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Impact of Corporate Governance Practices on Financial Performance of Listed Companies in Papua New Guinea

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Abstract. *The main purpose of this research is to examine the impact of corporate governance practices on the financial performance of listed companies in Papua New Guinea from 2018 to 2022. The corporate governance practices are established to monitor and evaluate the conduct of the management of the public listed companies. The Corporate governance charter is established in Papua New Guinea as part of the best practice to assist decision-making on the board of directors. The attributes of corporate governance practices of this study are at the board size, board diversity and the frequency of board meetings. The literature review of the study covers the theoretical framework and research attributes. This study has selected a list of 7 companies out of the twelve companies in Papua New Guinea, where the capital market has very limited growth in the country. A quantitative research approach was employed to conduct this study and using the secondary data for this research. The secondary data were collected from the respective listed companies' websites and those data are error-free since the financial statements of the listed companies were audited by external auditors. A total of 35 annual reports of the listed company were collected for the research and a convenient sample method is employed for the study. The overall findings of this research have established positive relationships between the board size and the board diversity with the return of equity. The negative relationship was established between board size, board diversity with the return of assets and the Tobin-Q respectively. Furthermore, the negative relationships were identified between the frequency of board meetings with return of assets, equity and the Tobin-Q respectively. The study has indicated that the frequency of board meetings had increased substantially during COVID-19 to mitigate contingency risk. The findings of this study can be used by the regulatory body and listed companies to enhance the effectiveness and efficiency of corporate governance practices so that the overall corporate governance practices could be improved in the future.*

Keywords: Corporate governance practices, financial performance, board size, board diversity and frequency of board meetings.

JEL Classification: G30, G38 & G39.

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Introduction

Papua New Guinea is the third biggest island in the world and gained its independence from Australia in 1975. Papua New Guinea is rated as a faster-growing economy in the South Pacific Islands with enormous natural resources. Papua New Guinea has well-diversified culture with more than 800 languages-speaking people living in the country. Papua New Guinea National Stock Exchange (PNGX) has 12 listed companies as of December 2022. Corporate governance has been an emerging concept in Papua New Guinea since its early stage for the listed companies. However, some companies are dual-listed on the Papua New Guinea

National Stock Exchange and in Australia or the United Kingdom Stock Exchanges. So, those listed firms are well aware of the code of corporate governance practices.

The PNG National Stock Exchange, Securities and the Exchange Commission of Papua New Guinea has issued the corporate governance charter. The charter emphasizes on the best corporate governance practices, its role and responsibilities in their conduct of the business operations. Corporate failures in global business have taught lessons to the regulators to establish tougher rules and regulations on corporate governance practices. The establishment of the corporate governance charter has helped to avoid corporate scandals in the future.

The listed companies in Papua New Guinea are the major contributors of the Gross Domestic Production. These entities are nationally recognized entities so all financial operations need to be conducted in a transparent manner. The listed companies are the major industry players of the banking and finance, mining, oil exploration, real estates and retailing etc. All of these listed companies are leaders in their respective industries. Therefore, the main objective of this study is to investigate, on how the impact of the corporate governance practices has on the financial performance of the listed companies in Papua New Guinea from 2018 to 2022.

This study examines the impact of the corporate governance practices on the financial performance. The corporate governance practices are highly influential factors for success of any listed entity. The implementation of the best practices of corporate governance implies the best conduct of business operation in the corporate world. The corporate governance practices ensure the business transactions are done in transparency, accountability and in a responsible way. Further, the corporate governance system outlines the role and responsibility of the stakeholders of the listed entities. Strategic decision of the entity is taken in the board level and it focuses for the foreseeable future of the entities. The self-regulated provisions are established in the corporate governance charter and it helps to conduct business in a professional and ethical way without compromising.

