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Role of Political Connections in the Relationship of Corporate Governance and Financial Performance – Study of Banks in Pakistan

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Abstract
This study aims to examine the relationship between corporate governance and the financial performance of banks in Pakistan, further investigate the moderating role of political connection. Panel data from 22 listed banks spanning the period 2013-2017 were gathered, sourced from the annual reports available on the Pakistan Stock Exchange website. Analysis was conducted using Gretl and MS Excel, involving descriptive statistics of variables, as well as other investigative tests such as correlation and regression analysis. Two hypotheses were tested through regression analyses. A positive relationship was identified between the independent variable, corporate governance, and the dependent variable, financial performance. Conversely, a negative relationship was observed between political connections and bank performance. Likewise, political connections were found to negatively moderate the association between corporate governance and financial performance. This study represents a significant contribution to Pakistani literature by comprehensively examining the impact of corporate governance on financial performance while acknowledging the moderating effect of political connections. The findings of the study are important for policy makers, investors and banks in formulating conducive policies.

Keywords: Corporate Governance, Banks Performance, Political Connections, Pakistan

Introduction
It is often asserted that banks are essential for the expansion of industry and allocation of capital to businesses and individuals. The role of banks in the economy is indeed crucial and it is not wrong to say that the sound performance of banks is as important for the prosperity of nations as the backbone is for the human body. Generally, banks facilitate the stream of capitals from investors to borrowers, providing necessary funds for businesses to invest and grow over time. The performance of banks can influence economic growth, stability, and prosperity. After the worldwide financial disaster in 2008, there was blame for numerous banks' failure due to a lack of good governance. Gradually, a better regulatory framework and supervision have been developed to overcome corporate governance deficiency and failure (Ferrarini, 2017). In the broader context, corporate governance is a collective bunch of social, economic, and legal institutions that may help protect the best interests of the institution's owners. In another system

of corporate governance, named the Anglo-American system, all such owners are the institutions' shareholders.

The basic notion of corporate governance explains the fundamental relation between corporate managers and shareholders (Javed & Iqbal, 2007). The main objective of shareholders of any financial institution is to earn profit from their investment. While the managers have designed specific goals that include holding power and reputation. In such situations, managers have the edge over shareholders because they have inside information, and they have the upper hand on shareholders due to their position up to some extent in any financial institution. Researchers have paid high attention to the literature on corporate governance in the current years, but still, in underdeveloped countries, corporate governance needs many improvements (Arun & Turner, 2009). There are several reasons for good corporate governance in banks. First, banks have a top place in the fiscal system of a rising economy and are highly imperative for the country's economic growth. Second, in developing countries, financial markets are not set, and banks are the primary source of providing funds. The third reason is banks are the primary depository of savings in any economy. Financial institutions adopt different corporate governance practices within existing codes and standards to measure corporate governance.

In Pakistan, clearance from the Central Bank is required to appoint the Board of Directors or CEO of any financial institution. Detailed minutes of board meetings are studied. The composition of the Board is assessed by the audit committee and makes sure that administrative directors do not comprise over 25% of the whole Board of management. Quarterly based financial statements published and circulated by the bank also aid in evaluating corporate governance. Banks' financial statements increase efficiency and build trust among depositors and shareholders. Sound political governance can be a prerequisite for good corporate governance. Pakistan is classified as an emerging country (Ali & Marwat, 2021), and in such emerging economies, governance is complex due to extensive political intervention in the banking system's operations. There is always a conflict between the government and the top management, who have to control the banking activities. The inefficiencies of government-owned banks lead to many corporate governance issues. Generally, it has been observed that government-owned banks have more independence in deciding banking strategies like opening new branches and introducing new products to the customers. Such financial institutions have fewer hurdles to face by having government support at the back.

