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Corporate Governance in Banking: The Relationship Between Governance Structures and Financial Performance

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ABSTRACT
This study investigates the relationship between corporate governance structures and financial performance in the banking sector, focusing on board size, ownership concentration, CEO duality, and gender diversity. It also evaluates the effectiveness of governance practices in enhancing operational efficiency and risk mitigation. A quantitative cross-sectional research design was used, collecting data from 50 publicly listed banks across various geographical regions and sizes through stratified random sampling. Governance information was sourced from annual reports, corporate governance reports, and Bloomberg and Thomson Reuters databases, while financial performance metrics, such as Return on Equity (ROE) and Return on Assets (ROA), were obtained from fiscal year 2023 balance sheets and income statements. Descriptive statistics, Pearson correlation, and regression analysis were conducted using SPSS software version 25. The results show that board size positively affects both ROE (r of 0.45, $p < 0.01$) and ROA (r of 0.42, $p < 0.01$), while CEO duality negatively influences both metrics (ROE: r of -0.37, ROA: r of -0.25). Gender diversity has a positive impact on ROE (r of 0.31, $p < 0.05$) and a weaker association with ROA (r of 0.18, $p < 0.05$). Regression analysis reveals that board size and gender diversity explain 38% of ROE variability, while board size and CEO duality account for 31% of ROA variability. The study underscores the importance of robust governance structures in improving financial performance and managing risks. Recommendations include enhancing decision-making processes, risk management, and board diversity, while regulatory bodies should improve disclosure standards. Future research could explore the impact of digital banking innovations and cross-border governance standards.

Keywords: Corporate governance, banking sector, financial performance, board diversity, risk management.

INTRODUCTION

Corporate governance in banking is a cornerstone for ensuring financial stability, safeguarding stakeholder interests, and promoting sustainable economic growth. Compared to other industries, banks are heavily regulated because of their function in monetary flow and vulnerability to systemic risks.[1] Managing these risks is crucial to avoid adverse impacts and increase people's confidence in banking organizations. This ensures effective accountability since the management and the board of directors have laid down roles and responsibilities to avoid vice-like mismanagement and fraud. Banks are subject to numerous regulatory requirements that require compliance with rules of reasonableness and accountability. Remedies for failure in corporate governance can be disastrous, especially as seen in the global financial crisis of 2008, which was characterized by poor risk oversight and lack of governance resulting in institutional failure.[2] In response, many regulatory authorities including the Basel Committee on Banking Supervision called for governance reforms to build up the strength of the banking systems.[3,4] Banks' governance structures consist of various elements such as the board of directors; ownership and control, risk management, and executive pay.[5] Management decisions are influenced by the board of directors which has powers to approve strategic decisions of the company and guarantee its shareholders' interests realization. A good board increases strategic supervision and minimizes agency issues between the management and shareholders.[6,7] Banks are owned in different ways, which include state ownership and institutions, institutional ownership, and family ownership. These ownership patterns determine the governance and the acceptable level of risks in an organization. For example, professional or large investors may prefer more rigorous governance requirements or greater disclosure, whereas, family or financially controlled commercial banks may exhibit greater riskiness likely due to over-concentration of authority.[8,9] Another important aspect of corporate governance is the CEO. They also separate power to prevent situations where managers become empowered to control the boards' outcomes. The separation of functions leads to improved risk management and bank financial performance.[10,11] Another important aspect of governance is the relationship between the executives and the shareholders because management remuneration influences management incentives and its orientation towards shareholders' goals.[12] In the banking sector, variable pay tied to financial performance is positively related to efficiency but it comes with the problem of ethical issues resulting from short-termism.[13,14] The risk management and internal control systems form part of a firm's governance framework. Robust frameworks address credit risk, liquidity risk, and operations market risk factors. Banks across the globe have been required by various empowered regulatory bodies to have effective risk management mechanisms in the protection of financial integrity.[15]

Objectives of the study :

1. To examine the relationship between corporate governance structures and the financial performance of banking institutions: This objective aims to understand how the chosen governance components, including the board of directors' composition, ownership structures, CEO duality, and risk management systems, affect the financial performance in terms of ROE and ROA.
2. To evaluate the effectiveness of governance practices in enhancing operational efficiency and risk mitigation in the banking sector: This is done to examine the hypothesis that clear governance practices can lead to more effective decision-making, less exposure to risk, and increased stakeholder confidence in banks across various regulatory and market contexts.

