DO BOARDS AND CEOs MATTER FOR BANK PERFORMANCE? A COMPARATIVE ANALYSIS OF BANKS IN GHANA

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Abstract

In this study, we examine whether Board characteristics have impact on bank performance by comparing listed and non-listed banks. The study uses panel data covering the eight year period, 1997– 2004 from all the 18 Banks in Ghana. Findings of the study confirm earlier studies. While the size of the board has positive correlation with bank performance whether listed or not listed, the more independent a board is the better the performance in spite of a bank's listing status. Of significance is the finding that when a CEO doubles as a board chairman, it impact positively on performance in the overall sample, but negatively in both sub-samples.

Keywords: corporate governance, bank-performance, Ghana.

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1. Introduction

There has been a great deal of attention given to the issue of corporate governance in recent times. Banking supervision cannot function as well if sound corporate governance is not in place, and consequently, banking supervisors have strong interest in ensuring that there is effective corporate governance at every banking organization. Changes in bank ownership during the 1990s and early 2000s substantially altered governance of the world's banking organizations. These changes in the corporate governance of banks raise very important policy research questions. The fundamental of such questions is, "how do these changes affect bank performance?"

To a large extent, most industrialized countries and multinational entities have tried redefining the notion on how corporate entities should be governed. Corporate governance has indeed attracted a lot of attention from both academics and practitioners. More interestingly, academics in the areas of law and economics are devoting much attention to the issue of corporate governance, La porta et al (1998). In spite of this overwhelming enthusiasm in the study of corporate governance, much of the studies in this area have rather dealt with other sectors rather than the banking sector, Shleifer & Vishny (1997). The seemingly lack of focus of corporate governance studies on the banking sector is rather surprisingly in that, so many studies have concentrated on the important role banks play in over-seeing firms in other sectors, Macey & O'Hara (2003).

Corporate governance could be stated more generally as mechanisms for establishing the nature of ownership and control of organizations within an economy. Company law, along with other forms of regulation (including stock exchange listing rules, and accounting standards), both shape and is shaped by prevailing systems of corporate governance. According to Jenkinson & Mayer, (1992), regulation impacts on corporate governance occurs through its effect on 'the way in which companies are owned, the form in which they are controlled and the process by which changes in ownership and control take place. Corporate governance, thus, describes how companies ought to be run, directed and controlled (Cadbury Committee, 1992). It is about supervising and holding to account those who direct and control the management.

One must point out that the concept of corporate governance has been a priority on the policy agenda in developed market economies for over a decade especially among very large firms. Further to that, the concept is gradually warming itself as a priority in the African continent. Indeed, it is believed that the Asian crisis and the relative poor performance of the corporate sector in Africa have made the issue of corporate governance a catchphrase in the development debate (Berglof and von Thadden, 1999).

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Again, poorly governed firms are expected to be less profitably, have more bankruptcy risks, lower valuations and pay out less to their shareholders, while well-governed firms are expected to have higher profits, less bankruptcy risks, higher valuations and pay out more cash to their shareholders. Claessens (2003) also argues that better corporate frameworks benefit firms through greater access to financing, lower cost of capital, better performance and more favourable treatment of all stakeholders. The position has been stated that, weak corporate governance does not only lead to poor firm performance and risky financing patterns, but are also conducive to macroeconomic crises like the 1997 East Asia crisis. Other researchers contend that good corporate governance is important for increasing investor confidence and market liquidity (Donaldson, 2003).

Several events are responsible for the heightened interest in corporate governance especially in developing countries such as Ghana. First, there has been a proliferation of scandals and crises across the globe in which the behaviour of the corporate sector affected entire economies and deficiencies in corporate governance endangered the stability of the global financial system. Second, the private, market-based investment process is now more important for most economies than it used to be, and that the entire process is underpinned by better corporate governance. With the size of firms increasing and the role of financial intermediaries growing, mobilization and allocation of capital have become more complex as a result of liberalization of financial and real markets, structural reforms including price deregulation and increased competition. These developments have made the monitoring of the use of capital more complex in certain ways, enhancing the need for good corporate governance Claessens,(2003). Again, governance of banks especially in developing economies is important in a number of ways as discussed henceforth. Banks do have an unparalleled presence in these countries' financial set-ups and thus serve as engines for growth, King & Levine (1993), and Levine (1997). Also due to the underdeveloped nature of the financial systems in developing economies, banks become the most single important entities for finance for most firms.