Increasing profitability and minimizing the risk of a financial institution within corporate governance compliance is helpful for sound decision-making. Accurate and complete information and accurate analysis are necessary for the correct decision-making. One of the proper methods for analyzing financial performance is financial ratio analysis. It explains the relationship between the two indicators. Previous studies have demonstrated that financial performance plays a central role in the effective functioning of a country's economy. It provides the foundation of correct decision-making to allocate the sources of funds so that the financial institution can improve the climate of investment and savings (Andrew, 1997). The performance of institutions is mainly depending on the size and ownership structure (Ali & Shah, 2023). Still, many analysts give the point of view that failure of governance also affects the financial soundness of the financial

institution. Many financial institutions have faceless financial growth due to catastrophic conditions of governance. Theoretically, it is supported that if there is good corporate governance in a financial institution, the financial position of that institution will be stable and rigorous. But there is a need to investigate empirically that corporate governance supports to lift financial performance and political connections play an optimistic part in the presentation of financial institutions.

Political connections can function as a financial safety net and serve as a tool for selecting equilibrium (Hall & Deardorff, 2006). Politically connected banks often provide loans to politicians at lower interest rates, and these funds are frequently directed towards various political activities rather than being invested in economic development initiatives Many politically connected directors may take decisions under the directions of different politicians (Haris et al., 2019). Initially, political connectivity was studied in different studies. Many researchers like Boubakri, Guedhami, et al. (2012); Faccio (2006); Khwaja and Mian (2005) have shown the evidence and documented that the government forces politically connected banks to provide funds for government projects at less rate. This activity reduces the profitability of the banks. This research also identified that government banks do not perform well during election tenure due to government intervention of loan allocation. The resource-based theory claims that banks can get a more significant competitive edge due to retrieving benefits caused by political connections (Cheema et al., 2016). Jackowicz et al. (2013) contended that political benefits are derived from the banks due to politically appointed directors of banks.

Corporate governance contrivance of financial institutions is also affected by political connection. For instance, there would be less authenticity in auditing accounting practices due to the government's involvement. Politically connected banks may damage the interest of shareholders, and there would be intervention among politicized directors and non-politically affiliated directors (Haris et al., 2019). Moreover, it has been recently documented that politically connected banks have less financial performance than non-politically affiliated banks. Such banks have a greater risk of default (Chen & Liu, 2013). Therefore, it is imperative to analyze empirical work of Pakistani banks' political connections and fiscal performance. As a developing country, Pakistan is an interesting case to investigate the connection between corporate governance and financial performance and the impact of political relations in financial institutions. Thus, the corporate governance system in Pakistan is most likely has significant concerns for the country's business arrangement and demeanour (Arslan & Alqatan, 2020). There are several aspects of politically connected institutions. First, it is ubiquitous in Pakistan to have political connections because political personalities have substantial stimulus on the corporate world. Second, less flourished capital markets; insufficient support of institutions, predominant governmental control hinders the success of financial institutions. Primary studies are conducted to investigate the relationship between corporate governance and financial performance or financial performance of firms and political connections of directors of financial institutions. These variables are mainly used as dependent and independent variables. There is limited literature on the impact of political connections or the moderating effect of political relations in financial institutions. The extent to which political connection affects the relationship of corporate

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governance and financial performance has received less attention so far. Hence, this research endeavors to address this gap.

Literature Review

Governance can be described as the clear and transparent set of rules required to run private and public businesses. By giving profound importance to banks, it would say that governance mechanism is an institutional assessment criterion that plays a central role in banks progress (Levine, 2004). The significance of good governance was defined as the predictable, comprehensive, and highlighting policy along with the bureaucracy and fundamental values. All these attributes are available in a strong civil society involved in public affairs where everyone is bound to perform their duties in the community under the rule of law.

