG_{it}$= GDP growth

α_1 = intercept

α_2-α_9 = coefficients parameters

3.11 Plan of Analysis

The main objective of this study is to measure the impact of corporate governance as well as bank specific variables and macroeconomic variables on bank's performance. In this study econometric techniques is used like panel regression analysis. To estimate the results of impact of corporate governance, banks specific variable and macro-economic variables on bank's performance Panel regression analysis is used and Ordinary Least Square OLS is estimation technique. Common effect model is used in this study. The OLS is estimation technique.

CHAPTER 4

4.0 EMPIRICAL RESULTS AND FINDINGS

This research is to observe the relationship between the variables: internal and external regulatory variables of corporate governance, bank specific financial variables as well as macro-economic variable and its impact on banking sector performance of Pakistan. In this chapter result of each variable and its impact on bank's performance of Pakistan is observed.

4.1 Summary Statistics (Performance)

First of all, the variables are observed through descriptive statistics in Table 4.1. Following results are calculated: total observations, mean, standard deviation (SD), skewness and kurtosis.

Table 4.1: Summary Statistic (Performance)

	Mean	Std. dev	Skewness	Kurtosis
ROA	0.004	0.018	-1.588	6.125
ROE	0.049	0.269	-2.662	12.257
NIM	0.051	0.063	3.479	19.852
NPLTA	0.134	0.108	1.605	5.78
LLPNPL	0.657	0.355	-0.999	12.977
ADVDEP	0.69	0.676	11.011	138.512
EPS	4.041	7.648	0.785	4.448
IRCG	3.423	0.962	-1.037	5.736
MCR	1.26	1.6	4.094	22.323
CAR	0.207	0.197	2.527	9.01
GDPG	3.6	1.5	0.111	1.946

4.2 Correlation Matrix (Performance)

Correlation matrix is constructed to find the multi-collinearity in the variables of this study. Results are in Table 4.2. Having a multiple variables in this study therefore we used correlation matrix. Correlation of individually variable with itself shows the value of "1". If that value is greater and closer to 1 its mean that there is high correlation and vice versa.

Table 4.2: Correlation Matrix of Variables

	ROA	ROE	NIM	NPLTA	LLPNPL	ADVDEP	EPS	IRCG	MCR	CAR	GDPG
ROA	1										
ROE	0.784	1									
NIM	-0.03	-0.101	1								
NPLTA	-0.469	-0.435	-0.086	1							
LLPNPL	0.076	0.045	0.16	-0.127	1						
ADVDEP	0.041	0.063	-0.008	0.002	0.074	1					
EPS	0.671	0.519	0.135	-0.414	0.225	0.085	1				
IRCG	0.074	0.102	0.164	-0.121	0.059	0.067	0.315	1			
MCR	-0.0492	-0.056	0.027	0.446	0.078	0.025	-0.115	-0.027	1		
CAR	-0.136	-0.158	0.269	-0.019	-0.015	0.009	-0.099	-0.047	-0.019	1	
GDPG	0.230	0.171	0.031	-0.205	0.060	-0.08	0.16	-0.018	-0.014	0.082	1

(The results reported in Table 4.2 represents that there is no multi-co-linearity problem exist in these variable because there is low correlation matrix.)

Primary focus of this study is to examine the impact of bank specific variables, corporate governance variables, regulatory variables as well as macro-economic variable on the banking sector of Pakistan. In this study panel data is used for estimation technique. Regression technique is used on panel data to obtain the results of bank specific variables, internal and external variables of corporate governance and also on macro-economic variable of 21 banks from the period of 2005- 2015.

4.2.1 Impact of Bank-Specific Financial Variables on Return of Assets (ROA)

Under this heading impact of bank specific variables on bank's performance of Pakistan is observed. Variables of Bank specific financial are: Non-performing loans to total advances named as NPLTA, loan-loss provisions as LLPNPL, advance to deposit ratio as ADVDEP and earnings per share is abbreviated as EPS. By applying pooled (panel) OLS technique

results shows that the non-performing loans (NPL) to total loans (TL) having a negative sign and significant. There is significance at 5 % significance level of loan loss provisions (LLP) to non-performing loans (NPL) with a negative impact which shows that performance of banks decreases, when bank keep more provision against NPL. Advance to deposit ratio (ADVDEP) having no impact on bank's ROA which means it is insignificant. Estimation shows that Earnings per share (EPS) is positive and significant at significance level of 1% and EPS has a positive role in bank's ROA. F-stat is 23.44 and p-value shows that model best fits the data. The R2 of the model is 52 % indicating that the variables well explains the relationship. The results of model 2 are shown in table 4.3.