MATERIALS AND METHODS

Research Design and Approach

The research work used a quantitative research approach to examine the impact of corporate governance structures on the financial performance of the banking sector. A cross-sectional research design was employed to ensure cross-sectional data were collected at a given time to allow the researchers to examine governance characteristics and the effects on financial measures. The adoption of a quantitative research method enabled quantitative measurement of the relationships between governance variables (board of directors' size, ownership concentration, and CEO duality) and financial performance measures including ROE and ROA. The data was then analyzed statistically, to establish the relationship and the direction between corporate governance and the performance of the banks.

Data Collection and Sampling Techniques

Questionnaire surveys were administered to 50 publicly listed banks from different geographical locations and of different sizes, governance structures, and ownership structures. To achieve the above objectives and to capture the views of small, medium, and large banks, a stratified random sampling technique was used. To have a cross-section of the banks, the stratification was done based on the market capitalization of the banks. Information on governance variables including board of directors, gender diversity, CEO duality, and ownership structure was obtained from annual reports, corporate governance reports, and Bloomberg and Thomson Reuters databases. The financial performance information in the study was obtained from the banks' balance sheets and income statements for the fiscal year 2023 with the help of the following equations:

$$\mathrm{ROE} = \frac{\text{Net Income}}{\text{Shareholder Equity}} \quad \mathrm{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$

Analytical Methods and Tools

Descriptive statistics were used to describe the demographic features of the sample, which include average board size, ownership, and financial performance. The correlation analysis was used to examine the relationship between the structures of governance and financial performance. To determine the relationship between the governance variables and financial performance in terms of ROE and ROA, the Pearson correlation coefficient (r) was used. The regression analysis was conducted to establish the degree to which governance variables accounted for the variation in financial performance. To reduce the possibility of confounding, the regression models were adjusted for bank characteristics, including size, market competition, and location. The data analysis was done using the Statistical Package for the Social Sciences (SPSS) software version 25, with an alpha level of 0.05.

RESULTS

Overview of Governance Structures in Sampled Banks

1.1. The governance structures of the sampled banks were analyzed to provide insights into key characteristics shown in Table 1. The average board size was 12 members; the minimum was 8 and the maximum was 18 with an SD of 2.3, therefore moderate dispersion. Average ownership concentration was 35% with a minimum of 15% a maximum of 70% and a standard deviation of 12.5% which shows that there are big differences in the distribution of shareholders. Among the studied banks, there was a CEO duality in 40%, with variation between 40-60%, and a standard deviation of 8% indicating the existence of differences in the leadership structure. Board representation of females was observed in 20% of the banks which had more than 30% women with a variation of 10%-35% and standard deviation of 6.5% suggesting low gender diversity.

1.1.

1.1. Table 1: Governance Structures in Sampled Banks

Governance Variable	*Mean Value*	*Range*	*Standard Deviation*
Board Size	12 members	8–18 members	2.3
Ownership Concentration	35%	15%–70%	12.5%
CEO Duality (Yes)	40% of banks	40%–60%	8%
Female Board Representation	20% of banks (>30% women)	10%–35%	6.5%

The governance structures in the sampled banks, highlighting the mean values of variables alongside their standard deviations illustrates in Figure 1. The boards' average size was 12 members and their standard deviation was 2.3, which refers to moderate variation. Ownership concentration was 35%, but with greater volatility (SD of 12.5%), while CEO duality was identified in 40% of banks, with less volatility (SD of 8%). The proportion of females in the board of directors was still low with a mean of 20 % and a standard deviation of 6.5%.