Corporate Governance

In prior research, corporate governance has been elucidated as the mechanism by which bank managers provide public stakeholders with assurance that they will act in the best interests of shareholders. On the contrary, according to well-known economist Adam Smith, it is contended that directors of financial institutions are always found hesitant to perform in good faith of shareholders (Arun & Turner, 2009). Numerous studies have highlighted the correlation between corporate governance and various economic indicators, including equity prices Gompers et al. (2003) is one such notable study that delved into this relationship. Other studied stock ownership and corporate governance (Loderer & Martin, 1997), corporate governance and ownership structure (Demsetz & Lehn, 1985), market valuation with a board size of directors (Yermack, 1996), board composition and board independence and firm performance (Bhagat & Black, 2001). In a broader context, corporate governance encompasses the mechanisms by which providers of finance oversee managers to ensure that their investments are protected from potential misuse and that they generate adequate returns on their capital (Oman, 2001). These methods of governance keep the financial institutions fiscally streamlined. Sound corporate governance adds to defensible economic development by increasing the performance of financial institutions and enhancing their admittance to external capital. There are different objectives of public policies which are served by corporate governance in developing markets. It minimizes risks of financial crises, reduces transaction cost and capital cost, and helps to boost the capital market (Javed & Iqbal, 2007). Corporate governance is a system based on a wide array of practices and institutions. It includes accounting principles and standards, financial revelation laws, composition, and size of boards.

In the context of banks surveillance, good governance plays a vital role. If the managers of banks focus on solid governance mechanisms, they would efficiently allocate the funds. Alternatively, suppose bank managers enjoy massive preferences to perform in their interests instead of working for stakeholders' interests. In that case, the banks will correspond less towards society's savings, and the soundness of good governance will be a question mark for the banks. Two main attributes of banks require a discrete investigation of the corporate governance of financial institutions. Firstly, financial institutions are denser than any other petty financial firm. While finding evidence, informational differences exist in all sectors, but such informational irregularities are located in the banking industry at a larger scale. Like banks can minimize the

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risk configuration of asset management more efficiently than any other financial institution. They can sanction the loans to the clients by keeping in view the previous debt compulsion record. Secondly, banks are more regulated than other financial institutions.They have established a foundation of financial returns, and governments enforce a complex array of procedures upon them (Levine, 2004). A viewpoint from the theoretical framework says that there are many good reasons to undertake that better corporate governance can increase the value of financial institutions. It also depicts that cost of capital decreases with good corporate governance (Beiner et al., 2006). On the contrary, few studies have shown that low standards of corporate governance increase the capital cost, diminish the operating performance of financial institutions, and obstruct the flow of investment (Wu, 2005).

Financial Performance

Performance entails achieving, fulfilling, and surpassing objectives in exchange for invested time, effort, and resources. It has a different meaning in finance by measuring financial institutions' policies, activities, and operational results. The financial performance also helps assess the company's success, concession, and financial strength in the market. Bank's financial performance can be measured by utilizing ratio analysis, computing performing by allocating budgets, or benchmarking them against industry standards (Kemal Avkiran, 1994). In almost every study, the financial performance of the banking industry is explained by higher return or profit by lowering the risk factors linked with investment. In literature several studies have been conducted where the financial performance of banks was assessed by taking profitability ratios as a dependent variable; For example, Tan (2016) studied 41 Chinese banks from the period extending between 2003 and 2011. These banks interpreted different ratios to measure the growth and productivity of banks. Likewise, profit margin (PM), return on assets (ROA), net interest margin (NIM), return on equity (ROE). In Pakistan, some studies were conducted to assess the determinants of financial performance. Almost every study suggests accounting ratios, profitability ratios, in particular, are the essential determinants to access the financial performance of Pakistan's banking sector. In a survey conducted by Yao et al. (2018), samples were drawn from 28 banks spanning the period from 2007 to 2016. The study applied four profitability measures, including profit margin, to assess bank performance (PM), return on assets (ROA), net interest margin (NIM), return on equity (ROE) as dependent variables. Therefore, this study included ROA as a measure of the financial performance.

Corporate Governance and Financial Performance

In the past, numerous studies have been conducted to study the influence of corporate governance on the fiscal and monetary performance of firms (Black et al., 2003). Weir and Laing (1999) found significant positive relations between the performance of banks and their governance. However, Eisenberg et al. (1998) experienced a negative relationship among variables. In corporate finance literature, the subject of ownership, corporate governance, and performance, has been under discussion for a long time. Santiago-Castro and Baek (2004) studied 71 large companies listed in the U.S. as American depository receipt (ADR) from 9 Latin American countries to explore the impact of board composition on the financial performance of firms. Return on assets (ROA) was used to measure financial performance. The study's findings showed zero association between

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board composition and a firm's financial performance. The structure of board ownership impacts the quality of corporate governance, which affects the firm's performance. The banking industry constitutes complex factors due to which the issues concerning corporate governance have been complicated.

