
DO CORPORATE GOVERNANCE “ACTORS” FEATURES AFFECT BANKS’ VALUE? – EVIDENCE FROM ROMANIA

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Abstract:

The purpose of our empirical study is to identify and discuss the influences of various features of corporate governance “actors” over strategies followed and performances reached in Romanian banking system. The features considered for analysis refers to provenience, size, independence and gender diversity of executive management and board of directors, as well as to provenience, structure, origin and concentration of shareholders.

The research methodology used for achieving our goal is based on econometric analysis using various statistical tools, like correlations for identifying the relationships between independent and dependent variables, and regressions for developing the models revealing how corporate governance characteristics influence banks value and their business strategy.

The results of the performed analysis reveal positive correlations between banks’ traditional strategies and performances, and foreign corporate governance (board of directors, executive management and shareholders), made majority by male members, where CEO duality avoidance is ensured, the board of directors is entirely independent and the majority of shareholders are coming from European Union members states. The only negative correlation appeared to be between shareholders structure and banks value, revealing that those banks that still have individuals within its ownership performed lower.

Keywords: corporate governance, banking, performance, Romania

1. Introduction

Corporate governance has become one of the most debated subject, especially in banking environment, as a consequences of the latest financial crisis that spread all over the world. In fact, this crisis made from corporate governance a controversial economic concept, bringing it as well to the attention of media and academic environment, and thereby becoming the most challenging topic of worldwide research. Many studies focused on corporate governance mechanism analyzed its components closely related to successes reached or unavoidable failures, concluding that weak corporate governance system negatively affect firm value, while strong governance mechanism improves efficiency.

Basing on this background, our paper aims to provide a comprehensive overview of possible influences that key players of corporate governance – board of directors, executive management and shareholders, might have on financial institutions' "road" to success, revealing as well how various features of these "actors" are affecting Romanian banking system. Unlike prior research studies which were focused on similar goals - to test possible influences of corporate governance on firms' value, our paper provides a particular approach on a specific business field, the banking one that was little explored on this topic before. Moreover, our research provides a more comprehensive approach of corporate governance impact over banks' road to success, considering not just performances reached, but also the strategies followed, ensuring by thus originality, which is adding value to our study.

The paper proceeds as it follows. Firstly, we briefly review prior literature concerning possible relationships between main "actors" of corporate governance and firms' value often expressed by their performance. We continue our study by developing particular hypotheses related to corporate governance influences over financial institution's efficiency in case of Romania. After explaining in detail the data collection method and empirical analysis design, we test our hypotheses using information from sampled banks' websites and we developed two models revealing significant influences of corporate governance features over strategies followed and performances reached in Romanian banking system. Finally, we provide our research findings and discuss their implications, closely related to previous studies focused on the same goal.

2. Literature review

The prior international literature provides various surveys on corporate governance impact over firms' value, by testing the influences that features of the board of directors, executive management or shareholders, such as their size, independence, foreign character or gender diversity, might have on their efficiency.

Their findings often appeared to be opposite and, consequently, we cannot talk yet about a "unique" model of good corporate governance. Thus, even if it has been widely agreed that a small board of directors made of maximum seven or eight people can help improve performance (Jensen, 1993; Lipton and Lorsch, 1992), on the other hand, there are controversial opinions as regards its independence, some authors considering outside directors as "a good thing" (Fama and Jensen, 1983), while others identifying a little or no association between board independent structure and performance (Klein, 1998; Weir et al., 2002; Pi and Timme, 1993; Adams and Mehran, 2004).

Moreover, there are studies conducted over time in various countries (France, Germany, UK, Switzerland, Malaysia, Hong Kong), whose findings generally suggest that leadership structure showed any relation with firm performances (Franks and

Mayer, 1990; Shamsul, 2004; Schmid and Zimmermann, 2008; Lam and Lee, 2008).