The best practices of the corporate governance help to attract more investors locally and internationally. The effective implementation of the best corporate governance practices reduces the agency cost and it creates more on the entity's valuations also in the maximization of the return of investment for the shareholders. The top management interests are in the entities for their maximum benefits while the shareholders' interests are focused on the creation of wealth, so there is conflict of interest between both parties. Therefore, the corporate governance practices play as a mediator between the principal and the agent to resolve conflicts of interest.

Furthermore, education and training have to be conducted for the board as the top management need to improve their understanding of the roles and responsibilities towards the best practices of corporate governance.

1. The Statement of Problem

There has been no study being conducted on corporate governance practices and the financial performance in Papua New Guinea so this study will fulfill the knowledge gap as a pioneer study in the country. Thus, this study has become the pioneering study in Papua New Guinea. Furthermore, the effectiveness and efficiency of the corporate governance charter of Papua New Guinea have not been tested yet, as this research will help to examine the outcome of the corporate governance charter implementation. In addition to the above, most of the previous studies ended with mix results between corporate governance practices and the financial performances of the listed companies. This study will be complementary to the existing literature review.

2. Theoretical Framework

Corporate governance practice emerged due to various theories and these theories appear from different perspectives.

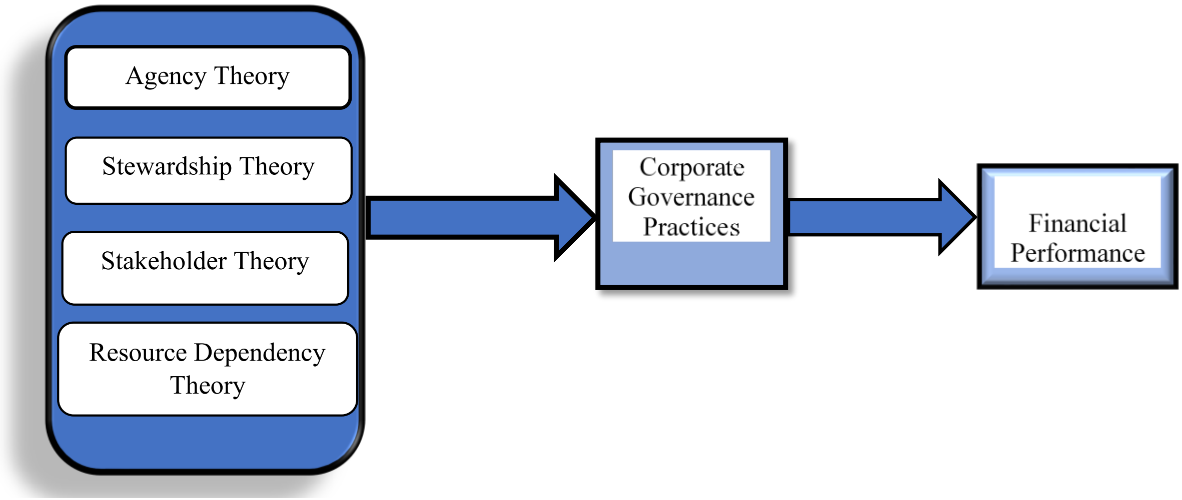

Figure 1. Theoretical Framework on Corporate governance practices and the financial performance

Source: Compiled by the author.

2.1. Agency theory

Agency theory explains the conflict of interest between the principal and the agent of the entities. This theory outlines the two main problems of the agency costs and the information asymmetry (Edogbanya & Kamardin, 2015). The established corporate governance charter of Papua New Guinea could minimize agency costs and information asymmetry. The principal commits to look after the agent's interest in order to produce the best result for the entities. The principal provides more incentives to the agent to balance both party's interests and benefits. The corporate governance practices act as a mediator between the principal and the agent to reduce agency costs and information asymmetry. Thus, the best-established corporate governance practices can reduce the conflict of interest between the agent and the principal.