In spite of the benefits of good corporate governance, developments in the Ghanaian banking industry show that absence of good corporate governance could probably be responsible for the dismal performance of the industry which is expected to be a catalyst for economic growth. Given the nature of banking business and the antecedents of the operators of Ghanaian banks, corporate governance is fundamental to the nation's financial stability. Further to that, after the financial liberalization, there has been a reduction in economic regulation in banks. This has had the result of increasing the available freedom to managers who run these banks.

The motivation for this study is to look at corporate governance and its impact on bank performance in Ghana from a developing country perspective. In the process, a comparative examination will be made between listed and non-listed banks. The rest of the paper is organized as follows: Section two deals with literature review; section three looks at data and methodological issues; Section four discusses empirical results; while section five draws conclusion and provides suggestion for a new research focus.

2. Review of literature

It has been observed by financial economists that the existence of the separation of ownership and control in large firms in the United States generates the possibility of agency conflict which is costly. In a situation where there are dispersed shareholders' limited incentive to monitor agents, there exist a considerable amount of freedom for agents to pursue their interest as against pursuing that of shareholders. It must be noted that there are a few studies on corporate governance and bank performance in emerging markets, however none of these studies have actually looked at the comparison between listed and non-listed banks especially in Ghana. Indeed, that is the dimension this paper has taken. In the study of corporate governance, "the principal agency problem in large corporations around the world is that of restricting expropriation of minority shareholders by the controlling shareholders", La Porta et al (1999).

In the banking industry, research has shown that well-functioning banks promote economic growth. When banks efficiently mobilize and allocate funds, this lowers the cost of capital to firms and accelerates capital accumulation and productivity growth. In addition, banks play important roles in governing firm to which they are major creditors and in which they are major equity holders (Caprio, Leaven and Levine, 2004). Thus, if bank managers face sound governance mechanisms, this enhances the likelihood that banks will raise capital inexpensively, allocate society's savings efficiently, and exert sound governance over the firm they fund.

We, at this point acknowledge that, in recent times, the debate on corporate governance has centred around two critical issues. The first of these issues deals with the question as to whether corporate governance should concentrate exclusively on protecting the interest of equity holders (shareholders), or whether corporate governance should be expanded to cover the interest of the other constituencies: the 'stakeholders'? The second critical issue which is of importance to interested parties in corporate governance such as scholars commences with the basic assumption that corporate

governance deals exclusively with the challenge of protecting equity claimants and attempts to specify ways in which the corporate entity can better safeguard those interests, BCBS (1999). This leads to the various theories that have been discussed in the context of running a corporate entity. Since the publication of the work by Berle and Means in 1932, studies on corporate governance have focused on the separation of ownership and control. Diverse solutions have been propounded from different perspectives and theories in providing a solution to the phenomenon. These include the agency theory, the stakeholder theory, the stewardship theory and the resource dependency theory. It is an acknowledged fact that the principal-agent theory is generally considered as the starting point for any debate on the issue of corporate governance Emanating from the classical thesis *"The Modern Corporation and Private Property"* by Berle & Means (1932). In this thesis, there is a profound description of a fundamental agency problem in modern firms due primarily to the separation between finance and management. Modern firms are run by professional managers (agents), who are unaccountable to dispersed shareholders. In this regard, the fundamental question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory? The principals in this wise are confronted with two main problems. Apart from facing an adverse selection problem in that they are faced with selecting the most capable managers, they are also confronted with a moral hazard problem because they must give the agents (managers) the right incentives to put forth the appropriate effort and make decisions aligned with shareholders interests.

In further definition of agency relationship and cost, Jensen & Meckling (1976) describe agency relationship as a contract under which "*one or more persons (principal) engage another person (agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent*". In this scenario, there exists a conflict of interests between managers or controlling shareholders, and outside or minority shareholders leading to the tendency that the former may extract "*perquisites"* (or perks) out of a firm's resources and be less interested to pursue new profitable ventures. Agency costs include monitoring expenditures by the principal such as auditing, budgeting, control and compensation systems, bonding expenditures by the agent and residual loss due to divergence of interests between the principal and the agent. The share price that shareholders (principal) pay reflects such agency costs. To increase firm value, one must therefore reduce agency costs. In agency theory, therefore, the following represent a summary of their proposition in overcoming opportunistic behaviour from managers:

Composition of board of director: The board of director is expected to be made up of more non-executive directors for effective control. This is because, it is argued that his reduces conflict of interest and ensure board's independence and monitoring and passing a fair and unbiased judgement o management;

CEO duality: Different individuals are to occupy the positions of CEO and Board chairman as this corrects the concentration of power in one individual and thus greatly reduces undue influence of management and board members.

