CG and ITS Impact on Firm Performance

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INTRODUCTION

The corporate governance's concept emerges to be directly associated with the firm's pattern of finance. Although several researches investigate the impact of corporate governance on the performance of finance, the pragmatic association between the capital structure of organization and corporate governance has basically been unknown. Many researches for example Du and Dai, (2005); Kumar, (2005) have examined the association between debt finance and corporate governance, however many research studies believe personal governance problems; for example structure of ownership, as compared to complete firm-level practices of governance. Significantly, not a single study has been there in the Bangladesh context.

Although financing debt is taken as significant mechanism corporate governance in justifying the agency issues between managers and shareholders (Harris and Raviv, 1991), what important to examine is the relationship pattern between debts. Theory of agency, better corporate governance and related strong rights of shareholder are going decrease costs of agency and advance the self-reliance of investors in future cash flow of firm (Gompers et al., 2003), and this in other hand diminish the equity capital cost to the organization (Drobetz et

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al., 2004). This ultimately increases the ability of an organization to earn equity finance leading to a reduction in the dependence of firm on debt finance. On the other hand, domineering owners of bad governed organization are probable to favour debt so as to fulfil financing requirements, whereas holding complete possession and command over the organization.

The significance of corporate governance has amplified lately particularly following the worldwide financial crisis and administrative and the financial scandals of some well-known international organizations outcome from fragile in-house systems of audit. Corporate governance is observed in rights protection of stakeholders and shareholders, commencement of companies' board and mentioning parts and controls of shareholders, executive management, the board and stakeholders. Furthermore, corporate governance diminishes the centralization of control through allocating control to the non-executive members and decreases the exercise of administrative authority in opposition to the shareholders interests (Haque et al, 2011).

RESEARCH AIM

The basic aim of this research study is to compare the practices of corporate governance in Oman and UK-based companies or organizations to analyze the difference in the corporate structure among the two countries.

OBJECTIVES OF STUDY

The basic objective of this research study is to analyze difference in corporate governance policies of Sultanate of Oman and United Kingdom. Further detailed objectives of this study are to:

1. Identify the patterns and systems of Corporate Governance in United Kingdom and Sultanate of Oman
2. Analyze the difference in the board structure and composition, audit committees and code compliance & enforcement between the two countries i.e. UK and Sultanate of Oman

CG & FIRM PERFORMANCE

Purpose of corporate governors is to attain economical benefit in an open market knowledge economy. This economical edge is probable if CG increase worth by using every existing resource. Excellent CG practice makes sure improved decision making, functioning competence, and decline in wastes. It more stables the interests of every stakeholder counting non-executive and executives (Shleifer and Vishney, 1997). Shareholders can trust that organizations with good practices CG to ensure that free cash flow is supposed to be come back to shareholders in the form of dividend as compared to be confiscated by the stakeholders (La Porta et al., 2002).

In the starting research, association between Corporate Governance and corporate performance has been extensively considered however come to no agreement. A broadly held observation there is that good CG practices are linked with better performance of firm. Since preceding researches demonstrate that bad governed organization have inferior functioning performance as good governed organizations show superior pecuniary performance and market appraisal (Shleifer and Vishny, 1997; Bebchuk et al., 2004).

Companies with good Corporate Governance practices not just grant additional cash dividend however also additional privileges to the shareholders. Moreover, it has been suggested by Arnott and Asness, (2003) that more cash dividend is normally paid by the firms to its shareholders where governance system is effective and adequate. Popularly ineffective and inadequate corporate governance has been considered as an associated product of the broader spectrum of corporate governance. This shows that corporate governance can also lead to financial losses and limited productivity if used unwisely and in a wrong direction. However, literature shows that equity returns can be enhanced by the effective implementation of CG practices or policies across the firm. In this similar context Gompers et al, (2003) have evaluated the relationship between long term equity returns, accounting measures of firm performance, firm value and corporate governance index. Their results have suggested that higher equity returns are shown by the firms where governance is proper and effective as well as such firms produce better accounting results and higher value in comparison with their counterparts where governance is poor.

Past Examples

In the context of this research study a very relevant and important reference point is the study conducted by Sunday-O, (2008) i.e. on the relationship between firm performance and corporate governance in listed organizations of Nigeria by covering the years from 2000-06. The results shown in their study were mixed and they used OLS as a method of estimation along with panel methodology. It showed that board size and CEO duality are noteworthy whereas, audit committees and board composition were not significant. These examples from the recent past are important to be included in this research study because these are providing increased awareness and knowledge regarding the developments and changing dynamics of corporate governance around the world in different countries using which this study can be completed in an enhanced manner.