4.2.2 Impact of Bank-Specific Financial Variables on Return of Equity (ROE)

Second bank's performance variable is return on equity (ROE) of bank which is affected by bank specific variable. Bank specific financial variables used for this study are: non-performing loans to total advances ratio (NPLTA), loan-loss provisions to non-performing loans ratio (LLPNPL), advance to deposit ratio (ADVDEP) and earnings per share (EPS). Results of estimations are showing that non-performing loans to total loans ratio (NPLTA) is significant having a negative sign at 1 % significance level, moreover, LLPNPL ratio is negative and significant at 5 % of significance level. ADVDEP ratio is insignificance on bank's ROE whereas estimations show that EPS ratio is significant at 1 %. F-stat is 20.45 p-value shows model is fitting well. The R^2 is 36 % showing 36% is explained by this model 3.The results of model 3 are shown in table 4.3.

4.2.3 Impact of Bank-Specific Financial Variables on Net Interest Margin

Third and last performance indicator for this study is Net Interest Margin (NIM).Regression results shows that except loan loss provisions to non-performing loans (LLPNPL) all the bank specific financial variables are insignificant for NIM which means that these variables has no impact on NIM. LLPNPL is negative and significant at 5% level of significance. F stat is 2.11 p-value indicates model is best fitted and R^2 is 4% which is too low.The results of model 4 are shown in table 4.3.

Table: 4.3: Results of Impacts of Bank Specific Financial Variables Models (2,3,4)

Variables	Model 2	Model 3	Model 4
Cons	-0.0114	-0.214	0.054
	0.008	**0.137**	**0.039**
NPLTA	-0.04 ***	-0.781 *	-0.011 NS
	0.01	**0.167**	(0.48)
LLPNPL	-0.00 **	-0.082 **	0.025 **
	0.002	**0.046**	**0.013**
ADVDEP	-0.045 ***	0.006 ***	-0.022 ***
	(0.001)	**0.023**	(0.006)
EPS	0.013 ***	0.013 ***	0.009 NS
	0.0001	**0.002**	0.707
R^2	0.52	0.36	0.40
F(5, 183)	39.07	20.45	2.11
Prob > F	0.000	0.000	0.0067

(Note: ***, **, * and NS symbolize significance at 1%, 5%, and 10% respectively and parentheses holds standard error values)

4.2.4 Impact of Financial Variables and Internal regulatory Corporate Governance on Return of Assets (ROA)

In this estimation variable of internal regulatory of corporate governance variables are added with bank specific financial variables to check its impact on performance of banking sector of Pakistan so basically this estimation is extension of model no 1. F-stat is 37.69 and p-value shows model best fits the data. The R^2 of this model is increased by adding corporate governance variables i.e. 55.4%. Both loan loss provision to non-performing loans (LLPNPL) and non-performing loans to total loans (NPLTA) are significant at 1 % level of significance. Loan loss provisions to Non-performing loans (LLPNPL) and non-performing loans to total loans (NPLTA) have a negative coefficient. Advance to deposit (ADVDEP) is insignificant but earning per share (EPS) is significant with positive sign to

ROA of the bank. On the other hand internal regulatory variables of corporate governance is negative significant at 1% level significance to ROA of the bank. The results of model 5 are shown in table 4.4.

4.2.5 Impact of Financial Variables and internal regulatory of corporate governance on Return of Equity (ROE)

This model is continuation of model 2 but besides impact of bank specific financial variables, internal regulatory of corporate governance impact on bank's performance (ROE) of Pakistan is observed under this model. Bank specific financial variables are regressed to observe the results against ROE. Outcomes show that there is negative and 1% level of significance. Loan loss provisions to Non-performing loans and Non-performing loans to total loans are negative and significant at 5 and 1% level of significant respectively. Advance to deposit (ADVDEP) is insignificant whereas earning per share (EPS) is positively significant. Internal regulatory variables of corporate governance is negative and significant at 1% level of significance. F-stat is 18.05 and p-value shows model is well fitted. The R^2 is 37.30 showing 37 percent is explained by this model. By adding the corporate governance variables with bank specific variables R^2 percentage has increased from 35% to 37% by adding the variable of corporate governance. The results of model 6 are shown in table 4.4.