2.2. Steward theory

Steward theory is the opposite of the agency theory. The management of the entities are more concerned with the shareholders interest and their welfare than in improving the financial performance (Edogbanya & Kamardin , 2015). The management of the listed companies ensures that shareholders achieve their goals. Steward theory argued that the delegation of authority enhances the overall performance of the entities. The board of directors consists of technical experts and they are independent to help improve the financial performance.

2.3. Stakeholder Theory

Stakeholder theory focus on the need to consider stakeholder's interest in decision-making process. Stakeholder theory emerged recently due to the changes in the pattern of business operations. The corporate governance practices make sure that all business transactions are taking place without any conflict of interest between parties (Alqatamin, 2018; Haddad , Ammaris , & Bouri, 2021).

2.4. Resource Dependency Theory

This theory emphasizes that adequate resources should be provided to the organization in order to achieve the best financial performance (Edogbanya & Kamardin , 2015; Alqatamin, 2018). Without adequate resources, the entities cannot achieve the best financial results. The resources of the listed companies are not all the same, but they are different from one to another. Thus, the financial results of the listed companies are then not thesame.

3. Literature Review and Hypotheses

This research on corporate governance practices and the financial performance of the listed companies in Papua New Guinea is designed and developed based on the existing studies of different countries. The key attributes of the corporate governance practices are the board size, board diversity and the frequency of the board meetings with their impact on the financial performances of the companies.

3.1. Board Size

The size of the board enhances the effectiveness and the control in corporate governance practice of the entities. The relationship between the size of the board and the organizational financial performance is inconclusive. Different arguments were raised for the size of the board. Some of the previous studies were supporting smaller sizes for the board to make effective decisions with the course of action. Other scholars expressed that, the larger the size of the board with diversity of board members with their skills and knowledge can help make effective decisions. However, sometimes the decisions cannot be made due to different opinions and arguments from the larger size of the board members resulting with no decision. The large size of the board, agency problems increase within the corporate governance practice (Balagobei & Velnampy, 2018).

A negative relationship was established in the previous studies between the board size and the firm's performance. According to Qeshta, Alsoud, A. Hezabr, Ali, & Oudat, 2021 study established there was no relationships between these two variables. Thus, the previous studies ended up with mixed results. This study will be a complement to the future research. Furthermore, the dependence theory argues that more resources are needed and should be provided to the corporate governance practices so that it has positive impact on the entity's performance. Therefore, the board members perform to the best with interest and use their experiences with the right board size, knowledge and skills to achieve the best results through their performance for the organizations as well as in the best of interest for the entities.

3.2. Board Diversity

Board diversity has emerged in research area in the corporate world. Most of female have started to involve decision processes in the recent years which led to change in board diversity proportion in the corporate governance practices. Papua New Guinea has been advocating gender equity in all aspects of the society. The National Parliament of PNG has passed legislation to reserve more seats for the women candidate for the national election. In this context, females have emerged to the top position in the country. Few listed public companies have included female directors on the board (Kina, 2022 BSP, 2022). The Security and Exchange Commission of Papua New Guinea has issued its diversity policy on the 3rd edition of corporate governance charter in 2014. Women have been featured for caring for the people and family members so once, they enter the board they shall protect shareholder interest in all aspects (Chacko & Kumar, 2020).

Women directors on the board can add more added value on transparency, strong strategic decision, effective monitoring system, more creativity, innovation and a rational function to improve the performance of the business (Solimene, Coluccia, & Fontana, 2017).

Empirical studies showed a small number of females on the board (Klettner, Clarke, & Boersma, 2016). Further, studies confirmed that women have less than 1 percent of the board composition in Papua New Guinea (Alphonse. 2019; Pacific, 2020).

However, female participation on the board have increased dramatically in recent years based on the annual report of the listed companies in Papua New Guinea. This indicates more studies are required for gender diversity on the board level. The contribution of women to the workforce has increased dramatically.

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However, the top-level female representations to the board are much lower globally (Campbell & Bohdanowicz, 2015).

Recent studies have concluded that no correlation is established between gender diversity and firm financial performance (Rahman & Saima., 2018).

