Evidence of Resilience in Islamic Banking System in Pakistan:The role of Islamic Corporate Governance System

* Dr. Adnan Ahmad
** Qazi Yasir Arafat

Abstract

Keeping in view the unique structure of corporate governance (CG) of Islamic Banks (IBs), this study investigates the effects of Islamic CG on the performance of IBs of Pakistan before and during the global financial crisis (GFC) of 2007-08. Specifically, the study investigates the performance of Sharia Supervisory Board (SSB), Board of Directors (BOD) and Ownership Concentration (OC). The sample consists of all the IBs from Pakistan for the period 2003-2016. The results of the study report a positive impact of the size of Sharia Supervisory Board on the performance of Islamic Banks. While GFC has a marginal negative effect on return on assets (ROA) of these banks, however, this effect becomes irrelevant by adding more CG variables such as Ownership concentration. The study in addition to contributing towards a theory of Islamic Corporate Governance, also contributes to the literature regarding the effects of GFC on IBs in Pakistan. Due to the scarcity of literature on CG of IBs in Pakistan, this study also contributes to the CG literature and its effects on IBs.

Key words: Islamic Corporate Governance, Corporate governance, Islamic Banks, Global financial crisis, Sharia Supervisory Board.

1.Introduction:

The global financial crisis (GFC) of 2007-08 affected the capital markets of the world and the resultant liquidity crunch negatively affected the capital markets. Some big financial institutions (FI) such as Bear Stearns and Lehman Brothers faced bankruptcy and others faced huge losses both inside and outside United States of America (US) [1]. The approximate losses of the financial institutions rose up to the tune of $ 4.05 Trillion till 2009 (IMF, 2009). It was the worst crisis ever in the financial history after the great depression of 1930 [2]. Prior literature investigates the causes and consequences of GFC. However, one strand of literature reports three major causes; i) Loose monetary policy; ii) Capital flows (rising global imbalances); and iii) Regulation and inadequate supervision. Others conclude a weak corporate governance (CG) mechanism to be the major cause of GFC and argue that the above economic factors only played a supplementary role[3]. For example, weak CG system such as risk management, remuneration system, shareholder rights and board practices are some of the CG mechanisms responsible for the GFC (Kirkpatrick, 2009). The crisis was felt by both non-financial institutions and financial institutions[4].

However, the effects of GFC on financial firms are more than non-financial firms since the investor lost their confidence on their business models[5]. On the other hand, Islamic financial system an alternate of conventional financial system, performed well during the GFC[6]. Studies examine the performance of Islamic Banks (IBs) during and after GFC and report that IBs are less affected by the crisis. Shafique, Faheem, and Abdullah, (2012) argue that it is the strength of IBs in terms of higher capitalization and investment in real assets in comparison with conventional banking, that resulted in

* Institute of Business Studies and Leadership, Abdul Wali Khan University, Mardan.
** PhD Student, International Islamic University, Islamabad.

better resilience. Similarly, Ambal and Al-mukharreq (2013) find that IBs remain more profitable in *Gulf Cooperation Council (*GCC) during and before GFC as compared to conventional banks (CBs). Shafique, Faheem, and Abdullah (2012) further argue that the leading financial centers of the world such as Singapore, Hong Kong and New York, use Islamic financial system along with conventional banking to improve risk management and liquidity. Thus use of IB system provides a more risk free system across the globe.

The performance of Islamic financial institutions (IFI) such as IBs during GFC raise the question that why these institutions are not affected or less affected? One strand of literature reports a variety of reasons for such performance. For example,[7] report participative mode of financing based on Islamic *Sharia* as a reason of good performance in GFC. They also argue that IBs do not deal in activities such as investment in toxic assets and *Riba* in their contracts. These banks are based on real assets and have less financial risk because of higher capitalization. According to Matoussi and Grassa (2012), CG system of IBs is an effective tool of corporate performance, because of two parallel CG mechanisms. The first one is *Sharia* supervisory board which protects the interests of investors and ensures *Sharia* compliance while the second mechanism is board of directors which protects the rights of shareholders for the ultimate goal of maximization of wealth. This strand of literature provides evidence that CG mechanism of IBs is different than the CBs which makes this system more resilient to crises[8]. The CG system and information reporting of banks is different from non-financial firms. Prudential regulations are more stringent and are in details in comparison to non-financial firms. The banking system is regulated by central banks around the world. However, Islamic countries started Islamic banking followed by western countries. This system is unique and different from conventional banking system which is based on Islamic Sharia. Islamic Banks not only follow this Sharia system but also reports and adheres to these other prudential regulations. The two tier system of CG of IBs makes these IBs different from the conventional banking system.

To ensure the efficient implementation of the CG systems, the State Bank of Pakistan adopted unusual and unique three-tier *Sharia* compliance structure i.e National *Sharia* Advisory Board (NSAB) by the State Bank of Pakistan (SBP), National *Sharia* compliance inspection unit and internal *Sharia* advisor. Due to this three-tier structure it seems that the transactional structure and performance of Pakistani IBs are keenly observed. This structure also reflects that the system of CG in Pakistani IBs is stronger than CBs. Thus, the aim of this study is to investigate the effects of CG on the performance of Islamic banking sector of Pakistan. Prior literature of IBs mostly investigated the growth of these banks and comparison with CBs, research is scare on the CG of IBs. This study highlights the effects of CG on the performance of Islamic banks. Especially, this study adds to the literature that IBs are less affected by any financial crisis. The study also adds to the growing body of literature of IBs by examining performance of IBs before and during GFC in the presence of its unique CG structure.