One of the unique features that determine board ownership is related to outside directorship, which increases the diversity of the board. According to the study conducted by Samaha et al. (2012), the inclusion of outside directors brings innovation, creativity, and diverse experience. Transparency is deemed crucial for the evaluation of the financial performance of businesses. Transparency is essential for financial reporting in modern aged companies. The information is readily available nowadays and has reached a level not previously observed. The volume of data is expected to grow exponentially in the future. The transparency, audit, and disclosure of information are linked with corporate governance issues due to greater emphasis by large shareholders and other stakeholders. Following the significant scandals, incorporation such as Lehman Brothers and Enron in the USA and Equitable Life in the U.K. have boosted the demand for transparency in financial reporting (Hooper & Kearins, 2007). In line with previous literature, we can assume following hypothesis:

H1: There is a significant positive relationship between corporate governance and financial performance.

Role of Political Connections

People exert significant influence on the economic system of Pakistan through politics. Banks tend to grant loans under favorable conditions to firms with established political connections. Politicians often utilize these bank loans to finance their election campaigns, thereby influencing management decisions and hindering substantial business growth. Managerial financial styles generally have an impact on institutional performance (Kutan et al., 2018). Consequently, managers with political connections may influence the board's decisions to align with political agendas at the expense of financial institutions, thereby undermining the effectiveness of bank operations (Liang et al., 2013). Political relations develop when government officials or retired government officials occupy high positions in government-owned financial institutions. The political system of Pakistan is very different from the political system of Europe, China, Malaysia, and Indonesia even equity market is different from that of G8 countries (Shah et al., 2012). In Europe, the local government is strong, unlike Pakistan, where the real power is vested in the provincial and federal government and thus weakening the system of government at the local level.

There has been a high level of political stability in Malaysia and Indonesia, whereas the political system of Pakistan has undergone many instabilities right from its independence (Nawaz et al., 2021).

China is a one-party state, whereas Pakistan has a multi-party system and has a history of military interventions in power-holding. There is no universally accepted definition for political connections or politically connected organization. However, in Pakistan, a politically connected organization can be defined as one where any member of the top officers or shareholders, or their close relatives or friends, holds a position as a Parliamentary member, minister, state head, or has

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served in a high-ranking military position. Therefore, a financial institution is politically connected when its chief position officers or large shareholders are (a) parliament members, (a) a state head or minister, or (c) has close relation with any political leader.

Faccio (2006) also documented that close relationships do not include contributions towards political campaigns or direct payments of cash to the politicians. It would not be wrong to say that organizations that are connected politically enjoy a variety of benefits. For instance, Bunkanwanicha and Wiwattanakantang (2009) studied politically connected organizations in Thailand and explored some helpful information such as the increase in the financial performance by 160% of politically connected organizations compared to non-connected ones. Other benefits that politically connected organizations enjoy including making changes in government policies in their favor, reducing tax, and new state contracts. These benefits help the connected organization enjoy a 50% increase in market expansion. Organizations having political connections impact not only the financial progress of the organization but also the economic progress as well. Different studies have been conducted to examine the effect of politically connected organizations on their performance.

Boubakri, Cosset, et al. (2012) conducted a study based on the database of Faccio (2006) to examine 234 organizations having political connections from 12 developed and 11 developing countries. They used return on assets (ROA) to measure organizations' financial performance. Study found that setting up the political connection in organizations increases ROA of that organization. Study also observed the elevated financial leverage due to an increase in the use of debt by organizations having political connections. The positive relationship between political connections and organizational financial performance has also been reported in the study conducted by Braun and Raddatz (2010). The government forces politically connected banks (government-owned banks in particular) to finance government projects by giving loans at a lower interest rate, consequently allocating funds inefficiently and decreasing profitability. Given the influence of directors with political connections on banks' lending decisions, thereby negatively impacting banks' performance, this study posits the following hypothesis regarding the role of political connections in bank governance and performance.