4.2.6 Impact of Financial Variables and NIM on Return of Equity

After running the model it is examined that Bank specific financial variables are insignificant to NIM of the bank but internal regulatory variables of corporate governance is positive and significant. The R^2 is 60%.The results of model 7 are shown in table 4.4.

Table 4.4: Results of Impact of Bank Specific Financial Variables and Internal Regulatory of Corporate Governess Models (5,6,7)

Variables	Model 5	Model 6	Model 7
C	-0.018	-0.1852	0.045
	0.008	0.136	0.039
NPLTA	-0.050 *	-0.809 *	-0.032 NS
	0.009	0.166	(0.048)
LLPNPL	-0.0627 ***	-0.088 **	0.027***
	(0 .002)	(0 .046)	(0 .013)
ADVDEP	-0.004 NS	0.007 NS	-0.002 NS
	(0.001)	(0 .23)	(0 .606)
EPS	0.014 ***	0.013 ***	0.0654 NS
	0.0001	(0 .002)	0.70
IRCG	-0.042** *	-0.037 ***	0.011***
	0.001	(0 .018)	0.005
R^2	0.55	0.37	0.62
F(6, 183)	37.69	18.05	2
Prob > F	0.000	0.000	0.0674

(Note: ***, **, * and NS symbolize significance at 1%, 5%, and 10% respectively and parentheses holds standard error values)

4.2.7 Impact of Financial Variables, Corporate Governance, External Regulatory Variables on Return of Assets (ROA)

In addition to impact of bank specific financial variables and internal regulatory variables of corporate governance in this model external regulatory variables of corporate governance is also be observed on ROA of the bank. External regulatory variables of corporate governance includes: Minimum paid-up capital requirement (MCR) and capital adequacy ratio (CAR).all of these 3 variables is regress with ROA in this model. Non-performing loans to total asset (NPLTA), earning per share (EPS), loan loss provision to non-performing loans (LLPNPL), Advance to deposit (ADVDEP) are the variables of

internal regulatory of corporate governance. EPS and MCR are positive and significant to ROA of the bank and having 1% level of significance. On the other side, CAR is negative significant to the bank and level of significance is 10%. Internal regulatory variables of corporate governance are highly negative and significant and level of significance is 1%. Moreover, non-performing loans to total asset (NPLTA) and loan loss provision to non-performing loan (LLPNPL) is also significant with negative sign with level of significance is at 1%. Value of F-stat is 31.40 and p-value shows model best fits the data. The R^2 rise to 58.25%.The results of model 8 are shown in table 4.5.

4.2.8 Impact of Financial Variables, Corporate Governance, External Regulatory Variables on Return of Equity (ROE)

In this model, Bank specific financial variable, both internal and external regulatory variables of corporate governance is regressed with return on equity (ROE) of the bank and result shows that earning per share (EPS) and minimum capital regulatory requirement (MCR) has significantly positive impact on return on equity (ROE) of the bank, but non-performing loans to total asset ratio (NPLTA), loan loss provision to non-performing loans ratio (LLPNPL), Capital adequacy ratio (CAR) and internal Corporate governance are negative and significant at 1% level of significance to ROE. The R^2 in this extended equation has increased to 40.54 and value of F-stat is 15.34 and p-value confirms model is well fitted. The results of model 9 are shown in table 4.5.

4.2.9 Impact of Financial Variables, Corporate Governance, External Regulatory Variables on Net Interest Margin (NIM)

In this model, bank specific financial variables and variables of corporate governance (both internal and external) are regressed against NIM of the bank. Except loan loss provision to non-performing loans (LLPNPL) all bank specific variables in this model are insignificant to NIM of the bank while LLNPL is negative and significant with 5% of level of significance. But internal regulator of corporate governance variable and CAR is positive and significant at 1% level of significance to NIM. The R^2 Percentage is 14.40 in this model 9 and value of F-stat is calculated as 3.79 and p-value confirm model is good fitted. The results of model 10 are shown in table 4.5.

