Impact of Corporate Governance on Performance of Financial Companies Listed in the NYSE

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Abstract

This study for financial companies listed in NYSE was done to evaluate the impact of corporate governance on the company performance. For this research, the corporate governance was measured by its elements namely the size of the board of directors, audit committee and gender composition of the board of directors. The company's performance was measured using the earnings before interest and tax.

Data from 30 listed financial companies was used to conclude. The data consisted of both large and small financial companies listed in NYSE. This data was analyzed using descriptive and inferential statistics. The study showed that all three variables used have some impact on the performance of the variable. However, the study failed to show any statistically significant relationship between the independent variables and the dependent variable.

Keywords: Corporate governance, financial performance, audit committee, board of directors, financial companies

1. Introduction

After the 2008-2009 financial crisis that nearly collapsed the US economy, corporate governance has become a significant topic for companies both large and small. Studies have shown that responsible corporate governance practices lead to an improvement in the economic performance stability of a company (Latif, Shahid, Muhammad & Arshad, 2013). It may be in the best interest of every company to ensure good corporate governance practices. When a company upholds good corporate governance practices, the management decisions are closely monitored, shareholders' interests are protected, and workers livelihood and performance is fully disclosed to all the users of the company's reports.

Company's overall performance is often measured by its short-term financial performance because financial performance is ultimately a crucial determinant of a company's success or failure. Good corporate governance practices are believed to improve the financial performance of a company (Latif, Shahid, Muhammad & Arshad, 2013). Good corporate governance practices ensure transparency and accountability, thereby providing better use of the company's resources. With efficient use of resources, revenues are maximized while overloaded expenses are controlled. Also, the efficient use of resources needs to ensure that the company's assets reach their optimal capacity.

Companies with good corporate governance practices have been known to perform better in the long term than those with poor corporate governance practices. Where the corporate governance is weak, managers often fail to achieve shareholders objective, which is maximation of long-term shareholders' returns (Kyereboah-Coleman & Biekpe, 2008). Instead, these managers concentrate on their interest rather than long-term corporate goals leading to poor returns for the shareholders. It has therefore been noticed that investors tend to avoid companies with poor corporate governance. With good corporate governance

practices, there is accountability, transparency, and consensus in decision making. And as a result, the company can generate more profits which means better returns for the shareholders (Kyereboah-Coleman & Biekpe, 2008). A company that offers consistent good returns attracts more investors and can expand and improve its financial performance.

This study, therefore, strives to test if indeed there is a relationship between corporate governance and performance of companies using data from 30 financial companies listed in the NYSE. The study used a different statistical test to conclude whether there is a relationship between a company's performance and its corporate governance practices.

2. Purpose of the Study

Several research studies have been conducted to evaluate the relationship between a company's performance and other factors that influence performance such as customers, employees, revenue and sometimes expenses. One such finding M, A.S.S. & Zhengge, T. (2016), reported that there was a study in South Korea (cited by Lee, 2008) which revealed a panel data from 2000-2006 showed ownership structure of organizations and financial performance that the “hump-shaped” level showed a positive correlation relationship. Until recently corporate governance was not considered a vital component of business performance and therefore studies on companies’ performance historically have not discussed this angle.

In this study, our focus was on the relationship between the performance of financial companies and corporate governance. The study looks at the different characteristics of a company's board of directors and how each of these characteristics affects its profitability. The objective of this study is to:

1. To determine the impact of different elements of corporate governance on a performance of listed financial companies

2. To contribute to the overall research on corporate governance and financial companies' performance.

3. Data Collection

The target population for this study is the financial companies listed in the NYSE. But since the list of listed financial companies in the NYSE is too long, a sample of thirty companies was selected. The sampling method used was a stratified sampling method where a group of companies from the different classes of the financial companies based on size (McBurney & White, 2013). Therefore, the result was a list made up of thirty financial companies with varied sizes. The record had both small and big companies alike.

Data collection was then done using secondary sources only. Both quantitative and qualitative data were collected for this research (McBurney & White, 2013). The primary sources of data were the SEC filings, an annual statement for the companies and the companies' investor section on their respective website.

The research had one dependent variable, which is profitability. Profitability of each company will be measured using earnings before interest and tax. The independent variables, on the other hand, were three in total and consisted of both qualitative and quantitative data. These variables were the size of a company's board of directors; gender of the board of directors, and the presence of an audit committee. The data on profitability was collected from the annual reports, while the size of board of directors, number audit committee members and the gender composition of the boards were obtained from the company's website in the corporate governance section.

4. Data Analysis and Results

4.1. Data Analysis

The data collected from the sample was analyzed using both descriptive and inferential statistics. Descriptive statistics were used to summarize the characteristics of the sampled data while the inferential statistics were used to conclude the population using the sampled data (Black, 2017; Lind, Marchal & Wathen, 2018).