H2: Political connections moderate the relationship between corporate governance and financial performance.

Methodology

Population and sample size

The population of the study is the banking industry. Population size is listed banks in Pakistan Stock Exchange (PSX). There are 34 listed banks on Pakistan Stock Exchange. There are 6 public sector schedule banks, 16 private zone banks, 7 foreign banks, and 5 Islamic banks functioning in Pakistan categorically. The sample size is 22 banks out of 34. These 22 banks are comprised of all commercial public and private banks of Pakistan. The reason for selecting 22 banks out of 34 banks can justify as the remaining banks are foreign banks, microfinance banks, and Islamic banks. Foreign banks are not included in the sample size due to the non-availability of relations of foreign politicians with top management of foreign banks in Pakistan. And foreign banks are excluded due to the non-availability of required data. The banks not included in the research

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paper are microfinance and investment banks due to different operating activities in nature. Such banks also do not involve commercial lending, borrowing, and deposits. Islamic banks are also not included due to different operational structures from conventional banks.

Data description

The study relies on secondary data, with quantitative analysis being employed for the research. The data collection spans the last five years, from 2013 to 2017. The final dataset consists of panel data from 22 banks, ensuring a balanced representation across the 2013-2017 period. The reason of selecting 22 banks is that the remaining banks are foreign banks, micro finance banks and Islamic banks. Foreign banks are not included in sample size due to non-availability of relations of foreign politicians with top management of foreign banks in Pakistan. And foreign banks are excluded due to non-availability of required data. The banks which are not included in the research paper are microfinance and investment banks due to different operating activities in nature. Such banks also do not involve in commercial lending, borrowing and deposits. Islamic banks are also not included due to different operational structure from conventional banks. The key goal of this study is to take all marketable banks which are completely intricate in commercial loaning and withdrawals. To ensure the originality of the work, the data were double-checked and established the steadiness with the source. The convenience sampling technique has been used for data collection. Convenience sampling is indeed a non-probability sampling technique where samples are selected based on their ease of access or availability rather than through random selection from the entire population. This technique has been employed to ensure that the necessary data from sample banks is readily accessible for the research, facilitating the collection process.

Measurement of variables

The corporate governance index utilized in this study is adapted from Javed and Iqbal (2007). To construct a corporate governance score for the banks listed with PSX (Pakistan Stock Exchange), a board rating system incorporating multiple factors related to corporate governance is devised. This rating is derived from reports submitted by banks to the Securities and Exchange Commission of Pakistan (SECP), which are required disclosures for regulatory compliance. The designed index is outlined as follows: Each bank is evaluated based on twenty-one governance indicators, which are subsequently grouped into three main categories. These categories are: (1) board composition, which comprises eight factors; (2) ownership and shareholding of the board, consisting of seven factors; and (3) transparency, audit, and disclosures, comprising six factors.

First factor board composition includes board size and categories of directors, such as the number of executives, non-executive, nominee, or independent directors. Other include chairman-CEO separation, presence of outside directors, board attendance, outside directors' attendance, the existence of CFO, and minority shareholders among directors.

Second factors ownership and shareholding of the board encompass the presence of outside block holders, CEO as a shareholder, director ownership, chairman or CEO as a block holder, holdings of the top five shareholders, dividend policy, and staff benefits. Third factors transparency, audit, and disclosures include full disclosure of CG practices, auditor's payments, biographies of board members, disclosure of the internal audit committee, share ownership

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according to code requirements, and information on employee ownership. These factors are assessed through various aspects, such as the percentage of government nominees, the separation of chairman and CEO roles, the presence of independent directors on the board, and the attendance of board directors and independent directors at meetings. The second indicator, ownership and shareholdings, aims to gauge the extent of the board and management's alignment with shareholders' interests. The third indicator seeks to quantify the banks' public commitment to enhanced corporate governance. Components of this indicator include directors' biographies, comprehensive disclosure of corporate governance practices, information regarding employee ownership, and disclosure of auditor's payments.