3.3 Frequency of board meetings

The numbers of board meetings determine the effectiveness and the efficiency of the corporate governance practice. Indeed, increased numbers of the board meetings enhance monitoring and evaluation of the organization's financial operations (Haddad , Ammaris , & Bouri , 2021). The board should meet at least three times a year. The planned meetings with time intervals ensure that right decisions are made at the right time.

The well-structured and organized meetings of the board enhances the strategic outlook process and internal control system. The effectiveness of the corporate governance practices is mainly dependent on the monitoring and evaluation of the business operation. Furthermore, it provides recommendations to improve the business operation system. Frequency board meetings signals the management of the entities that all business operations are examined, and corrective measures are taken.

Most of the previous studies have established the relationship between frequency board meetings and the firms' financial performances (Balagobei & Velnampy , 2018; Haddad , Ammaris , & Bouri, 2021).

The corporate governance charter plays a major role in the corporate governance after the global corporate entity's failure. An integral part of the corporate governance practice is the firms' direction, control and accountability. The corporate governance charter mainly considers the aspects of strategic outlook of the entities. This paper has exposed the board size, board diversity and frequency of the board meetings and its impact on the financial performance. All in all, frequency of board meeting increased dramatically during the COVID-19 periods since persist uncertainty of business environment and assess risk of the core business operation.

The following hypothesis has developed for the testing of the association between the financial performance and attributes of corporate governance practices.

H1: There is no relationship between the board size and the firms' financial performances.

H2: There is no relationship between the board diversity and the firms' financial performances.

H3: There is no relationship between the frequency of board meetings and the firms' financial performances.

3.4. Conceptual framework

The conceptual framework outlines the main independent variables of the board size, board diversity and frequency on board of meetings. The financial performance of the listed companies is measured using tools such as the return of assets, return of equity and Tobin Q and furthermore, this study uses firm size as a control variable.

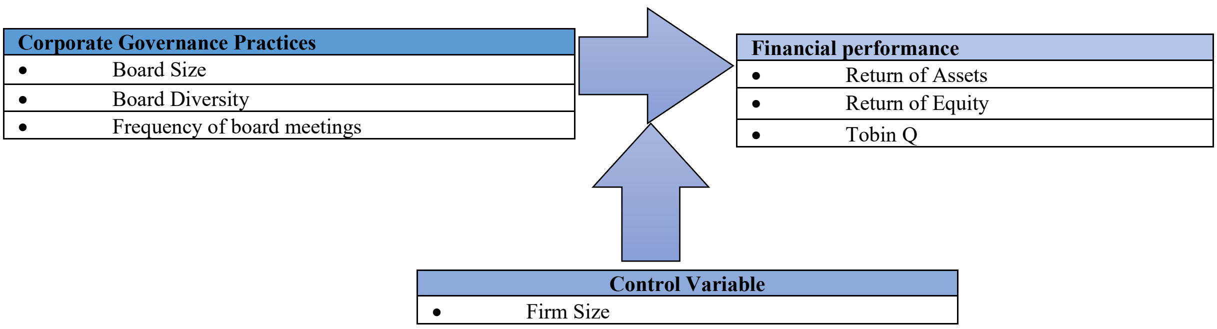

Figure 2. Conceptual Framework on Corporate Governance practices and the financial performance

Source: Compiled by the author.

4. Research Methodology

4.1 Sample and Data

The population of this research are the listed companies in PNG National Stock Exchange. Twelve companies are listed on the stock exchange however seven of them are selected for this study. This research is based on the quantitative data and the published financial statements are used as secondary data. The annual report of the listed companies is obtained from the respective companies' websites and further, this study has covered the period from 2018 -2022. The most important thing for this research is that the data must be reliable and valid since used the auditing financial statements. A total of 35 annual reports of the listed company were collected for the research and a convenient sample method is employed for the study. Therefore, data used in this research is reliable and valid without any errors. The researcher is confident that all data has been cross-examined within the available data and information.