For the descriptive statistics, a measure of central tendency, a bar chart, and a pie chart was used to show the frequency of two independent variables. The two independent variables analyzed using these charts were the size of the board of directors and the number of audit committee members. Only two variables were analyzed using the frequency charts because the results from the other two variables, EBIT and female composition of the board would have unreliable yield results. The EBIT data was collected from a mix of companies including huge and small companies (Black, 2017; McBurney & White, 2013). As a result, the data had outliers, and therefore measures of central tendency would not have been a good measure of the sampled data characteristics. This is also true for the board of directors' female composition. Most of the big companies satisfied the third gender rule while most of the small companies did not abide by this rule. As a result, there were two extremes making data analysis using descriptive statistics ineffective.

The inferential statistics used to analyze data in this study is the hypothesis test and regression analysis. The regression model that was used is as shown below.

$$Y = a + B_1X_1 + B_2X_2 + B_3X_3$$

Where; Y = Company Performance

a = The intercept

B_1, B_2, B_3 = Coefficient for X1, X2 and X3 respectively

$X_{1, X2}$, and X_3 = The size of BOD, Number of Audit Committee members and Proportion of females in the board.

In addition to the regression model, three hypotheses were tested. Hypothesis one was to determine if the size of the board of directors has an impact on a company's performance. Hypothesis two was to help us conclude whether the number of audit committee members has any impact on the performance of a company. And lastly, the third hypothesis tested whether the gender of the BOD has any impact on a company's performance. The hypotheses are stated below

Hypothesis 1 – H_0: $B_1 = 0$

H_A: $B_1 \neq 0$

Hypothesis 2 – H_0: $B_2 = 0$

H_A: $B_2 \neq 0$

Hypothesis 3 – H_0: $B_3 = 0$

H_A: $B_3 \neq 0$

Test of Significance

The tests of significance that were carried out in this research are the F test and the t-test. The F-test was carried out to determine whether the overall regression model is a strong one or not. To do this a significance level of 5% was used. The F-test shows whether all the independent variables used in the model are statistically significant (Lind, Marchal & Wathen, 2018). Also, the t-test was used to determine whether to reject the null hypothesis or fail to reject the null hypothesis. The t-test was used and not z-test because the data being analyzed in this study is from a sample and not a population. If the information was that of a

population, then the z-test could be applied (McBurney & White, 2013; Lind, Marchal & Wathen, 2018). By testing the significance, we were able to conclude whether corporate governance has an impact on financial company performance or not.

4.2. Results

4.2.1.1. Descriptive Statistics

Two of the independent variables namely size of the board of directors and the number of audit committee members were analyzed using mean, median, mode and frequency charts. The mean number of board of directors for the chosen sample was 11. The median was also 11 while the mode was 8. A mean of 11 people indicates that the typical size of a financial board of directors was found to be 11 people. This conclusion is further supported by the same median. Having the same value for mean and median also indicates that the BOD size data is not skewed (Lind, Marchal & Wathen, 2018). A mode of 8 is also pretty close to 11. We can, therefore, say this variable data is usually distributed.

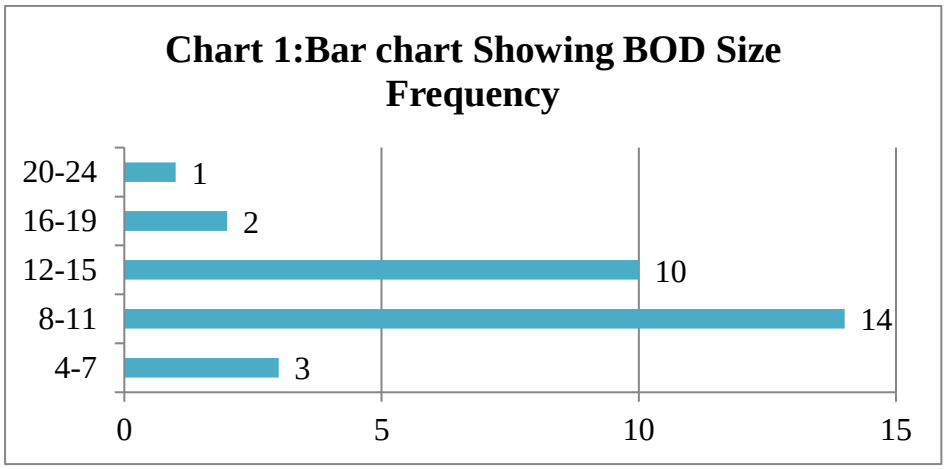

Chart one above shows that the highest frequency as 14 times. This is indicated by the tallest bar and the smallest frequency as 1indicated by the shortest bar. The highest frequency is for the range 8-11 followed by 12-15. From the chart, it is evident that out of 30 sampled

companies; most of them do not have an extremely high number of board of directors. Most companies either have 8, 9, 10, 11 or 12 board of directors. This observation supports the mean and median findings stated above.

