
Impact of Corporate Governance on the Financial Performance of Islamic Banks in Pakistan

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Abstract

The objective of the study was to examine the impact of corporate governance on the financial performance of Islamic banks working in Pakistan. The population of the study was Islamic banks working in Pakistan and seven (7) Banks were selected as a sample size through simple random sampling technique. The dependent variable was return on assets while independent variables were board size, female director, age of experience, firm size and productivity. Data was collected from the annual reports of Islamic banks websites for the year 2017 to 2021. Panel Diagnostic Test, regression analysis and correlation matrix were used for analysis. Results reflect that firm size, board size and productivity were found positively significant. While age of experience was inversely significant and female director was found statistically insignificant. The magnitude of firm size was high as compared to other significant variables. However, female director was found insignificant so it has no impact on return on assets.

Keywords: Corporate Governance, Board Size, Female Director, Age of Experience, Firm Size, and Productivity

Introduction

The Past research studies on corporate governance around the world has proven a number of empirical consistencies. Such different fundamentals of countries' financial systems as the extent and deepness of their capital markets, the pace of new security matters, corporate ownership structures, dividend policies, and the efficacy of investment portion appear to be elucidated

mutually conceptually and empirically by in what way well the laws in these countries look after external investors (Zahid & Rehman., 2018).

According to Chahine & Safieddine, (2011) the security of shareholders and creditors by means of the legal system is significant to understanding the forms of corporate finance is not the same countries. Investor security turns out to be important because, in various countries, expropriation of lesser shareholders and creditors by means of the controlling shareholders were widespread. When external investors finance organizations, they confront a threat, and at times nearby certainty, that the profits on their investments were never occurred for the reason that the controlling shareholders or managers purely save them.

Corporate governance is, in the direction of a large range, a set of mechanisms over and done with which external investors secure themselves alongside expropriation by the internals. Expropriation knows how to make a variety of forms (Ranti, 2011: Khattak., Saeed, & Tariq, 2018; Nasir et al., 2020). In several countries, internals simply takes the profits. In other countries, the internals sells the productivity of the assets of the organization they in hand, but then which external investors have financed, to another unit they possess at lower market values. Such transference rating and asset strip off, although frequently lawful; have mostly a similar influence as stealing. In still other examples, effortlessly lawful expropriation takings the form of installing probably unqualified family members in decision-making locations, or extra paying directors. Overall, expropriation is associated on the way to the agency problem defined by Meckling and Jensen (1976), who emphasis taking place the consumption of “perquisites” by means of managers as of the firm’s 2 profits.

Adams and Ferreira (2009) suggested raising the proportion of woman administrators is premised upon the knowledge that this was helpful for governance, and eventually, organization enactment. A tricky situation with these creativities is that the emphasis taking place demonstration may miscue the real amalgamation of woman directors into organization governance. The economic effects of board gender diversity variety may be confusing if decisions to rise woman demonstration on boards are, in part, focused by social and politically aware stresses that raise concerns as regards token demonstration.

Corporate governance is a developing field and in concerts a dynamic role as a whole enactment of a corporation. It can be purely defined as a relationship among stockholders, upper management, the board of managers which has the arrangement to managerial achievement (Wheelen & Hunger, 2011). Corporate governance should furthermore describe the connection between the goals of the panel of administrators and stockholders. Investors have furthermore effect in line to corporate governance for the reason that it is in owned attention i.e. workers, customers, lenders, borrowers, administrative offices, banks, finance house and community at huge.

The objectives of the study are to examine the strong effect of Board size on the Financial Performance of Islamic banks; Investigate the strong effect of Female directors on the Financial Performance of Islamic banks; Empirically find the strong effect of the Age of Experience on the Financial Performance of Islamic banks; Search out the strong effect of Firm Size on the

Financial Performance of Islamic banks; Evaluate the impact of Productivity on the Financial Performance of Islamic banks.