To measure the political connection variable, data is collected by scrutinizing the biographies of board directors and executive boards of banks from audited annual reports. Such annual reports are audited by reputed audit firms and then published on website. Following the methodology outlined by Saeed et al. (2016) dummy variables have been creadted. Moreover, political connections variable is assigned a value of 1 if a bank has at least one politically connected official, and 0 otherwise. Return on Asset is used to measure the financial performance. ROA is the main ratio used to evaluate financial performance which is commonly used in accounting literature (Boubakri, Guedhami, et al., 2012; Ding et al., 2014; Su et al., 2013). It is computed as the ratio of net profit after tax to the bank's total assets (ROA = NPAT/TA).

Moreover, bank size, age, and deposit-equity ratio are used as the control variables. Bank size is measure by taking the natural logarithm of the bank's total assets while bank age is calculated based on the number of operating years since its establishment. Banks of varying ages may demonstrate unique cost structures, with older banks generally possessing more vigorous financial structures as compared to newer banks. The deposit-equity ratio is computed as the ratio of deposits to equity, signalling the proportion of deposits relative to equity. Deposits are decisive investments for banks as they are the main source of capital for lending funds to customers.

Data analysis

First of all, descriptive statistics and correlation analysis have been carried out to check the behavior of the data. The regression analysis is conducted using Gretl software, employing Pooled Ordinary Least Squares (OLS) to examine the effect of governance on bank performance and to test the moderating role of political connection.

Model specification

To empirically examine the effect of corporate governance on financial performance and analyzing the role of political connections, this study developed following econometric equation:

$$FP_{i,t} = \beta 0 + \beta 1(CG)_{i,t} + \beta 2(PC)_{i,t} + \beta 3(CG * PC)_{i,t} + \beta 4(FS)_{i,t} + \beta 5(BA)_{i,t} + \beta 6(DER)_{i,t} + \varepsilon_{i,t}$$

Where, FP represents the financial performance of banks, measured by return on equity (ROA), i represents each individual bank, and t represents the number of years considered as time; FP_{it} signifies the financial performance of bank i at time t. $\beta 0$ represents the constant, and β represents the coefficient. CG_{it} indicates corporate governance variables, including the size, composition, independence, and meetings of the board, as well as ownership, transparency, and auditing

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practices. PC_{it} stands for political connections and measures the political connections of financial institutions. CG*PC is developed as an interaction term to explain the effect of political connections on the relationship between corporate governance and financial performance. Control variables are also included in this model. BS represents the size of banks, which is calculated by taking the total assets of the bank. BA denotes the age of banks since their initial public offerings. DER stands for the deposit-equity ratio of banks, representing the ratio of deposits to equity held by banks in a given accounting year. ℇ is considered as an error term to account for other unobserved variables in this study.

Results and empirical findings

Descriptive statistics

Descriptive statistics shows the general behaviour of data including standard deviation and mean. Following table 1 presents the detail of descriptive statistics.

Table 1. Descriptive Statistics

	ROA	CGI	PC	SIZE	AGE	DER	CGPC
Mean	0.8299	29.7242	0.7273	5.8806	30.0000	10.3667	21.5819
Median	0.9100	30.6785	1.0000	6.0525	23.0000	9.6038	28.9274
Std. Deviation	0.8728	3.0452	0.4474	1.1301	21.5500	4.7450	13.5828
Kurtosis	2.6220	1.9076	(0.9468)	0.1305	(0.4994)	3.0993	(1.0435)
Skewness	(0.9516)	(0.9111)	(1.0348)	(0.5608)	0.9275	1.2128	(0.8945)
Minimum	(2.6600)	20.0000	-	2.9178	3.0000	2.4356	-
Maximum	2.6700	37.3780	1.0000	7.8951	76.0000	32.2121	37.3780

The mean value of ROA is 82.9%. It means the overall average return on assets is 82.99%. The average political connection is 72%. It indicates that 72% banking industry is politically connected. In other words, it can say that this percentage explains the governments' influence on the banking sector in Pakistan. The average value of the age of banks is 30 years. It shows that the average number of banks have worked in Pakistan for the last 30 years. Political connection is considered a dummy variable by assigning 0, 1 value. The reason for selecting values as 0 and 1 is because the political connection is regarded as a dummy variable. If there is the presence of political connections in the bank, then it is considered as 1, and if there is the absence of political connections in the bank, then it is considered 0. So due to this, it has affected the interaction term's minimum and maximum value. The average value of the Deposit equity ratio is 10 times in summary statistics. It explains that deposits are 10 times more than equity in the banking industry.