4.2 Selection of Financial Performance tools and Control variables

Different assessing tools were used to evaluate the financial performance of the listed companies. Most of the previous studies used Return of Assets (ROA), Return of Equity (ROE) and Tobin Q (Abu Zraiq & Fadzil , 2018; Al-Jalahma, 2022). There is no universal accepted method to assess the financial performances of the listed companies. This study has selected two accounting methods and a market measurement to evaluate the financial performance. Most of the previous studies are highly recommended for use in the market measurement method since it is a realistic valuation for the business within the current market.

Table 1 designed to identify of the different types of variables and measurement of each variable to establish the relationships between them.

Table 1. Framework of Variables

Concepts	**Variables**	**Measurements**
Corporate Governance Practices	Board Size	Numbers of the Directors in the Board
	Board Diversity	Numbers of female directors in the board
	Meetings	Numbers of meeting in a year.
Financial performance	Return of Assets Return of Equity Tobin Q	Net Profit/ Total Assets Net Profit /Total Equity Market Value/ Total Assets
Control Variable	Firm size	The natural logarithm of total assets

Source: Compiled by the author.

4.3 Empirical Results

Table 2 of descriptive analysis represents independent, dependent and control variables for the period 2018 to 2022.

Table 2. Descriptive Analysis

	Board Size	Board Diversity	Frequency of Board Meetings	Return of Assets	Return of Equity	Tobin Q	Firm Size
Mean	8	2	7	0.03	0.12	1.13	15.23
Median	9	2	7	0.04	0.11	0.39	14.37
Maximum	10	4	12	0.07	0.28	3.86	18.81
Minimum	5	1	4	-0.06	-0.05	0.17	12.40
Range	5	3	8	0.13	0.33	3.69	6.41
Standard Dev.	1.68	1.41	3.25	0.04	0.10	1.57	1.94
Skewness	-1.20	0.00	0.50	-1.87	0.62	1.97	0.34

Source: Compiled by the author.

The table 2 indicates the average number of the board size is 8 while the minimum and maximum of board sizes are 5 and 10 respectively. The standard deviation of the board size is 1.68 in the list of public companies in PNG National Stock Exchange.

The average number of the board diversity in the board is 2 while the maximum number of the independent member is 4 and the minimum number is 1 in the public listed companies in Papua New Guinea. The standard deviation for the board diversity is 1.41 and the range is 3 members for the listed companies.

The average numbers of the meeting held by the board of directors is 7 while the maximum and minimum number of the meeting are 12 and 4 respectively for the listed companies in Papua New Guinea. The standard deviation for the numbers of meetings is 3.25 and the range is 8 for the same list companies.

The average returns on assets and equity are 0.03 and 0.12 respectively. The maximum for returns on assets and equity is 0.07 and 0.28 respectively. The minimum for returns on assets and equity ends with negative figures of 0.05 and 0.06 respectively. The standard deviation of return of assets and return of equity end up with 0.04 and 0.10 respectively for the public listed companies.

The average of Tobin Q is 1.13 while the maximum and the minimum are 3.86 and 0.17. The control variable of the average firm size is 15.83 and the standard deviation is 1.83. The maximum and minimum size of firms are 18.81 and 12.83 respectively for the listed companies in PNG.

4.4. Correlation Matrix

The above method computation is performed to identify relationships between variables which determine the association between the corporate governance practices and the financial performance.

Table 3. Correlation Matrix

Variables	Board Size	Board Diversity	Frequency of Board meetings	Return of Assets	Return of Equity	Tobin Q
Board Size	1.00					
Board Diversity	0.00	1.00				
Frequency of Board Meetings	0.00	0.00	1.00			
Return of Assets	-0.31	-0.16	-0.67	1.00		
Return of Equity	0.27	0.50	-0.56	0.61	1.00	
Tobin Q	-0.55	-0.86	-0.13	0.25	-0.21	1.00

Source: Compiled by the author.