2.Literature Review :

This section reports the association between corporate governance (CG) and Islamic banks (IBs). First, the importance of CG is presented in general and then specifically in financial institutions (FI). The CG of banks and its importance is discussed and finally the importance of CG in banking sector is reported. The last section reviews the association between CG and banking sector in Pakistan.

2.1.Financial Sector.

Financial sector plays a major role in the development of an economy. Alexander and Baden (2000) define the financial sector as, *"The set of institutions, instruments, and the regulatory framework that permit transactions to be made by incurring and settling debts; that is, by extending credit" (P.203).* In broad view financial sector includes banking, stock market exchanges, investment banks, insurance companies etc. Financial sector is one of the most important sectors of a country for economic development. The World Bank (2009) reports that developed financial sector is essential for long run growth prospect. According to IMF (2006) it is generally known that sound financial sector is essential for economic growth and the allocation of resources of an economy; but it has not yet been recognized fully that the importance of financial sector increases when economies develops and must be developed with rest of the economy. This system performs three functions for economy; first it handles payments, second it channelizes saving to investment and last the management of economic risk. Therefore, these functions not only play an important role in financial stability within the country but also encourage the foreign investment because a less risky financial market is ideal for international investors.

Financial sector of the world faced crises from time to time, such as Great Depression (GD) of 1930, Asian Financial Crisis 1999 and Global Financial crisis (GFC) 2007-08. The recent financial crisis of 2007-08 started in US capital market in 2007 from the subprime mortgage market, where the burst of housing bubble brought liquidity crunch. And rapidly this crisis of US subprime mortgage market spread out to all over the world and became global financial crisis (GFC). During this GFC, financial institutions (FIs), banks in particular, were seriously affected. Particularly in U.S. financial market about 140 banks faced failure by 2009 and 157 banks were collapsed in 2010 (Time, January 2012). This large scale bank failure had never happened in the history of the U.S. since the Great Depression. Literature reports different causes and consequences of GFC. For example, Kayed and Hassan (2011) report the major cause of this crisis is the laxity of lending based on greed of higher returns. Lim, Brooks, and Kim, (2008) explain the subprime mortgage as lending to household borrowers with weak credit worthiness. Shafique, Faheem, and Abdullah (2012) report similar reasons but also explain three factors that include greed to earn more profit, disobeying the market discipline regarding overflow of credits and lastly disobeying the system reforms such as not following the prudential regulations resulting GFC. Wilson (2009) also reports similar conclusions. On the other hand, researchers also report a different reason of this current crisis and report that failed morality According to some scholars the current crises is the result of the failed morality. Loundy, (2008) explains the failed morality is the cause of greed and corruption resulting the failure of relationship between investors and managers. This strand of literature reported that the main cause of the GFC was the failure of corporate governance (CG) system.

2.2. Corporate Governance:

The issues of corporate governance (CG) regain attention widely after the GFC of 2007-08, it is considered to be the result of agency theory[9]. Jensen and Meckling (1976) argue that managers tend to make decisions which favor them while investor wishes these decisions to be in their favor which creates conflict of interest. However, this conflict of interest can be reduced by aligning manager's interest with that of investors[10] and effective monitoring of the managers[11]. Farinha (2003) reviews CG literature from 1932 up to the recent financial crisis of Enron, Worldcom etc. for finding out the true nature and consequences of CG. The study investigates the reasons of conflict between managers and shareholders. The study concludes that the major conflict between managers and investors arise from their different approaches. The managers of the firm rely upon short term planning and quick cash flow while the shareholders rely upon long term planning for maximization of the firm value. The study suggests that for the minimization of agency costs the firms have to adopt complementary internal disciplining such as composition of the board of directors, insider ownership, large shareholders, compensation packages and financial policies of dividends and debts.

Another conflict between ownership and control is risk preference. Shareholders are concerned with the market risk and return on their shares, while managers prefer company risk because it is necessary for their survival[12]. They argue to solve this problem ownership structure is very important. The firms through the effective CG structure can implement a suitable ownership structure which may include different compositions such as board of directors (BOD), increasing inside ownership, compensation packages can reduce this conflict. They empirically examine family controlled firms of East Asia and Europe. They find that the operation of the firms located in East Asia is different from West and Europe because of distinctive culture and different legal environments. These cultural differences strongly affect the performance of firms. They identify the differences in CG impacts associated with different types of organizational shareholders. Their findings show that the major determinant of firm's performance is the control of the family over the executive board.

CG refers to a set of rules and regulations which define the relationship between management and other stakeholders to influence its operation. It also deals with the issues that result from the separation of ownership and control[13]. Zingales (1998) defines CG as, "*allocation of ownership, capital structure, managerial incentive schemes, takeovers, board of directors, pressure from institutional investors, product market competition, labor market competition, organizational structure, etc., can all be thought of as institutions that affect the process through which quasi-rents are distributed*" (*P.4*). Garvey & Swan, (1994) define CG as, *"governance determines how the firm's top decision makers (executives) actually administrate contracts" (P.139).* Shleifer and Vishny (1996) argue that CG is a system through which the financers of the money assure themselves of profit on their finance. Oman, (2001) defined CG as a mechanism for the organizations protected by law to govern the relationship between all the stakeholders and the managers. The Ministry of Finance, Singapore (2001) defines CG as a process through which the system of a firm is governed for the enhancement of shareholder's wealth reducing the conflict between shareholders and managers. Thus, CG is a system which reduces the information asymmetry between insiders and outsiders minimizing the agency conflict.