3. Empirical literature

Empirical studies have provided the link between corporate governance and firm performance, Yermack (1996), Claessens et al., (1999); Klapper and Love, (2002); Gompers et al., (2003); Black et al., (2003) and Sanda et al (2003) with largely inconclusive results. Others, Bebchuk & Cohen (2004), Bebchuk, Cohen & Ferrell (2004) have shown that well governed firms have higher firm performance. The main characteristic of corporate governance identified in these studies include board size, board composition, and whether the CEO is also the board chairman.

There is a view that larger boards are better for corporate performance because they have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate. However, recent thinking has leaned towards smaller boards. Jensen (1993) and Lipton & Lorsch (1992) argue that large boards are less effective and are easier for a CEO to control and that smaller boards reduce the possibility of free riding by individual directors, and increase their decision taking processes. This view is supported by empirical research; Yermack (1996) Eisenberg et al. (1998); Mak & Yuanto (2003); Sanda et al (2003).

With regards to board composition, it has been argued that boards are more independent when the proportion of non-executive directors is larger, enabling them to act as professional referees and this enhances performance, John & Senbet (1998); Fama (1980); Baysinger & Butler (1985), Rosenstein & Wyatt (1990); Brickley et al (1994); Kyereboah-Coleman and Biekpe (2005), though others suggest inside directors are more familiar with the firm's activities and can best serve as effective monitors to top management.. However, its been argued that the effectiveness of a board is largely dependent on the optimal mix of inside directors Fama & Jensen (1983), Baysinger & Butler (1985, Baysinger & Hoskinsson (1990), Baums (1994), yet there is very little theory on the determinants of an optimal board composition, Hermalin & Weisbach (2002). Again, some studies have found no significant relationship between board's independence and performance, Forsberg (1989); Hermalin & Weisbach (1991);

Bhagat & Black (2002); Yermack (1996); and Agrawal & Knoeber (1996).

Some studies find positive relationship between 2-tier board structure (CEO and board chairman are different individuals) and performance, Jensen (1993); Fama & Jensen (1983); Berg & Smith (1978); Bickley & Coles (1997); Yermack (1996), because it is argued that the 1-tier board structure leads to higher agency cost and conflict of interest.. Once again some find no significant relationship between CEO duality and performance, Daily & Dalton (1992), Brickley et al. (1997)

Klapper and Love (2002) examine corporate governance and performance in a sample of firms in 14 countries, most of which are developing economies. They find that better corporate governance is associated with better performance in the form of Tobin's q and ROA and that good governance seems to matter more when the legal environment of a country provides investors with weaker protections.

4. Data and methodological issues

4.1. Data and sample

The study uses secondary data based on the annual financial statements of all the 18 banks made up of listed and non-listed covering the eight year period, 1997-2004. Faccio and Lasfer (2000) recommend a separate treatment of banks from other firms due to their peculiar asset structure. The governance data was also obtained through personal interview.

4.2. Variable description and justification

Even though, corporate governance is considered to involve a set of complex indicators which face substantial measurement error due to the complex nature of the interaction between governance variables and performance indicators; the purpose of this paper is to examine the influence of Boards and CEOs on Bank performance. In this regard, the study looks at governance variables namely Board size (BDS), Board composition (BDC), and CEO duality (CEO) and CEO's tenure of office (CET) have on performance variables of Return on Assets (ROA), and Change in interest income (CIN), giving due recognition to some control variables such as the size of the firm (SZE), and the Debt structure (DTB). The variables are carefully chosen because of data availability and measurement. For variable explanation and measurement, (See Appendix)

4.3. Analytical framework

Our analysis is carried in a panel data framework due basically to its advantage of allowing a broader set of data points. Thus, we specify the basic framework for our analysis in the form of the following regression equation:

$$Y_{it} = \beta x'_{it} + \alpha z'_{i} + \varepsilon_{it} \quad (1)$$

Where $(i = \ldots\ldots\ldots\ldots\ldots\ldots\ldots, N)$

and $(t = 1\ldots\ldots\ldots\ldots\ldots\ldots\ldots, T)$

and x_{it} is a *K*-dimensional vector of explanatory variables not including the constant.

