The impact of Board Composition and Board Size on Financial Performance: Evidence from Banking sector of Pakistan

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ABSTRACT

The respective literature on the theory of the firm and corporate governance suggest that a firm's board of directors is an important institution for mitigating the agency problem that arises with absentee ownership. The agency problem in this context is that the interests of management may differ from the interests of the shareholders and that management may make business decisions in response to the former rather than the latter. The role of the board is, in part, to deal with this potential conflict of interest, and thus reduce agency costs. The affectiveness of the board is also considered a very potential determinant of financial performance. The influence of board size and board composition on firm valuation and performance has been an issue in the financial as well as the organizational economics literature.

Through substantive literature review the aim and objective of the study was to investigate and empirically determine the impact of board composition and board size on banks financial performance in Pakistan. Proportion of independent directors, and corporate board size was incorporated as the explanatory variable of the study. The financial performance will be incorporated as a dependent variable. Accounting base measure for measuring the banks performance (ROA & ROE), was used to measure the financial performance of the banks in Pakistan. Leverage and size of the bank are incorporated as control variable. The study also aimed to addressed the question substantively that whether its board size or board composition which is most crucial for the financial performance of banking sector in Pakistan. To empirically determine the relationship among board size, board composition and performance in the banking sector of Pakistan.

Cross sectional time series panel data ranging from 2007-2012 was collected from the financial statements of the respective banks. A panel data ranging from 2007-2012 was collected

from the financial statements of the banks comprising 174 observations. According panel data model analysis the presence of independent directors on bank's board has a potential impact on bank financial performance in Pakistan. The statistical measure signifies that both of the accounting base measure of firm performance has a strong causal correlation with proportion of independent directors on banks board. Corporate board size which is the second explanatory variable of the study was also proven significant to affect the banks financial performance in Pakistan. The panel data model estimated through generalized least square method signifies the significant causal relationship between banks financial performance and board size of the banks in Pakistan.