Prior literature focused on assessing “size” as a feature of corporate governance show a fairly clear negative relationship between board size and entity value, many authors arguing that large boards are less effective and difficult to coordinate (Yermack, 1996; Eisenberg et al., 1998; Fernández et al., 1997; Belkhir, 2009; Hermalin and Weisbach, 2003).

“Independence” is another important feature of corporate governance that has been widely studied at international level along time. Many empirical papers aimed to analyze the effect of board structure, assessed through members’ independence on firm value, show positive influences in this respect (Weisback, 1988; Rosenstein and Wyatt, 1990; Mehran, 1995; John and Senbet, 1998; Agrawal and Knoeber, 1996), arguing that managers will be more effectively monitor, thus reducing opportunistic managerial behaviors and expropriation of firm resources. But there are also opinions that stated otherwise, therefore associating “outside” members of the board with weak corporate governance, that might negatively affect performances and the flow of information between board of directors and management (Fich and Shivdasani, 2006; Adams and Ferreira, 2007; Harris and Raviv, 2008; Coles et al., 2008).

Similar associations have been made along time between top executive management independence and firm value. This time, the most evidences show that chief executive officer’s duality negatively affects performances (Brickley, et al, 1997; Palmon and Wald, 2002), sometimes in an indirect way, by decreasing the ability to effectively monitor investments or the reliability of accounting information (Jermias, 2007, Tsui et al., 2001, Leung and Horwitz, 2010). However, there are researchers appreciating that CEO’s duality might enhance financial performances (Faleye, 2007).

Opposite findings have been reached as regards “foreign character”, too, which was often analyzed as regards ownership. Thus, there have been identified positive influences over business values from foreign ownership in developing countries (Nada, 2005; Bonin et al., 2003; Claessens et al., 2001; Demircuc-Kunt and Huizinga, 1999) and negative influences in developed economies (DeYoung and Nolle, 1996; DeYoung and Hasan, 1998).

“Gender diversity” is a relatively new topic of interest in corporate governance literature and it is mainly due to the latest financial scandals, starting in 2001 with the case of Enron, when it became a subject of interest for those researchers focused on the board of directors (Williams, 2003; Burgess and Fallon, 2003; Singh, 2007; Werhane, 2007), their results often revealing a growing concern about the lack of heterogeneity in the composition of boards. This feature lead to controversial findings, too, while female directors performed better and companies’ financial results were higher, senior leaders proved to have a positive influence over the quality of reported earnings (Krishnan and Parsons, 2008), unlike female management (Shawver, et. al., 2006).

The above mentioned findings are just a few examples of controversies related to corporate governance, which allow us agreeing with some authors’ statement, who appreciate that its “size, composition and structure can be good or bad, depending on

what you are looking for” (Gup, 2007) or, moreover, who consider that there is an optimal corporate governance structure “which varies across firms and over time” (Dahya and Travlos, 2000).

Corporate governance in banking environment has proved to play a different role due to its particularities related to liquidity function, opacity of the balance sheet, complexity of activities run or stakeholders’ variety. All these aspects increased the researches interest in measuring corporate governance influences over banks’ value (Bonin et.al., 2003; Nada, 2005; Kyereboah and Biekpe, 2006; Pathan, 2009; Pathan and Skully, 2010), thereby offering us an outlook for research.

3. Hypotheses development

Thus, basing on previous findings on corporate governance influences on firms’ value in general and considering the conclusions already reached on banking environment, we formulate our first hypotheses related to Romanian banking system:

H1: Financial institutions’ performances are influenced by various features of corporate governance.

Moreover, banks proved to be different than other entities due to the complexity that characterizes their activities made of a combination of traditional banking operations (interest income based operations, such as taking deposits and issuing loans) and non-traditional ones (commissions and fee-based operations, such as securities trading and underwriting). A study conducted in this respect (Boot and Schmeits, 2000) proved that the increasing variety of banking transactions has opened up new opportunities for passing from relatively low-risk relationship banking activities to more risky trading activities. Thus, these different strategies created new challenges in bank corporate governance (Westman, 2009), being also a source of inspiration for our study and therefore allowing us formulate the second hypotheses:

H2: Financial institutions’ strategies (traditional/non-traditional) are influenced by various features of corporate governance.