This study plays a crucial role in the financial performance point of view of Islamic banks. The study helped the Islamic banks in Pakistan to have the in-depth sight of dimensions of corporate governance that greatly influences the financial performance of these banks. Corporate governance is one of the most important dimensions of any large organization and it greatly influences the financial performance of the organization. Nowadays in this modern era, corporate governance is affecting financial and non-financial aspects of any organization because the strategic decisions have a significant influence on the overall organization (Mustaq et al., 2017; Ahmad et al., 2022; Ghani et al., 2022). According to Hassan et al. (2014) in light of the Islamic way of thinking established the money related foundation on the genuine guarantee of some arrival and fixed pace of return. Since there is a strong relationship between corporate governance and financial performance therefore, once the determinants of corporate governance are known and their influence on the financial performance is known only then the organization can achieve its financial goals.

Literature Review

Larcker et al. (2007) for instance found the relationship in corporate governance & firm execution conflicting despite the fact that they surrender that their discoveries may result from trouble in distinguishing solid and hearty estimations of corporate governance in a meta-investigation concentrates identified with panel viability Dalton et al., (2015) infer that chief executive officer duality and the pariah panel extent have no immediate relation to firm execution.

Bhagat (2008) additionally expect nil connection between outward executive proportions & resource returns or resource change. While Kleins (1998) look into proposed that no connection is there in general panel autonomy & working execution, investigation recommends that there is a huge connection between inward nearness on a few funds and venture advisory groups and working execution concentrating on a different leading group of executive forte (Yarmack, 1996) reports a converse connection between board size and firm benefit. In spite of the fact that the connection between corporate Governance and the association's presentation is as yet not obviously settled it was the basic business rule for organizations to set up top managerial staff in screen trade execution prompting the organization's investors (Kosnik, 1990) is ensured.

Hussein and Othman (2012) thought about that good governance corporation performed during the monetary emergency as going for broke for money related steadiness is a related issue during the worldwide budgetary predicament. Surveying and estimating the connection and availability between corporate Governance instruments and monetary execution utilizing different factors for example CEO status.

Hassan et al. (2014) in light of the Islamic way of thinking established the money related foundation on the genuine guarantee of some arrival and fixed pace of return. This framework

supported business and advanced hazard sharing and underlined the accuracy of agreements with legitimate organization and control.

The ramifications of corporate Governance structure and money related execution have been examined in the current writing. It generally concurs that great corporate Governance rehearses are in basic component for an upgrade in budgetary execution of a bank in both created and creating nations (Mangla, 2017).

The qualities of the panel regarding panel size self-sufficient framework and viability had been generally investigated in hypothetical and experimental research at some examinations have non-covered that larger panel offices successfully observing & give banks more prominent heterogeneous ability information and aptitudes (Chahine & Safieddine, 2011; Saeed 2017; Obaid & naveed 2021).

Bahrain and Zain (2013) about Islamic banks experimentally survey corporate Governance exposure practices and its effect on bank execution are for the most part saved the second target of this audit is the connection between the degree of corporate Governance revelation by peroxide of Islamic banks have to evaluate. Zakariyah (2012) contends that the impact of refinements of Muslims from an interest in the current worldwide economy particularly property venture especially in Pakistan was put Muslim the befouling of riches.

Corporate Governance:

Frameworks of corporate governance in company to company and country to country are different (Jackson, 2010; Claessens & Yurtoglu, 2013; Matoussi and Jardak, 2012) and Rehman et., (2018). They find from the results debated the question whether a common, international framework of CG would be optimal for all countries.

(Askary, 2001; Maali et al., 2003; Hania & Hudaib (2007; Umar et al., 2020) are studied on the topic of social reporting and Islamic corporate reporting only notable exceptions to the analytical papers and normative papers. They find Muslims countries have cultures variable from other religions and Muslim culture has an influence factor for others and in the same way Islamic corporate governance follow Islamic law and corporate governance internal environment reflect Islamic culture.

Fisman et al. (2013) Regardless of whether more grounded administration enhances hold/supplant choices relies on upon which of these impacts commands. We utilize our hypothetical structure to survey the impact of administration on the nature of terminating and enlisting choices utilizing information on the CEO expulsions of substantial U.S. partnerships amid 1994-2007. Our discoveries are more reliable with a useful impact on feeble administration on CEO expulsion choices, recommending that protection from shareholder weight may take into account better long haul basic leadership.