McColgan (2001) argues that agency problem can be reduced by the help of effective CG mechanism. The study reviewed the literature for since 1976 regarding the agency conflict. He suggests that CG mechanism must be designed according to the nature and structure of the business firms because this system varies firm to firm, industry to industry, country to country and culture to culture. Kowalewski, Stetsyuk, and Talavera (2007) investigate the CG practices determining the dividend policy of Polish firms. They report that companies with strong CG practices pay higher dividends which mitigate the agency problems in the Poland.

Studies investigate the association of CG on firm performance (FP) and conclude a positive impact of CG on FP[14]. Okeahalam and Akinboade (2003) argue the African region is influence by corruption and mismanagement, therefore effective CG can act as safeguard to encourage the foreign investments. They argue that weak CG mechanism leads to the failure of huge organizations in Asia as well as in developed countries. Strong CG provides protection to stakeholders and facilitates efficient financial review system (FRS) ultimately improving firm performance.

2.3 . Corporate Governance of Banks:

Banks are different from nonfinancial firms in different dimensions. Therefore, the governance of banks and non-financial firms is also different due to the nature of business, regulations and capital structure of banks[15]. Bank governance differs because it is characterized by deposit assurance fund, asset structure, problem of loyalty, liquidity production function, and the greater opaqueness which cause a heavy regulation on these institutions[16]. These differences can further be explained; first the failure of the banks has serious consequences because it the backbone of a financial sector. Therefore, this sector needs to be heavily regulated than nonfinancial firms[17]. Levine (2003) argues that because of the importance of banks in financial sector its risk management is more important than nonbanking financial firms. Because the failure of the risk management of large banks not only affect the banks but can badly impact the macroeconomic conditions of an economy. The banks mainly rely on the depositors for funding, so this creates incentive for taking too many risks. Because investing in high risky projects or assets can bring more revenue to the banks but in case of failure of these investments substantial part is borne by investors. According to Shleifer and Vishny (1996), the depositors of the banks has powers to withdraw their investments often bearing short term maturity, so the banks needs more funds to pay its debts. Levine (2003) argues that bank diffuse its debts in the shape of small investors, therefore the renegotiation of the debts is very difficult, and they have to pay the same at the time of maturity. Because of high information asymmetry it is very difficult for investors to monitor the bank managers[18]. Therefore, the investors of the banks are protected by some deposit insurance funds. This trend provides the banks with stronger incentive for risky behavior [19]. This also provides cheap deposits to the banks because the depositors are protected and they do not demand compensation of risk taking from the bank [20]. Therefore; banks are much leveraged based. These leverages make the balance sheets of banks different from non-financial firms, and increase the debt-equity ratio of banks.

According to Marcinkowska (2012) the weak and ineffective CG of banks is reported as one of the main factors contributing to GFC. The weak area of CG in banks responsible for GFC is further discussed by[21]. He suggests that to avoid further huge crisis globally the major changes in the area of the structure of BOD which is the first line of defense a bank should have. The BOD must be well qualified and professional so that they understand their duties towards the performance of their bank. They pointed out that poor risk management was also a cause of the failure of these banks. Since banks and other financial services are very risky business therefore, proper risk identification, management and control is very essential for a bank to survive.

2.4 . Corporate Governance of Islamic Banks:

Financial institutions consist of conventional and Islamic banking system worldwide. The comparison of these two types of banks is documented by[22]. The study reports the superiority of IBs over CBs. Many empirical studies extended the literature by comparing the performance of CBs and IBs in Malaysia, Egypt, GCC countries and conclude that the performance of IBs is relatively better than CBs. For example, Kazarian (1993) investigate both the IB's and CB's and their findings also show that IB's are better than its counterparts. The efficiency of conventional and Islamic banks has been compared by Samad (1999) in

Malaysian market. He reports the superior skills of IBs than CBs. Samad and Hassan (1999) contribute to the literature on IBs and the popularity of Islamic lending by testing the hypothesis that liquidity ratios of IBs are higher in the initial years and smaller later due to learning curve. Zaher and Hassan (2001) report the working and structure of IB's and explains the theory behind the growth of Islamic finance. They argue that the difference between IBs and CBs is profit and loss sharing which exists in IBs while interest payment in CBs. Iqbal (2001) examines IBs and CBs by ratios for 8 years across various countries. He compares the performance of IB's and CBs "control group", and report that IBs have done better than CBs. Beck, Demirgue-Kent, and Quarda (2010) compare the performance of IBs and CBs across many countries, during recent GFC and report that there is a negative effect of GFC on both types of banks but IB's had higher capitalization along with higher liquidity reserves, which makes its performance better than CBs.

Islamic banking is not only rising in Islamic countries but it also flourishing in the West. Qorchi (2005) reports rise of Islamic finance not only in Islamic world but also in U.S and the Europe. The study further reports the reason of this rise, and argue that IB instruments is more contract based between investor and the banks, and these contract are common feature of IBs. One reason of the good performance of IBs is CG structure of Islamic banks which also different from CBs, because of some special features. According to Grassa and Matoussi (2014), the base of Islamic finance is *Shari'a* law and the activity in which IB involves must be under Islamic rules. The *Riba* free banking which is based on *Mudarabah* and *Musharakah* is a profit and loss sharing system entirely different from conventional banks. They further argue that the presence of *Sharia* compliant products makes the CG different from conventional banks.

The CG of Islamic banks is related with *Sharia* law. According to Chapra and Ahmad (2002), the CG of Islamic banks is a mechanism which ensures sharing of fair information to all stakeholders through accountable and transparent system towards Islamic principles. The governance of IBs looks the transactional structure to watch whether the transaction involves elements that make profit or gain *Haram* because *Sharia* is also concerned with the form of the business. Akhtar (2007)reports that CG of IBs can be divided into two parts; 1) Faith based approach which is related with *Sharia* and religious customs and 2) Profit based approach which emphasizes maximization of wealth. Thus, CG mechanism of IBs is different from conventional banking [23].

