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Imapct of Corporate Governance on Organizational Sustainability

Asma Mobeen 1
Lahore Business School
The University of Lahore Gujrat Campus
e-mail: asmamobeenuol@gmail..com

Mubashir Ali.2
Lahore Bsuiness School
The University of Lahore
e-mail: mubashirgc@gmail.com

Abstract
The corporate governance mechanisms in the Pakistan are normally thought to be less important to achieve organizational success. By enduring the good corporate governance organizations may enlarge the circumstances where management can convince the employees particularly and share holders generally to capture long term organizational gains. We used five point Likert scale questionnaire to measure the corporate governance in banking sector of Pakistan. This empirical study suggests that the corporate governance has widespread role in organizational success. The results suggest that discipline, social awareness, accountability, fairness and responsibility have significant effect on organizational success. However, effect of discipline and social awareness is higher than accountability, fairness and responsibility. Moreover, our study shows that independence and transparency do not effect on organizational success significantly.

Keywords: corporate governance, Discipline, transparency, independence, accountability, responsibility, Fairness, social awareness and organizational success

1. Introduction

Performance has a link with good corporate governance for the sustainable organizational success (Attiya Y. Javid, Robina Iqbal, 2010). It is also denoted that good corporate governance serves for a number of public policy objectives in new markets. According to SECP Corporate Governance Code 2001 every public limited company has to issue the corporate governance report so, it has created an important area for research in corporate governance in Pakistan. Since 1999 SEC has took over the responsibilities and power, it always laid stress on good corporate governance strategies to accept the challenges rose in changing global scenarios of corporate. It is a dynamic range of practices and institution which ensure the accounting standards, financial confession, to management compensation, performance and to size the corporate boards. Agrawl and knoeber (1996) define corporate governance as a system which has dual mechanism to control organizations; it can be external mechanism and internal mechanism. Outsiders define the external mechanism like share holding policy and outside block holding etc. Firm's decision makers (top management) decide the internal mechanisms like size of board, remunerations and other internal policies.

This research paper infers that corporate governance has become surprisingly the emerging concept in rising and competitive markets. This concept has also become a constraint in the innovative and emerging market to adopt readily changes in market. But it has become inquiring after larger disaster in corporate sector like Enron liquidation, Taj company, South Sea Bubble 1720 and other corruptions in corporate. This research is aimed to suggest the results to commercial banks working in Lahore because banks are the central institutions for country's economy. Commercial banks have sensitive customers so they have to focal point on corporate governance for its long term success.

y documents some frameworks to encounter the problems which may cause inefficiency in banking sector; it would be helpful in preventing such problems in future to gain long term organizational success in the sector.

Our research limitations lack in data collection as we took narrow segment which comprises of commercial banks. Further studies can focus on whole sector to see the broader impact of corporate governance on organizational success. We will discuss literature review, data and methodology and recommendations and conclusions further in this study.

2. Literature Review

Whenever people get close to each other to comprehend the societal and organizational need they must have direction and control. To govern is to give them direction and control by providing them proper laws and regulations (Serrat, O 2011). Corporate governance refers in making such set of laws and motivation through which administration of company is bounded and administered for profit maximization which ultimately ad the value for shareholders as well as for management. It also considers the interest of all other legitimate stakeholders to capture value in return (Stone, Andrew,et.al. 1998). SECP, an authorization institute for corporate working in Pakistan indicates in its manual of corporate governance (2002) as, corporate governance is emergent term which is used to describe it as a process which is civilized as corporate entities are. It carry on all the activities which ensures that all the actions which are done in corporate are according to extreme prevailing principles of ethics and it is best way to protect and encourage the interest of all stakeholders this is based on efficacy assumptions. Berle and Means (1932) specifies corporate governance as, it is regulation, ownership and control of the organization.

Corporate governance has another dimension that it serves and guides to secure the dedication of stakeholders with objective to functionalize their skills, knowledge and experience to avail the full benefits. To avail the maximum organizational benefits corporate governance sets legal terms and condition for the allotment of property rights among stakeholders, organizing their associations and manipulating their incentives for achieving their eager to work together. Further addition to corporate governance it is vital because of the delegation of responsibility for production, process improvement and innovation. (Suzanne, C. Neil et al. 2006).

“Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the directors include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The Board's actions are subject to laws, regulations and the shareholders in general meeting.” Cadbury commission (1992. “In his most comprehensive sense, corporate governance comprises all the forces that effect on firm’s decision making process. It would protect not only the stockholder’s rights, but also the bounding agreement and collapsing power of debtors. Corporate governance also gains the commitment of the employees, customers and suppliers. In adding together it is the Power to diffuse the risks by combining all the forces.