4. Research design and results

Sample Selection and Variable Measurement

For achieving our goal, we selected a sample of financial institutions that are running their activities in our country (80%), depending on the availability of information

needed on their websites, which was the main source of information for our research.

For performing the analysis we considered three corporate governance key-players: board of directors, executive management and shareholders. For each of them we selected a series of characteristics, that will stand as independent variables, in order to assess their influence on banks' performances and strategies (dependent variables).

In this respect, we considered various features, part of them being tested before, such as foreign character (Oxelheim and Randoy, 2003; Choi and Hasan, 2005; Gulamhussen and Guerreiro, 2009), gender (Krishnan and Parsons, 2008; Shawver, et.al., 2006), size (Hermalin and Weisbach, 2003; Belkhir, 2009; Yermack, 1996; Eisenberg et.al., 1998) and independence (Faleye, 2007; Ferris et.al., 2003; Pi and Timme, 1993).

Thus, the independent variables used for performing the empirical analysis are presented in Table 1.

TABLE 1 Independent variable description

Corporate governance "actor"	Variables	Description
<i>board of directors</i>	<i>provenience</i>	<i>BP</i> percentage of foreign directors
	<i>gender</i>	<i>BG</i> number of male members
	<i>size</i>	<i>BS</i> number of members
	<i>independence</i>	<i>BI</i> outside members
<i>executive management</i>	<i>provenience</i>	<i>MP</i> percentage of foreign directors
	<i>gender</i>	<i>MG</i> number of male members
	<i>size</i>	<i>MS</i> number of directors
	<i>independence</i>	<i>MI</i> CEO's status
<i>shareholders</i>	<i>provenience</i>	<i>SP</i> percentage of foreign ownership
	<i>origin</i>	<i>SO</i> EU majority ownership
	<i>structure</i>	<i>SS</i> presence of individual ownership
	<i>concentration</i>	<i>SC</i> percentage in equity

For testing our first hypotheses, we had to decide which independent variables to use as a measure of performance. One of the most frequent proxy used in prior literature was Tobin's Q (the market value of equity plus the market value of debt divided by the replacement cost of all assets), some researchers using various modified forms of Tobin's Q indicator.

Because it was difficult to get the required information relating to the market value of sampled banks, since these are not all listed and such information are not usually disclosed in their financial reports, we decided to use ROA (Return on Assets) and ROE (Return on Equity) as proxies for banks performances, these variables being often used in prior related research, too.

For testing our second hypotheses, we appreciated the nature of strategy followed, by making difference between the traditional one, mainly made of interest incomes and the non-classical one, focused on riskier activities, such those with securities.

Accordingly, the dependent variables considered for the performed analysis are presented in Table 2.

TABLE 2 Dependent variable description

Dependent variables		Variables description	
<i>Performance</i>	Return on Assets	<i>Perform.ROA</i>	ratio between net profit and total assets
	Return on Equity	<i>Perform.ROE</i>	ratio between net profit and equity
<i>Strategy</i>		<i>Strateg</i>	ratio of net interest / non-interest income to total assets

The research methodology used, appropriate for such empirical studies, is based on econometric analysis using SPSS software. Thus, firstly, we established the correlations between dependent and independent variables selected, testing as well their significance. Then, we developed two functions, using linear regression, which reflect each considered factor' s influence over banks' performances and strategies.

Data analysis and hypothesis test results

For performing the correlation analysis, we calculated Pearson coefficient that is usually used for measuring the strength of linear dependence between two variables, giving a value between “1”, that describes the perfect direct relationship and “-1”, that reveals an indirect one, “0” value meaning that there is no linear correlation between variables.