CG of IBs consists of two tier structure; *Sharia* Supervisory Board and Board of Directors. The *Sharia* supervisory board is related with faith based approach ensuring *Sharia* compliance, while the board of directors is related with profit based approach ensuring maximization of wealth of shareholders. The researchers mainly focus upon the performance of the Islamic banks therefore there is scarcity of literature regarding CG of IBs but however, there are some studies regarding CG and Islamic banks. For example, Grassa and Matoussi (2014) compare the conventional and IBs of Southeast Asia with respect to CG, their result shows the significant impact of director's fee, CEO duality, CEO age, SSB on the performance of the banks. Others such as Rehman and Mangla (2012) study the performance of banking sector of Pakistan with respect to Board Size, Ownership Concentration, Independent Audit Committee, Tier *Sharia* Compliance and report the positive impact of board size with the performance.

2.5 . Corporate Governance of banks in Pakistan:

Financial sector of Pakistan has experienced many changes in its history since 1947. Pakistan started the financial services with just one commercial bank in 1947 out of 99 banks of subcontinent. The State bank of Pakistan was incorporated in 1948. During 1948 and 1974 banking sector of the country grew rapidly [24]. Private sector invested huge amount for establishment of new banks, meanwhile, The State Bank of Pakistan issued licenses to foreign banks to establish their branches in Pakistan. During 1974 the political government of Pakistan decided to nationalize all the commercial banks operating in Pakistan. 13 banks were nationalized and merged in 5 banks. This decision was not to be a good decision because the quality of services of banking sector suddenly dropped.

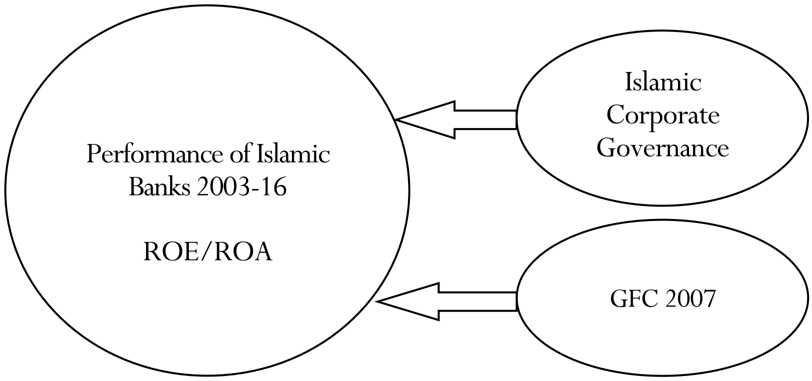
Realizing this situation, the government has start privatization of the banks. According to Khalid and Hanif (2005), the percentage of ownership of Govt. is dropped from 100 to 20 percent during 1991 and 2003. Meanwhile, the government encouraged private banks and foreign banks for investment in the country for competitive advantage. The privatization decision worked and the banking sector of Pakistan enjoyed tremendous growth. And currently 6 nationalized, 19 commercials, 6 foreign and 7 full fledge Islamic banks are functioning in the country. The concept of CG is new not only in banking sector but in all the capital market of Pakistan. However, some steps were taken by the SBP and Security and Exchange Commission of Pakistan (SECP) in 2002 for the stability of the financial sector. A major project was designed to make and implement code of CG for Pakistan by SECP and UNDP in August 2002. This code of CG was designed for corporate sector although there were some regulations included for banks but due to the nature of banking separate code of CG was essential. To overcome this problem, the SBP issued separate handbook of CG for banks in 2003 (SBP, 2003). This hand book was mainly designed to provide the guidelines to BOD, Shareholders and management. The recommendations and guidelines of this handbook are mainly taken from OECD and Basel Committee on CG which covers four areas, BOD, Management, Financial Disclosure, and Auditors. According to [25] the Ernst & Young published a comprehensive handbook of CG for banking sector which can be considered a base of CG of banks in Pakistan.

For the governance of IBs, prudential regulations along with a unique three tiered *Sharia* Compliance Mechanism adopted. This three tiered structure consists of internal *Sharia* Advisors of bank, Sharia Compliance Inspection and central Sharia Board of SBP. The SBP claims that this structure is very helpful in maintaining the quality of Islamic banking services, this is also helpful in adoption of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Standards/Guidelines (SBP, 2007). Thus the CG structure of IBs of Pakistan is more regulated than CBs and is keenly observed by the SBP. Prior literature reports the effect of CG on the performance of banking sector. However, these studies have methodological issues such as reporting of CG of CBs and IBs in one econometric model. Studies provide inconsistent results with respect to the impact of CG on IBs and CBs when put jointly. A probable reason may be the nature of CG mechanism in IBs. This study investigates the effects of CG on the performance of IBs separately.

3. Research Methodology:

This section reports an overview of methods used in this study. Specifically, section 3.1 shows research design consist on Theoretical framework and regression models used, 3.2 shows sample size, 3.3 shows data collection techniques used.

3.1. Research Design:



The above mentioned model shows the effects of Corporate Governance and Global financial crisis on the financial performance of Islamic banks i.e ROE and ROA.