In the context of sub-continent countries the effect of corporate governance on the performance of organizations was analyzed by Javed & Iqbal, (2006) and they found that there are various components of CG that enhances the performance of firms, but not all components do so which gives an important consideration in the context of this study. Moreover, Javed & Iqbal, (2006) also added that high quality measures of CG tends to uncover bad management practices and low production within the organizations using transparency standards and effective disclosure which ultimately helps in making the financial position better for the firm.

In the current literature associated with Corporate Governance as well as firm performance, Ehikioya, (2009) carried out study on Corporate Governance structure and performance of firm focused on listed firms of NTE (Nigerian Stock Exchange) and concluded that concentration of ownership has positive influence on productivity and more than single family members on the board demonstrate negative impact on performance of company. Abdullah and Page, (2009) carry out research on Corporate Governance and performance of corporate, employing data of FTSE 350 UK's companies discover small backing of relationship between Corporate Governance and corporate performance. They moreover mentioned that Corporate Governance parameters explicate small changes in risk factors. Although Sueyoshi et al, (2010) get new pragmatic proofs that CG modifications through the Japanese government have impact on the productivity of Japanese organizations. They moreover demonstrate that overseas shareholders bring professional order and experiences which eventually improve the functioning productivity of Japanese organization.

A full literature review demonstrates that the researchers haven't come to on a point of agreement and document that few research studies signifies important influence of Corporate Governance on financial productivity and efficiency (Ehikioya, 2009; Gruszczynski, 2006; Drobetz et al., 2003) whereas rest show no linkage association (Abdullah and Page, 2009; Bauer et al., 2010). Such varied outcomes prompt the researchers to study the function of Corporate Governance and financial performance furthermore. Even these researches which

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offer uncertain outcomes discuss that Corporate Governance has as a minimum indirect impact on productivity (Maassen, 1999). More studies are required to conclude interaction of Corporate Governance with financial performance. Like this, this study tries to examine the formerly unexposed relation between Corporate Governance and financial performance.

Agency Theory and a Simple Solution

In the context of this research study where the impact of corporate governance practices is being evaluated on the firm performance and financial indicators, the role of agency theory is vital because this theory endorses some clear points related to the matter in consideration. Agency theory is one of the widely used theories and sometimes referred as financial paper given by Jensen & Meckling, (1976) and they highlighted the loss of value injected by a separation of control and ownership for the firm. This aspect of separation is crucial for firms in order to gain sustainability and improved financial performances because this happens when principal (shareholders) tend to hand over their assigned powers to the agents (employees). This shows that the role of top management in important in allowing implementation of good CG practices. Two main problems have been studied due to which agency costs are derived and firm performance gets questioned.

First problem is the fact that their rewards can be correlated insufficiently in the context of firm financial performance i.e. a scenario where if management put additional effort then shareholders can get enhanced rewards. Secondly, it has been observed that generally different interests are possessed by higher management in comparison to shareholders which naturally gives rise to conflicts and slowness in the firm performance overall. This theory also provides an effective solution to the problem faced by organization regarding harmed financial performance i.e. a simple method is to obtain an adequate interest convergence between shareholders and managers, and to facilitate higher management with a meaningful stake in the firm or else defining compensation based on equity (Mayer, 1990).

What this discussion has reflected is the awareness that this simple solution (embedded in agency theory) depends on the role of a top management personnel who can single handily injects a strong impact on the financial performance of that particular organization. This also reflects that the role of top management in central in the implementation of good CG practices in a firm. The efforts of any top management personnel via his equity- based compensation for creating value for company shareholders then get rewarded directly. But one thing needs to be taken in consideration here that common employee's behavior creates only minimal effect on the equity value due to which such mechanism cannot be applied which restricts the use of this simple solution. This also means that for the sake of applying agency theory solution and gaining better financial performance, it is important to first establish a strong CG system in the organization.

CORPORATE GOVERNANCE IN OMAN

Since, this research study is in the context of Oman and UK, which makes it imperative to discuss the developments and application of corporate governance in both the countries. Firstly, Oman's context will be discussed here.

In the last few years, the economy of Oman has experienced a number of modifications and reformations which has resulted in an increasingly market- oriented economy. The beginning of a positive start and trend in the field of corporate governance has been signaled from the financial impetus extended in the country throughout the last ten years. It is important to note that the expectations of majority of stakeholders is consistently rising in Oman because the industry size in the country is becoming bigger and bigger due to which good corporate

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governance is crucial which will also satisfy the stakeholders expectations (Shankaraiah & Rao, 2008).