Table 3 shows the values of Pearson correlations among all considered variables:

TABLE 3 The correlation matrix between variables

<i>Independent</i>	Board of directors			
<i>Dependent</i>	BP	BG	BS	BI
Strateg	.624**	.742**	.167	.700**
Perform.ROA	.461*	.287	-.263	.250
Perform.ROE	.482*	.491**	.090	.491**

<i>Independent</i>	Executive management			
<i>Dependent</i>	MP	MG	MS	MI
Strateg	.593**	.700**	-.177	.624**
Perform.ROA	.593**	.850**	-.063	.472*
Perform.ROE	.535**	.661**	-.138	.542**

<i>Independent</i>	Shareholders			
<i>Dependent</i>	SP	SS	SO	SC
Strateg	.521**	-.632**	.562**	.078
Perform.ROA	.674**	-.474*	.399*	.280
Perform.ROE	.526**	-.478*	.356	.271
** . Correlation is significant at the 0.01 level (2-tailed)				
* . Correlation is significant at the 0.05 level (2-tailed)				

By analyzing the values of Pearson's coefficient we reached to the following conclusions:

- board of directors features, like gender, independence and provenience, proved to have the strongest influence over strategies (0.742; 0.700 respectively 0.624), being significant with a high probability of 99% (Sig. <0,01), while performances expressed by ROA are influenced just by provenience, in a medium extent (0.461) and with a smaller probability of just 95% (Sig. <0,05). There have been also identified correlations of medium intensity between the same board characteristics already mentioned above and the other measure of performance – ROE. Board size proved to be the only feature that did not have a significant influence over banks performances and strategy, thus being excluded for the rest of the analysis.
- executive management, which was analyzed from the same perspectives as the board of directors, proved to have similar influences over strategy and performance expressed by ROE. As regards ROA, correlation coefficients reveal significant influences with a high probability of 99% (Sig. <0,01) from gender (0.850) and provenience features (0.593), while management independence have a medium influence over ROA (0.472), being significant with a probability of 95% (Sig. <0,05). Management size was excluded from the rest of the performed analysis, basing on the same criteria of insignificant influences over dependent variables, as in case of board of directors.
- shareholders provenience is the only independent variable that influenced both banking strategies (0.521) and performances (0.674 for ROA and 0.526 for ROE), being significant with a high probability of 99% (Sig. <0,01) in all cases. Medium intensity correlations, with the same significance probability, have been also identified between strategy and shareholders' structure (0.632),

respectively shareholders' origin (0.562). The only independent variable that did not have any influence over banking strategies and performances was shareholders concentration, thus being excluded for the rest of the analysis, too.

Basing on Pearson correlation coefficient values, we can conclude that performances reached by Romanian banks, expressed by ROA, depended the most on management and shareholders features (especially gender and provenience), being influenced by board provenience, management independence, shareholders structure and origin, too, but in a less extent and with a lower significance.

As regards performances expressed by ROE, significant correlations have been identified especially with management features, but also with shareholders provenience, board independence and gender. Board provenience and shareholders structure were the only variables that have a lower significant influence.

Consequently, considering the wide range of correlations between variables presented above, we appreciate our first hypotheses (H1) as being accepted. Thus, we can assert that financial institutions' performances are influenced by various features of corporate governance.

For testing our second hypotheses, we analyzed the correlations identified between all independent variables and the nature of strategy followed by banks. Pearson correlation coefficient values allows us reaching to the overall conclusion that strategies have been influenced by corporate governance feature to a grater extent than performances. The strongest influences, highly significant, came from board of directors features (gender, independence and provenience), followed by management (with the same features as the board) and shareholders (structure, origin and provenience), too.

Accordingly, we can accept our second hypotheses (H2), too, thereby asserting that financial institutions' strategies are influenced by various features of corporate governance.

Model development

Considering the purpose of our research – to find the most appropriate answer to our question “Do corporate governance “actors” features affect banks' value?” – we appreciate as the best alternative to develop a model expressing all significant influences of the board, executive management and shareholders over strategies followed and performances reached by banks.