The table 3 indicates the correlation matrix between independent, dependent and control variables. The relationship between board size with the return of assets and Tobin Q are negative, however, a positive relationship exists between board size and the return of equity. Negative relationships are established between board diversity with return of assets and Tobin Q respectively. Nevertheless, the positive relationship is established between board diversity with the return of equity. Furthermore, the correlation matrix establishes the negative relationship between the frequency of board's meeting with the return of assets, equity and Tobin Q respectively.

4.5. Hypothesis Testing

Hypothesis testing is a form of statistical inference that uses data from a sample selected in this study to determinate the conclusions about a population parameter. Testing of the three hypotheses as part of the data analysis. The table 4 is a correlation matrix and is constructed based on the average financial performance which is against the indicators of the three independent variables. The average financial performance calculation- is based on ratios of returns of assets and equity and Tobin Q to find out the overall financial performances of the listed entities.

Table 4. Correlation matrix: Financial performance and Corporate Governance practices independent variables

	Financial Performance	Board size	Board diversity	Frequency numbers of board meeting
Financial Performance	1.00			
Board size	-0.55			
Board Diversity	-0.86	0.85	1.00	
Frequency numbers of board meeting	-0.15	-0.35	-0.15	1.00

Source: Compiled by the author.

The p-value analysis is performed to examine the validity of the hypothesis made in this study. The average financial performance measured is based on the returns of assets, equity and Tobin Q. The following p-values are computed for the study. It is obvious there are negative correlation between and financial performance and the three independent variables. Table 5 is constructed with “p” values corresponding with the “r” value of the data analysis that has to be executed.

Table 5. Coefficient of correlation and P values

Variables	“r” value	“P” Value
Board size	0.28	0.65
Board Diversity	-0.79	0.33
Frequency of Board meetings	-0.02	0.75

$P < 0.05$

Source: Compiled by the author.

Hypothesis Testing One:

The conclusion of null hypothesis one “There is no relationship between the board size and the firms’ financial performances” is not rejected, as p value 0.65 which is more than 5% is statistically not significant. Further it establishes the weak positive association between two variables. Therefore, it can be concluded that there is no relationship between the board size and the firms’ financial performances at 5% significant level.

Hypothesis Testing Two:

The conclusion of null hypothesis two of “There is no relationship between the board diversity and the firms’ financial performances” is not rejected as p value 0.33 which is more than 5% is statistically not significant. Therefore, it can be concluded that there is no relationship between the board diversity and the firms’ financial performances at significant 5% level.

Hypothesis Testing Three:

The conclusion of null hypothesis three of “There is no relationship between the frequency board meetings and the firms’ financial performances” is not rejected as p value 0.75 which is more than 5% as statistically not significant. Therefore, it can be concluded that there is no relationship between the frequency of board meetings and the firms’ financial performances at significant 5% level.

Conclusion

The corporate governances’ practices of the public listed company have become a core part of business to maintain transparency and accountability in the business operation. The main objective of this study is investigating the impact of corporate governance practices on the financial performances of the listed companies in Papua New Guinea. The various attributes of the corporate governance practices considers board size, board diversity and frequency of board meetings and financial performance, which are measured by the return of assets, equity and Tobin Q. The overall findings of this study have established positive relationships between the board size and the board diversity with the return of equity. The negative relationship was established between board size, board diversity with return of assets and Tobin-Q respectively. The finding of this study can be used by the regulatory body and companies to enhance the effectiveness and efficiency of the corporate governance practices so that the overall corporate governance system could be improved.

Future studies could conduct the quality aspect of the corporate governance practices and its impact on financial performance of the listed companies. The financial performance depends on the quantity and quality factors of entities. The author sums up that corporate governance has not taken adequate control mechanisms on the strategic level which has led to corporate failure globally. The success of the corporate governances' practices depends on the degree of independence and not being window dressing. The best practices of corporate governance are well-recognized in the corporate world.

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