3.2.Multivariate Regression Model:

To investigate the effects of CG and GFC on the performance of Islamic banks of Pakistan the following multiple regression models are proposed for the study.

$$ROE/ROA = \alpha + \beta_1 SSB + \beta_2 BOD + \beta_3 LogTA + \epsilon i \qquad (1)$$

$$ROE/ROA = \alpha + \beta_1 SSB + \beta_2 BOD + \beta_3 GFC + \beta_4 LogTA + \epsilon i \qquad (2)$$

$$ROE/ROA = \alpha + \beta_1 SSB + \beta_2 BOD + \beta_3 GFC + \beta_4 OC + \beta_5 LogTA + \epsilon i \qquad (3)$$

where, ROA is Return on Assets and is measured as net income over total average assets (assets at the start of the year plus assets at the end of the year averaged), ROE is Return on Equity and is measured as net income over total equity and both measures represent performance variables. BOD is Board Size and represent number of board of directors, SSB is Sharia Supervisory Board Size and is measured as number of members on the Sharia board, O.C is Ownership Concentration and is calculated as total percentage of shareholdings of top 5 shareholders in the bank, GFC is Global financial crisis and is a dummy variable where it takes the value of 1 if the year is a GFC year, otherwise zero. LogTA is Log of total assets while Year is a dummy variable and are included in the model as control variables.

ROA and ROE are dependent variables and represent the performance measure of a bank because Sabi (1996) argues that these ratios are the best measures of performance of a bank since they evaluate the managerial efficiency. ROE is net earnings per rupee equity capital which means the higher ratio is an indicator of higher managerial performance. The higher ROA ratio indicates higher ability, therefore it is an indicator of better performance. Grassa and Matoussi (2014) report the positive impact of SSB on the performance of Islamic banks in GCC and Southeast Asian countries, rest of the variables were also included in the study.

3.3. Sample Size:

The sample size includes all Islamic banks of Pakistan for the period of 2003 to 2016. The year 2003 is selected since Islamic banking started in this year in Pakistan while 2016 is the last year of data since the audited final accounts and balance sheets were available at the time of data collection. Secondary data is used for the study, ROE/ROA and log of total assets is calculated from the balance sheet and profit and loss of the Islamic banks already available on the website of the State Bank of Pakistan, CG variables such as board size, Sharia board size, and ownership concentration are hand collected from the annual reports of these banks. The methodology sections describe the effect of CG on the performance of IBs, the effect of GFC is also highlighted. Research design explains the effect of CG and GFC on the performance of IBs. The CG variables i.e. BOD size, SSB size, O.C is taken from the annual reports of the banks. ROE and ROA are calculated from the profit and loss and balance sheets of these banks. LogTA is included as control variable and calculated from the balance sheets.

4. Results:

This section reports the results of the study, first the multivariate and descriptive statistics for all the data is reported followed by the results of regression analysis. Table 1 reports descriptive statistics for ROE, ROA, BOD, SSB, LogTa, O.C, LogAdv. For ROE its mean is 0.026 and its median is 0.0144. The normality of the distribution of data is checked by its skewness and kurtosis which suggest that the data is normally distributed. The mean and median CG variables BOD, SSB is (9.43, 9.00) and (2.9 and 3.0) which is almost the same, its skewness and kurtosis suggest that the data is normally distributed. Another variable of CG the ownership concentration (0.C) has large variation in its standard deviation due to the ownership structure of one bank which is 100 % owned by a foreign bank however, its skewness and kurtosis suggests that the data is normally distributed.

Table 1 reports descriptive statistics for the dependent and explanatory variables. ROE and ROA are two performance variables. BOD represents the size of board of directors, SSB represent the size of Sharia Supervisory Board, LogTA is log of total assets included as control variable, O.C is ownership concentration. LogAdv is log of total advances.

Table 1: Descriptive Statistics

Variables	Mean	Median	St.Dev.	Minimum	Maximum	Skewness	Kurtosis
ROE	0.026	0.0144	0.115	-0.216	0.279	0.07	-0.28
ROA	-0.001	0.0022	0.015	-0.035	0.0192	-0.79	-0.44
BOD	9.436	9.000	1.373	7.000	9.000	-0.41	-0.53
SSB	2.974	3.000	0.986	1.000	4.000	-0.99	0.18
LogTA	7.531	7.653	0.494	6.604	8.518	-0.12	-0.60
O.C	84.91	84.03	12.80	58.00	100.00	-0.44	-0.90

The skewness and Kurtosis of the data of each panel is within the range. The mean and median of the data is almost the same. This indicates that the data is normal. The standard deviation of O.C is a 12.80 which is comparatively high it is because of 100 percent ownership concentration of one foreign bank, over all the Mean and median of O.C is almost the same while the skewness and kurtosis is under (+1.00, -1.00) which indicates that the data of O.C is also normal.

4.1.Multivariate Statistics:

The result of correlation coefficient suggests a positive and statistical significant correlation between ROE and ROA with SSB which shows that the more the SSB size the good the performance. BOD also shows strong correlation with ROA but statistically not significant. GFC shows negative correlation with both the performance variables but for ROA it is significant while for ROE it is not significant. Control variable LogTA is also positively and strongly correlated with ROE and ROA which means the larger the size the good the performance. Theoretically it shows that the larger size of the banks also matters the good performance.

Table 2 represents the Multivariate statistics of dependent and the independent variables. ROE and ROA are two dependent variables and proxied for performance of the banks. BOD is size of board of directors, SSB is size of Sharia Supervisory Board, O.C is ownership concentration means ownership percentage of top 5 shareholders, LogTA means log of total assets, GFC is dummy variable which is included in the study, from 2003 to 2006 it is included as zero while from 2007 to 2016 it is included as 1 which shows the presence of global financial crisis. The correlation co-efficient is represented by first row while the p-value is documented in italics.