Correlation Analysis

Table 2 shows correlation matrix of the study variables. The positive coefficient indicates a positive association while negative coefficient suggests a negative correlation between variables.

Table 2. Correlation Analyses

	CGI	PC	Size	Age	DER
CGI	1				
PC	-0.0264	1			
Size	0.3302	0.1448	1		
Age	0.1193	0.1436	0.6540	1	
DER	-0.1358	0.02165	0.1907	-0.2988	1

The table provides a pairwise correlation among different variables. It has given information about each variable that how it is correlated with each other. The table shows that corporate governance has a negative correlation with political connections. It means that corporate governance has negative relation with political connections, which explains that if banks are politically influenced, then the corporate governance of banks is also affected. Corporate governance is negatively associated with political connection and interaction term while positively related with bank size and age. Political connections have a positive correlation with other control variables. Size as a control variable is also positively associated with control variables like age and deposit-equity ratio. Age is negatively correlated with the deposit equity ratio, but it positively correlates with an interaction term. Deposit-equity positively correlates with political connection, size, and the interaction term. Despite that, there is a negative relationship between the deposit-equity ratio, age, and corporate governance. By unfolding all correlation results, it is clearly shown that control variables (age, size, deposit-equity proportion) also have a positive association with political connection.

Regression Analysis

Pooled Ordinary Least Squares (OLS) has been run to investigate the effect of corporate governance on performance of banks and corporate governance with the moderation of political connections. Further an interaction term (CG*PC) has been created to estimate the moderating role of political connection in the relationship between corporate governance and bank performance. Table 3 shows the result of regression analysis.

Table 3. Result of Regression Analysis

	Coefficient	Std. Error	t-ratio	p-value	Sig.
Constant	38.552	11.806	3.2655	0.0014	***
CGI	0.9953	0.3759	2.6471	0.0093	***

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PC	-8.1115	2.545	-3.1866	0.0019	***
Size	-4.7371	1.7127	-2.7658	0.0067	***
Age	0.3697	0.0763	4.8461	0.0000	***
DER	-0.9043	0.3896	-2.3213	0.0222	**
CGPC	-0.2827	0.0816	-3.4629	0.0007	***
R-squared	0.7224				
P-value (F)	0.000				
Durbin-Watson	1.1754				

**** Level of significance at 1%*

*** Level of significance at 5%*

The coefficient of corporate governance index (CGI) is positive and statistically significant (p<.05). Keeping in view R-squared value, it can be stated that independent variables explain 72% financial performance of banks. Regression results also indicate a positive effect of corporate governance on financial performance (p<.05). Therefore hypothesis 1 has been accepted as it states that corporate governance positively and significantly impacts financial performance. Thesis finding is consistent with prior studies such as they documented that corporate governance mechanism positively influence bank performance (Bhatia & Gulati, 2021). A robust governance framework enhances the overall success and vitality of banks by facilitating prudent decision-making, bolstering shareholder confidence, adeptly managing risks, and fostering enduring sustainability. Further results indicate that political connection (PC) has a significant negative effect on financial performance (p<0.05). The negative and significant value of interaction term confirms moderation role of political connection.

Political connections can lead to unnecessary interference in the operational sovereignty of banks. Banks with political connection may have political goals that can result in lower performance (Chen et al., 2018; García-Meca et al., 2015). Political connection negatively affects the relationship of corporate governance and financial performance of banks. Hence hypothesis 2 has been also accepted as political connection negatively moderates the relationship between variables. It significantly converted the positive impact of corporate power into negative on financial performance through interaction terms. The effect of governance on financial performance is positive however when moderator political connect is included it becomes negative. It may be due to the political interference in decision making process. Banks with political connections may prioritize lending or investment decisions based on political affiliations rather than financial viability (Bhatia & Gulati, 2021). Galal (2017) also noted that the moderating variables considerably alter the link between bank governance and its performance.