Therefore, the progress and the exercise of uniform standards of accounting is a crucial spirit of CG and diverse organizations have been adding their understanding to build up the standards to make the CG highly efficient in the framework of the shifting corporate settings. The management of corporate is also currently sensing the demand for modification of accounting exercises and transparency level originating from attentive lenders, financial analyst, board of directors and above all regulatory agencies which provides realization that quality of information is what matters the most in determining the extent of efficiency using which they have transferred their allotted roles within the frame of good CG (Shankaraiah & Rao, 2008). This means that the financial indicators are strongly influenced by the CG practices in the Oman organizations. However, CG standards may have been led by developed economies of the world and mature economies as compared to less developed and less mature ones e.g. Oman, Kuwait, and other GCC countries. Interestingly these countries have now recognized that establishing healthy CG standards contains enhanced chances of encouraging economic growth and foreign investment.

Each member country of GCC has developed their own Corporate Governance Code from which Oman has led the way since 2002 when they initiated this step and recently Bahrain has followed. Increasingly financial institutions and public companies were the focus of these codes (predictably), as the countries included in GCC urges to boost confidence in the financial sector and grow their respective capital markets. However, an increased ratio of initiatives has been directed towards private organizations as well in recent years. Still there is large room in the context of CG for financial institutions and publicly listed companies in Oman (Pinsent Masons, 2013), which means that this study will unlock and unleash some productive points and aspects regarding the relationship of firm performance and CG practices.

GOVERNANCE PHILOSOPHY OF HSBC BANK OMAN

HSBC Bank Oman has played a significant role in the establishment and application of corporate governance practices for obtaining better financial performances and has set the tone of CG in the country for other financial institutions; also HSBC in Oman is devoted to higher levels of CG (HSBC, 2012). The BOD of Bank believe that high-quality governance is essential to protect every stakeholder's interests, and to attaining the business strategies of Bank. The Bank has exercised a CG framework which make sure that the governance of bank fulfill every domestic regulations of Oman; additionally to global best practice, that comprise global standards of HSBC Group global.

The philosophy of bank governance is focused on the given principles: i) An efficient and responsible BOD, ii) A lucid and planned course for business development, iii) far-sighted information and accounting principles, iv) Sound mechanisms of decision-making, v) Strategy-related performance appraisal, vi) HRD

Board Committees

The Board has exercised 2 board committees as needed under domestic law (HSBC, 2012) known as: i) A Risk Committee, ii) An Audit Committee

Capital Market Authority in Oman

1. Capital Market Authority facilitates the Code of CG related to best global standards and practices which is taken as one of its kind in the country. It was implemented fully in 2004 but it has been partially practiced before it.

2. The endeavors remain the same to commence and set up the principles of CG and conduct seminars and conferences etc as the Code for Insurance firms was facilitated in 2005 so as to set off the lowest regulatory needs for firms functioning in insurance division (CMA, 2014).
3. In the year of 2007 a division for CG was set up and then the CG Committee was established which includes both private and public sectors.
4. In the year of 2010 the Oman Centre for CG was established so as to qualify and train executive managers and directors to execute top practices that would support the standards of sound exercises of CG in public firms functioning in the country.

This Centre for CG initiated an award three years ago that is known as the Corporate Governance Excellence Award, and also held a numerous training exercises target to uphold accountability of individuals' attentiveness of CG (CMA, 2014).

This heading has made it clear that the intention and awareness at the Government level exists in Oman which certainly will impact positively on the financial institutions and organizations. The use of CG is comprehensive in nature which allows the achievement of financial gains and improved firm performances and this pursuit towards comprehensive CG is still going on in the Sultanate of Oman. Another good thing that can be taken out from the above discussion on the CG in Oman's context is the fact that a professional culture and awareness of CG principles, codes and practices is existent in Oman and is increasing with the passage of time. This has allowed organizations both public and private to realize the importance of each CG performance indicator and component which is essential for extracting optimal benefits from the corporate governance practices.

CG in UK

Developments and proceedings in CG practices in Oman's organizations have made it clear that this study can make good use of its comparison with the UK CG where its implementation is well established comparatively and more examples will be available for reaching on a concluding point in this regard. However, in the context of UK the literature studies and research works have been conducted in good numbers which have shown positive and aligned results. The results have shown that there exists high awareness and development of advanced CG practices in the UK financial sector and private organizations. The research study of Gedajlovic & Shapiro, (1998) has been significant which showed positive relationship between firm ownership and performance in the context of UK, France and Germany.