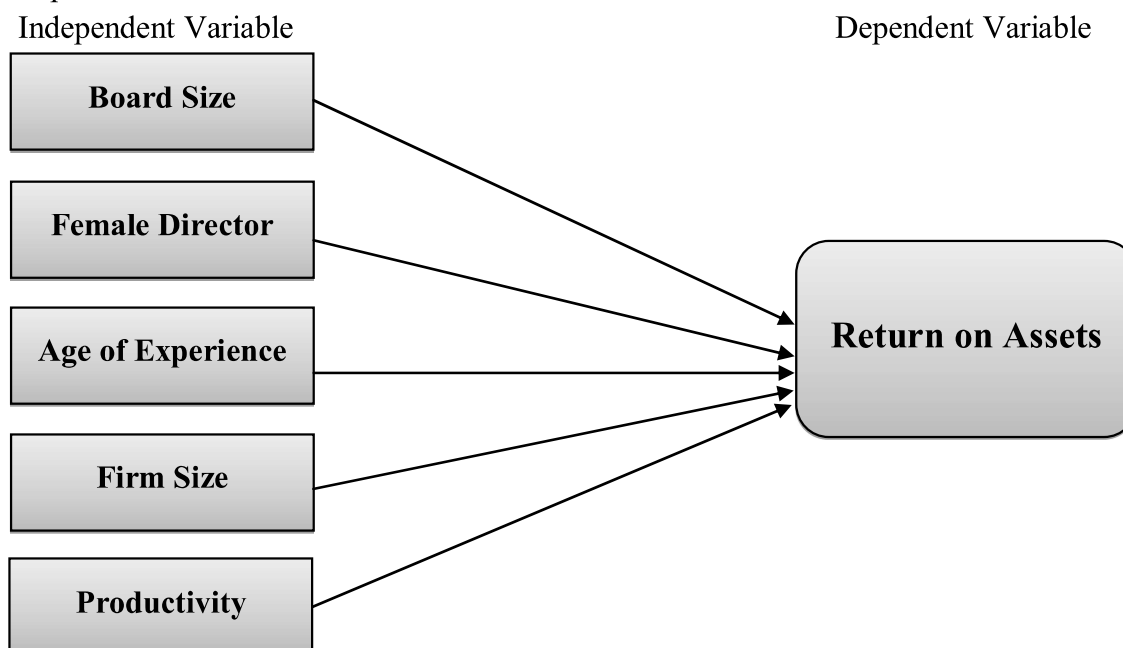
Islamic Banking in Pakistan:

Islamic banks need to look for after separated principles granted in the Quran Majid and also the most appropriate cash techniques in Muslim social requests, especially Islamic banks (Suleiman, 2000). Banking, as demonstrated by the Sharia, resembles the standard budgetary structure by

beneficiation various organizations and profit entity things to consumers and perceives this devotion inside cash related trades between them. The Islamic Fiqh states to vital and common Islamic decisions and make sure that overall pursuit actions continue in the light of Sharia law (Siddiq, 1985).

Day by day Islamic budgetary structure is turning out to be rapidly worldwide especially in Pakistan as it has been seen that for all intents and purposes every standard bank has separate branches similarly as Islamic money related window (Asif et al., 2017; Saleh et al., 2022). Premium free budgetary suggestions push ahead dependent on Sharia and Modaraba, Musharika, Ijara, etc. which significantly sway Islamic banks. The Islamic money related system has grown perseveringly since the last two decades and in specific years its bit of the pie is by 7% (Samad, 2004; Younas et al., 2017).

Conceptual Framework:



Source: Hassan et al., (2014)

Hypothesis of the Study

H₁: Board size has a significant impact on the Financial Performance of Islamic banks.

H₂: Female Director has a significant impact on the Financial Performance of Islamic banks.

H₃: Age of Experience has a significant impact on the Financial Performance of Islamic banks.

H₄: Firm Size has an important strong effect on the Financial Performance of Islamic banks.

H₅: Productivity has a significant impact on the Financial Performance of Islamic banks.

Research Methodology

Research Nature

The recent study was strong and purely quantifiable in nature. The study was based on the Deductive Approach therefore hypotheses of study were confirmed statistically by using STATA-16 through regression analysis.