Further analysis was accompanied with control variables, and it has shown that the Deposit to Equity Ratio has a significant negative impact on financial performance. It also shows that the size of banks has a significant negative impact on the performance of the banks. It is noted that the results of size explain that small size banks have better performance than the big banks. It is also noteworthy that the size of the bank has a negative relationship with financial

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performance. It means banks are not achieving their optimal level of assets. The results of another control variable age reveal that bank age positively and significantly impact bank performance.

Conclusion

The study investigated the relationship between corporate governance and the financial performance and assed the moderating role of political connection. Panel data have been collected and used to test the hypotheses. In line with previous studies a corporate governance index has been developed to measure the governance while return on asset has been used to measure financial performance. Regression analysis have been used to test the study hypotheses. The regression analyses indicated a positive association between bank governance and its financial performance, suggesting that good governance is likely to enhance the performance of banks. A stable governance contributes to the overall success and spirit of banks by advancing sound decision-making, increasing shareholder faith, managing risks effectively, and promoting long-term sustainability. Furthermore, the analysis unveiled that political connections have a negative impact on the performance of banks. Banks with political connections may prioritize political and other social objectives, potentially leading to decreased performance. Moreover, political connections also significantly and negatively moderate the relationship between governance and financial performance of banks, indicating political involvement in banking decision-making processes. Political connections may lead to interference in the decision making processes of banks as decisions and policies are influenced by political agendas rather than entirely business concerns.

Implications of the study

This paper has made a significant contribution to the current literature in many ways. Pakistan, in particular, has been affected by the strong influence of political interventions in the banking industry, which has affected its performance adversely. This political intervention is due to Pakistan's weak and unstable political system. Thus,

- The result of this paper will allow academicians, investors, and various banking industry stakeholders to gain helpful knowledge to improve its financial performance.
- Based on findings and analysis, lawmakers, regulators, and policymakers are suggested to implement strict control over the decisions, plans, and strategies made by directors, who have political connections to increase the banking performance in Pakistan.
- SBP, a central bank, should implement policies for extending loans at a lower interest rate and adopt different measures for politically connected firms so that overall economic growth may be achieved.
- Furthermore, the analysis of the results suggests that the deposit to equity ratio and bank size negatively influence the performance of banks. In contrast, the bank's age has a significant positive effect on the financial growth of banks. As a result, it has been recommended that banks maintain deposit-to-equity ratios at a level that does not negatively impact the firm's profitability.
- The number of years of establishing banks, as measured by the age of banks in years, increases their financial performance. It means that experienced banks have the expertise to manage their assets efficiently.

- Better financial performance of banks will increase the profitability of banks, and it will lead to performing corporate social responsibility (CSR) activities.
- Banks in Pakistan can enhance customer relationships by offering benefits such as discounts on food, electronics, and other household items through debit or credit cards.

Limitations, Recommendations, and Future Directions

This study has comprehensively considered the important variables such as corporate governance, political connections of banks, and the Pakistani banking industry's financial performance. However, there are certain limitations. This paper has been conducted on the banking industry of Pakistan by taking five years of dataset. Future researchers may expand this dataset to include additional years for a more comprehensive understanding of the research topic. Furthermore, there were certain limitations while developing the corporate governance index due to Governance Code 2017. It is recommended that those developing countries where characteristics of the banking system closely resemble the banking system of Pakistan may apply these results in their countries. In this study, three main characteristics of corporate governance are considered.

These characteristics serve as the basis for the corporate governance index (CGI). They include the composition of the board, ownership structure, transparency and shareholdings, auditing practices, and disclosure of corporate governance practices. In the future, additional characteristics may be examined to further explore corporate governance. This research included ROA as a proxy of performance. Future studies could explore alternative measures and variables such as return on equity (ROE), gross profit margin (GPM), return on capital employed (ROCE), net profit margin (NPM), among others. Additionally, researchers may conduct comparative analyses across various industries and countries to enrich the understanding of financial performance dynamics.

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