Similar results were found by Thomsen & Pedersen, (2000) as they conducted study on more than 10 European states. Beiner, (2006) and Brown & Caylor, (2006) are other significant studies that showed that UK organizations believe in implementing effective CG practices for the sake of obtaining consistent and increasing financial returns and profits.

Revenue & CG Practices/Policies

The improving corporate governance takes into account the consideration of both public and private interest. For effective working of corporate governance, there is need for considerable investment and the related benefits as well. Revenues are highly important for the working of corporate governance. Incremental benefits have to outweigh the loss of private control benefits (Bebczuk, 2005). The way in which corporate governance and taxation are interacted is complexity and obfuscation of taxation for tax avoidance. Revenues tend to be highly important especially for competing in the time of financial crisis. Financial crisis badly influence corporate governance (Desai & Dharmapala, 2007). This can be vice versa as well i.e. poor or bad corporate governance can severely damage the financial gains and financial performance of the firm at large. Economic, financial and debt crisis have highlighted the need for tax reforms to increase revenue as well as increase tax compliance.

Administration of taxation is moving up their forcing efforts to ensure the payment of tax by the companies. The focus on cross-border Administration (FTA) and OECD's Committee on Fiscal Affairs in order to identify movements in aggressive devise responses, tax planning and enhancing greater voluntary compliance (Singh, 2005). Tax authorities are recognizing that traditional audits are not sufficient for working with aggressive tax planning in an effective manner. Requirements of disclosure are increasing to support tax managements in dealing with risk and uncertainties.

The higher the tax revenue, the higher will be the performance of companies (Robinson et al, 2006). The effectiveness of risk management depends on the early disclosure from taxpayers. Tax administration is required to work using five attributes of understanding based on commercial awareness, openness (disclosure and transparency), impartiality, proportionality and responsiveness in order to encourage this type of co-operative behavior from large corporate taxpayers.

Profitability & CG Practices/Policies

Profitability comes through the mode of increased revenue. Increased tax revenue requires higher transparency and effective working of tax administrations. There is need to respond to the perception of involvement of preferential treatment of taxpayers in corporative compliance programmes including the estimation of benefits to the society in terms of reduced costs and high tax revenue (Desai et al, 2003).

It is important to note that corporate governance practices have been argued by many organizations and researchers as vital ingredient to the recipe of gaining profitability by organizations (Brown & Caylor, 2006; Stephen et al, 2013). The aspects of control and transparency within the frame of CG have been observed as the most important ones that contribute in reaching and obtaining profits for the firms. However, this discussion on control and transparency is very long but it certainly has indicated that profitability can certainly be increased with the help of CG practices.

CG & Dealing with Financial Institutions

Corporate governance has become an important since the most of big companies have collapsed. There is need to enact rules and regulations because of the failure of in corporate governance. The world countries are finding the best solution to deal with corporate governance issues and improve performance of financial institutions.

In order to prevent corporate governance issues, Malaysia has also made reform. In order to build good repute of corporate governance, phase by phase implementation has been done. Level of diversion is increased by higher tax rate and on the other hand it is reduced by stronger tax enforcement. It is very simple intuition. Return of tax avoidance is increased by a higher tax rate and in turn the amount of sheltered income. Private benefits will also increase by controlling shareholders and sheltered income. The return to sheltering income is reduced by increased level of tax enforcement and private benefits are reduced. An increase in the extent of tax enforcement increases the shareholders minority amount for low level of statutory tax rates. Therefore, the stock market value of a company will increase by an increase in tax enforcement rather than a decrease (Hege, 2011).

Board Structures and Firm Performance

Board structures and their working manner create an impact on the performance of firm. The way, in which companies devise their board structures and management authorities, firm performance can be enhanced or reduced. Performance and related improvements are important decision for any corporate management. The policies and decisions of board members and their intention towards the performance of firm highly matters. We examine the relationship of selected Board of Directors' characteristics and firm´s financial performance. Horváth & Spirollari, (2012) using a sample of large U.S firms in 2005-2009 found that insider ownership degree creates a positive impact on the performance of firm by reducing agency problems. The age of Board of Directors matters for the better performance of firms. Younger members in Board of Directors are more willing to take risks for major changes in the structure of organization in order to improve its performance for future.