In equation (1), the heterogeneity or individual effect is $\alpha z'_i$ where z'_i represents a constant term and a set of observable and unobservable variables.

4.4. Model specification

We employ a modified version of the econometric model of Miyajima et al (2003) which is given as follows:

$$Y_{it} = \beta_0 + \beta_1 X_{it} + LST_i + \ell_{it} \quad (2)$$

Where Y_{it} represents performance measure Return on Assets (ROA), for bank i in time t. X_{it} is a vector of corporate governance variables; Board Size (BDS), Board Composition, a dummy variable (CEO) to capture if the board chairman is the same as the CEO or otherwise, CEO's tenure of office (CET) and control variables, Size of the bank (SZE), and the Debt structure (DTB) of the bank. LST is a dummy variable where $LST = \begin{Bmatrix} 1 = listed \\ 0 = non-listed \end{Bmatrix}$ and ℓ_{it}, the error term.

The essence of the control variables is to give recognition to the fact that the performance of a firm and for that matter listed firms may be influenced by several factors.

The regression is run in a panel manner; and results reported are based on the GLS panel estimation because it showed more robustness.

5. Empirical results

5.1. Descriptive statistics

Of the banks studied, the mean board size is about 10 with the maximum and minimum being 15 and 4 respectively. This suggests that, on the average, banks in Ghana have moderate board sizes. On board composition, the study shows that an average of 25% of all board members are outsiders which suggests that these boards are relatively not independent, John & Senbet (1998).

The descriptive statistics also points to the fact that CEOs' tenure in office does not exceed 4 years, with the average tenure being about 3 years. These banks on the average have been performing quite well with an annual average ROA of 27.2%. The maximum on this performance variable is 105% with a minimum of -29%. With regards to change in

interest income, the mean performance of 46.5% is encouraging. Sampled firms were of varied sizes indicated by their asset base. Most of these banks also have their assets, most of which are in current form, being financed mostly with debt as against equity. Of the 18 Banks, just about 17% are listed meaning that most Banks in Ghana are not listed on the Ghana Stock Exchange.

Table 1. Do boards and CEOs matter for bank performance: a comparative analysis
Summary statistics

Variable	*Obs.*	*Mean*	*Std. Deviation*	*Minimum*	*Maximum*
ROA	144	0.2720562	1.303024	-0.2895	10.5
CIN	144	0.4650133	0.4912917	-0.9987	2.9836
BDS	144	9.819444	2.685503	4	15
BDC	144	0.2477208	0.3113126	0.066	1.43
CEO	144	0.2727273	0.4474001	0	1
CET	144	2.576389	0.5981302	2	4
LogSZE	144	15.77531	2.956933	10.0346	21.33708
AST	144	0.1715096	0.2120109	0.002132	0.86038
DTB	144	1.822948	11.51146	0.00153	106.2377
LST	144	0.1666667	0.3739788	0	1

Source: Authors' estimation

5.2. Regression results and discussion

Table 2 is the presentation of the interaction of the dependent variable and the independent variables in the various sample groups. The results point to a positive relationship existing between the board size and return on assets in all three same groups. The result is rather surprising and contrary to studies conducted by Jensen (1993), Lipton & Lorsch (1992), and Yermack (1996). However, this confirms studies that support the view that larger boards are better for corporate performance because members have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate.

On board composition, the study shows that the more outsiders there are on a bank's board, the worse the performance. The implication is that when a board is independent, performance of banks is worse. This was corroborated once again by the results of both listed and non-listed banks. This contradicts other empirical studies by Brickley & James (1987), Weisbach (1988), Byrd & Hickman (1992), and Brickley et al. (1994).