In this respect, we used multiple regression as the method of analysis and Ordinary Least Squares (OLS) as the method of estimation. For developing our models, we start for the general economic model used in prior literature focused on similar goals:

$$Y = \alpha + \beta_i * F_{it} + e_{it}$$

where, Y is the dependent variable. α is constant, β_i is the coefficient of the explanatory variable, F_{it} is the explanatory variable (corporate governance features in our case) and e_{it} is the error term (assumed to have zero mean and to be independent across time period).

For developing our model, firstly we had to test the significance of the relationship between dependent variables and all independent variables, where proved to exist a correlation, according to Pearson coefficient values.

Using linear regression and both “enter” and “stepwise” methods, we selected for our model just those independent variables that proved to explain better the influences over the dependent ones, considering R square coefficient values. Also, the analysis of variance performed, using Anova test, helped us measuring the strength of each relationship established.

The first model developed reveals the influences of corporate governance features over performances, expressed separately by ROA (Model 1a) and ROE (Model 2b). Values presented in Table 4 show the results of the regression analysis performed in this respect.

TABLE 4 Regression analysis for “Performance Model”

<i>Model 1a³⁾</i>					<i>Model 1b³⁾</i>				
Variables	<i>Perform.ROA</i>				Variables	<i>Perform.ROE</i>			
	Coeff.	Sig.	Tolerance	VIF		Coeff.	Sig.	Tolerance	VIF
(Constant)	-.590	.007			(Constant)	-.151	.476		
BP	.215	.014	.375	2.664	BI	.238	.100	.840	1.190
MG	.643	.000	.379	2.640	MG	.488	.002	.840	1.190
SP	.268	.005	.300	3.330					
SS	-.227	.066	.669	1.496					
F value: 24.744 F significance: .000 R Square: .818 Adjusted R Square: .785					F value: 11.939 F significance: .000 R Square: .499 Adjusted R Square: .457				
³⁾ <i>this model is significant for p-value<0.1</i>									

As it can be seen, both models have a high significance (at .000 levels of ROA/ROE). The first model is more complex than the second one, containing four independent variables and being explained in 81,8% of cases, unlike the second model, which has a lower relevance, being explained in just 49,9% of cases. As regards the direction of relationships identified, there are positive influences of management gender and shareholders provenience over performance expressed by ROA, while board provenience and shareholders structure have a negative impact, as the signs of coefficients reveal. In case of performance measured by ROE, both board independence and management gender have a positive influence.

The last model developed was aimed to express the relationship between corporate governance features and strategies followed by banks, the results of the regression analysis performed in this respect being presented in Table 5.

TABLE 5 Regression analysis for “Strategy Model”

Model 2a ⁾					Model 2b ^{**)}				
Variables	Strateg				Variables	Strateg			
	Coeff.	Sig.	Tolerance	VIF		Coeff.	Sig.	Tolerance	VIF
(Constant)	-.760	.000			(Constant)	-.792	.000		
BI	.251	.050	.576	1.735	BI	.314	.017	.627	1.594
MG	.343	.005	.694	1.440	MG	.409	.001	.777	1.287
BG	.370	.005	.602	1.662	BG	.381	.006	.603	1.658
MI	.207	.081	.680	1.471					
F value: 24.098 F significance: .000 R Square: .814 Adjusted R Square: .780					F value: 28.129 F significance: .000 R Square: .786 Adjusted R Square: .758				
⁾ this model is significant for p-value<0.1									
^{**)} this model is significant for p-value<0.05									

As it can be seen, we developed two models, too, but with different significance and different variables considered. The first model has the same significance as the previous ones expressing the relationship between corporate governance and performances. It explains 81,4% of cases, all variables (gender and independence of board and executive management) having a positive impact on bank strategies. The second model developed has a higher rate of significance (95%), explaining 78,6% of cases, which is a quite good rate.