Further to make clear the path of corporate governance SECP manual helps the readers that SEC companies ordinance 1984 is primary regulating authority in Pakistan for corporate entities, the SEC Ordinance 1969, SECP Act 1997, and related worthy rules and regulations made there under. Listed companies are not only monitored by SECP but also from stock Exchange in which these are listed. State Bank of Pakistan is controlling Banks in Pakistan responsibly. The companies which are handling generation, transmission or distribution of electric power, telecommunication companies and extractive companies are administered by National Electric Power Regulatory Authority, PTA (Pakistan Telecommunication Authority) and OGDC (Oil and gas development corporation) respectively. This is not comprehensive list. Corporate Law Authority (1999) was taken over by SEC since it becomes the origins of corporate Governance in Pakistan by delegating the authority and gaining the power. SEC took the charge to manage the changes at national or international which may directly or indirectly can affect home businesses. This step is projected to provide strict audit compliance, to defend the interests of stakeholders, transparency and accountability in the corporate sector, including protection of minority shareholders' rights.

Miles, L. (2010), indicates that Anglo American model is based on normative free market’ principles, relies on various pre-requisites for its successful operation, guides about corporate governance that it has focus on the association between company directors and shareholders. To alleviate corporate governance problems different system has been adopted under the Anglo American governance model to stream line the benefits of directors concerned to shareholders. Anglo American Model focuses first on director’s independency as it is integral part of corporate governance control because these are the eyes and ears of shareholders and it can invite a constituent of objectivity for internal communication of company. Secondly, it emphasis on independency not only because, it can help in internal discussion but also due to commandment usually consider board of directors liable for different integral duties of company. (Deakin, S. Hobbs, R, et.al. 2005) Another contrasting view on role of independency in good corporate governance has been emerged by Organization for Economic Co-operation and Development it indicates that efficient CG mostly relies upon the severances of power connecting a company’s managers, directors and majority and minority shareholders. This study held’s accountable to manger under the self-governing oversight by the board of directors and an external auditor. Good economic and political governance can result of good economic outputs, and for the business prosperity, good corporate governance is significant which can be assured by accountability.

Additionally corporate governance makes certain that electorates and stakeholders in a corporate are taken accountable. Lusaka, Zambia (2005) Report indicates that many of the Asian businesses are intrinsically characterized by lack of transparency. SEC manual of corporate governance (2002) stress on importance of transparency that it is the counter of good corporate governance moreover it also guides about transparency which can be achieved by three key elements: Accounting standards, Openness and Compliance reporting. Efficiency of business and market profoundly depends upon the investor trust and assurance in the correctness and availability of provided information to general public. Transparency can also be confirmed with accounting method recognized internationally is mandatory to guarantee with the aim of financier can successfully interpret and contrast company data. It is amended in corporation code of listing of companies in stock Exchange of Pakistan that these companies are now under compulsion to act transparently. Some other convergent arguments have also been discussed by Ananchotikul, Nasha (2008), Black et. Al. (2003), Klapper and Love (2002) and Khanna et. Al. (2001) about transparency. They say that transparency is extremely imperative to a good corporate governance system hence it motivates shareholders confidence in the firm. Another note able corporate governance element which can enhance the function of good corporate governance is accountability. Being the key composition of company accountability elaborated the director's duty to shareholders.

They are specially held accountable and responsible for company's tactical vision and share values for long term. By performing these key tasks at same time the management and board should be open and available to all the stakeholders on inquiry about the condition and performance of corporate. Furthermore they are also held accountable to disclose all the key decision criteria's whom decisions were made, addition to this the information regarding executive compensation, intentional planning, nomination and appointment of directors and succession of managers and financial controls (Sec manual 2002). First report which was presented internationally mentions that by joining public accountability and control both will profound the company. It also suggests that economy of country mostly bases on strength and effectiveness of its companies. So, to make these corporate efficient major responsibilities lies to board how they discharge their responsibilities and determine their competitiveness position in the market. They must be independent to set the rules of companies but mean while they should exercise their freedom in context of accountability effectiveness.

It is the foundation of any good corporate governance structure (Cadbury Commission 1992). An added concept of corporate governance can be defined as system of accountability among share holders, the BOD's and the management of corporate entity (. Lusaka, Zambia 2005). For achieving strategic corporate objective decision making process must be held accountable. Furthermore he also encompassed the essentials of good corporate governance like; fairness, transparency, accountability and responsibility are least standards which can offer maximum protection from financial crisis and can intensify the access to capital. One more developing inspection reports that transparency, independence, accountability, discipline, fairness and social responsibility are major principles in good corporate governance. Mwanakatwe, C. (2005) also noted that corporate governance is more crucial in banking industry because of its role being the custodian of public funds due to high leverage of responsibility banks are more accountable. Furthermore he mentioned that banks are organism of financial intermediaries and have a position of trust in economic system.