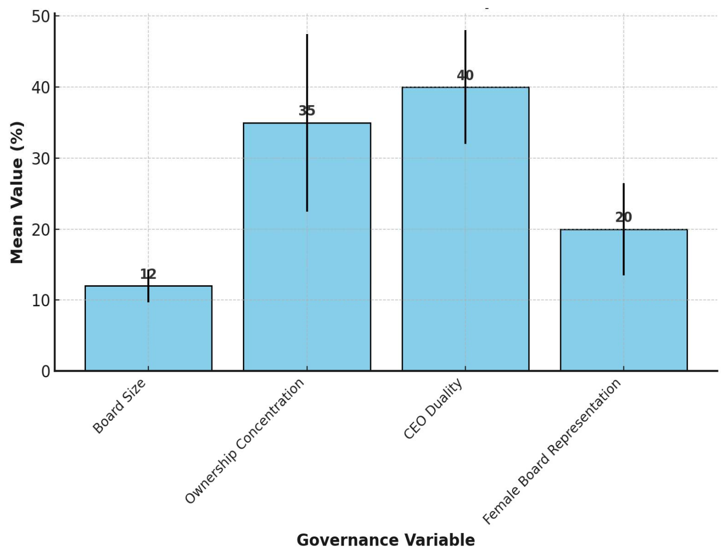

Figure 1: Governance Structures in Sampled Banks

Correlation Between Governance Variables and Financial Performance

The Pearson correlation coefficient between the governance variables and the financial performance measures (ROE and ROA). Board size was positively related to ROE and ROA with correlation coefficients of 0.45 and 0.42 and a high level of significance ($p < 0.01$). Ownership concentration was positively and insignificantly related to ROE (r of 0.15) and unrelated to ROA (r of -0.02, $p > 0.05$) shown in Table 2. CEO duality was found to be inversely related to both ROE (-0.37) and ROA (-0.25), while gender diversity was positively related to ROE (0.31) and had a weaker but significant relationship with ROA (0.18; $p < 0.05$).

Table 2: *Correlation Between Governance Variables and Financial Performance*

Governance Variable	*ROE (r-value)*	*ROA (r-value)*	*Significance (p-value)*
Board Size	0.45	0.42	<0.01
Ownership Concentration	0.15	-0.02	>0.05
CEO Duality	-0.37	-0.25	<0.05
Gender Diversity	0.31	0.18	<0.05

The relationship between the governance variables and financial performance in terms of ROE and ROA was shown in Figure 2. A significant relationship was also established between board size and both ROE and ROA with coefficients of 0.45 and 0.42. The second variable, ownership concentration, had a very low negative relationship with ROA (r of -0.02). CEO duality negatively affected the value a negative relationship was observed between CEO duality and ROE (r of -0.37) and between CEO duality and ROA (r of -0.25). Gender diversity had a positive relationship with ROE (r of 0.31) and a weak positive relationship with ROA (r of 0.18) to stress on its role in performance.

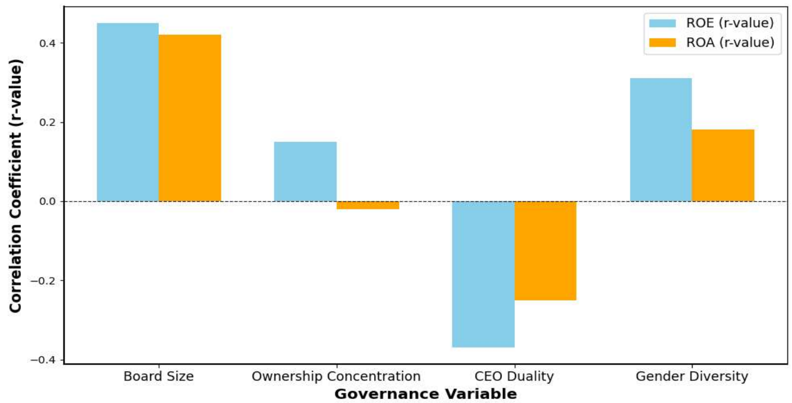

Figure 2: Correlation Between Governance Variables and Financial Performance

Statistical Analysis

The regression results of ROE and ROA, where the important governance factors were highlighted in Table 3. The analysis showed that the board size and gender diversity accounted for 38% of the variability in performance with a p-value of <0.05. On the board size and CEO duality explained 31% of the variability in the ROA and the p-value is less than 0.05. These findings revealed that board size and gender diversity were the significant factors affecting ROE while board size and CEO duality affected ROA.

Table 3: *Regression Analysis Results*

Financial Metric	*Significant Variables*	*R² Value*	*p-value*
ROE	Board Size, Gender Diversity	0.38	<0.05
ROA	Board Size, CEO Duality	0.31	<0.05

In Figure 3 the regression analysis of ROE and ROA was presented and the R^2 values of significant variables were shown. It was established that board size and gender diversity accounted for 38% of the variation in the metric, at a significance level of less than 0.05. ROA the variation in the model was explained by board size and CEO duality with a p-value that was significant.