Table 2: Correlation Analysis

Variables	ROE	ROA	BOD	SSB	O.C	LogTA
ROA	0.865 *0.000*					
BOD	0.202 *0.219*	0.054 *0.742*				
SSB	0.655 *0.000*	0.560 *0.000*	0.203 *0.216*			
O.C	0.017 *0.916*	-0.088 *0.596*	0.579 *0.000*	0.277 *0.088*		
LogTA	0.486 *0.002*	0.404 *0.011*	0.293 *0.070*	0.379 *0.017*	0.225 *0.169*	
GFC	-0.283 *0.081*	-0.345 *0.032*	0.010 *0.951*	-0.325 *0.043*	0.228 *0.163*	0.245 *0.133*

4.2 . Results:

Table 3 reports results of Hausman diagnostic test. The results show that fixed effect model of panel data approaches is the most suitable model for analyses. Hence, the results of fixed effect model are reported in table 4 of the current study.

Table 3: Hausman Test Results

Panel A	prob>Chi2	0.0000
Panel 1	prob>Chi2	0.0000
Panel B	prob>Chi2	0.0000
Panel 2	prob>Chi2	0.0000
Panel C	prob>Chi2	0.0000
Panel 3	prob>Chi2	0.0000

4.3 .Fixed Effect Model Results:

The following Table 4 presents fixed effect model results. The results of model 1 show highly significant relationship between the size of SSB and performance variables. The relation is positive and statistically significant which means the larger the SSB size the good the performance. SSB is taking care of the religious interests of the investors, they keenly observe the transaction on Islamic parameter to avoid *Riba* then they allow or disallow the transaction. Thus, it is proved that investors of the IBs trust on SSB which protects the prohibition of *Riba* in Quran.[26] LogTA which is a control variable has also significant impact on ROE of these banks, while size of the BOD has no significant impact on the performance of these banks.

Model 2 shows significant results of SSB on both the performance variables. Log of total asset is also significant positive impact on ROE/ROA. GFC is included in this model which shows that there is a negative impact of GFC on ROA while ROE is still unaffected. The model shows no impact of BOD on performance.

Adding OC in the model 3 shows interesting results, SSB in this model positively impacts on both the ROE/ROA while there is no impact of GFC on performance variables, which shows that adding CG variables minimize the impact of GFC. BOD and O.C has apparently no impact on the performance variables.

Table 4: Fixed Effect Model

Variable	**Panel A Model 1**		**Panel B Model 2**		**Panel C Model 3**	
	ROE	***ROA***	**ROE**	***ROA***	**ROE**	**ROA**
Intercept	-0.657 *0.005*	-0.071 *0.000*	-0.742 *0.002*	-0.084 *0.012*	-0.627 *0.008*	-0.072 *0.033*
BOD	0.001 *0.940*	-0.001 *0.405*	0.000 *0.967*	-0.001 *0.355*	0.012 *0.327*	-0.000 *0.985*
SSB	0.064 *0.000*	0.008 *0.002*	0.051 *0.005*	0.005 *0.045*	0.061 *0.001*	0.006 *0.021*
LogTA	0.064 *0.047*	0.008 *0.098*	0.088 *0.012*	0.012 *0.015*	0.078 *0.024*	0.011 0.026
GFC			-0.080 *0.094*	-0.015 *0.030*	*-0.047* *0.348*	*-0.011* *0.124*
O.C					*-0.002* *0.110*	*-0.000* *0.208*
F-Stat	11.42***	6.82***	9.79***	7.01***	8.76***	6.04***
Adj-R^2	45.1%	31.5%	48.00%	38.7%	50.5%	39.9%

***, **, * represent 1%, 5%, 10% level of significance, respectively.

Panel A reports results for Model 1, Panel B is for Model 2, Panel C for model 3. The explanatory power of regression model is shown by the F-stats and Adjusted R-squared. The first row represents co-efficient of the variables while the second value in italics is the respective p-value of the coefficient. BOD represents the size of board of directors, SSB represent size of Sharia supervisory board, LogTA is log of total assets, GFC is global financial crisis, O.C is ownership concentration means the percentage of top 5 shareholders.

5. Conclusion :

Corporate governance is an important element for firm performance. Many studies conducted worldwide reporting the positive impact of CG on firm performance. This study also supports the prior strand of literature that CG impacts FP positively. The CG system of Islamic banks is different from non-financial firms, this two tier CG system of IBs makes it differs from conventional banks. This system makes the governance of these more banks stronger. The presence of this two tier CG mechanism makes these banks more resilient to any crisis.

The results of the study report important findings. Size of SSB positively impacts the financial performance (ROE/ROA) of these banks. The second important finding is that these banks are immune from global financial crisis 2008. The results report a small impact of global financial crisis 2008 on the ROA but this impact becomes statistically not significant while adding more corporate governance variables, which means that the corporate governance of these banks makes it resilient to global financial crisis. The study also reports that ROE is not affected by global financial crisis at any stage. Another important finding of this study is the size of the bank. The large assets of the bank positively impact the performance of the banks. Size of the board of directors has no significant effects on the performance of IBs. The effect of ownership concentration on the performance of IBs is also not significant.

This study contributes the literature of CG of Pakistani Islamic Banks. Prior studies of Islamic banks mainly emphasize on the growth and comparison of Islamic banks with its conventional counterparts. The findings of the study are important contribution to the literature.

The sample period of this study is not large because it is just the beginning of Islamic banking in Pakistan. The first full fledge Islamic bank of Pakistan started functioning in 2003. The study is also limited to the full fledge Islamic banks of Pakistan, conventional banks with Islamic windows are not included because of the mixed financial statement of its Islamic and conventional products. We suggest that adding more corporate governance variables such as Board Fee, Board meetings, Audit Fee, presence of women directors, percentage of independent directors etc. will be more beneficial for further research.