Table 4.5: Results of Impact of Bank Specific Financial Variables and External Regulatory of Corporate Governance Models (8, 9, 10)

Variables	Model 8	Model 9	Model 10
Cons	-0.053	-0.131	0.019
	0.007	**0.136**	**0.038**
NPLTA	-0.065 ***	-1.012 NS	-0.007**
	0.01	**0.181**	**0.051**
LLPNPL	-0.075 ***	-0.102 ***	0.025***
	0.002	**0.045**	**0.012**
ADVDEP	-0.039 ***	0.079 ***	-0.002***
	(0.001)	**0.023**	**0.006**
EPS	0.013***	0.012***	0.009***
	0.0001	**0.002**	**0.0007**
IRCG	-0.042*	-0.038***	0.011***
	0.001	0.017	**0.005**
MCR	0.001 ***	0.003***	0.002***
	0.00	**0.00**	**0.0003**
CAR	-0.078***	-0.163*	0.091***
	0.004	**0.078**	**0.022**
R^2	0.58	0.41	0.41
F(8, 183)	31.4	15.34	3.79
Prob > F	0.000	0.000	0.0004

(Note: ***, **, * and NS symbolize significance at 1%, 5%, and 10% respectively and parentheses holds standard error values)

4.2.10 Impact of Financial Variables, Corporate Governance, External Regulatory and Macroeconomic Variables on Return on Assets (ROA)

In this model all the variables including: Bank specific financial variables, corporate governance variables and regulatory variables and now the macroeconomic variable which is: GDP growth is regressed with ROA of the bank to examine the performance of banking sector of Pakistan. GDP growth is positive significant at 5% level of significant against the ROA of the bank. Positive sign in regression represents that if GDP of a country rise then performance of the banks automatically rise. Besides GDP growth, MCR and EPS also positive and significant to ROA. However, ADVDEP is insignificant to ROA as in early models. LLPNPL, NPLTA, IRCG and CAR is negative and significant to ROA. % of $R^{2 \text{ in}}$ this model is 58.76, F-stat is calculated as 28.34.The results of model 11 are shown in table 4.6.

4.2.11 Impact of Bank-Specific Financial Variables, Corporate Governance, External Regulatory and Macroeconomic Variables on Return on Equity (ROE)

Bank specific financial variables, corporate governance variables, regulatory variables along with macroeconomic is regressed with ROE in model 12 to examine its impact on bank's performance of Pakistan .result shows that GDP growth is insignificant when test is run against ROE. However MCR and EPS is significant to ROE of the bank with 5% and 1 % level of significance respectively. On the other side, CAR and IRCG having 5% significant level with negative sign against ROE of the bank. F-stat value is 13.66 and p-values show that model is well fitted and R^2 percentage is 40.72.The results of model 12 are shown in table 4.6.

4.2.12 Impact of Bank-Specific financial Variables, Corporate Governance, External Regulatory and Macroeconomic Variables on Net Interest Margin

In this Model 12 all variables: Banks specific variables, corporate governance, macro-economic variables and regulatory variables are regressed against NIM of the bank. Result of regression shows except CG, LL PNPL and CAR are insignificant to NIM of the bank however the mentioned variables have significant impact on NIM with positive sign. In this model, f-stat is 3.35 and p-value tells model best fits the data. The R^2 is 14.48.The results of model 13 are shown in table 4.6.

Table 4.6: Results of Impact of Financial Variables, Corporate Governance, External Regulatory and Macroeconomic Variable Models (11, 12, 13)

Variables	Model 11	Model 12	Model 13
Cons	-0.0855	-0.159	0.022
	0.005	0.101	0.023
NPLTA	-0.062 ***	-0.988 NS	-0.099 **
	0.016	0.298	(0.054)
LLPNPL	-0.073 ***	-0.102**	0.025*
	0.004	0.053	0.01
ADVDEP	-0.019***	0.096 ***	-0.031***
	(0.0008)	0.006	(0.002)
EPS	0.013 ***	0.012 ***	0.092 ***
	0.0001	0.002	0.0009
IRCG	-0.003***	-0.036 ***	0.011***
	0.0001	0.02	0.006
MCR	0.001***	0.002***	0.002 ***
	0.00	0.00	0.00
CAR	-0.084***	-0.001***	0.091***
	0.004	0.0001	0.042
GDPG	0.009***	0.080 ***	-0.074 ***
	0.0005	0.009	(0.002)
R^2	0.41	0.59	0.41
F(8, 183)	13.66	28.34	3.35
Prob > F	0.000	0.000	0.0008

(Note: ***, **, * and NS symbolize significance at 1%, 5%, and 10% respectively and parentheses holds standard error values)

CHAPTER 5

5.0 SUGGESTIONS AND CONCLUSION

As mentioned in earlier chapters that primary objective behind his study is to observe the relationships between the variable and their ultimately effect on performance of Pakistani banks. Those variables are corporate governance which includes both internal and external regulatory, financial variables as well as economic variable. Net Interest Margin (NIM), Return on Equity (ROE) and Return on Assets (ROA) are used as performance indicators. In chapter 4, estimation technique is used to examine the results.