Because of theses intensive obligations banks are very sensitive to ineffective corporate governance. To support his arguments he presented a view that good corporate governance in banking sector can yield investor's confidence and can attract more investments. The researcher highlighted some key issues in banking sector regarding corporate governance like internal controlling process, risk management, auditor's independence, material disclosures and internal audit competence. He stated that sound financial condition and good corporate governance practices can attract the national investments primarily and foreign investment majorly. Musasike, L (2005) He stated that the DBSA's (development bank of South Africa) witnessed good business outcomes by inculcating fairness, transparency and reduction of corruption via implementing good corporate governance. However, it is observed that there is no single corporate governance model to implement; there is room for improvement, proper monitoring and system for early caution signs in risky projects.

In this view government is considered as major cause of discouragement in good corporate governance. (Chandi, E 2005) Indicates that independence of the directors is closely related with structure of corporate it has, and also associated with awareness of directors to laws, regulations and values that control the enterprise. One theory proposes that the legal competence of country does matter a lot. Finally it can be assumed that countries with weak judicial system expect less corporate governance. (Leora, F., Klapper, Love, I. 2002) Another hypothesis also proves that effectiveness of country level system affects a lot in governance of company. It also suggests different variations across the environment while making contracts with different companies Himmelberg, Chales, P., Glenn, R. et. al. (1999).

Theoretical Frame work

Figure 1 shows the theoretical frame work of study by depicting the influence of corporate governance on perceived organizational success. This frame works indicates corporate governance as Independent variable and perceived organizational success as dependent variable. Transparency, Interdependency, Accountability, Fairness, Social Awareness, Discipline and Responsibility are dimensions to measure the corporate governance as a construct variable.

Questionnaire to measure the corporate governance organizational success have been adopted from CLSA[1]. This study uses five point Likert scale questionnaire carried from "strongly disagree" toward "strongly agree" with number "1" to "5" representing respectively as instrument of data collection. The instrument used in this research measures the link between corporate governance and organizational success.

[1]This questionnaire has been adopted form Credit Lyonnais Securities Asia (CLSA) to measure the corporate governance. Further it is amended according to the situation. This research is not using exact questionnaire but in amended form.

This questionnaire includes 37 questions to measure the corporate governance and 13 questions to measure the organizational success. We collected data from commercial banks working in Lahore Pakistan. Lahore is the second largest city of Pakistan and is considered the hub of economic activities. Research focuses more on the importance of sample size because it is critical and vital in obtaining the sufficient statistical outputs. Normality of data and estimation methods both require a standard minimum sample size which is recommended to be 10 participants for each parameter (Schrieber et al. 2006). Same thoughts are found in (Sivo et al, 2006), Garver and Mentzer (1999), and Hoelter, D. R. (1983) and it has become rule of thumb that there must be sample size of 200 at least because it is sufficient for statistical data power analysis. This research study is consisted of 452 respondents. We distributed 500 questionnaires out of them 452 were returned with response rate of 90%. Table shows the demographic details of respondents.

3.2 Methodology

This study use the Principle components Analysis (PCA) to measure factors from different items on each construct like good corporate governance and organizational success with respect to their reliable scales. To get the optimal weight from each variable related to a factor PCA has been for this study in form to get linear combination of observed variable related to a factor.

$$PC = a_1(X_1) + a_2(X_2) + \ldots\ldots\ldots\ldots + a_n(X_n)$$

where

PC = principle component

$a_n =$ Regression weight for observed variable n

$X_n =$ Subject's corresponding score on observed variable n.

Varimax method has been used in this study to get components. To check the sampling adequacy for data analysis Kaiser-Meyer –Olkin (KMO) test has been used. This study also use Bartlett's test of sphericity to insure whether data used in this study is ample or not. Principle component is retained by using KMO criterion. This criterion suggests that those components must retain which have come with an Eigen value greater than 1.0. This research is using factor loading in order to check that how much a variable loads into its corresponding factor. Reliability is measured through value of Cronbach;s alpha for all scales which suggest that its value should be greater than

.80 in order to get internal consistency. Regression analysis is employed to find out the impact of corporate governance on organizational success in consumer banking of Lahore.

4. Empirical Findings

Corporate governance and organizational success is measured with help of 37 and 13 questionnaires respectively for each construct variable in this study. Responses of all 50 respondents vary from 01 to 05, whereas Cronbach's alpha test is used to determine the reliability and inter item consistency of the constructs used in the present study i.e corporate governance and organizational success. Table 4.1 depicts that values of Cronbach's alpha for organizational success, discipline, transparency, independence, accountability, responsibility, fairness and social awareness are .968, .958, .968, .968, .930, .890, .973 and .738 for each respectively.