Endnotes:

[1] (Terazi & Şene, 2011.
[2] Akbar, Rehman, & Ormord, 2013; Blundell-Wignall, Atkinson, & Lee, 2008.
[3] Kirkpatrick, 2009.
[4] McKibbin & Stoeckel, 2009.
[5] Rixtel & Gasperini, 2013.
[6] Memon & Aciland, 2013.
[7] Phulpoto, Shah, & Shaikh, 2012.
[8] Addawe, 2012.
[9] McColgan, 2001; Shleifer & Vishny, 1996.
[10] Shleifer & Vishny, 1996.
[11] McColgan, 2001.
[12] Filatotchev, Piesse, & Lien, 2004.
[13] Shleifer & Vishny, 1996.
[14] Claessens, Djankov, & Larry, 2000; Black, Jang, & Kim, 2003; Gompers, Ishii, & Metrick, 2003; Sanda, Mikailu, & Garba, 2005; Weir & Laing, 1999.
[15] Adams & Mehran, 2003.

[16] Macey & O'Hara, 2003.
[17] Flannery & Mark, 1998.
[18] Demirgüç-Kunt & Detragiache, 2002.
[19] Merton, 1977.
[20] Mehran, Morrison, & Shapiro, 2011.
[21] Kirkpatrick, 2009.
[22] Zineldin, 1990.
[23] Lewis, 2007.
[24] Hussain, 2003.
[25] Khalid & Hanif, 2005.
[26](1) See (Quran, Al-Baqarah, 2: 275) (Quran, Al-Baqarah, 2: 276) (Quran, Al-Baqarah, 2: 278)(Quran, Ali-Imran, 3: 130)(Quran, An-Nisa, 4: 161) (Quran, Ar-Rom, 30: 39)

- Adams, R., & Mehran, H. (2003). Board structure, banking firm performance and the Bank Holding Company organizational form. *Federal Reserve Bank of Chicago Proceedings; May Issue*, 408-422.
- Addawe, S. (2012). what are the impacts of the global financial crisis on Islamic banking system and how Islamic bank spared from the crisis? Aalto University Library Thesis number 12737.
- Akhtar, S. (2007). *Islamic finance-emerging challenges of supervision* . BIS Review No. 68/2007.
- Alexander, P., & Baden, S. (2000). Glossary on macroeconomics from a gender perspective . Institute of Development Studies, University of Sussex .
- Ambal, M., & Al-mukharreq, F. (2013). Impact of the financial crisis on profitability of the Islamic banks vs conventional banks: Evidence from GCC. *International journal of financial research, 4*(3), 83-93.
- Beck, T., A., D.-K., & Quarda, M. (2010). *Islamic vs. conventional banking – business model, efficiency and stability.* The World Bank, Development Research Group.
- Black, B., Jang, H., & Kim, W. (2003). Does Corporate Governance Affect Firm Value? . *Stanford Law School; Working Paper No. 327.*
- Blundell-Wignall, Atkinson, P., & Lee, S. (2008). The Current Financial Crisis: Causes and Policy Issues: Financial Market Trends .
- Chapra, U., & Ahmad, H. (2002). *Corporate Governance in Islamic Financial Institutions.* Islamic Development Bank Occasional Paper No. 6.
- Claessens, S., Djankov, S., & Larry, L. (2000). The separation of ownership and control in East Asian corporations.,. *Journal of Financial Economics, 58*(1), 81–112.
- Demirgüç-Kunt, A., & Detragiache, E. (2002). Does deposit insurance increase banking system stability? An empirical investigation. *Journal of Monetary Economics, 7*(49), 1373–1406.
- Filatotchev.I, Piesse.J, & Lien.Y. (2004). Corporate Governance and Performance in Publicly Listed, Family-controlled Firms: Evidence from Taiwan. Department of Management , King's college of London.
- Flannery, & Mark, J. (1998). Using market information in prudential bank supervision: A review of the U.S. empirical evidence. , 30(3). *Journal of Money Credit and Banking, 3*(30), 273-305.
- Garvey, G., & Swan, P. (1994). The Economics of corporate governance: Beyond the Marshallian firm. *Journal of Corporate Finance, 1*(2), 139-74.