While the results of the study suggests that one-tier board typology is positively related to ROA in the overall sample, the results for both listed and non-listed banks samples show otherwise. Thus, the results of the listed and non-listed banks sample is consistent with studies which have found out that the one-tier board structure type leads to leadership facing conflict of interest and agency problems (Berg & Smith 1978, Bickley & Coles 1997) thus giving preference for the two-tier system. Again, it has been argued that problems tend to be higher when the same person holds both positions.

The study points to the fact that the tenure of a CEO has a negative impact on ROA. Whiles, this is significant in the over all sample; it is insignificant in both the listed and non-listed banks as the results indicate. This however, contradicts the popular conventional wisdom that suggests that the longer the tenure, the better the experience, coupled with contacts that could have been built, which inevitably enhances performance.

The control variables showed the expected signs. The size of a bank measured by its asset base has a positive impact on ROA largely because a large bank has the ability to accommodate shocks and cope with inherent risk in the sector. Again, the more debt there is on a bank's capital structure, the better the ROA as a performance variable. This results confirm findings by Hadlock & James (2002), Petersen and Rajan (1994) and Roden and Lewellen (1995), who posit that profitable firms use more debt and suggesting that that profitable firms depend more on debt as their main financing option.

Table 2. Do boards and CEOs matter for bank performance: a comparative analysis (Regression results)

Variable	*Dependent Variable*		
	Overall Sample	*Listed Banks*	*Non-Listed Banks*
Board size (BDS)	0.004611	0.003218	0.003717
Board composition (BDC)	-0.004646	-0.088445	-0.024205
CEO duality (CEO)	0.036742	-0.026921	0.027277
CEO tenure (CET)	-0.019140	-0.006175	-0.005454
Log of bank size (LogSZE)	0.010220	0.001124	0.008085
Debt structure (DBT)	0.052446	0.022579	0.047537
Constant	-0.166449	0.059955	-0.137772
Adjusted r-squared	0.3689	0.74	0.23
Test of probability	F-statistics = 14.93	F-statistics=11.92	F-statistics=6.94

Source: Authors' estimates. Notes: All estimates include a constant. T-values are in brackets with asterisk and probability values in square brackets. ** indicates significance at 5% level.

6. Conclusion and future research agenda

The banking industry is strategically important to the growth of all sectors of an economy and consequently the desired over-all development of a country necessitates that the sector remains healthy and sound. Thus, one major concern that could undermine the strategic importance of the sector is corporate governance. In this regard corporate governance is crucial for bank performance since it sets the agenda and rules for the effective internal operations of a firm.

The study examined the role of boards and CEOs in the performance of the Ghanaian banking sector by comparing both listed and non-listed banks. The mean board size for the sample was observed to be about ten. The rather apparent wide deviation of 2.68 suggests that there are wide variations in the board size between the cross-sections. For board composition the mean percentage of about 25% implies the use of more inside directors on the board in the overall sample. The results showed largely that most of the banks in Ghana adopt the two-tier board structure. The tenure of CEOs in the Ghanaian banking industry also ranges between two and four years with a mean of about there years. Indeed, banks in Ghana have wide variations in size, and employ more debts to finance their assets.

The regression results show further that board size is positively related to ROA whether the bank is listed or otherwise. The board composition rather pointed out that the more independent the board is, the worse the profitability of a bank irrespective of whether listed or otherwise. There were mixed results with regards to the CEO duality. While, the two-tier board structure had a positive impact on the profitability of the overall sample, it showed a negative effect in the case of listed banks and non-listed banks and a CEO's tenure largely indicated a negative impact on ROA in all three samples.

It is obvious therefore that boards and CEOs mater for the performance of the banking sector whether listed or otherwise. Subsequent to this, we would want to explore the factors that affect both board size and its composition in the banking sector.

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Firm performance variables

ROA=this is defined as return on assets and is computed by dividing EBIT by total assets;

Governance variables

BDS=this is the number of members serving on a firm's board;
BDC=the board composition is the ratio of outside directors to the total number of directors (i.e. number of outside directors divided by total number of directors)
CEO=this is a dummy variable which takes the value of 1, if the CEO combines as the board chairman and 0 if there are different people occupying the two positions of CEO and board chairman
CET=this is a measure of the tenure of office of a CEO

Control Variables

SZE= this is the size of the firm measured by the value of its asset base. For the regression analysis, we take the log of the assets because the values are widely spread;
DTB=this the debt structure of a firm measured by the total of debts (both short and long term) divided by the total assets.

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