Population of the Study

The target population of the study was Islamic banks working in Pakistan. Presently there are seven such banks in Pakistan (SBP-IBP Bulletins).

- Al-Baraka Bank Limited (ABBL)
- Meezan Bank Limited (MBL)
- Dubai Islamic Bank (DIB)
- Bank Islami Pakistan Limited (BIPL)
- MCB Islamic Bank (MIB)
- Bank Al-Falah Limited (BAFL)
- Faysal Bank Limited (FBL)

Sample and Sampling Techniques

The study used simple random sampling techniques in which the researcher selected all the Islamic banks mentioned above as a sample of the study i.e. seven. Since the Islamic banks are fewer in number and the nature of data to be analyzed can be easily accessed, therefore all the target banks were selected as samples.

Data Collection Tools and Procedures

The data was collected from the annual reports of official websites of Islamic banks operating in Pakistan from 2017 to 2021.

Econometric Model

The relationship among variables is explained in the following equation:

$$ROA = \beta_0 + \beta_1 BS + \beta_2 FD + \beta_3 AE + \beta_4 FS + \beta_5 PRO + e_i$$

Such that;

ROA: Return on Assets

BS: Board Size

FD: Female Director

AE: Age of Experience

FS: Firm Size

PRO: Productivity

β_0 : Intercept (Constant)

β_1 - β_5 : Slope of Explanatory Variables

ei: Error Term or Residual

Dependent Variable:

- Return on Assets:

Bosch's (2007) return on assets is the broadly useful monetary proportion that is utilized to gauge the relationship of benefits earned to interests in resources important to procure that benefit. Profit for resources is a standard and it can quantify the necessary benefit commitment from new. As a speculation, it distinguishes the pace of return required to keep up in any event for the present execution that all new ventures ought to expect endorsement to set up the hindrance rates. An extensive investigation of the arrival of resources was additionally done by George Waugh. Gallinger (2007) he built up a model that included variable markers, for example, returns and deals, monetary profits, intrigue costs. This offers an organization a chance to oversee resources and redeploy resources later on. Concentrates on resources are an intermediary for money related execution. It very well may be estimated as isolating net benefit by absolute resources.

$$\text{Measurement: ROA} = \frac{\text{Net profit}}{\text{Total assets}}$$

Independent Variables:

- i. Board Size:

Board size states to the quantity of members of the board present on a corporation's board of directorates. This should be restrained by the quantity of individuals on the panel (Penny and Wama, 2012). The first prose on panel size exists Lipton and Lorch (1992), & Jensen (1993) said that the inclination for minor panel sizes trunks from technical and executive changes that eventually lead to price reductions then declines. Hermlin and Wisbach (2003) claimed that greater panels may be fewer active than smaller panels. Agency problems can increase when the board has too many members, as some directors may tag as free-riders. Limiting the number of directors on the board to 7 or 8 is recommended by Lipton and Lerch (1992), beyond which the Chief Executive Officer would be difficult to the controller.

$$\text{Measurement: (Board Size=Number of Board Members) } \setminus$$

Female Director:

Olutoye and Akinyomi (2014) discovered that having a lady executive on the Panel of Administrators of Banks in Nigeria positively affected the productivity of the bank. Letting' et al. (2012) inspected the connections between top managerial staff assorted variety and corporate execution of the differing gathering of organizations from every one of the areas recorded on the Nairobi Securities Exchange. Their discoveries show that factually noteworthy positive relationship exists among ROA and time of load up individuals, ladies on the load up, instructive capabilities and load up part proficient specialization; DY and time of load up individuals and instructive capabilities.

Oba and Fodio (2013) completed an investigation onboard sexual orientation assorted variety on money related execution in Nigeria. The learning-focused uniquely on

the non-budgetary part organizations that are cited on the ground level of the Nigerian stock exchange. Data examination was led utilizing a relapse model in other to test the connection between the load up sex blend and organization execution. The outcomes uncovered that there was a normal of nine chiefs on each example company's board while 44.4% of the tested firms had a female executive on the top managerial staff.