Starting from Financial variable first is: Non-performing loans to total loans ratio (NPLTL) which is representing total non-performing loans in the bank's portfolio of TL's .Higher the value of NPLTL the greater Non performing loans (NPLs) in Total Loans (TL).In the following study result shows that Net interest margin(NIM) is insignificant to Non-performing loans to total Loans(NPLTL) and negatively significant with Return on Asset(ROA) as well as Return on equity and but for provision which bank need to held against NPLs is negatively associated to return on asset and return on equity as well. That provision amount is deducted from the bank's earnings. Hence, lower provision ultimately have better impact on bank's performance. Therefore outcomes represent that non-performing loans to total loans (NPLTA) and provisions against the NPLs should be small value because which they ultimately reduces the bank's performance and continuous decline in bank's performance leads towards serious results like bankruptcy. Net interest margin have positive relationship with Loan loss provision to non-performing loans (LLPNPL) which means if bank needs high net interest margin then bank should hold high amount of provision. Investments and savings of the banks is directly associated to Net Interest Margin (NIM).

Another financial variable taken in this study is: earning per share (EPS), reason behind taking this variable is that it represents the price of each share of bank which means higher the value of earning per share we can say bank performance is improving. Price of per share of bank trading in market itself revels the whole story of bank's performance hence

Earning per share is directly associated with bank's performance. Continuous increase in value represents high performance and vice versa. Results of this study represents that earning per share is insignificant to net interest margin but having positively associated with return on equity and return on asset .therefore higher value of earning per share represents better performance and lower value shows decline in performance of bank.

Second variable taken in this study is: Corporate governance internal regulatory. This practice is used inside the bank for improvement in inside the structure. There are many reason for implementation of this practice in banking sector. Firstly this is a worldwide practice which is provided by BASEL Committee and also a mandatory requirement to fulfill it. Another reason is because of implementation of this practice owner, shareholder and other stakeholder feel safe that their investment is protected. In this study we have taken five attributes of corporate governance quantified with dummy variables to examine whether there is any kind of impact on bank's performance and found that the corporate governance is negatively significant to the performance. We deduced from the results that primarily, the introduction to the mechanism of corporate governance to be adopted by the banks was to lessen the moral hazard problems that ascended within the bank. This is mainly implemented to mitigate the dangers of bankruptcy and insolvency. Topic of Corporate governance became the center of interest globally after 1990's and gained more attention after the corporate scandals like WorldCom's and Enron's but in Pakistan implementation of corporate governance starts in 2000's but there is still need of reform. In developing countries like Pakistan practice of corporate governance in banks is much needed because banks are the main source of deposits of savings and generally accepted mode of payment in the economy. The Income statement and financial statements of the banks published by banks for its shareholders, depositors and other stake holders are prepared by accountancy firms whose cost is charged to bank. In addition to that, study shows that size of board and independence of board has impact on bank's performance, greater number of board size has negative impact on bank's performance. Size of board and Board independence are the factors which directly influence on bank's performance therefore, administration should carefully tackle this ratio. Similarly, bank performance is also influenced by managerial ownership. Bank's executives should be given enough shares so that they put interest and show outstanding performance. Study shows that CEO

duality has a negative impact on bank's performance. BASEL committee also have reservations on duality in executive management. Results of this study shows that corporate governance is positively significant with NIM.

Corporate governance practice in bank can protect from unnecessary risk taking practices and also ensure to achieving financial soundness .Condition of State bank of Pakistan regarding external regulatory is also part of our this study and also observed its impact on bank's performance .from our result we have examined that minimum capital requirement (MCR) is positively significant to return on equity and return on asset as well but insignificant to net interest margin. Reason behind this condition of State bank of Pakistan to create a buffer if bank got insolvent so, by MCR, SBP is ensuring to safeguard the interest of depositors and other stakeholders and it has also somehow benefit for banks too because it increase confidence in depositors and investors that their investment is safe. Results of this study suggest that return on equity and return on assets is negatively associated to capital adequacy ratio. High value represents that bank is investing in risky assets which ultimate decrease the bank's performance. Net interest margin is directly associated with capital adequacy ratio greater the value of capital adequacy ratio greater the net interest margin. On the other side, minimum capital requirement is insignificant to Net interest margin.