- Gompers, A., Ishii, J. L., & Metrick, A. (2003). Corporate Governance and Equity Prices. *Quarterly Journal of Economics, 2*(118), 107–55.
- Grassa, R., & Matoussi, H. (2014). Is corporate governance different for Islamic banks? A comparative analysis between the Gulf Cooperation Council and Southeast Asian countries. *Int. J. of Business Governance and Ethics, 9*, 27-51.
- Hussain, I. (2003). Regulatory Strategy of the State Bank of Pakistan, Comments of the paper. Islamabad: 18th Annual General Meeting of the Pakistan Society of Development Economists.
- Iqbal, M. (2001). Islamic and conventional banking in the nineties – a comparative study. *Islamic Economic Studies, 2*(8).
- Jensen, M., & Meckling, W. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305-360.
- Kayed, R., & Hassan, M. (2011). The global financial crisis and Islamic finance. *Thunderbird International Business Review*(53), 551-564.
- Kazarian, E. G. (1993). *Islamic versus traditional banking: financial innovation* . Colorado West view press 1993.
- Khalid, A., & Hanif, M. (2005). *Corporate Governance for Banks in Pakistan.* Recent Developments and Regional Comparisons.
- Kirkpatrick, G. (2009). The Corporate Governance Lessons From the Financial Crisis. *OECD Journal: Financial Market Trends. 2009. 3-3, 3*(3).
- Kowalewski, O., Stetsyuk, I., & Talavera, O. (2007). Corporate Governance and Dividend Policy in Poland . *Wharton Financial Institutions Center Working Paper No. 07-09.*
- Levine, R. (2003). The corporate governance of banks: A concise discussion of concepts and evidence. *World Bank Policy Research; Working Paper No. 3404.*
- Lewis, M. K. (2007). Islamic banking in theory and practice. *Monash Business Review, 3*(1), 1-8.
- Lim, k., Brooks, R., & Kim, j. (2008). Financial crisis and stock market efficiency: Empirical evidence from Asian countries. *International Review of Financial Analysis, 17*(3), 571-591.
- Loundy, D. (2008). Islamic finance and the U.S. sub-prime mortgage mess: Lessons to be learned. Retrieved from www.usbahrainbusiness.org/view/images/uploaded/Loundy_Lessons_Learned.pdf
- Macey, J., & O'Hara, M. (2003). The corporate governance of banks. *Economic Policy Review Federal Reserve Bank of New York; Special Issue 9,*, 91-108.
- Marcinkowska, M. (2012). CORPORATE GOVERNANCE IN BANKS: PROBLEMS AND REMEDIES. *Financial Assets and Investing*(2), 47-67.
- Matoussi, H., & Grassa, R. (2012). Is Corporate Governance Different for Islamic Banks? *Corruption and economic Development; ERF 18th annual conference.*
- McColgan, P. (2001). Agency theory and corporate governance: a review of the literature from a UK perspective. Department of Accounting & Finance, University of Strathclyde Glasgow.
- McKibbin, W., & Stoeckel, A. (2009). The Global Financial Crisis: Causes and Consequences; Lowy Institute for International Policy. *Working Paper No. 2.09*.
- Mehran, H., Morrison, A., & Shapiro, J. (2011). *Corporate Governance and Banks: What Have We Learned from the Financial Crisis?* . Federal Reserve Bank of New York; Staff Report No. 502. .
- Memon, M., & Aciland, D. (2013). Islamic Finance and Banking in the Great Recession: A Comparison of Profitability with Conventional Banks.

- Merton, R. (1977). On the cost of deposit insurance when there are surveillance costs. *Journal of Business, 3*(51), 439-452.
- Okeahalam, C., & Akinboade, O. A. (2003). A Review of Corporate Governance in Africa. *Literature, Issues and Challenges; Global Corporate Governance Forum.*
- Oman, C. P. (2001). Corporate Governance and National Development . *An outgrowth of the OECD Development Centres Experts Workshop in 2000 and Informal Policy Dialogue in 2001 sponsored in part by CIPE.*
- Phulpoto, L., Shah, A., & Shaikh, F. (2012). Managers knowledge about basic management concepts in telecommunication industry. *Journal of Asian Business Strategy, 6*(2), 142-152.
- Qorchi, M. (2005). *Islamic finance gears up.* imf.org.
- Rehman, R., & Mangla, I. (2012). Does corporate governance influence banking performance? *Journal of Leadership, Accountability and Ethics, 9*(3).
- Rixtel, V., & Gasperini, G. (2013). Financial crises and bank funding: Recent experience in the euro area . *BIS Working Paper; No 406.*
- S, A., Rehman, S. U., & Ormord, P. (2013).
- Sabi, M. (1996). Comparative Analysis of Foreign and Domestic Bank Operations in Hungary. *Journal of Comparative Economics, 22*(2), 179-188.
- Samad, A. (1999). Comparative efficiency of the Islamic bank Malaysia vis-à-vis conventional banks. *Journal of Economics and Management, 1*(7).
- Samad, A., & Hassan, K. (1999). The performance of Malaysian Islamic bank during 1984-1997: an exploratory study. *International Journal of Islamic Financial Services, 3*(1).
- Sanda, A. U., Mikailu, A., & Garba, T. (2005). Corporate Governance Mechanisms and Firm Financial Performance in Nigeria. . *AERC Research Paper; No.49.*
- Shafique, A., Faheem, A., & Abdullah, I. (2012). Impact of Global Financial Crises on the Islamic banking system. *Arabian Journal of Business and Management Review (OMAN Chapter), 9*(1).
- Shleifer, A., & Vishny, R. W. (1996). A Survey of Corporate Governance. *Journal of Finance , 52*(2).
- Solomon, J. (2013). *Corporate governance and accountability* (4 ed.). John Wiley & Sons Inc.
- Terazi, E., & Şene, E. (2011). The effects of the Global Financial Crisis on the Central and Eastern European Union Countries. *International Journal of Business and Social Science, 17*(2).
- Weir, C., & Laing, D. (1999). The Governance-Performance Relationship: The Effects of Cadbury Compliance on UK Quoted Companies; . European Accounting Association Conference, Bordeaux.
- Wilson, R. (2009). Why Islamic Finance is Successful? Islamic Banks are Unscathed of Financial Crisis. Islamic development bank group.
- Zaher, T. S., & Hassan, M. (2001). A comparative literature survey of Islamic finance and banking; , 10(4). *Financial markets, Institutions and Instruments, 4*(10), 155-199.
- Zineldin, M. (1990). *The economics of money and banking: A theoretical and empirical study of Islamic interest-free banking.* Almqvist & Wiksell International, Stockholm.
- Zingales, L. (1998). Corporate governance. In *in Peter Newman* (pp. 497-502). London: The New Palgrave Dictionary of Economics and the Law.