In the domain of cash connected revealing, company Governance, and speculation decisions, a developing assortment of analysis offers proof that gender influences totally different company results. Some studies have reached the accord that feminine administrators area unit additional freelance than their man matching part which organization enactment is higher for companies with additional feminine panel illustration 2003 (He and Conyon, 2017) inexperienced (Liu et al., 2014 & Homroy, 2018). Furthermore, companies with feminine administrators build rarer acquirements and pay lesser offer premier, serving to produce stockholder worth (Levi et al., 2014) and better shares are originated at companies with poor control that use dividends as a control method (Chen et al., 2017). Whereas gender diversity on businessman groups is related to lesser hazard and higher enactment (Perryman et al., 2016) alternative analysis do not notice such a connection as well as need a lot of analysis to perceive the advantages in this place (Sila et al., 2016 & Adams 2016).

Measurement: (Presence of Female Director in Board;
0=No Female in Board, 1=Female in Board)

Age of Experience:

Associations must return to current work forms, frameworks, arrangements, and performances to figure out that one's push to work wasteful aspects, thus might make pointless pressure and exhaust for representatives" (Prottas, Andreassi & Thompson, 2003). Examine recommend that one out of five individuals experience the ill effects of high work and word related pressure. It is by and large being said that one can battle very well with word related pressure when the individual in question is in the period gathering of eighteen years to forty years and following 40 years the intensity of battling with word related pressure continues diminishing.

Measurement: Number of Years from the date of Commencement of business

Firm Size:

Firm Size utilized as a control variable and should be estimated even as the regular record of all-out resources (Bauer et al., 2008). Firm size is frequently utilized as an intermediary for data accessibility in the market. Data for huge firms ought to be more accessible in the market than for little firms. Albreth and Richardson (1990) discover proof that huge firms have less motivation to smooth profit than little firms. Lee and Choi (2002) additionally locate that firm size is a variable that could impact a company's inclination to oversee income.

Measurement: Natural Log of Total Assets

Productivity:

We pursue Garicano (2000) and Rossi-Hansberg (2004, 2006 and 2011) and model Örms as information founded chains of importance wherever chiefs manage exemptions. In this generation arrangement laborers in Örm give working period. Aimed at every part of the working period they are able to possibly deliver products. Issues must be comprehended with the goal for yield to be figured out. So as to take care of issues operators secure specific information. Gaining information is exorbitant, and laborers can just utilize their insight to take care of the issue they face without anyone else generation action. So all in all, it isn't to cause laborers to figure out how to take care of inconsistent issues. Rather, chains of importance are made where administrators figure out how to take care of the less basic issues the special case and laborers manage the standard issues. At the point when laborers are gone up against an issue, they don't have the foggiest idea how to understand, they ask the chief. The hierarchical structure decides the information procured by operators, the request wherein various specialists go up against issues, and how they speak with one another.

The consequence of the manner in which creation is composed given the degree of interest for its items. This connection among request and profitability is available in any creation innovation in which requirements to settle on some expensive speculation choice so as to extend generation. An exemplary model is present the choice on the way to grow by expanding the quantity of plant life. One more is the choice to put resources into fresh advances (Yeaple, 2005; Burstein et al., 2008; Atkeson and Burstein, 2010, Bustos, 2011, Lileeva&Treáer, 2010).

Data Analysis

Multicollinearity Table 1

Variable	VIF	1/VIF
PRO	1.75	0.572862
FS	1.48	0.676335
AGE	1.39	0.719143
BS	1.11	0.897083
FD	1.10	0.908697
Mean VIF	1.37	

The value of variance inflation factor (VIF) must be less than "10 "(Hair et al., 2006). The above table suggesting that all the variables having VIF value less than 10, so there is no problem of multicollinearity in the data.

Panel Diagnostic Test **Table 2**

Tests	Hypotheses	P-values	Decision
Breusch-Pagan test	H_0 = Pooled OLS model is appropriate H_1 = Random Effect model is appropriate	0.315	Pooled OLS model is appropriate
Chow test	H_0 = Pooled OLS model is appropriate H_1 = Fixed Effect model is appropriate	0.028	Fixed Effect model is appropriate
Hausman Test	H_0 = Fixed Effect model is appropriate H_1 = Random Effect model is appropriate	0.271	Fixed Effect model is appropriate

The above table shows that Breusch pagan test suggesting pooled OLS model as appropriate model. While Chow test a test and Hausman test suggesting fixed effect model. As a conclusion “Fixed Effect Model” is appropriate.