Similarly mean, median and mode were used to identify typical audit committee members in a company. The results showed that mean audit committee members are four people. The median was also four people, and the mode was 3. Therefore, we concluded that the typical audit committee member number for the sampled companies is four people. Also, we found that the audit committee member was normally distributed since mean, median and mode were equal (Black, 2017; Lind, Marchal & Wathen, 2018).

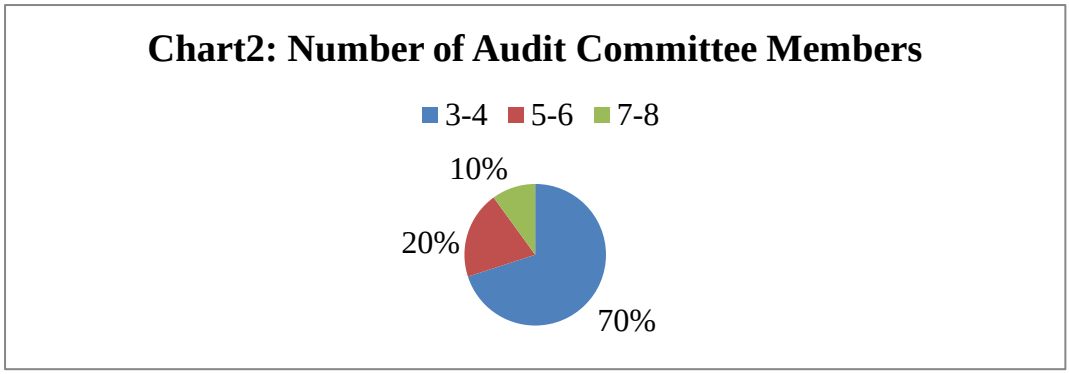

Chart 2 above shows that 70% of the sampled 30 companies have audit committee members consisting of either 3 or 4 members while only 20% have a committee composed of 5 or 6 members. This observation supports the measures of central tendency discussed above.

4.2.1.2. Inferential Statistics

The table below shows the regression and hypothesis tests statistics.

Summary		
Regression Statistics		
Multiple R		0.478857806
R Square		0.229304798
Adjusted R Square		0.140378429
Standard Error		8853.954489
Observations		30
F-test	0.075	
Hypothesis Test Statistics		
		t Stat
Intercept		-1.823661419
Size of directors		0.90953698
Number of Audit Committee		1.301617986
The proportion of females in the board		0.978582502
Two tail test Critical t value at df= 29 and 0.05 significance level	- 2.045 to 2.045	

From the results in the table above, the R-squared is 0.2293 indicating that 22.93% of variations in a company's performance is explained by the differences in its corporate governance structure. The regression statistics also show the F-test. The F-significance value is 0.075. 0.075 >0.05 indicating that the strength of the model in answering our research

question is weak. This can be explained by the high dispersion in the independent variable data. Therefore, hypothesis tests will be used to determine whether corporate governance composition has any impact on the performance of a financial company listed in the NYSE.

The t-test used was a two-tail test because the hypotheses stated above did not show any direction. And the rule of thumb for a test is to reject the null if the t-statistics falls within the critical value range (Black, 2017; McBurney & White, 2013). Our critical value was found to be between – 2.045 and 2.045. Therefore, we will reject the null the null hypothesis because the t-statistic for BOD size is 0.9095 meaning it does fall within the critical value range. We also failed to reject hypothesis two and three based on the same reasons as hypothesis one. Therefore, we concluded that all three independent variables had an impact on the profits of a company.

5. Conclusion

Corporate governance is a vital part of a company, and it is therefore essential that its impact on the performance of a company is understood and not underestimated. This study was therefore conducted to determine whether corporate governance has any form of impact on a company's performance. We choose to use companies from the financial sector because of the high, poor governance risk companies in this industry are exposed to.

The results of the study show that the typical size of a board for a financial company listed in the NYSE is 11 while the average number of audit committee members for these companies is 4. Therefore, we can conclude that the ideal BOD size is 11 and the ideal audit committee size is 4. The results also showed that the size of a company’s board of directors has an impact on that company’s performance. The number of individuals in the audit committee also affects the performance of the company. And finally, the gender composition

of the board also has an impact on the performance of a company. All these variables are elements of corporate governance. In a nutshell, corporate governance does affect the performance of a financial company as illustrated by this empirical study.

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