In order to examine the association between two important committees of corporate governance practice, firm performance and audit committee characteristics and executive committee characteristics, data of non-financial companies listed through 2011 and 2012 in Muscat Security Market (MSM) was used. The role of executive committee with the performance of firm was studied with the relationship of corporate governance and firm performance. The weakness of protection of investor and the absence of well-developed markets for controlling corporate has led investors in the Arab countries in the developing world to depend on governance structures that are dominated by very intense ownership.

Performance of firm improves the ownership and through concentration of ownership, managerial interests are merged. Control cannot be disputed easily when major shareholdings are acquired. In this case, intense ownership can be lowered or eliminate agency costs. An opportunity of exact corporate resources can be provided by block-holder for private benefits that can have a negative impact on the performance of firm (Al-Matari et al, 2014).

Audit Committees and Firm Performance

For the protection of interests of shareholders and stakeholders, the Audit Committee plays an important role. The effectiveness of Audit Committee depends on its characteristics that are related to the independency of its member's committee size and number of meetings that are held along with expertise members of the committee. All these factors determine the effectiveness of Audit Committee. Bouaziz (2012) tried to find the impact of audit committee on financial performance of firms measured by Return on Equity (ROE) and Return on Assets (ROA) in Tunisia. There was positive impact found by expertise of audit committee and its size on financial performance that was measured by ROE.

The study found that if there exists any one member of audit committee with skills related to professional accounting or any experience with experience in accounting or finance can increase the financial performance of companies. In order to explore the relationship between the role of audit committee and firm value, five characteristics of an audit committee have been studied to determine the effectiveness of audit committee (Ojulari, 2012). The five financial performance measures were the return on equity, net sales/turnover growth, profit margin, the dividend yield and Tobin's Q. Dividend yield and Tobin's Q are both investment ratios that usually reflect the confidence of investors in a business organization.

On the other hand, return on equity, sales/turnover growth and net profit margin reflects management of business organization in a proper way for the achievement of high financial performance that creates confidence of investors in the share of such firms. This in returns increases the value of firm.

Executive Compensation System and Firm Performance

Media is increasingly targeting executive compensation. Other than media, executive compensation is also the focus of government regulators and shareholders. Poorly structured compensation programs for executives were another reason for financial crisis of 2008 in U.S. A number of questions were raised on the bonuses and benefits given to the executives regardless of their companies being into losses and company was losing shareholder value. Part of the problem was explained by Agency theory that it is because of the separation of management from ownership. Demirer & Yuan, (2013) investigated the relationship between executive compensation and performnace of firm in the restaurant industry. Executive compensation is an important component of incentive structure of a firm and at the basis of corporate governance. The study is helpful in evaluating the quality of corporate governance in terms of success.

It has been evidenced by economic theory that close links are involved between executive compensation and firm performance (Kato & Long, 2004). The link between firm performance and executive compensation is well established. Wallsten (2000) explored two features of this relationship. Mostly, executives are not punished in bad performance years of firm and always rewarded good in boom time. This consitently happens across different firms and give rise to risk taking behavior with limited or restricted downside punishment.

The study also found the compensation of top executives is most linked with their performance at first highest ranking, it is less at the second-highest ranking and een less at the third-highest ranking. This result is reliable with associating compensation to performance only to the level when employees directly infleunce it (Wallsten, 2000).

CEO Ownership and Firm Performance

Evidence has been provided by various studies that at high level the ownership concentration in New Zealand does not oblige excessive management power however it intensifies agency problems linked with the compensation of executives. Potential justification has been provided by a highly concentrated ownership structure for the misalignment between compensation of CEO and firm performance in New Zealand. It has been suggested by the positive effect of a low ownership concentration level on CEO Compensation-firm performance relationship that analyzing the efficiency of large shareholders works effectively at a low ownership concentration level (Jiang et al., 2009).

CEO is regarded as an increasing value for any organization. Every market knows the value increasing activities of CEO. Sikavica (2008) studied the impact of ownership and company performance on CEO tenure and turnover in Swiss companies. It was found that both market-based and accounting-based performance measures have been found to increase the occurring of forced CEO departure that is not related to CEO tenure.

For poor performance, CEOs are dismissed in Swiss only when they have no relation to the shareholders family. CEOs who are members or founders of the firm's founding family have occupancies that are 4.5 years longer than those of non-family CEOs. For changes in CEO, both the size of shareholdings and the type of shareholders are found to be decisive. Evidence has been found that likelihood of CEO dismissal increases by large institutional shareholders. Moreover, it has been found that institutions and family shareholders shorten CEO tenure supported with the fact that CEO is not a member of the founding family (Chen et al., 2008).

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