In Table 6 there are presented all models developed as a result of the regression analysis performed, including each one’s significance. The results confirm that no collinearity exists between the independent variables, all the VIF values of the independent variables having acceptable values (Myers, 1990; Menard, 1995).

TABLE 6 Corporate governance influences over performances and strategies - regression models

Models	Significance
Perform.ROA	$\alpha + \beta_1*BP + \beta_2*MG + \beta_3*SP + \beta_4*SS$ p-value < 0.1
Perform ROE	$\alpha + \beta_1*BI + \beta_2*MG$ p-value < 0.1
Strateg	$\alpha + \beta_1*BI + \beta_2*BG + \beta_3*MG + \beta_4*MI$ p-value < 0.1
Strateg	$\alpha + \beta_1*BI + \beta_2*BG + \beta_3*MG$ p-value < 0.05

where values for coefficients α and β_i are presented in Table 4 and Table 5 for each model

In conclusion, the results of our empirical analysis, expressed by the models developed, provide a comprehensive answer to our research question “Do corporate governance “actors” features affect banks’ value?”, allowing us as well to discuss upon the influences identified over strategies followed and performances reached in Romanian banking system.

5. Findings and conclusions

Many empirical analysis performed at international level so far were focused on possible relationships between corporate governance mechanism and firm performance measures, but the outcomes of these studies are mixed. On the other hand, banking system was little explored on this topic before, providing us the chance to enrich the research literature with an empirical study aimed to reveal how corporate governance actors’ features affected financial institutions value in case of Romanian banking system.

The results of the correlations tests reveal positive relationships between banks’ traditional strategies and performances, and foreign corporate governance (board of directors, executive management and shareholders), made majority by male members, where CEO duality avoidance is ensured, the board of directors is entirely independent and the majority of shareholders are coming from European Union members states.

Our results are consistent with some general prior literature findings as regards the foreign character of ownership (DeYoung and Nolle, 1996; DeYoung and Hasan, 1998), the independence of board’s members (Weisback, 1988; Rosenstein and Wyatt, 1990; Mehran, 1995; John and Senbet, 1998; Agrawal and Knoeber, 1996), CEO’s duality (Brickley, et al, 1997; Palmon and Wald, 2002) or leadership structure gender diversity (Krishnan and Parsons, 2008).

The only negative correlation appeared to be between shareholders structure and banks value, revealing that those banks that still have individuals within its ownership performed lower.

Also, there were found factors such as shareholders concentration, board and management size, which proved to have no influence in this respect, and therefore they have been excluded from the linear regression function created for emphasizing the intensity and the direction of influence of corporate governance features over strategies and performances in case of Romanian banking system.

Finally, the regression models developed provides a comprehensive and more relevant image of the Romanian banking system, therefore offering us the opportunity to make comparisons with prior related studies focused on the same topic and area of research. Thus, our banking system encounters both similarities and differences, one example in this respect being the Portuguese banking system, which appears to be different than ours, the results of Gulamhussen and Guerreiro’s study (2009), who tested among other factors the influence of foreign equity and board membership over interest / non-interest margin, revealing that there is a positive relationship between

foreign shareholders and non-traditional activities. On the other hand, some of our findings are consistent with prior research results on banking system. Thus, we reached to the conclusion that chief executive officer's duality weakens banks' value, in accordance with other authors' findings which suggest that cost efficiency and return on assets are lower for Chairman-CEO banks (Pi and Timme, 1993). Also, the foreign character of ownership has a positive influence over performances, closer to other authors finding (Nada, 2005; Bonin et al., 2003; Claessens et al., 2001; Demirguc-Kunt and Huizinga, 1999), which concluded that foreign owned banks are more efficient than domestic private banks, by reaching higher net interest margins and higher net profitability.

Being aware of our study's limitations, coming from the sample of banks, the limited number of factors and the fact that only one year data were considered for analysis, we are appreciating these as a challenge that give us outlooks for future research.

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