PCA is used for factor analysis with help of Varimax rotation method to assure construct validity. Principle components analysis's result is shown in table 4.2, 4.3, 4.4. KMO and Bartlett's are used to measure sampling adequacy test whether the adequacy of data is applicable for factor analysis or not. Table 4.2 represents the results of KMO and Bartlett's tests which shows that our data were sufficient for factor analysis. Values of KMO for organizational success, discipline, transparency, independence, accountability, responsibility, fairness and social awareness are .759, .762, .790, .839, .746, .602, .859 and .766 correspondingly. Values ranging from .6 to .9 show KMO's value from good to superb (Hutcheson and Sofroniou, 1999). Relationship between two construct variables is investigated by Bartlett's test. Factor analysis can be conducted if items of a construct are mutually related to each other. Table 4.2 demonstrates the significance level of Chi-square that is less than .001 in case of all constructs hence null hypothesis of no correlation is rejected and factor analysis is applied in this scenario.

For further analysis we use only those components of construct as principle component which have Eigen value greater than 1. Total variance explained for construct and Table 4.3 illustrate the Eigen values. For all the construct variables one component is retrieved as principal component using Eigen value rule to analyze.

To study that how each item is loaded into its relevant principal component we use table 4.4 for the factor loading of each item. Straub et al (2004) suggest us that value of each item in factor loading should at least 0.40 into its relative principal component.

Discipline (include 5 items) has PCA extracts just one component as principle component and its value range from .895 to .954. Transparency has six components and PCA extract only one component as principle components whereas independence has also same components but accountability consists of five components and all of them has single component as principle components value ranging from .799 to .966. Responsibility and social awareness have four components each whereas fairness and organizational success have components seven and thirteen respectively. Cumulatively they have single component as principle component and their value vary from .996 to .407. All values are more than 0.40 so overall, result of factor analysis remain in the criteria hence construct validity is satisfied.

Regression Analysis
Organizational success is dependent Variable

Note: *denotes significance of the coefficient at less than .005

Table 4.6

Necessary Statistics
Organizational success is dependent Variable

Tables 4.5 and table 4.6 shows the results of regression analysis. Impact of corporate governance on organizational success is significant in consumer banks. The regression analysis shows that the effect of discipline and social awareness is higher than other construct variable with values of .995 to .724 each respectively.

However transparency and interdependence have insignificant effect on organizational success as individuals. Value of adjusted R^2 (.83) shows that the corporate governance related to Transparency, Interdependence, Accountability, Fairness, Social awareness, Discipline and responsibility shows 83 % effect on organizational success. F test (F-statistics= 40251), P= 0.000 shows that our model of corporate governance and organizational success is good fit because effect of independent variables is jointly significant.

5. Findings

Some previous studies show the significance of study according to (Attiya Y. Javid, Robina Iqbal, 2010) performance has a link with corporate governance. This study contradicts the literature of Miles, L. (2010) which indicates that independence of director has effect on organizational success but our study proposes that independence has insignificance effect on organizational success in our environment when collective to other variable it has significance. Our analysis specifies that discipline and social awareness has strong impact on perceived organizational success. Similar indications can be found in study of (Mungule, O 2005) in support that discipline is one of major contributor in organizational success. Empirical findings of this study in concert with direction of SEC manual corporate governance (2002) which force the importance of accounting standards being part of discipline in organizations, this study has also proven that discipline is most important and viable variable for banking sectors organization

6. Conclusion and recommendation

To its advocate, the role of corporate governance in organizational success is vital and integral to ensure the accomplishment. Analysis of present study tells that the corporate governance has different impact on organizational success. Discipline and responsibility plays a stronger role in making organizations successful in commercial banks operating in Lahore, Pakistan. According to our study these two variables significantly contribute in creating good corporate governance which insures organizational success.

According to the interpretations of our study we propose that policy makers should focus more on discipline and social awareness. Results suggests that if consumer banks working in Lahore, Pakistan focus more on disciplinary actions, corporate governance practices should explicitly implemented. This study also proposes that social awareness also contributes in developing good corporate governance but our study does not show the significant effect of transparency and interdependence on organization success but jointly these have significance. Strategy makers should also focus on public policy, ethical behavior in organization, company culture that prohibits the employment of under-aged, responsibility of workers, fairness in record keeping and in selection criteria. Generally top management should take attention toward corporate governance in return to gain customers delighters which insure the overall organizational s

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