Regression Analysis

In statistical modeling, regression analysis is a set of statistical process for estimating the relationship between dependent variables and one or more independent variables.

Coefficients **Table 3**

ROA	Coef.	Std. Err.	t	P> t
FS	8.635713	1.343083	6.429	0.000
BS	0.337278	0.089885	3.752	0.013
AGE	-.4375586	.03140449	-13.933	0.000
PRO	1.2540236	0.165894	7.995	0.000
1.FD	.2294199	1.962275	0.12	0.908

F- Stats= 13.28 (P-Value= 0.0000) | R-Squared= 0.7775 | N= 35

F-Stats of the model is 13.28 and its p value is 0.000 which shows that over all model significant. R square shows the variation in dependent variable due to change in independent variable the r square of the study model shows 77.75% variation in dependent variables due to change in dependent variables (i.e. firm size, board size, age of experience, productivity and female director).

Further, the study result shows that firm size, board size and productivity are found positively significant. While age of experience was inversely significant. However, female director is statistically insignificant.

The magnitude of firm size is high as compared to other significant variables. It is 8.64, which suggest that, if there is, a change of 1 unit in firm size it will increase the return on assets by 8.64 units. The magnitude of productivity is 1.25 it shows that if there is change of 1 unit so it will increase the return on assets by 1.25 units. The magnitude of board size 0.34 so its shows that there is change of 1 unit in board size it will bring 0.34 units change in return on assets. Age of experience has inverse relationship with return on assets with the magnitude of 0.44. It

represent that a change in age of experience can reduce return on assets. Though, female director was found in significant so it has no impact on return on assets.

Conclusion

Objective of the study was to find out the impact of corporate governance on the financial performance of Islamic banks in Pakistan. Population of the study was full-fledged Islamic banks working in Pakistan and sample we selected this on the simple random sampling technique. Dependent variable was return on assets and independent variables were board size, female director, age of experience, firm size, productivity. Data collection the data was collected from the annual reports of seven Islamic banks from years 2017 to 2021 and the study of this research was secondary data. Tools of analysis for this data were used regression analysis, Panel Diagnostic test and correlation matrix.

Regression analysis used for estimating the relationship between the dependent variable and one or more independent variables. Regression analysis shows that firm size, board size and productivity were found positively significant. While the age of experience was inversely significant and female director founded statistically insignificant. The magnitude of firm size was high as compared to other significant variables. However female director was found in significant so it has no impact on return on assets.

Recommendations

Manager must be focused on financial performance of Islamic banks and also must be try to attract the customer announce different packages through which manager attract them to Islamic banks rather than customer attract to other banks if unfortunately customers attract to other banks due to this bad effect on the productivity of the banks. And also bad effect on the return on assets of the banks. Investor must consider the important role of incorporated administration in monetary execution of Islamic banks. In the other perspective of investor consideration must include the board size, firm size and most important productivity of the banks if the productivity of the bank was more than investor want to more investment in banks and investor also consider and see up the return on assets of the banks if the return on assets was high then the investor get more profit from banks so investor was interested in the above context of banks.

Corporate governance is the frame work of rules and practices by which a firm was directed and controlled and also ensure the accountability of share holders. In financial performance of Islamic banks matter a lot in the context of customer and customer's attention. Because customers attraction was closely linked with financial performance of Islamic banks. If the financial performance of Islamic was able to attract the customers it's very beneficial for Islamic banks. So most of the Islamic banks depend upon on its financial performance and operating working process.

Future Research Directions

- ROE can also be used as a dependent variable

- In future study can be done by taking a big sample which can be more than 5 year.
- Some other variables can be used in future study while new codes of corporate governance must be used.
- Other study can be done by including conventional banks for a comparison.

Limitation

The study was limited with Islamic banks operating in Pakistan. And this study not included any perspective which is related to conventional banks and the financial performance of these banks was also excluded from this study.

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