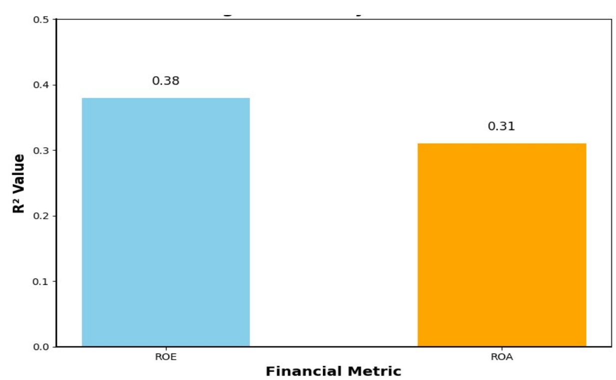

Figure 3: Regression Analysis Results

DISCUSSION

This study explores the impact of corporate governance structures on the financial performance of banks, focusing on key governance variables like board size, ownership concentration, CEO duality, and gender diversity. The results indicate several significant relationships and offer some knowledge regarding the governance structures that help in determining performance indicators such as ROE and ROA. The findings show that board size has a positive relationship with financial performance with Pearson's correlation coefficients of 0.45 for ROE and 0.42 for ROA both at a 1% level of significance. This indicates that large boards may improve strategic decisions because of the variety of knowledge brought to the table and decreased agency issues between managers and shareholders. Other prior research has also established that board diversity enhances performance through effective monitoring and sustainable value generation in banks. Ownership concentration was not strongly correlated with ROE (r of 0.15) and it was not significantly correlated with ROA (r of -0.02, $p > 0.05$). This finding is in line with prior literature indicating that increased ownership concentration can improve accountability yet has no bearing on operational performance. CEO duality was found to have a significant negative relationship with the financial performance measured by ROE (r of -0.37) and ROA (r of -0.25, $p < 0.05$). These results also support the practice of the separation of the CEO and chairman of the board to prevent a buildup of power and conflicts of interest, as recommended in previous studies on corporate governance to enhance organizational monitoring. The findings for gender diversity revealed a moderate and positive correlation with ROE (r of 0.31) and a weaker correlation with ROA (r of 0.18, $p < 0.05$). The results of this study underscore the importance of gender diversity on boards as a way of enhancing creative decision-making and stakeholder confidence in line with earlier studies that have established that gender diversity enhances governance practices and firm performance. By applying regression analysis, it was found that board size and gender diversity jointly predicted 38% of the variance in ROE ($p < 0.05$), and board size and CEO duality jointly predicted 31% of the variance in ROA ($p < 0.05$). This re-asserts the importance of governance variables in the financial results and underlines that the sound structure of the boards and the balanced leadership are essential for banks to demonstrate sustainable growth. The study results support prior research on corporate governance in the banking industry. The large board sizes lead to better financial performance of a firm because of improved decision-making and wider experience.[16,17] The negative effect of CEO duality is consistent with Jensen and Meckling's agency theory, which suggests that the separation of leadership positions mitigates agency costs and enhances control structures.[18,19] The effect of gender diversity on performance also supports work showing that diverse boards improve innovation and decision-making in uncertain contexts such as banking.[20,21] The low positive relationship between ownership concentration and performance differs from some other works that argue that concentrated ownership can have a very close linkage between managerial activities and shareholder objectives.[22,23] Several implications for policy and practice are discussed in the study. First, policies should call for the right board size and board composition to increase efficiency in corporate governance and performance.[24] The authorities can use different incentives and policies to support the emergence of gender diversity programs in banks. Second, the issue of the separation of the CEO and chairman positions should be a priority since consolidation of power is dangerous and can lead to imbalanced decision-making.[25,26] From a managerial perspective, the issue of diversity and inclusion should be of paramount importance to banks when establishing their governance structures because these factors determine stakeholder confidence and the effectiveness of operations.[27] Systemic risks must also be incorporated into risk management practices in governance frameworks. In the future, more research could be conducted to assess the effects of governance reforms on the performance of banks over time, within various geographical locations or under different regulatory systems. Further, qualitative research may help to shed more light on how board configuration and diversity affect decision-making.

CONCLUSION

The study finds that there is a positive relationship between good governance structures and effective management of risks, innovation, and stakeholders' confidence among banks. These key findings stress the importance of an agile governance model, capable of quickly reacting to changes in the market and the regulatory environment. In addition, the roles of the board of directors diversification, independent auditing, and sound risk management policies were found to play a central role in increasing governance quality and reducing systemic risks. To enhance governance in banking institutions, it is suggested that banks focus on the enhancement of well-defined decision-making processes and also continuous risk operation and financial risk monitoring. The use of technology in handling data in real time and decision-making could also improve governance capacity. More attention should be paid not only to gender but also to the type of board diversity, which would bring different points of view regarding governance. It is suggested that regulatory bodies should enhance the disclosure standards of banks so that their governance structures remain responsive and effective. Future research should pay attention to how digital banking innovations influence governance structures, especially issues of cyber-security and data protection. The effect of cross-border governance standards on banking stability is another research area that may yield fruitful results. Cross-sectional research could also offer useful information on the dynamic impact of changing governance systems on the performance of the banks.

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