In this study role of economic variable is also examined on bank's performance and outcome shows that GDP growth is positively significant to return on asset and insignificant to return on equity and Net interest margin.

Financial variables, internal and external regulatory variables of corporate governance as well as macroeconomic variable are used in this study to see its impact on performance on banks of Pakistan. It is examined in this study that performance of banks in Pakistan has improved in recent years specifically between 2013 to 2015

Regression model is used in this study to observe the relationship between financial variables, internal regulatory, external regulatory of corporate governance and macro-economic variable on bank's performance of Pakistan. There are some mandatory requirements (Like MCR) imposed by State Bank of Pakistan which banks have to fulfill otherwise the banks are punished. These kind of requirement have impact on Bank's

performance. In addition to financial variables, results shows that corporate governance and economic variables are also important factors to determine bank's performance.

To conclude, performance of banking sector of Pakistan has improved during the period of 2006 to 2015 as compared to past. Banks are performing all the mandatory requirements imposed by SBP in effective way. Moreover, they have also buffered themselves against any unfavorable circumstances that might occur in future. In addition to SBP mandatory requirements, BASEL committee requirements of corporate governance is also fulfilling successfully which ultimately results towards better performance. Risky assets are managed by Pakistani banks so well that Capital adequacy ratio is insignificance to bank's performance. Despite all this there is improvement is needed to compete with international level.

5.1 Recommendations

Following are the recommendations on behalf of results and following study

- Without any doubt banking sector of Pakistan has improved tremendously in last few years but there is a still gap to improve the bank's performance by banking reforms
- There is a need for proper implementation of corporate governance practice in Pakistan in which Pakistan is lacking far behind from the other countries.
- Banks must create strong boards, improve their accuracy, timing and should also focus the rights and interests of depositors, shareholders and other stakeholder. By implementation of accurate corporate laws, accounting standards, and effective judicial systems together can ensure the foundations of corporate governance strong and effective.
- Reform is needed in hiring process of directors also in their remunerations and transactions regulations.
- To check the how much effective implementation of corporate governance in banks, rating system should be introduce to evaluate, which cover various governance categories such as: ownership, board composition, transparency, auditing and proper disclosures of financial reports.

- Non-performing loans to total loans ratio (NPLTL) and loan loss provisions to non-performing loans to total loans ratio (LLPNPL) have a high role on bank's performance, therefore, the banks should be very vigilant against these ratio. Benchmark should be set by banks against these ratios if the values of these ratios goes high from that benchmark then it will be an alarming position and strict monitoring should be carried out.
- Performance of banks is directly related to GDP growth therefore banks should protect themselves from recession period of business cycle and to ensure, that, that situation will not give any harm to them.

5.2 Future Prospects of Study

- This study was conducted taking into account the financial, corporate governance, regulatory, and macroeconomic factors, by including industry specific factors advanced research can be conducted.
- In current corporate governance speculating, the split between shareholding and stake holding is less valuable, meanwhile in recent time's material conditions and philosophical insights have changed knowingly by making the division of shareholding and stake holding now rather terminated.
- Policies in fever of financial development or promoting liquidity in the banking sector might not essentially enhance the banking stability is the theoretically as well as practically important policy implication.
- Only one macroeconomic variable was incorporated to see the impact, there are a lot of other economic variables which influence the bank's performance.

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APPENDIX. 1

List of Banks

Sr. No	Bank Name	Sr. No	Bank Name
1	Allied Bank Limited	12	KASB bank
2	Albaraka Bank Limited	13	Muslim Commercial Bank (MCB)
3	Askari Bank Limited	14	Meezan Bank
4	Bank Al-Habib	15	National bank of Pakistan (NBP)
5	Bank Alfalah Limited	16	NIB
6	Bank Islami	17	Silk Bank Limited (Saudi Pak Commercial Bank Limited)
7	Bank of Khyber	18	Soneri Bank Limited
8	Bank of Punjab	19	Standard Chartered
9	Faysal Bank Limited	20	Summit Bank
10	Habib Bank Limited	21	United bank Limited (UBL)
11	JS bank		